Committee on Economic and Monetary Affairs (ECON) of the European Parliament – exchange of views on the failure of Silicon Valley Banks and the implications for financial stability

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José Manuel Campa at the exchange of views on the failure of Silicon Valley Bank and the implications for financial stability

Honourable Chairwoman, honourable Members of the European Parliament,

Thank you for this very timely invitation to exchange our views.

In the past days, we have been confronted with events which brought back memories of the Great Financial Crisis.

Firstly, there were bank failures in the US. These bank failures were idiosyncratic and affected US banks with only limited exposure to the European banking sector. A very concentrated client base with uninsured deposits and lack of proper risk management have paved the way for liquidity then solvency issues leading ultimately to swift resolution action of US authorities.

Then, last week, there was the situation with Credit Suisse. Here, a prolonged restructuring of the bank that has had repeated risk management failures made markets and investors lose confidence. Two years ago, Credit Suisse lost 5.5 bn USD during the Archegos collapse. Other issues included Greensill exposures in their funds and a franchise that was losing customers.

Those failures hit at times of heightened uncertainty, geopolitical risks and major societal transformation in response to the energy crisis and climate change. As monetary policy is changing course, there is no time for complacency. Over the past decades, we have faced low interest rates. With the gradual increase in rates, banks were beneficiaries in the short run. Their profitability increased last year as net interest income and interest margin gains materialised. On the other hand, an increase in interest rates has impacted valuation of financial assets and expectations of potential deterioration of credit quality. Bank deposits have also become more sensitive to interest rate differences and susceptible to be moved at short notice. This sensitivity is heightened by digitalisation and instant communication technology which can easily accelerate this quest for deposit yield. Adding a pinch of uncertainty on financial stability may then reinforce a downward spiral.

All banks – regardless of size or complexity – need to manage this new environment with rising and volatile interest rates.

Recent events have raised the question: Are we back in 2008? I do not think that is the case.

At this point in time, we are confident that more than a decade of work has put us in a better position: EU banks have better capital and liquidity positions. The regulatory framework and the Single Rulebook have added a layer of resilience. Enhanced supervision and governance provide better risk management. Let us look at the progress on capital and liquidity positions since the Great Financial Crisis. Banks' capital ratios and leverage stand at comfortable levels with a CET 1 ratio (fully loaded) of 15.3% and a leverage ratio (fully loaded) of 5.5%. EU banks vastly exceed the minimum liquidity requirements as stipulated by the LCR and NSFR ratios (LCR ratio of 164.5% and NSFR ratio of 125.8%). As EBA, we are closely monitoring the situation and effectively coordinating with our Board of Supervisors Members, whenever needed.

From a regulatory point of view, the Single Rulebook provides a consistent and robust regulatory framework across Member States. The comprehensive application in our implementation of Basel standards to all banks operating in the EU further ensures resilience. In particular, Basel rules on liquidity risk (LCR and NSFR), have been fully implemented both at an individual and consolidated level in the EU. This contrasts with the US, where international regulatory standards only capture the 13 systematically most important banks[1]. As we have learnt with SVB, the failure of a less-significant bank can trigger a crisis of confidence with knock-on effects to other banks. This shows that completing the Basel regulatory package with a timely and loyal implementation is critical.

Enhanced supervision and governance by banks have also put us in a better position to assess risks in a more forward-looking manner. For instance, the sensitivity of banks to changes in interest rate

[1] out of more than 5000 in total

has been in the focus of EU regulators for over a year. At the EBA, we published an RTS on the management of IRRBB last fall and increased our scrutiny of the way banks are managing this risk launching a QIS on this issue late last year. The ECB banking supervision performed a review, last year, of the interest rate and credit spread risk management practices of the significant institutions.

Against this backdrop, we are currently in the middle of performing the EBA stress test exercise that will provide further evidence on the resilience of the largest banks. We have increased coverage of banks (i.e., 70 banks compared to 50 banks in 2021) and used a particularly severe scenario with assumptions for both interest rates and inflation. The adverse scenario puts banks to the test of high and persistent inflation and interest rates and a severe GDP contraction. This is a stress test focused on solvency concerns and will therefore test the resilience of banks to this new environment, which will put under stress credit quality and assets valuations.

Recent crises show that despite all enhancements in banks capital and liquidity positions, better regulation, and improved supervision, failures and lack of confidence may still occur. We need to remain vigilant and not be complacent.

I would see two takeaways for policymakers and regulators from the development of the last weeks:

First, upholding the confidence in our strong regulatory framework requires to complete pending regulatory packages swiftly. We continue to argue for a full, timely and faithful implementation of Basel III. The completion of the other pending legislative files – such as the AML package – will foster market confidence by providing better supervision in areas such as crime prevention in the financial sector and therefore enhance the resilience of our framework.

Second, the European banking sector remains fragmented along national lines. There is no rationale for Europe to keep the Banking Union resting on two pillars only. Proper risk and capital allocation need the foundation of a common deposit insurance scheme. The crisis management framework needs to be strengthened to reduce fragmentation and divergences. Likewise, the Capital Market Union remains incomplete. Both merit proper translation from political ambition into reality to weather our economy for more volatile times to come and to cater for funding needs of some economic sectors.

The EBA will continue to monitor the events and we stand ready to provide our expertise going forward.

Thank you for your attention and I now stand ready to take your questions.