EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Andrea ENRIA
Chair of the Supervisory Board

COURTESY TRANSLATION

Ms Francesca Donato
Mr Antonio Maria Rinaldi
Mr Marco Zanni
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 19 August 2019

Re: Your letter (QZ041)

Honourable Members of the European Parliament,

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 30 July 2019.

As established in the Interinstitutional Agreement between the European Parliament and the European Central Bank (ECB), any reporting obligations vis-à-vis the European Parliament are subject to the relevant professional secrecy requirements outlined in the Capital Requirements Directive (CRD IV)[1]. I therefore cannot comment on individual credit institutions and their business decisions.

However, within the boundaries of the applicable confidentiality rules, allow me to set out some considerations that may help you better understand the ECB's supervisory role. These will necessarily be confined to the sphere of prudential banking supervision.

As a general principle, banks are responsible for determining their internal capital targets, provided they adhere to a range of minimum regulatory and supervisory thresholds. A bank that strengthens its business model and associated risk profile may choose to reduce the capital ratio it targets internally if it can demonstrate that it consistently meets regulatory Pillar 1 and 2 requirements within the context of an overall sound capital planning process. Pillar 2 requirements themselves may evolve in relation to improvements in a bank's business model, governance, risk profile, risk management and controls. Such enhancements can

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013

European Central Bank
60640 Frankfurt am Main
Tel.: +49 69 1344 0
E-mail: info@ecb.europa.eu
Website: www.bankingsupervision.europa.eu

also be seen in gradual improvements in stress test results, as well as reductions in global systemically important bank (G-SIB) or other systemically important institution (O-SII) scores, where applicable.

ECB Banking Supervision continually assesses the situation of supervised banks to ascertain whether they are in a position to comply with all prudential requirements in the foreseeable future. Heightened scrutiny is applied in periods when a bank's business model undergoes changes which impact its risk profile and thus its capital and liquidity planning.

Consequently, ECB Banking Supervision engages in detailed discussions with these banks on their strategic and financial planning in order to gain assurance that they are maintaining adequate levels of capital and liquidity, commensurate with their risk profile, and the buffers needed to manage the risks inherent in their strategic plans. More specifically, as part of its assessment, ECB Banking Supervision would analyse the drivers and components of a bank's financial and strategic plan, as well as the execution of this plan. Any additional information collected as part of the supervisory work is swiftly taken into consideration in supervisory assessments and informs our decision-making.

As described in more detail in the Supervisory Manual[2], the key supervisory tool supporting ongoing supervisory assessments is the Supervisory Review and Evaluation Process (SREP). Its aim is to capture the best possible overall picture of an institution's risk profile, taking into account risks and mitigating factors. ECB Banking Supervision applies the common SSM SREP methodology to all significant institutions, facilitating peer comparisons and large-scale transversal analyses. The methodology thus ensures a level playing field across supervised institutions, while taking into account their specific features.

Turning to your question on the implications for financial stability, let me stress that ECB Banking Supervision carries out all its supervisory tasks in order to promote the safety and soundness of the banking sector and the stability of the wider financial system. As for your question on competition, please note that ECB Banking Supervision is tasked with maintaining a level playing field, not enforcing competition (which is the responsibility of EU and national competition authorities). By ensuring even and consistent supervisory practices across the euro area, as noted above, ECB Banking Supervision may indeed contribute to competitiveness within the banking sector.

Lastly, I cannot comment on specific banks' exposure to illiquid securities. Thus, I would like to refer you to ECB Banking Supervision's general approach to dealing with less liquid and illiquid securities. Our supervisory objective is to ensure that balance sheet positions are valued, managed and controlled in an appropriate manner. From its inception, ECB Banking Supervision has promoted awareness of valuation risks and the application of prudent valuation and risk management approaches. Starting with the asset quality review in 2014, ECB Banking Supervision has put a great deal of effort into assessing the robustness of banks' valuation practices, using the full range of supervisory instruments at its disposal. For instance, in line with our 2019 supervisory priority to focus on trading risk and asset valuations[3], we use on-site inspections at banks that have major trading operations and exposures to instruments measured at fair value to evaluate how well they have implemented the valuation framework and the controls of the pricing models

[2] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorymanual201803.en.pdf

[3] https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory_priorities2019.en.html

that are used to produce fair values. My predecessor outlined this approach in more detail in response to a letter from Mr Zanni.[4]

Yours sincerely,

[signed]

Andrea Enria

4 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter180508_zanni.en.pdf