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COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS

PUBLIC HEARING WITH CLAUDIA BUCH, CHAIR OF THE SUPERVISORY BOARD OF THE EUROPEAN CENTRAL BANK

BRUSSELS

THURSDAY, 21 MARCH 2024

1-0002-0000

IN THE CHAIR: LUDĚK NIEDERMAYER

Vice-Chair of the Committee on Economic and Monetary Affairs

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(The hearing opened at 9:03)

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Chair. – Welcome back, colleagues, to our ECON session. So we continue with yesterday's programme with point number 12 that is public hearing with Claudia Buch, the Chair of the Supervisory Board of the ECB.

So first let me warmly welcome you here. This is actually your first hearing here, because we have just met you last time at the moment when your appointment was on the agenda. So welcome here. But to even show that this hearing has more significant features, obviously this is the last hearing in this parliamentary term. And also this year we will celebrate the 10-year anniversary of SSM. So it's a little of a celebration. So that's why I don't want to take more time speaking about SSM.

Just from the organisation point of view, as always you have time for the introduction, we assume five minutes, but we can be a little bit flexible, and then we go for Q&A. The first round should be should be around six minutes, but we will manage time according to how we proceed. So I don't want to take any more of your time. Welcome here. The floor is yours.

1-0004-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – Vice-Chair, honourable Members of the Committee on Economic and Monetary Affairs, I'm really delighted to be here in my first hearing as Chair of the ECB Supervisory Board and I'm bringing three main messages. The first one is that the European banking sector has really coped well with recent shocks, but we also need to be aware that the banks face new risks. The second message is that ECB banking supervision will remain agile and proactive in addressing these risks. And the third message is actually a thank you to all of you for what you've done in this parliamentary term to support the banking union. I think further progress on the banking union is now needed more than ever to further increase the resilience and also the integration of the European banking sector.

Let me come to the first point: where do we stand in terms of resilience and what are the new risks? So, first of all, one needs to say that European banks have robust capital and liquidity positions and there's, of course, lots more detail in our ECB report on supervisory activities that was published today but let me just give you the key numbers. So, the aggregate CET1 capital ratio of banks has increased from the beginning of the SSM in 2015 from 12.7 % to 15.6 %. That's the latest number we have for the third quarter of last year. The liquidity coverage ratio is above the levels we've seen prior to the pandemic in 2019, where it was at 140 %. Now it's almost 160 % and I think this is also a great success of the SSM. Non-performing loans have declined. They are now less than 2 % of total outstanding loans and bank profitability, bank valuations, have increased also due to the higher interest rates that we've seen recently.

But, of course, we all know that the evolving economic and financial landscape, along with geopolitical risks, is challenging the resilience of European banks. So the profit outlook may deteriorate if funding costs increase, if loan growth weakens, and also if losses increase due to higher interest rates. And we're seeing already an increase in non-performing loans gradually. So they're not at a very high level, as I said, and this is driven primarily by commercial real estate and consumer credit loans.

The second point here is that banks also operate under a high degree of uncertainty. So we know that there's a lot of structural change due to the global trends, demographic change, digitalisation, climate change. And this is exactly why we have made these issues priorities for the coming three years. So, again, these priorities are heightened macroeconomic and geopolitical risks, the impact of digitalisation on the banking sector and climate change. I will tell you later what precisely we do with regard to climate risk but, just in a nutshell, our priority is really to maintain and to strengthen the resilience of the banks that have coped well with yesterday's problems, so to say. But we also need to make sure that they can equally well withstand tomorrow's challenges.

Now, when I say resilience, I really mean all aspects of resilience. We, of course, know that sufficient capitalisation of banks is really the backbone of a resilient banking sector, and better capitalised banks can better support the real economy, they can better compete internationally and this is why it's so important that we implement Basel III in 2025. So this is really in Europe's best interest.

A second element of resilience is that new risks require robust governance and adequate provisioning. So we as ECB supervision address long-standing deficiencies in banks' credit risk management frameworks, the functioning of management bodies, and also related to the capacity to efficiently handle data that is used to assess risk, and also, in particular, in the space of climate risk. So here we're really encouraging the banks to assess, to manage and disclose the risk that they have on their balance sheets.

The third element of resilience is investment in IT systems and operational resilience. So this is, of course, for the banks to be able to compete in an increasingly digitalised world, but it's also to ensure resilience against cyber incidents. And we will learn more about the exposure to cyber risk in our system-wide cyber resilience stress test, which we're actually conducting as we speak, and the first results are coming in. But in addition to that, we will continue assessing deficiencies in banks' outsourcing arrangements and, as I said, cyber security management.

