The European banking supervisory framework and its institutional arrangements since Austria’s accession to the European Union

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Agenda

I Harmonization and deregulation leading up to the financial crisis

II Paradigm shifts in banking regulation triggered by the financial crisis

III Establishing the European banking union in response to the sovereign debt crisis

IV Conclusions
Situation at the time of Austria’s accession to the EU on 1 January 1995: “Acquis Communautaire” in banking regulation and banking supervision

<table>
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<th>Main elements of the banking supervisory framework¹</th>
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<th>Additional body of rules and regulations</th>
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<td>Directive 89/117/EEC – Council Directive on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents</td>
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<td>Directive 94/19/EC – Directive on deposit-guarantee schemes</td>
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¹ Excluding provisions on ancillary matters (consumer borrowing, anti-money laundering prevention, etc.) – Source: Authors’ compilation based on EU legislation.
Harmonization with an increasing tendency to deregulation leading up to the financial crisis

1966
- **Segré report**: initial considerations for achieving a common capital market also contain recommendations for removing obstacles in the banking sector that conflict with a level playing field.

since 1973
- **First efforts** of the European Community to establish an internal market for financial services through European legislative acts in the form of directives to be implemented nationally.

1999
- **Financial Services Action Plan** (FSAP) with the objective of "drawing all conceivable advantages from the introduction of the euro".

2001
- **Lamfalussy Report** initially with a focus on EU securities markets: Introduction of the four-stage legislative process to accelerate the EU legislative process. Leads to the creation of CESR with later expansion to banks (CEBS) and insurance companies (CEIOPS).

2005
- **White paper on financial services policy**: European Commission takes up the increasing criticism regarding the “density of regulation” and “gold plating”. This is to be countered with "Better Regulation".

2006
- **CRD I package** for the implementation of Basel II with the introduction of internal models also for credit risk. It also contains first elements of “Better Regulation".
Paradigm shifts in banking regulation triggered by the financial crisis
The De Larosière Report: the EU’s first reaction to the crisis

Reduce the likelihood of a crisis:
• Strengthening banks’ resilience and risk-bearing capacity
  ➞ More and better quality capital, improved liquidity position for banks
  ➞ EU-wide uniform definition of regulatory capital
  ➞ Regulations on remuneration practices
  ➞ Revision of accounting rules with regard to "Mark to Market"
  ➞ Regulation of shadow banks
  ➞ Simplification and standardization of OTC derivatives
  ➞ Etc.

Reduce the impact of a crisis
• Improved crisis management
  ➞ Early Intervention: regulatory framework for crisis intervention
  ➞ Resolution: enable failed banks to exit the market in an orderly manner and establish banks’ resolvability ex-ante
  ➞ Ex-ante financing of deposit insurance by industry

Improve the supervisory structure
• European System of Financial Market Supervision (ESFS)
  ➞ Establishment of a European Systemic Risk Board (ESRB) chaired by the ECB
  ➞ Conversion of the committees CEBS, CEIOPS and CESR to European agencies EBA, EIOPA and ESMA with extended competencies for harmonizing the tasks and competencies of the national supervisory authorities.

Nonetheless: a strong role for central banks in banking supervision proves necessary (e.g. UK, IE, BE, role of the ECB in the SSM)

No role for ECB in microprudential banking supervision
**ESFS: Improved interaction between micro- and macroprudential oversight**

### European System of Financial Supervision (ESFS)

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<th>Microprudential oversight</th>
<th>Macroprudential oversight</th>
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<td><strong>JOINT COMMITTEE</strong></td>
<td><strong>ESRB</strong></td>
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<td>- Cross-sectoral coordination</td>
<td>- Early warning of systemic risks, if necessary recommendations for action to address these risks</td>
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<td><strong>ESAs</strong></td>
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<td>- Ensuring an effective, consistent level of regulation</td>
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<td>- Coordinating role in crisis situations</td>
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<td><strong>COMPETENT SUPERVISORY AUTHORITIES</strong></td>
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<td>- Ongoing supervision</td>
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January 1, 2011
The evolution of the Single European Rulebook in banking regulation

1. Crisis reaction

BCD: Banking Consolidation Directive
BID: Banking Insolvency Directive
CAD: Capital Adequacy Directive
CRD: Capital Requirement Directive
CRR: Capital Requirement Regulation
BRRD: Banking Restructuring and Resolution Directive
DGSD: Deposit Guarantee Scheme Directive

1 Excluding provisions on ancillary matters (consumer borrowing, anti-money laundering prevention, etc.) – Source: Authors' compilation based on EU legislation.
Establishing the banking union in the euro area in response to the crisis culmination with the “sovereign debt crisis” in 2011/2012

