EUROPEAN BANKING AUTHORITY

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Reshaping European banks – how far have we come and what remains to done?

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

Introduction

It is an honour and a pleasure to have the opportunity to address such a distinguished audience here at the Danish National Bank and to provide you with my observations on key developments in European banking since the financial crisis. I will take the opportunity not only to look at what has occurred over the period, but also to provide my views on what needs to be done to complete the reforms and deliver a banking system that is robust and actively contributing to economic growth in the European Union.

I will focus on a few major trends and developments and look at them through two separate, but complementary lenses: the first zooms in on balance sheet changes and on the resilience and viability of European banks; the second explores the measures put in place to manage any future crisis.

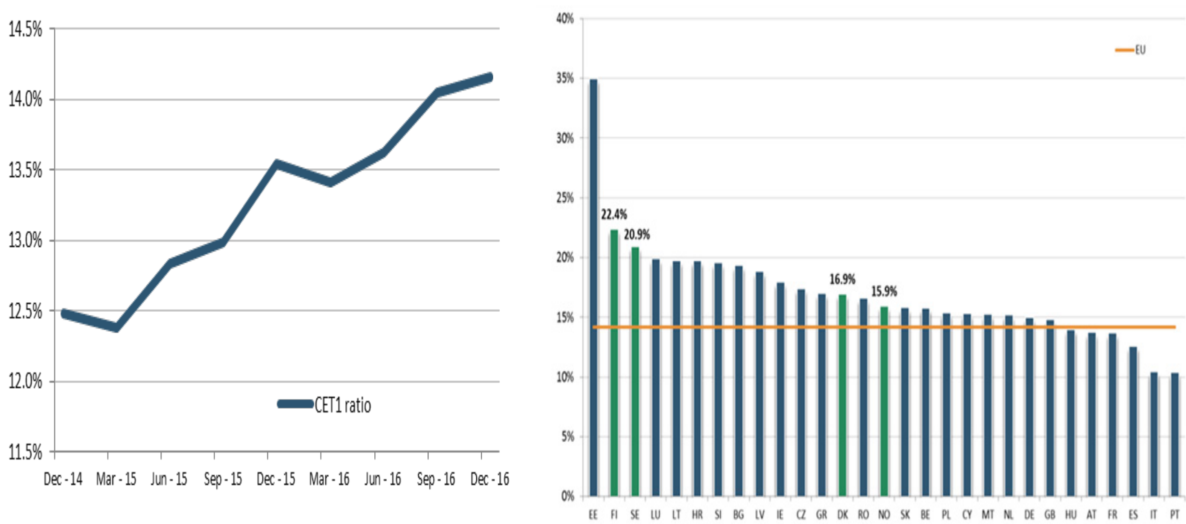
Safer and sounder banks: how far have we come?

Market sentiment towards European banks has improved markedly in recent months. Progress in balance sheet repair has been instrumental to restore trust in the EU banking sector and laid down the foundations for the recovery of cross-border banking.

In the aftermath of a crisis, there are three major steps for balance sheet repair: i) strengthening the capital position; ii) assessing the quality of bank assets; and iii) cleaning balance sheets to restore lending capacity and profitability. The recent financial crisis has confirmed the lessons from previous episodes of instability: the sooner and more decisive is the action in these three areas, the faster and stronger the recovery in banking activity. The US have been very effective in accomplishing the three steps almost in a single shot, with a comprehensive Federal support programme, which led to a much quicker conclusion of the repair cycle. In the EU, the three steps have been taken in a sequence and while significant progress has been made, the process is not yet completed.

I believe the **first step**, capital strengthening, has been broadly accomplished in the EU. Also as a result of significant supervisory pressure coordinated by the EBA via several stress test and recapitalization exercises, banks' capital ratios have significantly increased in recent years: in December 2006 the Common Equity Tier 1 (CET1) ratio reached 14.2%, a 500 bps increase with respect to the end of 2011. The fully loaded CET1 ratios, obtained without considering the transitional provisions, as well as the Tier 1 and total capital ratios show a comparable trend. Major EU banks' capital ratios are now comparable to their US peers. Banks from Nordic countries are in the upper part of the distribution.

Figure 1: Evolution of transitional CET1 ratios (weighted average) and CET1 ratio (weighted average) by country as of 2016Q4 (source: EBA RAR, EBA risk indicators)