Like you just said, we are celebrating the 10th anniversary of the SSM and I think we've really made great progress in terms of having strong supervisory standards working together. We have a strong first pillar of the banking union and I think, for the second decade, this really allows us to adapt to the new environment and also be proactive in dealing with emerging risks. So, in this period, we are, I am, the Supervisory Board is fully committed to conclude the reform of the supervisory review and evaluation process. As you know, there was independent expert advice that we are now looking at and implementing and this year we are also strengthening our use of escalation mechanisms to ensure that supervisory findings are addressed and deficiencies are remediated by banks. So we are applying this, first and foremost, currently to climate-related and environmental risks, where we've formulated clear supervisory guidance and follow-up procedures for the banks. We have set progressive deadlines and we will, ultimately, if the banks don't meet our expectations by the end of this year, we will also use periodic penalty payments to ensure that we are effective in this space.

Let me say a few words on moving forward and what our priorities are for the future. I think, given the challenges that lie ahead, completing the banking union is more important than ever to ensure that the banking sector is resilient and can also service the citizens and the corporate sector.

As stress in the system may increase, I think we need to close remaining gaps in our crisis management framework. And I'm saying this because effective and credible resolution is really crucial also for supervision and the two parts of the banking union actually reinforce each other. I think that CMDI will provide a more flexible toolkit to ensure that failing banks are able to exit the market in an orderly fashion, but we also know that this requires adequate funding, including from deposit insurance funds.

A second point on where further progress is needed is, of course, EDIS. So, I think we need EDIS to ensure that we have a high level of depositor protection throughout our systems and again, this would increase resilience and integration of the European banking system.

But the final point is, of course, that completing the banking union really goes hand in hand with building a capital markets union. So we know that financing the green transition, financing innovation requires both bank lending but also capital market finance. So, I think in that sense, the CMU can foster also cross-border activities of banks and ensure better risk-sharing.

Very final point, and that's why I'm so glad to be here, accountability to European institutions and the European Parliament is really essential for us, so we're doing more now also to even more reach out to all stakeholders to explain what risks we see, how we address them. I think we have achieved a lot together, and I'm really looking forward to working with the European Parliament, also over the next term, to complete the banking union and also to support your work to further strengthen the regulatory framework.

1-0006-0000

Markus Ferber (PPE). – Vielen Dank, Herr Vorsitzender! Frau Buch, herzlich willkommen hier im Europäischen Parlament und im ECON-Ausschuss – zum ersten Mal in der Funktion, in die wir Sie gebracht haben.

Ich habe zwei Fragen: Sie haben vor Kurzem in einem Interview mit der *Financial Times* die Sorge geäußert, dass viele Instrumente und Kennzahlen bei der Risikoanalyse von Finanzinstituten zu sehr in die Vergangenheit schauen, also zu rückwärtsgewandt wären. Eine vorwärtsgerichtete Risikoanalyse würde, so Ihre Aussage, nur unzureichend stattfinden, und man müsste eigentlich viel mehr in verschiedenen Szenarien denken. Gerne würde ich zu diesen Überlegungen etwas mehr erfahren. Stellt das eine neue Aufsichtsregel dar, die Sie beim SSM einführen wollen? Und wie könnte das dann konkret übersetzt werden in Anforderungen an die zu beaufsichtigenden Institute?

Und die zweite Frage: Sie haben jetzt gerade wieder Ihr Glaubensbekenntnis abgelegt, was alles notwendig ist. Aber ich habe einen Teil vermisst: Es gibt ja noch die ausstehende Richtlinie über den beschleunigten außergerichtlichen Forderungsvollzug, der Teil des *Non-performing-Loan*-Pakets ist und der bisher nicht umgesetzt ist. Sind Sie der Meinung, dass das auch in diese Litanei mit aufgenommen gehört? Und warum haben Sie es nicht mit aufgenommen? Danke schön.

1-0008-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – You asked about risk analysis and what did I say in this interview about risk analysis and the forward-looking part.

So, what I have in mind here and what we're discussing very intensively, also internally, is exactly related to what I said before, that we have a changing macro-financial environment, we come out of a period with very low interest rates, interest rates have increased quite significantly, and that requires the banks also to plan their profits, make their forecasts based on new data, on a new environment. And we have a lot of structural breaks in our economies, maybe in particular in the German economy, but also in many other countries. So that means the risk models that banks are using are really based on historic data, so they can't really capture these new trends and how depositor behaviour would evolve, how credit risk may increase in the future, because over a long period of time we've seen a decline also in corporate insolvencies. So this is not, in and of itself, criticising the models of the banks, but it's just a feature of this model.

