EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Danièle NOUY
Chair of the Supervisory Board

COURTESY TRANSLATION

Mr Mario Borghezio
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 06 April 2016

Re: Your letter (QZ-031/2016)

Honourable Member of the European Parliament, dear Mr. Borghezio,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 17 March 2016.

Regarding your question on how the ECB plans to restore the confidence of European and Italian savers, let me first point out that trust in the banking system depends on the strength and resilience of banks, which is a goal first and foremost of the banks themselves. The ECB, as the banking supervisor for the Member States participating in the Single Supervisory Mechanism, imposes strict supervisory standards to ensure that banks do not deviate from this goal.

At the same time, a return to more robust growth would facilitate the improvement in banks' balance sheets. The adoption of growth-promoting reforms would therefore help to strengthen the banking sector in the euro area. Furthermore, ECB Banking Supervision works closely together with the Single Resolution Board, whose mission is to ensure an orderly resolution of failing banks with minimum impact on the real economy and on public finances of the participating Member States and beyond.

On your question as to whether the resolution mechanism is a key element in strengthening banking institutions, let me emphasise that the supervisory authorities have several tools to ensure improved resilience of banking institutions. These tools range from the ability to determine conservative capital requirements via the Supervisory Review and Evaluation Process (SREP) to the imposition of supervisory and early intervention measures should a deterioration in a bank's situation not be properly addressed. In addition to these powers, the Bank Recovery and Resolution Directive (BRRD)[1] introduced a number of provisions making banks safer. Importantly, resolution authorities have to adopt credible resolution plans which can be implemented in the event of need. Resolution planning comprises a resolvability assessment, which requires the removal of any impediment to resolvability ex ante, for example by imposing changes in

[1] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014.

the legal and operational structure of a bank. Thus the resolution authorities have the responsibility and the means to reduce the complexity and interconnectedness of big banks, which, depending on the institution-specific characteristics, should in my view also improve banks' risk management and contribute to the achievement of other supervisory objectives.

The BRRD provides the resolution authority with a set of resolution tools, including the bail-in tool, to deal with failing banks if there are no alternative private sector solutions and if deemed necessary in the public interest. The bail-in tool is essential for ensuring that losses in resolution are absorbed by the private sector and thus for protecting tax payers. In this context, the Financial Stability Board's Total Loss-Absorbing Capacity (TLAC) requirement for global systemically important banks and the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) for all EU banks will be instrumental in ensuring that there is enough private sector loss-absorbing capacity in the event of resolution. In the EU, several discussions are ongoing on how to design and implement the MREL so that it facilitates the application of the BRRD bail-in tool without causing instability in the system.

Concerning your question on bank structural reform, let me recall that the ECB published its opinion on the European Commission's legislative proposal on bank structural reform in November 2014.[2] In its opinion the ECB supported the proposal, saying that it would contribute to ensuring a harmonised Union framework addressing concerns regarding banks that are "too big to fail" and "too interconnected to fail".

Inconsistent national legislation could – among other things – limit the effectiveness of European banking supervision by increasing the complexity of supervision and supervisory costs. It could furthermore lead to regulatory arbitrage and a lack of a level playing field within the Member States participating in the SSM and the Single Market as a whole. There is hence a strong need for harmonisation at the Union level. The ECB opinion included principles which in our view should be taken into consideration when reaching an agreement on this matter. Let me reiterate the most important of these principles.

First, from a financial stability perspective, there is support for the separation of certain trading activities from the deposit-taking entity. However, the ECB considers it important to sufficiently preserve market-making activities as they play an important role in increasing asset and market liquidity, moderating price volatility and increasing security markets' resilience to shocks. Such market-making activities could, therefore, be allowed to continue in the deposit-taking entity.

Second, the competent authority's decision to separate trading activities should not be triggered automatically by thresholds being exceeded. Supervisory discretion is necessary for the assessment of the need for supervisory measures. To this end, the ECB also believes that the burden of proof should formally rest with the credit institution, which should be required to demonstrate to the supervisor that its trading activities do not pose any significant risk to depositors and financial stability.

Yours sincerely,

[signed]

Danièle Nouy

[2] https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2014_83_f_sign.pdf