

## European Banking Authority Chairperson, José Manuel Campa, interview with Paweł Minkina and Maciej Rudke, Polish Bank Association

The interview was conducted in cooperation with the Business Insider.

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- **How do you assess the risk to European and Polish banks due to Russia's attack on Ukraine? Is banking sector in Europe safe in terms of capital, liquidity and cybersecurity?**

First of all, let me say that we have been closely monitoring the recent geopolitical developments together with the relevant competent authorities to make sure we can immediately identify and address any associated risk. What I can tell you and which is rather reassuring is that banks in Europe have maintained stable capital ratios in the past year which are comfortably above regulatory minimum requirements (on average the EU CET1 capital ratio stood at 15.4% in Q3 2021, up by around 40bps from pre-pandemic levels). For the PL banking sector the CET1 ratio stood at 16.8% as of Q3 2021. The EBA 2021 stress test results indicated that overall, the EU banking sector is overall resilient even in the adverse scenario, except for few banks.

When it comes to liquidity, banks have continued to strengthen their liquidity positions and currently hold substantial liquid assets. There is no doubt that accommodative monetary policies have helped. The average EU Liquidity Coverage Ratio (LCR) is close to 175%, up from less than 150% in December 2019. Going forwards the tightening of monetary policies may drive banks' liquidity ratios back to pre-pandemic levels. The LCR for Poland was 212% as of Q3 2021. This good situation should allow banks to properly manage the increased geopolitical uncertainty we are currently living in.

Cyber risk and data security are regarded by banks as the most prominent drivers of increased operational risk according to respondents to the EBA's Risk Assessment Questionnaire (RAQ) (88% agreement). Strongly growing usage of and reliance on technology in the past few years, and which has increased during the pandemic, was accompanied by a higher number and impact of ICT related incidents. Risks stemming from increasingly sophisticated and more organised cyber-attacks as well as other ICT related incidents are therefore unabatedly high. The Russian war further amplifies these risks. No major incidences have been reported recently, but this can change any day. Banks and supervisors are in any case on high alert regarding this risk.

- **The newest and urgent challenge for world is to protect our world. We must now concentrate our attention on the future of our planet. How new regulation in area of ESG will be implemented for banks and how to do it not hampering the economic development and not limiting the role of banks in the economy? How the present structure of different economies will be taken into account in the transition period in regulation in order not to destabilise financing the economy?**

The impact of climate change, the transition to a sustainable economy, and other environmental, social and governance (ESG) related challenges are bound to transform our economies and societies. ESG risks are changing the risk picture for the financial sector, which has an important role to play not only in terms of financing the transition, but also of managing risks.

The EBA is strongly committed to providing adequate supervisory frameworks and tools to support the European banking sector in the objectives of transitioning to a more sustainable economy and mitigating risks stemming from climate change and broader ESG factors.

To that end, we are currently actively complementing the Single Rulebook in the areas of disclosure, supervision, stress-testing and prudential treatment, in collaboration with key stakeholders both inside the EU and internationally. In this we are taking a sequential approach. First, we need to better embed ESG risks in institutions' practices and have metrics that can be clearly understood, measured and managed in relation to their strategy. The EBA has developed technical standards on Pillar 3 ESG risks disclosures, which were published in January of this year, and which provide for comparable metrics, as well as a report on the management and supervision of ESG risks with recommendations to institutions in June last year.

Second, the EBA will consider how environmental risks interact with the prudential framework and will work further on climate risk stress testing.

It should be noted that the EBA sees the need for institutions to incorporate ESG risks into their risk management, taking into account an assessment of their materiality over different time horizons. The materiality of ESG risks can differ across institutions and economies. When conducting materiality assessments, institutions should focus on those ESG risks that are material to their specific situation.

The assessment of material ESG risks should progressively and proportionally be integrated into risk management practices. The proposed measures of ESG risk management are to be applied in a manner that is appropriate, taking into account the institution's individual risk profile, business model, size, internal organization and the nature and complexity of its activities.