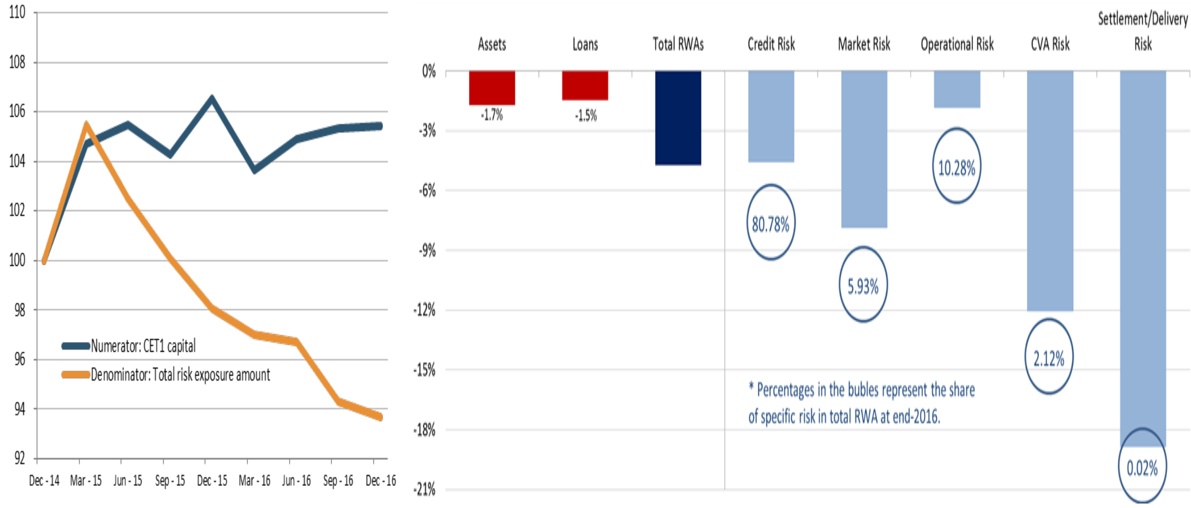


The increase in the ratio has been driven to a very large extent by the growth in common equity, which increased by EUR 180 bn between end 2013 and end 2015. Supervisory restrictions on dividends have contributed to increase retained earnings, despite the low profitability environment. In fact, since the beginning of 2016, retained earnings have replaced capital issuances as the main factor behind the increase in common equity levels.

The **second step**, the in-depth assessment of the quality of bank assets and the clear identification of problem loans, has also been conducted. A wide ranging asset quality review was conducted in 2014 and has been a key focus of regular supervisory assessments in more recent years. Let me add that a common EU definition of non-performing and forborne loans, developed by the EBA, has been a key element in this process.

The **third step**, the cleaning of banks' balance sheets, is still under way. After the strengthening of capital positions and the clear identification of problem assets, the increase in provisioning for non-performing loans should enable banks to write problematic loans off or sell them in the secondary market. In general, there is much yet to be done in dealing with legacy assets: non-performing loans (NPLs) remain at extremely high levels and are declining at a disappointingly low pace. I will come back to this issue more in detail. But there has been some progress in this area. In 2016, the write offs and selling of problematic loans have contributed to a downward trend in risk weighted assets (RWAs), mainly driven by a decrease in credit risk (see Figure 2). At the same time, banks shifted towards exposures carrying lower risk weights to corporate and retail customers. As a result, since the end of 2015, banks' loans and assets have decreased by 1.5% and 1.7%, respectively. In parallel, RWAs have decreased by more than 5%, mainly in the credit risk component, which represents more than 80% of total RWAs. This is a change from recent years, where the reduction in RWAs was mainly focused in the trading book, as a (desired) result of the stricter requirements being implemented on capital market business. The drop of credit RWAs is apparent for both banks using Standardised Approaches and IRB approaches; therefore, it does not look like a matter of optimisation of internal models.

Figure 2: Comparison in the development of Assets, Loans and RWAs (YoY change to end-2016; source: EBA RAR, EBA risk indicators)



We must be careful in the interpretation of data as at the current juncture of the credit cycle, and due to significant differences across Member States, there are contrasting signals. For instance, important asset disposals to non-EU banks help explain the drop in RWAs (in addition to the foreign exchange drive decline in pound sterling denominated assets). On the other hand, and during the same period, banks in some EU countries like Denmark and Norway show increases in total assets. Also, it is not easy to read the data on costs: at first sight, the increase in aggregate costs and cost to income ratios, commented more in detail below, is not a good sign, as it continues to cast a shadow on banks' ability to restore profitability at sustainable levels. However, a deeper dive in the underlying data shows that in several cases the increase in costs is linked to restructuring actions, that might prelude to a long overdue change in business models - a precondition for restoring banks to sustainable profitability.

In other terms, progress in cleaning banks' balance sheets is still slow and uneven. But underneath the big picture provided by aggregate data, we might have an increasing number of banks that after having completed the capital strengthening phase are now moving more decisively to restructure their business and deal with legacy assets. We need to continue monitoring these developments to ascertain how well-ingrained, or fragile, this process is.

Safer and sounder banks: what remains to be done?

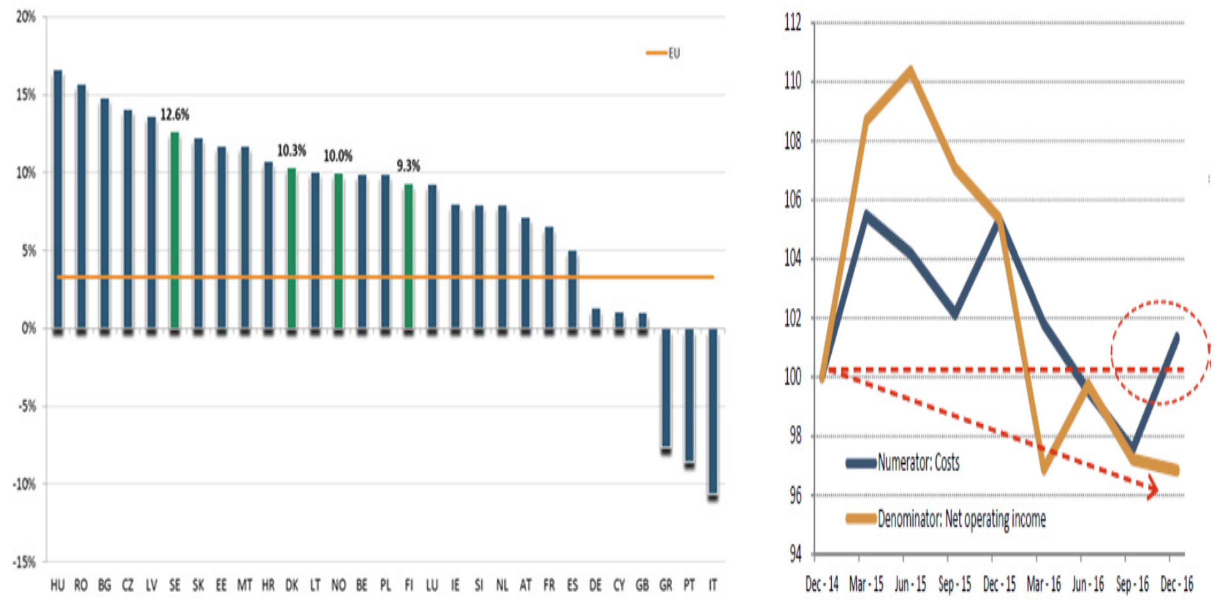
The process of bank balance sheet repair has been long and protracted in the EU. We are moving in the right direction, but the job is not finished yet. What remains to be done?