What we're doing in supervision, and this is actually enshrined in the Basel core principles, is that we need forward-looking elements and we're doing this with the EBA stress test. So there we have adverse scenarios, which we use to look at the forward-looking stress in the system. So, in that sense, we are not changing our approach but, of course, we continue to use stress tests to do the forward-looking part. But we also have to be aware of the fact that these stress tests are kind of very general for all the banks, that it's the same scenarios for all the banks. The individual bank might be affected very differently. So, there's adverse geopolitical situations that can have very different impacts on individual banks. So this is where we want to do more to really understand how these geopolitical risks affect the individual bank. And this is, again, not a change from our current practices because we look very closely at the capital planning of the individual banks, we look at the capital plans, what adverse scenarios do they do they use. So, we've done this all the time but I think, at this particular juncture, where we are in this new environment, where we have a lot of structural change in the economy, it's even more important than before to really be very careful and really think through the forward-looking aspects. And we've actually also given guidance already to the banks how in their capital planning – I mean, in the end it's in the interest of the individual bank – they should do this forward-looking part.

And then the part about what else is there for the banking union and also for the capital markets union to become completed and you mentioned the work on NPLs. Well, I can just say from the point of view of supervisors, we have done a lot, as I said, to reduce NPLs, to give very clear guidance to the banks, how they can work out loans, how they have to do the provisioning and the staging of the loans. And this has been successful together, of course, with the relatively benign macro-environment that we had up until prior to the pandemic. So clearly, I mean, going forward, we need very good frameworks also to deal with potential new non-performing loans. So, we are looking at this very closely from the point of supervisors and I think, in the legislative discussions that you are having here, which are of course in your remit, one also needs to make sure that there are no changes being made that tilt the balance and make it more difficult for the banks to work out potential new non-performing loans. I think this would be, from my perspective, from the supervisory perspective, the most important element of this discussion: that we can't just lean back and say, well, non-performing loans are low. As I've said, they are now increasing gradually, but we need to make sure that also working out non-performing loans, dealing with non-performing loans, making sure that they don't impede the functioning of the banking sector, that that's also ensured in the future.

1-0009-0000

Markus Ferber (PPE). – Ja, zu dem letzten Teil: Wir haben ja dann drei Pakete im Rahmen des Vorschlags der Kommission für den Umgang mit *non-performing loans* gehabt. Zwei davon sind umgesetzt, also das eine war für die schon vorhandenen, das andere war für die neuen. Und jetzt geht es ja noch um die Frage des beschleunigten außergerichtlichen Forderungsvollzugs – was der Rat schon beschlossen hat, aber wozu vom Parlament noch keine Stellungnahme da ist. Halten Sie das für eine sinnvolle Ergänzung?

Das war eigentlich meine konkrete Frage, weil Sie bei den anderen ja sehr konkrete Gesetzgebungspakete angesprochen haben – CMDI und EDIS –, und deswegen habe ich AECE, um den Begriff einzuführen, vermisst. Gehört das für Sie auch mit dazu?

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Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – Yes, as I said, I mean, everything that makes it easier to work out loans and that reduces the bureaucratic burden, that's of course important. But I know in all these discussions one needs to weigh the interests of borrowers and creditors. So, this is really a decision you have to take here. But everything that makes it easier to prevent the build-up of new non-performing loans and to make it easier to work it out so that they don't burden the balance sheets of banks for an excessive period of time, that would be useful from our point of view.

1-0011-0000
Pedro Marques (S&D). – Senhora Presidente, muito obrigado pela disponibilidade e pela vontade que afirmou de reforçar ainda mais a *accountability* no contexto da interação com o Parlamento Europeu. Isso é muito importante para nós e para os cidadãos, naturalmente.

Queria começar, precisamente, pela questão da estabilidade estrutural do sistema financeiro. Julgo que concordará que a maior parte dos analistas, neste momento, prevê um ambiente de taxas de juro em que as taxas de juro de longo prazo serão mais altas do que aquelas que tivemos antes desta situação de aumento significativo da inflação. Como é que está a incorporar, na avaliação que faz da estabilidade do sistema financeiro, um ambiente em que os bancos terão de operar com taxas de juro estruturalmente mais altas? Que impacto terá na sua atividade? E como se devem preparar para esse novo ambiente de taxas de juro?

Nesse contexto, queria recordar uma questão que coloquei aqui ao Sr. Henry, já mais do que uma vez, mas que lhe quero colocar já nesta primeira oportunidade, que é a forma como os bancos, neste período, tiveram um aumento absolutamente extraordinário dos seus lucros, por causa do efeito do aumento das taxas de juro nas operações passivas, mas também por uma grande lentidão – para não dizer de outra forma –, no correspondente aumento das taxas de juro dos depósitos. Os bancos aproveitaram um período de aumento mais rápido das taxas de juro dos empréstimos, nomeadamente da habitação – as famílias sofreram imenso com isso –, mas aumentaram muito devagar as taxas de juro dos depósitos e, com isso, tiveram lucros muito altos.

