Diario Expansion XV Financial Forum

Madrid, 07/10/2024

REFUERZO DEL MARCO DE SUPERVISIÓN PARA UN SECTOR FINANCIERO SANEADO, FUERTE Y COMPETITIVO

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Ladies and gentlemen.

Thank you for inviting me, it is always a pleasure to speak here in Madrid on the occasion of the ENCUENTRO FINANCIERO organized by **KPMG** and **Expansión**

Last year I came to talk about the future of digitalisation and all the challenges and opportunities it brings for the financial sector. Beyond banks, digitalisation is in fact one of the many daunting challenges that Europe is facing today, and that requires heavy investments in all sectors of the economy.

Enhancing banking regulation to maintain financial stability

To highlight this, just a quote of the recently published Draghi report on the reforms the EU needs:

"To digitalise and decarbonise the economy and increase our defence capacity, the investment share in Europe will have to rise by around 5 percentage points of GDP to levels last seen in the 1960s and 70s. This is unprecedented: for comparison, the additional investments provided by the Marshall Plan between 1948-51 amounted to around 1-2% of GDP annually."

Needless to say the 1950s to 1970s in Europe was the so called "Golden Age' of the western world with high ratios of investment and rapid diffusion of US technology (mainly manufacturing), trade liberalisation, improvements in productivity, and with financial stability.

To raise investment on such a massive scale and at rapid speed, Europe will be required to coordinate efforts. Funding needs to come from a mixture of public money, private money andpublic-private partnerships (PPP). We will discuss on the panel the role that central banks can play in these challenges.

Let me focus my remarks on the narrower role that financial regulation and in particular prudential regulation can play in enhancing these mandates. Strong prudential regulation is the necessary condition for intrusive and effective bank supervision, a key mandate for any central banks.

Allocating savings and private financing in an efficient way will be essential to facilitating our transition. European banks, acting as intermediaries, will have a crucial role to play in pooling together funds, thereby supporting the financing needs required for a more competitive Europe.

Why do we need a strong regulatory framework?

As we embark on this journey, it is crucial to ensure that our banks remain resilient. This is where the EBA steps in. As the European regulator, the EBA's role is to ensure that we have a robust regulatory framework in place that can withstand times of crisis.

Where are we coming from: an historical perspective on the cost of non-regulation

To understand the necessity of a strong regulatory framework, we must first reflect on our recent history.

The Global Financial Crisis (GFC) of 2007-2008 revealed serious weaknesses in our financial system, vulnerabilities which were detrimental for economic activity and growth. Banks and the financial sector had taken too many risks, risk management failed, while at the same time banks did not hold enough capital to protect themselves.

More than 10 years later we faced the COVID-19 pandemic, a crisis of an entirely different nature but no less impactful. Economic activity slowed sharply, global trade was severely disrupted, and labour markets were massively hit as restrictivemeasures were taken to contain the virus. While this cannot be considered as a comprehensive test of banks' resilience, given the magnitude of the public support provided, it was nonetheless re-assuring to see that the banking sector was, this time, part of the solution rather than part of the problem. Banks were able to support customers and firms with liquidity support, which also subsequently ensured a quick rebound of the economy, as there was no disruption in the credit supply, which quite the contrary reacted well and provided the financing for firms, when needed.

A similar observation can be made with recent challenges following the Russian invasion of Ukraine, which triggered wider geopolitical tensions, driving up energy prices and intensifying inflationary pressures across the globe.

Despite all these shocks, EU banks have shown remarkable resilience and experienced limited direct impact.

The natural question is therefore what has changed in between the two periods. Banks have learnt from their past mistakes, for sure. Governance and risk management has improved.

Regulators have also learnt and the revision of the prudential framework that occurred in the years following the Global Financial Crisis has helped build a more robust system.

Over the years, we have adopted a series of regulatory reforms to improve banks' solvency, liquidity, governance and risk management, and resolvability boosting the resilience of banks to economic shocks.