The main challenges for the EU banking sector seem to lie in: i) low profitability (also influenced by the low interest rate environment); ii) high non-performing loans (NPLs); iii) the challenges raised by financial technology (FinTech) competitors; and iv) uncertainty about institutions' litigation risks and conduct risk-related concerns.

i) Low profitability

In 2016, EU banks' profitability has decreased to the lowest point since end-2013. The weighted average return on equity (RoE) was at 3.3%, 120 bps below the level at end-2015, 20 bps below the 2014 RoE. Banks in Nordic countries present a RoE (weighted average by country) well above the EU average. The dispersion across the EU is significant (see Figure 3).

Figure 3: RoE (weighted average by country) and Cost to income components (EU; Source: EBA RAR, EBA risk indicators)



The main drivers for low profitability are (i) the low interest environment, which is exercising pressure on the net interest margins (NIM) – recently, also fees and commissions have been on a declining path; (ii) the need for higher provisions, due to the remaining high level of NPLs; (iii) stickiness in operational costs and higher non-operational expenses (especially conduct costs, which I will mention later in more detail).

Amongst EU banks, higher levels of profitability have in particular been achieved by those firms that have been more successful in their pursuit of operational efficiency, with prompt restructuring of their business model and reduction in the number of branches and staff, supported by a greater reliance on new channels for the distribution of their products. Many banks, instead, have not been able to drive down operational expenses at the same pace as income and assets. This stickiness of expenses, therefore, seems to be a key factor preventing banks to recover profitability – or at least limit the adverse effect of decreasing earnings - via efficiency gains. But poor asset quality remains the most important factor, especially if we look at countries where the average RoE turned negative in recent years.

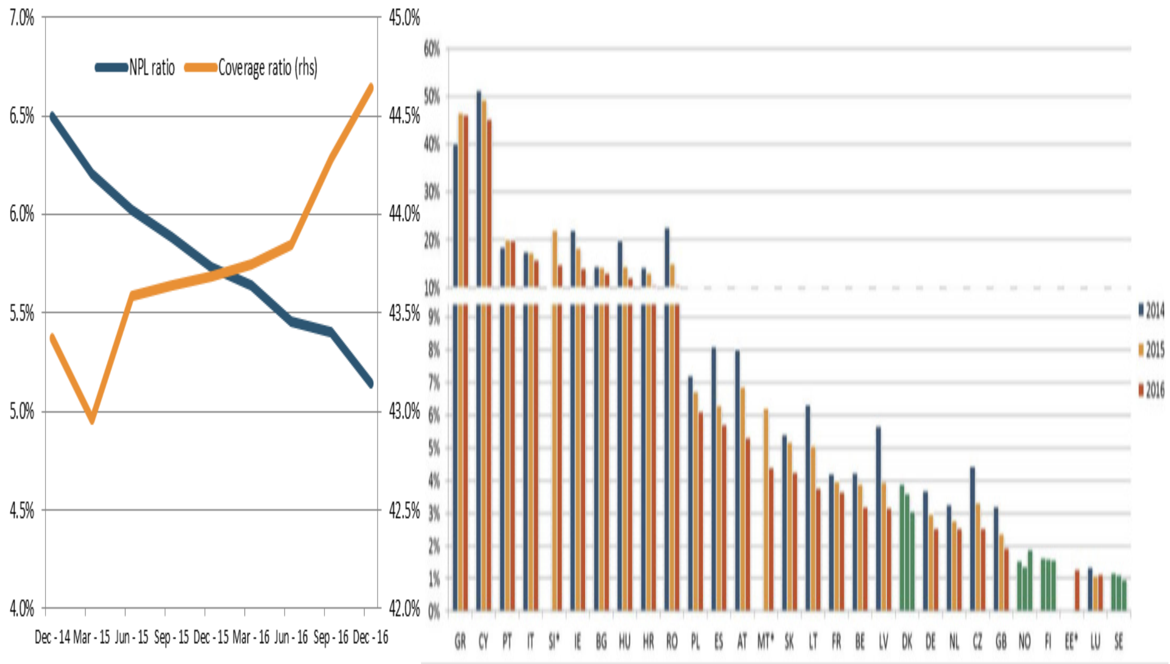
Looking forward, it is likely that impairments for loan losses will continue to increase, at least in the short term, as banks still struggle to deal with legacy assets and write them down or sell them at a discount. The introduction of the new accounting standard on provisioning for expected credit losses (IFRS 9), to be implemented for the first time at the beginning of 2018, will also drive to an increase in provisioning needs, although the co-legislators are considering transitional provisions that would smoothen the impact across time. Also conduct costs should continue to contribute to the negative evolution, according to the expectations expressed by both bankers and market analysts in their responses to our risk questionnaire; but they should be gradually trending down in the course of 2017.

ii) High non-performing loans (NPLs)

Asset quality continues to be a big concern and NPLs remain a challenge for the EU banking sector. According to the most recent data, the stock of NPLs currently stands slightly below one trillion euros.