O que é que o SSM está a fazer? O que é que pode dizer-nos que está a fazer para garantir que esses lucros extraordinários fiquem no balanço dos bancos e não sejam apenas distribuídos em dividendos? Porque nós precisamos que esses lucros fiquem nos balanços dos bancos para aumentar, de facto, a sua resiliência. O que é que está a fazer em concreto – e que isto não seja apenas uma preocupação geral –, para que esses lucros fiquem no balanço dos bancos?

E tenho uma última questão. Uma vez que referiu a questão da União Bancária, queria juntar-me à sua preocupação com essa importância de completar a União Bancária. Este Parlamento, nas últimas semanas, tem dado passos muito concretos nesse sentido. Acabámos de votar, ontem, o pacote CMDI, aqui mesmo na Comissão ECON, e estivemos a discutir e ainda procuraremos votar o avanço no âmbito do EDIS. Com uma renovação da liderança do lado da supervisão, com novas instituições que aí vêm, como é que vê avanços na União Bancária? O que podem fazer do vosso lado para incentivar o Conselho a parar de «arrastar os pés» em relação à União Bancária?

1-0012-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – Thank you very much for a very good set of questions and they're also actually a bit related, I think the first and the second.

So your first point about the structural sustainability of banks' profits, I think this has actually been a question that you've also discussed with Andrea Enria previously, and that is a very big concern for us, independent from the current interest rate environment. But we do a lot of analysis of business models and business model sustainability because, as I've always said, for us, profitability of banks is, of course, an important indicator, we look at it, but we look at it from a longer term perspective. So that's why we're doing exactly the type of analysis you're alluding to. So we're looking at and working with the banks very closely on how do they model the adjustment of depositors to the higher interest rates. So we've seen that in most of our countries, for most of our banks, there's been a shift from term deposits to sight deposits and slowly the depositors are also moving back from sight to term. And term deposits, already when you look at the new deposits, they're remunerated at a much higher rate already than the sight deposits. So we're working with the banks to see how they model this 'risk'; it's of course good for the depositors, but for the banks it would mean higher funding costs.

And we're seeing with some of the banks, this is also what I said earlier, that they haven't fully adapted to the new environment yet, so they're still using the behavioural assumptions from the period of low interest rates. So this is something we look at very closely because we know, of course, like you said, that the pass-through of higher interest rates to deposits has been has been slow.

Same on the lending side, so of course, on impact, the banks increased their lending rates much quicker. And to what extent? This is also an issue about competition. We are not the competition authority but this is something one may want to look into. But to what extent can this be sustained? This is also a question, because we're seeing that of course, with higher interest rates, we have also probably more problems on the borrower side to really pay these higher interest rates and in many of our countries we have a relatively weak loan demand because the growth projections are revised downwards. So also the potential for the banks to pass further increases or further higher funding costs onto their creditors that is also limited. So that means, in a nutshell, my expectation would be that these high profits that we're seeing now, are not really sustainable because a large extent is driven by the higher interest rates. And that's where we're working with the banks, so that they model this in a realistic way and don't assume higher profits for too long a period of time. We also find deficiencies in the way they analyse the competitive responses. So they can't just look at their own business, they have to consider also what other competitors are doing. And there we also see weaknesses and these weaknesses in this whole asset liability management might become more relevant over time.
So with that, I already answered part of your question on the higher profits and what you asked is what do we do? I mean, is there anything we can do about dividends and distributions? So I think the first answer I gave already. I said that we're working with the banks to make sure that they manage the interest rate risk, credit spread risk, prudently, that's the first point. And then of course, our steering comes, first and foremost, through the capital requirements, the Pillar 2 requirements, the Pillar 2 guidance. That has also implications for the ability to distribute if the banks are not meeting the P2G requirements, for instance, this has implications for how much they can distribute. And we look at the medium-term planning, the capital planning of the bank. So this is very much related to what I answered earlier, that we work with the banks to make

sure that, in their medium-term capital planning, they also take adverse scenarios into account, which then would have implications, of course, also for their dividend distributions.

As I said earlier, I think it's actually the fact that we have higher profits now that, in all likelihood, none of us know what the future will bring, but in all likelihood, profits will go down. I think this is also a good opportunity to work on the pillars of resilience that I mentioned. So capital is important. It's also, I think, in the best interest of the banks to have sufficient buffers against unforeseen events.

IT investments: I think this is also a good opportunity to invest in IT. And so this is also what we are telling the banks. But this is not a requirement. I think in the end it's in the best interest of the banks.