These materiality and proportionality aspects aim at ensuring that the transition towards a sustainable economy and the mitigation of ESG risks take place in a manner which continues to preserve a robust banking sector and overall financial stability.

- **We experience a big technology revolution in banking industry. Banks have to be active 24/7. They have to compete with Fintechs. Which chances and new kinds of risk emerge in the era of digitalisation of banking activities? how to limit these kinds of risk?**

We have seen an acceleration in the digital transformation of the EU financial sector in the context of the response to the COVID-19 crisis and expect the digitisation trend to continue in the coming years as incumbents and new entrants leverage technology to improve front and back-office processes.

The digitisation of the EU financial sector is creating new opportunities for consumers and businesses. For example, the increasing use of mobile banking solutions and digital platforms enhances convenience for users by facilitating 24/7 access to a wide range of financial products and services. Platforms can enable financial firms to tap into a broader customer base, including cross-border, and capture efficiencies of scale. And outsourcing to tech companies (e.g. re cloud services)

allows financial institutions to focus on their core services, resulting in flexibility and efficiency gains.

Yet these developments are bringing new risks and regulatory/supervisory challenges.

In particular, increased digitisation places an emphasis on the need for the highest standards of operational resilience, for instance to protect against cyber-attacks. The EBA welcomes the –the legislative proposal on Digital Operational Resilience Act (DORA) - which will strengthen information and communication technology risk management across the EU financial sector and indeed expand the boundary of financial sector supervision to those firms that provide critical ICT services to financial entities.

Increased digitisation means we also need to take actions needed to better protect consumers. There are two aspects to this: (i) supply-side measures such as measures to ensure that disclosure requirements are fit for the digital age, and (ii) demand-side measures to ensure consumers have the skills they need to help make informed choices. To achieve this objective, we are working on further actions to promote a higher level of digital and financial literacy. Our recent joint-ESA High Level conference on Consumer Education and Financial Literacy provided some excellent inspiration for our work.

Finally, as we see new interconnections between financial sector and technology companies we identify a need for even closer cooperation between different types of authorities, including financial, data, cyber, consumer protection and competition authorities in order to ensure joined-up supervisory decision-making.

- **In Your opinion, what regulatory changes should be introduced in the context of accelerating the digital transformation and economy 4.0 as well as to facilitate the progress and next level of innovation in the financial ecosystem? How to speed up with it?**

A multi-faceted approach is needed to provide the relevant legal and supervisory certainty to financial institutions as they seek to leverage innovative technologies in front and back-office processes. This involves some new legislation in combination with efforts to promote convergence in supervisory expectations.

For example, the existing legislative proposal on digital operational resilience (DORA) will create clear and consistent requirement across the EU financial sector thereby raising standards and providing a framework that gives certainty as regards supervisory expectations on operational resilience regardless of where the firm is located.

The legislative proposal on markets in crypto-assets (MiCA) will also create the necessary consistency in the regulation of crypto-asset activities, thereby providing both effective and convergent risk mitigation and the ability for firms to carry out their services in multiple Member States without having to comply with different local regimes.

But convergence in supervisory expectations and practices through non-legislative means is also important to support the industry in rolling out innovative technologies. One good example is in relation to AI where we consider that forward guidance is needed on expectations regarding what we described in our 2020 report as ‘elements of trust’ including ethics, explainability and

interpretability, fairness and the avoidance of bias. The same can be said for expectations regarding RegTech, for example, in the context of suspicious transactions reporting.

This year, the EBA will be continuing its work to facilitate knowledge sharing between competent authorities on innovation-related issues, including via the EBA's FinTech Knowledge Hub, in order to foster the necessary convergence in supervisory practices.

- **The pandemic showed the benefits of higher prudential regulations. Banks were not the problem, but they could help solving the problem that emerged in other areas. However, the fundamental question is where is the limit of rising prudential regulations? How to be safe, prudent but also be able to finance real economy?**

I indeed agree with the assessment that the pandemic was a timely example of the importance of a high-quality regulatory framework when the memory of the 2008 financial crisis is fading away. The recent events in Ukraine are another example that the rules should be designed to ensure that the financial sector is sufficiently strong to absorb any type of shocks, and in particular external and unexpected ones.