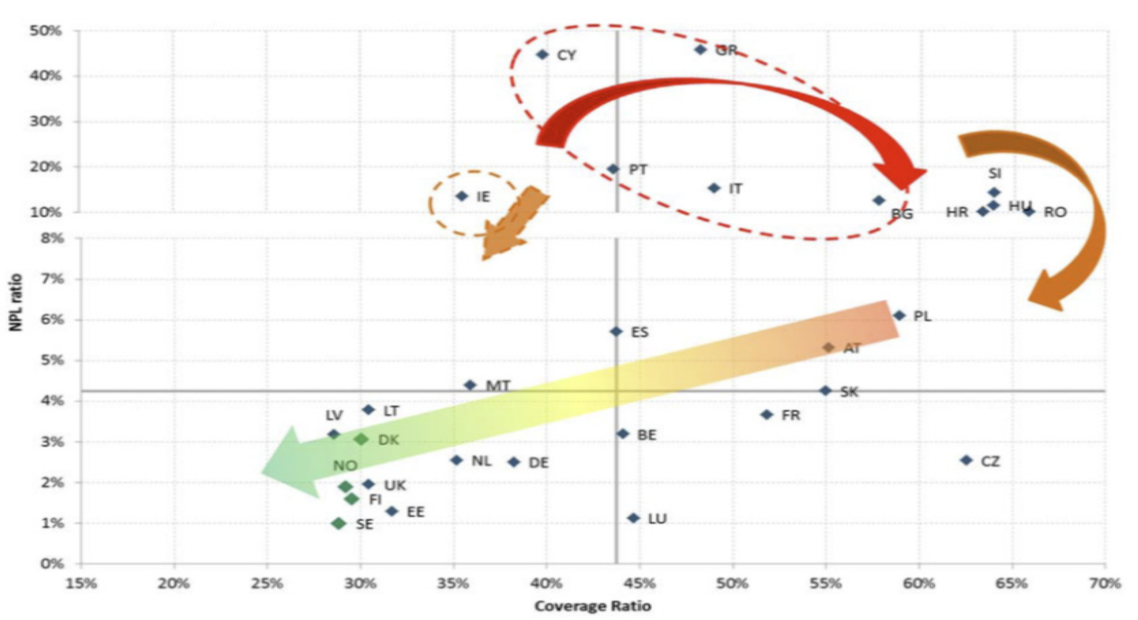
The ratio of non-performing to total loans declined by 30 bps in Q4 2016, to 5.1%, continuing the declining trend of previous quarters. The coverage ratio increased slightly, from 43.7% in 2015 to 44.6% in 2016. However, the pace of adjustment has been slowing down. In particular, only minor changes occurred in high NPL countries. Still, banks in 10 Member States continue to show average NPL ratios above – sometimes well above – 10%. At the other end of the spectrum, Nordic banks present NPL ratios well below the EU average. Hence, progress remain slow, with widening differences across Member States (see Figure 4).

Figure 4: NPL ratio (weighted average) and coverage ratios (weighted average by country; source: EBA RAR, EBA risk indicators)



The different stage and pace of the adjustment process in Member States is visible Figure 5, which maps national banking sectors within the EU in relation to the NPL ratio and the coverage ratio. The adjustment process after a crisis generally sees a banking sector starting in the upper left quadrant of the chart (high NPLs – low coverage ratio), then move to the upper right quadrant (high NPLs – high coverage ratio) as a result of supervisory pressure, until banks are in a position to write-off the exposures or sell them at a discount in secondary markets; at that stage, the direction of travel starts pointing downwards and leftwards, back to pre-crisis levels. It is clear that in several countries the tipping point of the adjustment has not been reached yet. Even when provisioning levels are high, the disposal of the assets looks hindered, as a result of inefficiencies in the functioning of the secondary market, which remains shallow and illiquid.

Figure 5: NPL ratio (weighted average) vs Coverage Ratio (weighted average by country; source: EBA RAR, EBA risk indicators)



Although the asset quality problems look significantly concentrated in 10 Member States, three channels of contagion suggest this is a Single Market problem. First, the very sizeable absolute volume of NPLs in the EU, including in its largest economies, suggests that the issue cannot be ignored, even where the NPL ratio does not signal particular concerns. Second, the direct and indirect exposure of large EU banks to NPLs across borders represents a potential channel for cross-border contagion, if the problem remains unaddressed. Third, the adverse effect of legacy assets on the banks' ability to resume new lending in some countries is significant, as bank capital is trapped in non-performing exposures and is not available to support positive NPV investments. This impairs the transmission of the single monetary policy and its effectiveness in sustaining the recovery.

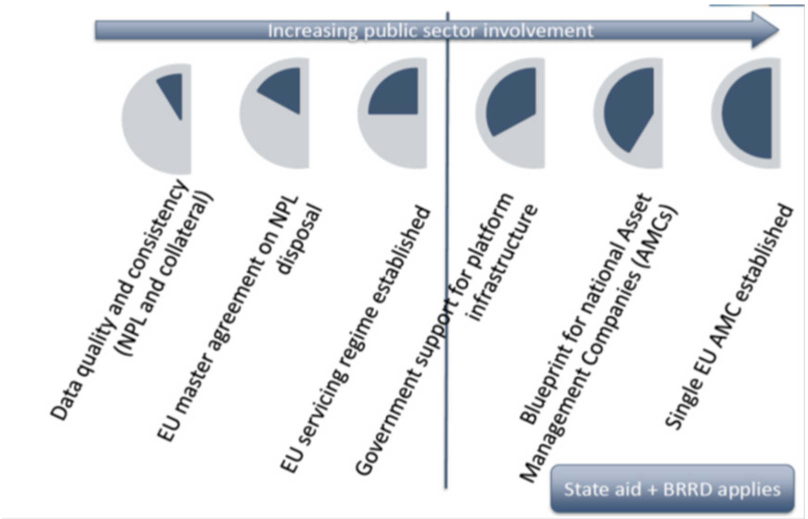
More generally, the integrated functioning of the Single Market implies that if a significant part of the banking sector is impaired in its functioning, the whole market is not functioning properly. It could be compared to a lake, where you have some shores where the waters are clean and others where the levels of pollution are very high: this cannot be good for the flora and fauna of the lake – banks and other financial institutions operating in the Single Market; also, if the average level of pollution is high, it is also unlikely that even the resorts with cleanest beaches will be seen as a top holiday destination – i.e., there is a reputation effect at play that should not be downplayed.