According to our latest analysis, the capital and liquidity positions of EU banks remain strong. The CET1 ratio stood at 16.0% and the leverage ratio at 5.7% as of June 2024, comfortably above the regulatory requirements. The liquidity coverage ratio (LCR) also remained at robust levels of 160.9%.

Evidence on the net benefit of regulation

While financial stability is a precursor for stability and economic growth, financial stability is not the only objective for regulation in the financial sector.

Banks are structurally leveraged institutions. This may end up with the banks not having enough capital to weather downturns and to cover for potential losses. On the other hand, requiring too much capital is also costly and may result in a higher cost of financing for the economy and hampering future investment.

It is clear that setting up the correct level of capital requirement is not an easy task and should hence be approached with humility. There are however various elements that make me think that the enhanced regulatory framework has helped us to achieve a more appropriate level. Let me point to three.

First, a robust regulatory framework provides net benefits beyond the mere absorption of shocks and losses by equity holders. it strengthens the governance and the measurement of risks, which allows banks to be better equipped to take good credit decisions and adequately manage their risk. In addition, it ensures trust in the solidity of all the actors in the financial sector, smoothing transactions and capital flows.

Second, I will note that there is no evidence that the cost of regulation has led to credit being rationed, quite the contrary academic evidence shows that credit supply flows well when banks are strong.

For instance, when looking at the cost of borrowing for households and corporates across the EU, we even see a reduction of the spreads relative to central bank rates in recent years.

Furthermore, evidence suggests that regulatory relieve for specific portfolios does not encourage further lending from healthy banks. For example, this observation is corroborated by the EBA previous work on various attempts to boost the lending in EU some specific sectors via a lowering in the own fund requirements. I am refereeing (referring?) here to the SME and infrastructure supporting factors. In both cases, the EBA did not find evidence that the reduction of own fund requirements was met with an increase in lending.

Third, the macroeconomic impact assessments performed by the EBA's, ECB and other central banks and international institutions, show that the Basel III regulatory reforms have only short-term economic costs, which are far outweighed by the long-run benefits coming from a reduction in the frequency and severity of financial crises.

Upcoming work in the regulatory framework

Implementation in the EU

The EU has recently finalised its banking package legislation in light of the implementation of the final Basel III rules in the EU. As always, this was a lengthy process, as building the needed political consensus at the trilogues is by no means an easy task. But it is worth highlighting that we delivered.

Implementation in the other jurisdictions

The movement towards the implementation of the Basel III framework in a harmonised manner across jurisdictions is paramount for ensuring global financial stability and fostering a level playing field within the banking sector.

It is very good in that context that many jurisdictions across the world have implemented the Basel standards.

I am also pleased to see that the UK implementation is going forward with an implementation of January 2026 and in a manner largely aligned with the final Basel III framework.

I am however more concerned with the implementation delay in the US, with some significant uncertainties still in their timing and the specificities of their implementation.

A common regulatory framework is even more important in the area of market risk, given the global nature of the trading business.

In this vein, the European Commission has adopted a delegated act to postpone the Fundamental Review of the Trading Book in the EU by one year to January 2026, aligned with UK implementation.

Finally, I am also very pleased by the efforts of other European jurisdictions beyond the EU, to adjust their regulatory framework so as to make it equivalent to the EU rules and the progress that has been done in this area. Equivalence in regulatory frameworks will allow us to deeper integrate the

financial markets across Europe and to benefit from open financial markets and better risk sharing. The EBA will continue to support this process with its mandate to assess the equivalence regimes of these third country jurisdictions.

Conclusion: there is a world beyond regulation

Over the past decade, the world and Europe in particular has built a strong and robust regulatory and supervisory framework. This is essential for promoting EU's competitiveness. However, it is important to recognise that to truly advance, we must focus on making the single market deeper and more integrated by finalizing the banking union and deepening capital markets.

In conclusion, a robust regulatory framework is an essential tool for financial stability, to facilitate the allocation of savings and to support the investment needs in Europe.

Thank you for your attention.