Then you mentioned banking union and also CMDI. I think what I said on CMDI is that it's really also in our interest of supervisors that the CMDI package is in its entirety and the different parts of it are closely connected, that this is approved in the end. And when it comes to also the different institutions and how supervisors work with them, this is what I've always said, we really need to cooperate very closely with all other institutions of the banking union. We do this with the SRB – I notice Dominique Laboureix will be here as the next speaker – and we very closely cooperate with ESMA and EIOPA to really make sure that we understand the entire financial system and how risks are migrating in the system. This is crucial for us. I'm not sure whether it goes to your question.

1-0013-0000

Pedro Marques (S&D). – A very short maybe question or comment on the willingness of the banks to understand that this is also in their interest, not just for structural reasons, but even for short-term reasons. They should be attentive to the way our society is perceiving what they will do with these profits now. It's for me very obvious that, I mean, you have seen a number of countries already introduce this windfall profit taxation, because it's simply too high, the earnings at this stage. And if the banks are not active – and there they need your help, I think, that's why I'm always insisting on this – if the banks, if the system is not active on showing society that they are using this period to make themselves more resilient, instead of just sending money to some offshore place where they earn the dividends, they will also suffer from making, for instance, these taxes permanent. This is happening in some countries. It's also in the financial system's interests that they react the way we want them to these profits, which is retain it in their balance sheets. I think that's very important also for the system to perceive.

1-0014-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – Just very quickly, this is also why the ECB of course is always saying that the decisions on the taxation are in the remit of fiscal policymakers, but the ECB has said very clearly that this needs to be accompanied by a very thorough analysis of the resilience supply of credit to the economy. So I think there have been public statements also of the ECB exactly to that effect. And I can't say to what extent these trade-offs are discussed in the banks. We're not part of that discussion. But this is clearly, I mean, we act in the interest of the European citizens. And this is something that we very clearly take into consideration, that this plays an important role.

1-0015-0000

Chair. – Thank you. I would add that it's also a matter of competition, always the profitability.

1-0016-0000

Georgios Kyrtsos (Renew). – Thank you for the interesting presentation. The first question has to do with non-banks. From what I read, they have reached a market share of 27 % of lending to businesses. So you are supervising the banks, but if there is a dynamic in favour of the non-banks, how can you deal with it? And what is the perspective? We read 27 % of the market share today. Is it going to be 35 % or 40 % in four years' time? We count on your judgement.

The second has to do with the increase in non-performing loans, that you described, in the real estate sector and consumer credit. Could you please elaborate a little, in the sense, how big is this increase? Does it have to do with certain countries? Is it overall? And what do you think should be done?

And finally, the third question: you sound very optimistic about pushing forward with the banking union, EDIS, capital markets union. During the last years we haven't seen a lot of progress on these issues. Do you think that something is about to change, or you are, let's say, optimistic by nature?

1-0017-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – I try to be realistic by nature. A little bit of optimism in these difficult times I think is also not bad, but let me take your questions in order.

On the non-banking issue, I don't have estimates where we go in terms of market shares of non-banks. I think – that's what I said also related to capital markets union – overall to finance the green transition, to finance also innovation in our economies, I think it's important to also have a higher share of capital market funding. But this is more the debt versus equity. You mentioned the lending to firms. So I think, in terms of the overall composition of finance, I think it would be conducive to growth if we had a little bit of a higher share of equity finance.

Coming to the non-banks and the credit activities of non-banks, I think to some extent this is the reflection also of the reforms of the banking sector post-crisis, so when we speak about the higher resilience that we now have in the banking sector, that's of course because of the very well justified reforms to the global regulatory framework. And I think we also seeing – this is just a side remark – that this has been not only positive in terms of resilience, but it hasn't really, in and of itself, it hasn't come to the detriment of funding for the economy. So I think that's an important driver. And maybe there's other comparative advantages of certain types of non-banks in providing funding. So I wouldn't necessarily see this as a negative development, but it's just the adjustment of the system to these reforms.

Having said this, of course we need to understand that typically we treat non-banks and banks as if they were something separate, also when we have regulatory discussions, but of course they're closely connected. So counterparty credit risk, for example, is very important for our banks. And we are doing a lot of work also with the banks so that they understand counterparty credit risk, and that can be related to non-banks.

The liquidity stress situations that we had on financial markets over the past years very often came from high leverage in the non-bank financial sector. And so this of course has immediate implications for the banks. So I think from after a long period of discussions about non-banks and what is driving it, what could be potential risks, I think we also need more tools to address systemic risk issues in the non-bank financial sector. And that's actually in the interest of the stability of banks. And I think Europe is actually moving when it comes to funds and to the possibility to apply also macroprudential tools to the liquidity management of funds. I think that's a welcome development. And as I said, in the end it's also in our interest.

I think more transparency in the non-bank space would also be good. That's good for our analysis, but it's actually also important for the banks to manage their counterparty credit risk, because they need to understand whom they're exposed to and how risky these counterparts are.