This is why I believe that it is imperative to take action at the EU level to accelerate the cleansing of bank balance sheets: irrespective of the distribution of the problem across countries, the asset quality problem is an EU-wide issue, which calls for EU-wide policies.

The EBA has pointed out the main elements of a coordinated, EU-wide policy effort in a report published in July 2016. These include: enhanced supervisory pressure for an active management of NPLs – an area where the Single Supervisory Mechanism (SSM) of the ECB has recently issued important guidance; active policies to address structural inefficiencies and impediments in the functioning of national judiciary process, out of court proceedings, taxation and accounting issues; measures aimed at improving the functioning of secondary markets in loans to facilitate the disposal of NPLs.

I remain convinced that an involvement of the official sector in the process of balance sheet cleansing would be extremely helpful in order to have significant and rapid progress in presence of dysfunctional secondary markets. It could and should occur in full compliance with the new rules set out in the Bank Recovery and Resolution Directive (BRRD), which aim at limiting the scope of public support to well specified cases, and after the appropriate involvement of private investors in absorbing losses, as envisaged also in the EU rules on State aid. Ideally, such intervention could be framed at the EU level, with the establishment of a single asset management company (AMC) and safeguards to avoid mutualisation of risks across Member States. But if this is not possible, a common blueprint for national AMCs would also prove extremely useful in moving the adjustment process forward.

Figure 6



An important factor to improve the functioning of secondary markets and reduce the currently high bid-ask spreads for NPL portfolios is greater consistency, reliability of and accessibility of information on impaired assets. The European Commission recently issued a mandate for the EBA asking to "…investigate the possibility of issuing guidelines on data standardisation, specifying the set of information required from banks". The project is focusing on the data needs for potential investors, on the assessment of the information that is already available, and then on the development of standardised templates for transparency, portfolio screening and due diligence.

iii) FinTech (financial technology)

The increasing competition from new entrants, exploiting new technologies to provide traditional banking services – so called FinTech companies – adds further pressure on banks' business models, distribution practices, as well as on their current and perspective profitability.

Enhanced competition and the use of more efficient and user-friendly technologies in the provision of banking services is welcome, in light of the positive effect expected for final users and retail consumers. In a number of areas this has clearly been a policy objective for the European legislators. For instance, the revised Payments Services Directive (PSD2) will, as of January 2018, open up access to customers' bank accounts for a new set of institutions, Payment Initiation Services Providers and Account Information Services Providers, in an unprecedented push to increase competition and challenge the informational advantage of incumbent banks.

For banks, this wave of technological innovation and entry of new players is a double-edged sword. On the one hand, there is a significant disruptive potential on current business models, as safe margins in certain areas of business are eroded by competition and long term viability is put under question, in an industry that is already characterized by excess capacity. On the other hand, banks could embrace the change and incorporate new technologies in their value chain, thus increasing their own efficiency and profitability. Several banks have already developed their own

FinTech offer, often via partnerships with existing FinTech companies. This allowed a reduction in operational costs and shifting from product-oriented to client-oriented models. Others have focused more on venture investment in FinTech start-ups, in order to help them create better, faster, and cheaper services for their final customers. The different speed of reaction to the FinTech challenge could prove to be an important driver in the restructuring of the EU banking sector; it will create winners and losers, inside and outside the banking sector.

These developments have to be followed closely also with an eye to their impact on consumer protection – an angle we have taken, for instance, in our work on virtual currencies, crowd-funding, robo-advice, and big data. Also, from the prudential perspective, supervisors need to sharpen their focus on the medium term viability of banks' business models. Finally, there is a major issue concerning the perimeter of regulation: we are still working with a definition of banking that dates back to the First Coordination Directive of 1988, while technological and financial innovation have allowed unregulated or lightly regulated players to provide bank-like services, often breaking down the traditional intermediation process in different bits and pieces. We need to go back to the drawing board and review the appropriateness of the correspondence between the current authorisation system, the regulatory and supervisory coverage it triggers for different types of institutions, and the risks that their business poses to consumers and to financial stability.