I would like then to refine a bit your question on “rising” prudential regulation, as it can be understood in multiple ways. When it comes to the general level of own fund requirements, in fact there is now a consensus that the current level of capital is adequate. This has been expressed several times by the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision, which was of the view that the revision of the framework should not significantly increase overall capital requirements.

On the other hand, this same GHOS has reiterated unanimously their expectation for the full, timely and consistent implementation of all aspects of the Basel III framework. This is because the so-called finalisation of Basel III is not a “rise” in the prudential regulation, but rather the final point of a regulatory review that started more than 10 years ago in the aftermath of the global financial crisis. It strikes the correct balance between maintaining a risk-based framework and the necessary constraints to restore trust in global standards and should therefore be seen as a necessary enhancement of the framework.

- **In recent years there were very little M&A transactions of European banks, especially in Eurozone. In the same, European banks are smaller and less profitable than their American or British peers. Do you think there should be more mergers, maybe international, of banks in Europe? Is this needed, are there conditions necessary to do so?**

As you rightly pointed, banking M&A activity in the EU/EEA dwarves in comparison to the US. From 2015 to 2019 M&A volumes in the US were around EUR 350bn per year while in the EU they rarely exceeded EUR 10bn.

Also EU/EEA banks' profitability has also been significantly lower. Although factors like the low and negative interest rate environment in the EU/EEA explain some of this difference, a slower consolidation process that prevented the exit from the market of less competitive players might have also played an important role.

Even though the return on equity (RoE) levels and the degree of banking concentration are diverse across EU/EEA countries, I believe that several national banking systems might benefit from consolidation. But consolidation should not be a goal in itself. The goal should be to build better and more robust banking institution better able to compete and to serve EU citizens across the single market.

M&A benefits seem to be easier to exploit at a domestic level. The economies of scale of the banking activity seem less relevant when it comes to operating in several jurisdictions with, for example, different legal frameworks or where there is the need to maintain a certain branch network.

Mergers can take place not only among banks but also between banks and FinTech companies. Analysts point out that the revenue per client of FinTech firms, though rapidly increasing, is still below that of traditional banks. Thus, a merger of the two can be mutually beneficial. In any case, the goal should not be consolidation but to have effective financial institutions to provide competitive services to finance our growth.

- **In Poland almost all (98%) mortgage loans are floating-rate and nowadays instalments are rising due to higher interest rates. Do you think it is risky and it is necessary to change that in favour of fixed rate? Should it be done by regulatory intervention, which would prefer fixed to floating ones (relatively)?**

The usage of variable vs. fixed rates tends to be strongly country specific, and this has remained unchanged for a long time. Variable rates tend to bear higher risks for borrowers, as they may be confronted with higher costs in case of rising rates. However, this higher cost may not necessarily transform as inability to pay – as rising rates may go hand in hand with growing economy, growing salaries, and higher ability to pay from borrowers. In general, fixed rates are by far less risky for borrowers since they provide certainty on the amount of future financial obligations..

It is important for financial institutions to properly assess the financial product that best fits the needs of their customers. This principle should apply to the offering of mortgage loans as well. The EBA I Guideline on loan origination clearly point in this direction. They include messages like “institutions should also take into account principles of responsible lending,” and are an example for the need to design credit products that are offered to consumers in a responsible way.

- **When should we expect implementation of Basel IV, CRR III and CRD VI? Which of these regulations would be most important for banks in EU and why?**

The finalisation of the Basel 3 framework has taken a long time. We very much welcome the Commission’s proposal to implement this framework in the EU. By the time it is fully implemented, it will be more than 20 years after the financial crisis, so it is important that we move forward with a timely and loyal implementation of the Basel reforms. The critical components of the last part of Basel III are the Fundamental Review of the Trading Book (FRTB), and more broadly the risk sensitivity of the models that banks use. It is important that the framework is risk sensitive, but it is also important that the use of internal models does not result in unwarranted decreases in capital requirements, which is why the output floor is such a crucial part of the overall package.