- **Banking union**
  - **Joint oversight**
    - Single Supervisory Mechanism (SSM)
  - **Joint resolution**
    - Single Resolution Mechanism (SRM)
  - **Joint deposit guarantee**
    - European Deposit Insurance Scheme (EDIS)

Uniform rules (Single Rulebook)
## Completion of the banking union still pending: status-quo and challenges

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<th>Integration of the internal market</th>
<th>Objective</th>
<th>Status</th>
<th>Main challenges</th>
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<td><strong>SSM</strong></td>
<td>Uniform supervision of banks</td>
<td>▪ The ECB is responsible for direct supervision of (around 120) significant institutions (Sis) since November $; 2014&lt;br&gt;▪ Less significant institutes (LSIs) in the SSM continue to be directly supervised by the NCAs. ECB promotes harmonization in supervision</td>
<td>▪ Further harmonization of supervisory processes&lt;br&gt;▪ Promotion of a common supervisory culture&lt;br&gt;▪ Improvement of the incentives for &quot;opt-in&quot; (i.e. „close cooperation” with the SSM)</td>
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<td><strong>SRM</strong></td>
<td>Uniform rules for bank resolution</td>
<td>▪ SRM creates two elements:&lt;br&gt;a) SRB: operational since 1.1.2016&lt;br&gt;b) SRF: establishment of the fund since 1.1 2016 (until 2024); Target volume EUR min. 55 billion&lt;br&gt;▪ Division of tasks between SRB and NRA similar to SSM</td>
<td>▪ Harmonized treatment of failing banks&lt;br&gt;⇒ Resolution versus liquidation according to national law&lt;br&gt;⇒ Application of EU state aid rules&lt;br&gt;▪ Fiscal backstop for the SRF&lt;br&gt;▪ Liquidity in resolution</td>
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<td><strong>EDIS</strong></td>
<td>Cross-border depositor protection</td>
<td>▪ European Commission&lt;br&gt;• Nov. 2015: draft regulation&lt;br&gt;• Oc. 2017: modified proposal&lt;br&gt;• Political agreement still pending&lt;br&gt;▪ Currently: national deposit guarantee schemes based on harmonized rules (Deposit Guarantee Schemes Directive, DGSD)</td>
<td>▪ A political agreement is required. This proves to be extremely difficult&lt;br&gt;▪ Risk sharing requires further risk reduction, examples:&lt;br&gt;⇒ Faster reduction NPLs&lt;br&gt;⇒ Treatment of sovereign risk&lt;br&gt;⇒ Harmonization of (banking) insolvency law</td>
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Conclusions

In the last 25 years since Austria joined the EU, **EU legislation** in the area of banking regulation and supervision has been strongly influenced by the **prevailing atmosphere**:

- **By the mid-2000s**: Harmonization with the aim of **completing the internal market for financial services** with increasing tendencies towards deregulation ("Better Regulation")
- **Since the financial crisis**: Strengthening **crisis resilience** and improved **crisis management**
  - Both phases led to a **convergence** in EU banking regulation, since 2012 also in supervisory practice (banking union)

When Austria acceded to the EU in **1995**, the **EU regulatory framework** was **fragmented** into a number of directives that only (minimally) harmonized individual aspects. In **2020**, large parts are based on **directly applicable regulations** (CRR, SSMR, SRMR). The supervision of SIs is carried out directly by the SSM, also for LSIs convergence through SSM oversight.
  - **Austria’s financial sector** has thus become more **crisis-resistant** over the past 25 years
  - The **level playing field** for Austrian banks in the EU and especially in the euro area has **improved**

Since the **introduction of the euro**, there is an ongoing discussion to what extent a **monetary union** also requires a **banking union** (arguments: cross-border crisis management and financial market stability, level playing field). The first institutional response to the crisis, however, was only improved coordination and further harmonization (ESFS). It was not until the second peak of the crisis ("sovereign debt crisis") that a political agreement was reached in March 2013 to form the banking union in the euro area. However, the **completion of the banking union** (EDIS) is still **pending**.

From an **institutional perspective**, a key lesson from the crisis is that **central banks** should play a **strong role** in **banking supervision** (UK, IE, BE, most recently IS, reintegrated supervision into the central bank, ECB as the central body of the SSM). As of today, in the SSM there are only three countries (MT, LV, EE covering <less than 0.5% total assets in the SSM) without any involvement of the central bank in banking supervision.

Danke für Ihre Aufmerksamkeit

Thank you for your attention

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