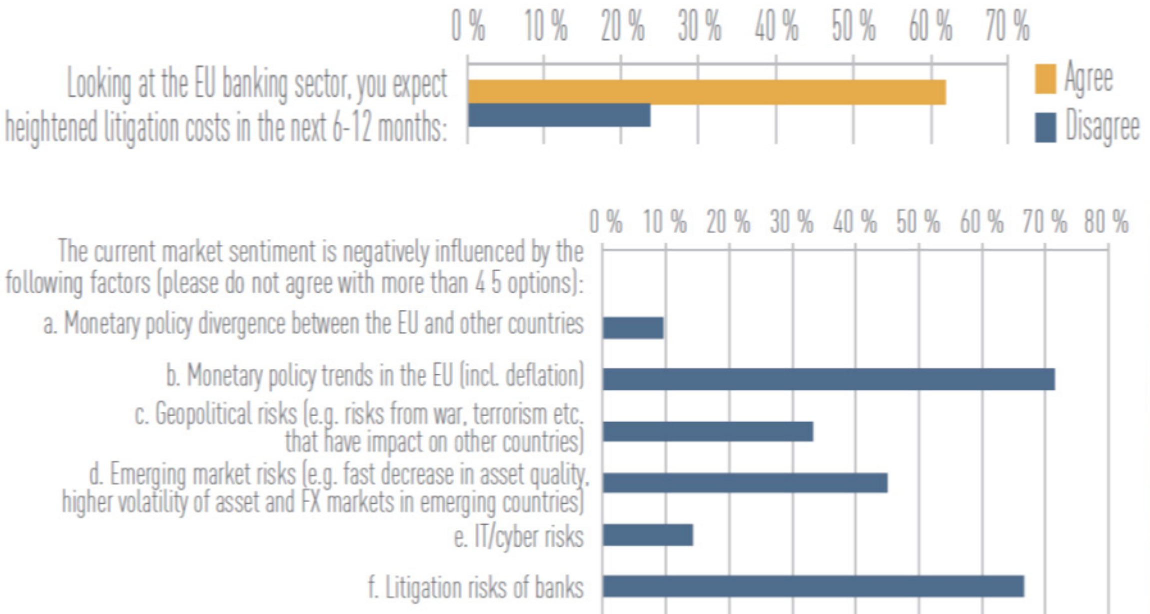
iv) Conduct risk

Finally, uncertainty about institutions' conduct-related risks is still one of the most important concerns negatively affecting current market sentiment towards EU banks.

The high volume of litigation, combined with a string of high profile cases of misconduct triggering sizeable sanctions, fines and settlement agreements with authorities, significantly dented public confidence in the banking sector. The impact on costs and capital levels has also been very sizeable. According to the information collected in an EBA survey, almost half of the banks in the sample paid out more than EUR 500 million in compensation, litigation and fines since the financial year 2007-2008; one third paid out more than EUR 1 billion. In addition, other expenses, which include for instance provisions related to conduct and cyber risk, continue to have a relevant effect on banks' net income.

Further pressure from conduct costs on EU bank's balance sheets is still anticipated by market analysts. In the responses to our questionnaire, they expressed widespread consensus that compensation and redress payments will remain high during 2017. Although conduct costs expected to be trending down after the current year, they are still are identified as the second most important driver negatively affecting market sentiment towards EU banks, after monetary policy (Figure 7). The issue of conduct risk has accordingly been put very high in the list of priorities of EU supervisors.

Figure 7: Expectations in respect of compensation, redress, litigation and similar payments



Resolution and the financial safety net

The changes outlined above demonstrate how the landscape of European banking has strengthened since the crisis. There can be no doubt that the buffers now in place will act as a strong bulwark against any future financial crash. However, experience has taught us an additional salient lesson: there can be no guarantees against financial collapse or systemic crises. Accordingly, the second key component in building a more robust system of European financial oversight necessitates planning for any future breach of these buffers, regardless of cause, in order to protect against the hugely negative impacts that arise, both social and economic.

The response in the EU has been multi-faceted. National resolution authorities have been established in all Member States. The Single Resolution Board (SRB) has been set up with its responsibility focused primarily on resolution of larger banking groups in the Banking Union. These institutions have been empowered by the wide ranging provisions of the BRRD, which in turn has been supported with numerous technical standards and guidelines developed by the EBA.

This infrastructure forms the foundation for a strong resolution planning capability in the EU, one that did not exist when the crisis hit in 2007-2008. While it will take more time to attain the resilience that is desired of this new regime, evidence of the progress is there to see.

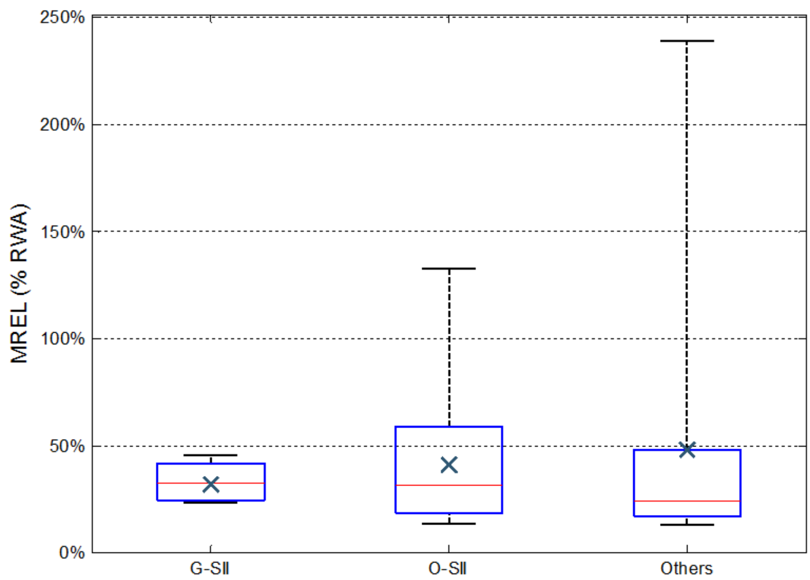
Let me briefly examine two of the key features that now exist namely, the minimum requirement for own funds and eligible liabilities (MREL) and resolution plans.

Loss Absorption Capacity

Of a paramount importance, in the shift from bail-out to bail-in, is to progressively build-up gone-concern, loss absorbing and recapitalisation capacity. However, we are not there yet. The conclusions of EBA's quantitative observations since the beginning of the regulatory reform provide mixed evidence.

On average, banks appear to have a sizeable stack of MREL eligible debt on their balance sheet. The MREL Report published by the EBA in December 2016, on the basis of a diversified sample of 133 banks[1] and end-2015 data, identified that banks held around 37 per cent of their risk weighted assets in MREL eligible liabilities[2] (Figure 8).

Figure 8: MREL ratio in percentage of RWAs as of December 2015 (Source: EBA)



As you know, MREL targets should be bank-specific and based on individual preferred resolution strategies. However, actual targets have not yet been set. In the report, the EBA tried to overcome this issue by considering alternative proxies of common MREL targets (an approximate but necessary assumption) availing of various policy considerations at that time. Based on this analysis, half to two-thirds of the banks in the sample would have complied with their targets if this calibration was in force at that time. Aggregate shortfalls against these targets ranged between 2.1% and 2.9% of system wide risk weighted assets.