Your second question was about NPLs and what do we see, how does it look across sectors and across countries. I would say that there's a few patterns which are actually relatively consistent across countries, namely that we generally have seen a decline in non-performing loans. And of course, this is bigger for the countries where we started with high non-performing loans to begin with. And I think this is actually also one of the success stories that needs to be told, that with the work of the national authorities, with the work of the SSM, we've been able to reduce the non-performing loans. They are on average now around 2 % overall.

There's one sector that stands out a little bit, and that's the commercial real estate sector, where we have non-performing loans of around 4 %, if I recall the exact number correctly. And that, of course, has to do with the fact that this is a sector which is very cyclical. We see the decline in demand for buildings and office space. It's very sensitive to increases in interest rates because they're more flexible loan arrangements.

At the same time I need to say that commercial real estate is 5 % of total assets of the European banks, so it's not the biggest share. Residential real estate would be much more relevant for many of the banks, but here – and this brings me to the kind of the consistency across countries – we have a relatively stable labour market and income situations of the private households, so that contains the risk in residential real estate for the banks.

Coming to this area of commercial real estate where we have very much heterogeneity across countries – it's also difficult to get consistent data across countries. There we're working very closely with the banks, and we've done so for some time, because there was also a lot of work by the European Systemic Risk Board. So we've understood this problem and we are working very closely with the banks to make sure they deal with their with their customers, do proper risk assessment, and I hope we're on a track there.

Well I answered your question about my personal optimism, realism. I scribbled down something. I'm not sure I'm reading this correctly, but where do I think this is going? Or what do I think is a realistic way forward? In the end, as you know, these are political discussions and the political arguments have to be sorted out. But all we can do is really contribute to this debate by explaining how supervision, bringing supervision also to the European level, how this is really helping to understand the system. I think also we have around the Supervisory Board table a European spirit. Of course there are different pieces of information where the national authorities have better information, but I think here in this space, and banking, it has really served us very well to have a European supervisor within the network, of course, of national authorities. And I think we also have areas – I mentioned the NBFI space, where it would be better also to have more supervision and more, as I said, capital markets union, also more supervision at the European level because we do have issues that are really European issues and not just national issues.

1-0018-0000

Dorien Rookmaker (ECR). – Thank you, Ms Buch, for your elaboration on the previous questions. I have four questions, or five maybe.

The banking industry is always claiming that they cannot compete with their US peers on an international level, since they are subject to much higher capital requirements. Is there any truth in this? Has the SSM ever looked into these claims? They have. And it turns out US large banks are subject to higher requirements compared to their EU peers, and whereas mid-sized and small banks are slightly better off in the US. So are big banks using opportunistically this situation?

With great interest I read the ECB's opinion on the various aspects of the banking package, and especially those related to the implementation of Basel III. We noted that you were urging the co-legislators to mind the gap with Basel, to minimise the deviations from the international agreed Basel framework. It seems that, unfortunately, our co-legislators did not hear your warnings. And even though at the time of the CRR III negotiations there was significant bank turmoil in Switzerland and the US, which was at times on the verge of spreading to the EU, but fortunately it did not.

The European Banking Authority, at the end of last year, published the results of its annual Basel III monitoring exercise, which shows that under the watered-down CRR III, the impact of implementing Basel III is roughly four percentage points lower than under a pure Basel approach, and that is without even considering the many transitional arrangements in CRR III, which may become permanent deviations from Basel. I also hear that these aggregated impact figures mask the fact that the increase in capital requirements is concentrated in a handful of large euro area banks. My question is, therefore: is the SSM intending to impose additional capital requirements on these banks in order to, using your own words, 'close the gap with Basel'?

The third question: I read in the *FT* that both the UK and US are proposing a much stricter implementation of Basel III than will be implemented in the EU. What are the consequences on an international level of being the sole large jurisdiction with a watered-down Basel implementation? I am assuming that this impacts the reputation and credibility of both the EU banks and supervisors. How will the SSM try to manage this reputational damage?

And secondly, when UBS acquired Credit Suisse after the turmoil of March last year, many commentators rightfully pointed to the old discussion on 'too big to fail'. Yet in the same interviews with supervisory board members they point out the advantages of further consolidation, especially via cross-border deals, stating they, and I quote, 'think a merger of big EU banks is possible in Europe because when you compare the degree of concentration in the US and Europe, we are still in fact behind'. It's a quote from an interview with Mr Edouard Fernandez Bollo. What is your view on the 'too big to fail' issue and the scope for cross-border deals?

One final remark: as a former risk manager in banking myself, I was a little bit surprised that you said you had to teach banks that risk was something that was future-orientated, because we all know of course that a risk is always in the future, right? It's never in the past and it's an incident.