[1] The sample comprises 133 banks from 18 EU Member States and covers approximately two thirds of the total EU banking sector's assets. The sample includes 12 G-SIBs and 53 O-SIIs. The sample decomposition per funding model reveals that 53 banks rely significantly on retail deposit funding.

[2] Without taking into account any subordination requirement.

Our analysis broadly corroborates the impact assessment produced in November 2016 by the SRB. We identify larger shortfalls in absolute value (from EUR 186 bn to 276 bn compared to EUR 112 bn) due to a larger sample (133 banks instead of 65) and stricter calibration assumptions which extend subordination requirements to O-SIIs rather than to G-SIIs only. However, when we look at shortfalls relative to risk weighted assets of banks with shortfalls, our analyses show similar ratios.

Another positive element we observed was the stable maturity of MREL eligible instruments. On average, only around 25% of MREL instruments fell in the maturity bucket between 1 and 2 years, signaling rather limited cliff effect. Among the different banks, O-SIIs seemed to have the longest maturity structure – over 40% of MREL instruments were above 5 years remaining maturity.

We are currently in the process of updating the MREL report using end-2016 data. From the sample of banks under consideration in this exercise, the ongoing analysis is pointing to rather limited progress in the intervening period in terms of actual increase of MREL eligible instruments, although the message is more positive when the numbers are expressed as a percentage of RWAs, due to the observed decrease in the latter.

Breaking down the numbers into key sectors, there are some positive aspects. G-SIBs have been very active in the markets for some time. It appears from analysis conducted by the FSB that most G-SIBs are already well placed against the 2022 minimum TLAC requirements, with many already exceeding it.[3] The significant demand that exists for TLAC eligible instruments is very encouraging given the scepticism that existed in some quarters when the requirement came into existence. The clarity around TLAC requirements has opened the door to an efficient market where supply and demand forces are working.

When one steps outside the G-SIBs, the picture is less promising. In the case of smaller banks, liquidation is the likely option in the event of failure and their MREL requirements will largely converge with capital requirements. On the other hand, mid-sized banks for which resolution action would be in the public interest are likely to need to build more demanding levels of loss absorption capacity. For those, the current work being undertaken is suggesting that, in fact, the funding gaps have increased since the MREL report was prepared.

This situation is disappointing considering that the current market environment of ultra-low interest rates and accommodative monetary policy is very supportive of the build-up of buffers. This issuer-friendly environment is not going to last forever and unless progress is made in the short term, there is a real risk that activity will only get underway when markets are tighter and costs are higher.

[3] BIS Basel III Monitoring Report February 2017: "Applying the 2019 minimum requirements, nine of the 25 G-SIBs in the sample have a shortfall totaling €131.4 billion, compared with €216.3 billion at the end of 2015. Applying the 2022 minimum requirements, 18 of the G-SIBs in the sample have a combined shortfall of €318.2 billion, compared with €416.2 billion at the end of 2015".

Addressing this situation requires action on several fronts. First and foremost, banks should be proactive and take advantage of the current market conditions. However, I do understand the argument that this is not simple and there are challenges with the regulatory situation. Market access is also more complex when it comes to non-GSIIs without well-established access to wholesale markets.

The EBA is encouraging resolution authorities to clarify their approach and communicate this to banks as soon as possible. While the indications are that 2017 may bring more clarity to consolidated MREL targets, the situation with respect solo MREL decisions remains unclear. This needs to be addressed and, in our opinion, all MREL decisions should be accompanied by (i) credible plans to achieve compliance (which would of course be annually reviewed in the context of the resolution planning cycle) and (ii) clarity on the expected composition and quality of MREL both in terms of subordination and if applicable, other eligibility criteria and potential exclusions.

Transparency is another crucial factor to support the take up of MREL debt by the markets. When buying an instrument, investors need to be able to understand the risk, including the waterfall of potential losses and the buffers provided by more junior tranches that exist before they are called to contribute. This requires that information on the MREL stack is routinely disclosed in a clear and concise manner.

Finally and in parallel, legislators also have a role to play in providing clarity on the future framework as soon as possible so as to avoid hesitation in the interim. At the very least, it would be useful if the Council General Approach or the Parliament's report sent an early signal to banks and markets that, if they are introducing any changes in MREL eligibility criteria, there will be grandfathering clauses for debt in existence. This would reward the efforts of banks which are willing to issue at this time.

Resolution Planning

MREL is an important and quantifiable measure of the extent to which taxpayers are protected from again having to bail out the banking system. However, maximising its usefulness is dependent on it being part of a properly developed resolution plan.

For over two years authorities across the EU have been working on the development of plans to guide the management of any future banking failure. Following an initial period devoted to understanding the banks, the focus shifted to identifying the preferred resolution strategy. After much effort, this process is basically complete and now, for the vast majority of banks, there is an understanding of whether single point of entry, multiple point of entry or a liquidation strategy should be deployed.

That brings us to the current juncture, which is the most complex and resource consuming stage. It involves the development of well-defined plans that contain sufficient operational detail to execute a resolution, simultaneously defining the tools and powers that can be exercised, in a coordinated manner, to address problems in group entities. A good foundation for this work requires authorities to develop a clear understanding of the critical functions that the bank provides to the economy, its involvement with key financial market infrastructures and the nature of the interconnectivity between the various businesses it conducts.

The evidence suggests that this work is beginning to impact on the shape of Europe's banking sector. Some of the most notably changes relate to:

- simplification of organisation structures, including reductions in the number of legal entities in banking groups, rationalisation of intra-group financing arrangements and streamlining of governance arrangements;
- significantly improved operational continuity arrangements through enhanced service level agreements and, in some cases, the establishment of service companies with stand-alone capital and liquidity resources;
- development of databases and information systems to facilitate actions in the lead up to and during resolution. These systems seek to ensure that actions taken in these crucial, highly stressful periods, are supported by the best possible information;
- identification of employees likely to be critical to smooth resolution, the critical IT systems to support the business and processes for asset and liability valuation.

However, a lot remains to be done before we can achieve the overall objective of the Directive. We must transition from descriptions of banks and their businesses, to fully operational plans that provide a sufficient level of comfort that robust resolvability arrangements are in place for all systemic banks in the EU. As mentioned earlier, we need to swiftly move to decisions on MREL being determined, not only at a consolidated level but also with respect to internal MREL, to provide a firm foundation for home and host authorities' relationships and as the basis for decisions on other aspects of plans.

In addition to MREL, there are a number of other areas where progress needs to be made rapidly. Good examples of these are:

- far greater exchange of information between resolution authorities in the development of resolution plans and more bilateral engagement in advance of college discussions. The Nordic countries have been leading the way in this regard. But it is essential to the efficiency of the process that the full intent of the BRRD is comprehensively applied across all jurisdictions. Without proper and timely communication, all authorities, including the EBA, end up working with incomplete information;
- also with respect to colleges, we need to see (i) a significant change in the approach to planning for the failure of third country banks and investment firms and (ii) an avoidance of the paralysing concentration of college meetings in the final months of each year, leading to inevitable failure to adhere to agreed timelines and joint decision-making;

- developing plans that are more operationally focused, thereby improving their practical benefits. One example of this concerns the mechanics of bail-in execution and the interface of resolution action with securities laws;
- identifying sources of funding, private and public, to facilitate the stabilisation phase of a resolution;
- valuation methodologies that ensure that the necessary valuations can be conducted in a timely and reliable manner; and
- the linkages between recovery and resolution plans and how transition will occur to enable authorities to intervene at a sufficiently early stage and maximise the chances of a successful resolution.

Use of resolution tools

As the components of resolution are put in place, the capacity of European institutions to handle severe stress and financial instability is improving. Although it is always painful to go through a banking crisis, the recent actions taken to deal with Banco Popular, following it being declared 'failing or likely to fail' by its supervisor, are a welcome example of what is now possible.

This use of the sale of business tool is one of the important provisions introduced by the BRRD. I expect that its use will lay to rest what I perceived to be a belief in some quarters that there is a lack of appetite in the EU to fully avail of the powers contained in the Directive. In recent months, I have read suggestions in the media that precautionary recapitalisation by governments was becoming the standard approach for addressing bank failures in Europe. Extrapolating from this train of thought, some commentators considered that senior debt was some form of 'safe haven' in bail-in situations and consequently, was over-priced as these instruments would in all likelihood never be written off or converted.

I have never subscribed to this view and do not believe that it is well founded. Let me briefly set out my reasons for holding this view. First, the experience gained through the global financial crisis (and from crises before that) has taught us many lessons, not least, that there is no 'one size fits all' solution to managing the failure of institutions conducting functions critical to an economy. For this reason, the BRRD provided a range of tools for authorities to use, knowing that such flexibility is needed to reflect the specific conditions of both the institution and of the economy at the point of failure. I don't think there are any grounds to deviate from this position. Second, we have to acknowledge that it will take time to put in place all the elements of the new regime that are necessary to facilitate the exercise of the powers which have been introduced. As MREL requirements are met, impediments to resolvability are addressed and comprehensive resolution plans are agreed, resolvability options increase. As the structure matures, it becomes much harder to sustain the case for any form of public intervention, particularly given the legal and political scrutiny such decisions attract. Therefore, if a situation demands that senior debt must absorb losses, then I consider that, inevitably, this will be the case. Finally, by way of general comment, I fear that some commentators have drawn long term conclusions from a very limited number of recent cases – a number of which have yet to reach a conclusion. I consider it more appropriate to base my views on a very vivid recollection of the angst that existed over taxpayer support for failed banks throughout the crisis. I believe that this clarity of recollection is shared by many. By way of example of the support that exists, I cite the work that is going on to improve some technical aspects of the Directive and in particular, the Commission's proposals for 'non-preferred senior debt' to further facilitate loss absorption capacity. These developments demonstrate that after over two years of operation, the core objectives of the BRRD remain extant and any changes that may be necessary are not designed to change the fundamental principles, but only to improve the efficiency of the system.

For completeness, I should add that precautionary recapitalisation is one of those tools that exist in the BRRD and I think we should support its use when all the necessary conditions are fulfilled. It should, however, be noted that the circumstances when it can be used are strictly defined and limited by the Directive. When the accompanying State aid rules are added into the equation, the result is that there are very onerous consequences for the stakeholders when this tool is used. In my opinion, the cases currently under consideration demonstrate that the authorities are taking a firm line to ensure that all relevant conditions are applied. It is not therefore, some form of easy option, as sometimes portrayed.

In conclusion, the new resolution regime is driving a major change in EU banking and there cannot be any let up in putting the framework in place. In fact, the pace of change needs to accelerate. Resolution planning must advance rapidly and cohesively, underpinned by all the members of the resolution college. This will require proper information exchange, active bilateral engagement, the removal of impediments to resolvability and clear joint decision making. Additionally, it is absolutely vital to support this process and the engagement between home and host authorities that decisions are taken with respect to MREL requirements and that banks quickly move to meeting these requirements. Failure to do so at this time, when conditions are so favourable, runs the risk that delays or procrastination will mean that action will only occur when markets are more demanding and impacts on bank profitability are more severe.