1-0020-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – Maybe just quickly on this one, yes of course risk is always a forward-looking concept. The point I wanted to make is that the data, the information that we typically use to assess risk in banks' internal models, by definition it's always backward-looking data, because we don't have data about the future. And the question is, to what extent is this past behaviour, the past data, representative of how the future is likely to look? And that was the point I was making, that if we're in a period of structural change with new risks emerging, we need to think about how we can improve upon this forward-looking part. I think scenario analysis is very important and a lot of banks are using this, and we're working with the banks on how to improve it and what to do in that space. So this was the point.

But let me go to your questions. They were very good ones and I'll try to answer them as precisely as possible.

So on your first question, the comparison of capital requirements in the US versus Europe, so it's a bit of a counterfactual exercise because we have different banks, we have the same Basel framework, but then of course we have differences in application. Having said this, what we did is indeed an exercise where we kind of did the thought experiment 'what if the European banks were under the US rules and what would we see'? And indeed we would see that if anything, the European larger banks would actually face higher capital requirements in the US. And these are actually the banks, I mean the large banks, they're the ones competing on international markets. So if anything, if you would take that argument that we also often hear from industry, that would not say that because of the tighter regulation in Europe the banks are at a competitive disadvantage. In any case, I also think that higher capital, better resilience makes banks more competitive, and we see this, that the better-capitalised banks can also lend more.

But this argument, it's right what you said that if anything the larger banks, European banks would have higher capital requirements in the US. It's different for the smaller and mid-sized banks, not by big margin, and also of course it depends on how you model this. And I would actually say I'm glad that we had a bit stricter, higher requirements on the small and mid-sized banks, as we've seen that the problems that they had in the US were with the regional and mid-sized banks, and the European banks during this period last year – it's almost a year now since the turmoil in the US – the European small and mid-sized banks have done quite well. So I'm actually glad about this stricter approach. In any case, these are not the banks competing on the same markets as also regional markets.

On your second point about 'mind the gap', I don't have any additional data to the EBA data that you mentioned. And of course what we've always said is that we would be happier with no deviations from Basel in terms of the implementation. I think the Basel framework is a good framework, but of course you know best also the political discussions around the deviations from the Basel framework that we now have implemented. So my point was that I'm glad the banking package has been agreed upon. It should be implemented. And I think that's in the best interest. At the same time, as I've also said here, we will of course closely monitor to what extent the deviations from Basel are material and have implications for the risk and the resilience of the banks. We set up this monitoring framework, and we can at any time report back to you if we have some evidence, because I think this is also a piece of information you would need for your future deliberations. So that information we will definitely provide.

In terms of would we try to close the gap by applying the framework differently, no. We take the framework – we are not the rule-makers! – we take the framework, we are applying it, and what drives our decision, like I explained earlier on the capitalisation requirements, that really depends on what we find in the banks in terms of risk and risk control. So that is driving our decisions. But we work with the framework that we have.

So I think implicitly I also answered your third question on Basel III. I don't know what the outcome of the deliberations in the US will be, and I think nobody knows. We all know that there's a very intense discussion and I wouldn't want to say anything about this. I think, if anything, the US is also starting from a different position, in particular because of the use of internal models that's more restricted with the Collins floor. So let's see where their lending place is. I think we should set our standards, based on what we see here, based on what the Basel framework gives us. And I think the best we can do to support the European banks is to have good and consistent and strict supervision. I think that's in the best interests also of the banking system.

Then you asked about 'too big to fail'. So a lot of work was also done in the Financial Stability Board on 'too big to fail', and I think the report was concluded around the time of the pandemic, but I think a lot of the lessons still hold true, also when you look at what happened last year. First of all, I think the improvements, or actually the establishment of a resolution framework for banks, was really highly beneficial. And this is also what the authorities are telling you that have been working with the cases of distress recently. And that's also what the FSB found, that having the frameworks and having resolution frameworks is really beneficial and also sets the incentives right.

At the same time, there were also gaps being identified in terms of transparency. So the total loss-absorbing capacity, understanding again where the risk lies in the system, that goes a bit to the NBFI question we just discussed. That's not always clear, but that's important for the markets to also price the TLAC, or, for that matter, the MREL instruments. And then also the report calls for closing the gap, so I think CMDI goes a long way towards closing the gaps that we have in Europe. But there's also issues like liquidity backstops, liquidity and resolution, which are also very crucial for the whole system to be credible. And I think there's also work that needs to be done, maybe in terms of the wish-list that your colleague Mr Ferber mentioned earlier. So I think that's also an important part to make the whole system more credible.

In the end, I think a credible resolution framework sets better incentives also in the going concern, and then also has, of course, the objective to make a failure less likely. So whether or not these backstop facilities then need to be used for it remains to be seen. But we need them in order to enhance credibility.

On cross-border mergers, the Supervisory Board doesn't have kind of a preference for what type of consolidation is needed or is preferred. All that we can say is that we certainly don't stand in the way of more cross-border activity. Actually I think it would be good, in terms of sustainability of business models, if banks can really use the whole internal market and what we can do in order to ensure that these cross-border activities go smoothly, we can do. I sometimes wonder whether we should also look for the barriers to more integration, not just in the space of regulation where we have a common, single rulebook, the same supervisory standards, but I think there are many other areas where we don't have full integration or full consistency that also hold back mergers. So I think that it's also useful to look a little bit outside of banking regulation to look for these impediments.

1-0021-0000

Chair. – Thank you. We've finished the first round. I'm the only one in the second round and the only one who hasn't asked a question, but I will try to be very brief.

Let me address two issues that you mentioned. At the beginning you thought that it seems that the banks successfully passed the interest rate cycle period, but there could be some risk on horizon. I would like to mention two, and I wonder how serious they are in your view. If I look at the global economy, the real estate bubble in China and as well the risk that there is a lot of over-investments in China would be, in my view, one of the risks. And at home, for me, there is a question how, peaceful would be the restructuring of the economy or possible changes of the business model.

And the second question, I would echo what was said just now and what Pedro said, on one hand, some people are talking that in Europe we should have consolidation in the banking sector. The others would argue that the banks are systematically very profitable. That would rather indicate that there is a lack of competition. So would you think that there is a too high cost of entry or some other factors that are slowing down competition, and as the result of that, for example, the banks can afford to react relatively slowly on interest rate cycle, and that means to increase the profit in good times and keep high profit in all other times.

1-0022-0000

Claudia Buch, *Chair of the Supervisory Board of the European Central Bank***.** – As I said, geopolitical risk is one core priority of the SSM, and that of course has many dimensions, but of course China is a big global economic power. And that's of course a core element here. And you mentioned the real estate developments in China. So whenever I see work being done – and that's including our work – as to what is the direct exposure to China and the risks there, then I typically get the response, well, the direct exposure is not that large. So if you take that in isolation the banks would be able to cope with stress there. But of course it's important to take a wider picture. That's also my answer to the first question we had this this morning.

So also the China-related risk can be indirect. It can be because there's also Chinese banks that are active on global markets and if there's stress in the economy that can have a feedback effect on the European banks. There's also many corporates that are active on the Chinese market and I think you need to also take into consideration what is the indirect exposure that banks have to these corporates and thereby to the Chinese market. So that's exactly the type of analysis we are doing already to look at different channels of transmissions, also the indirect ones, and then also work more with the banks to break down these broader narratives and stories as to what could be exposure, but to really break it down to the level of the individual bank, because that's the entity in the end that we are supervising and that has to manage these risks. So this is exactly the type of work we are doing.

The issues at home, the restructuring, that's actually much related also to what's happening globally. So I think a large part of the restructuring needs in our economies are about the energy transition, which is of course related to climate change. They are related to more fragmentation, de-globalisation and what's happening with regard to global value chains. And it's just extremely unlikely that we have a period of structural change where we don't see higher insolvencies and restructuring also at the corporate level. So I think the important thing is now to understand how much restructuring is happening already, and when does it show up in banks' balance sheets. So this is exactly the forward-looking element that I mentioned before. The data from the past with corporate insolvencies that have for sure during the pandemic declined and in many countries also declined over a sustained period of time, this doesn't really give us the information about what is what is likely to come.

And you're absolutely right: when it comes to consolidation and profitability we're seeing different patterns across countries. And this has to do with market size, whether in a particular country there are sufficient economies of scale – so to make it worthwhile entering that country. So the stories – this is why it's actually for us very important to also go to the countries to really talk to the supervisors there, talk to the banks, talk to the civil society to understand what is happening there, how different are the circumstances. And there's definitely – I'm not sure whether it's constraints to entry or just a scale issue that doesn't necessarily have to be a constraint to the entry. So we do everything again to have common European supervision, but markets are sometimes very small. So we need to consider what else can be done to ensure that really the banks can use the full internal market.

1-0023-0000

Chair. – Thank you very much. So we are perfectly on time to finish this hearing. Let me thank you very much. I guess this was very rich, very precise. I appreciate how well structured our discussion was. Unfortunately we will not probably meet at the same setting as our term is finishing, but I am sure that you will be here, and I hope that future exchanges with you will have such a quality and will be beneficial for both of us – Parliament and yourself and your institution. So thank you very much, and we will start as soon as we can with the second part of our morning.

1-0024-0000

(The hearing closed at 10:00)