Sabine Lautenschläger: Supervising banks - four priorities

Statement by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism, at the International Monetary Conference, London, 13 June 2017.

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Many thanks for your question, Howard. So what priorities do I see at the moment? In respect of banking supervision there are four things that come to mind.

Most importantly, regulation has to remain a global issue; the banking system is global in scope and we need to take a global approach to regulating it. Reforms of banking regulation have now been under way for almost a decade; it is time to finalise them, implement them and see how they work.

But it is not only about the rules themselves; it is also about their application. Supervisors around the world apply the rules very differently. Globally we should focus on how supervision is carried out and how we can learn from each other. What approaches are used? What are the best tools and methods? What are the best structures in terms of budget and independence, for instance? These are things we should discuss at global level – also with respect to Brexit.

That, in fact, is the second thing on my list of priorities. We all know that, in the event of a “hard” Brexit, UK banks would have to seek a licence in the EU to do business on the Continent.

And here, I get the feeling that many banks are a bit too relaxed about this. So my message today to the banks is quite simple: the clock is ticking. Obtaining a licence takes some time, so don’t put off applying for one for too long.

But it is not just about banks. In the wake of Brexit, we might also see entities, such as broker-dealers or third-country branches, setting up shop in the euro area. These entities would probably be supervised at national level.

The market would become more fragmented and all the conditions for a race to the bottom would be present. It might thus be appropriate to have such entities supervised at European level. The current review of the European rulebook offers a chance to adapt the relevant rules.

Non-performing loans, or NPLs, are the third item on my list. In some parts of the euro area, banks still have large exposures to NPLs on their balance sheets – a legacy of the economic crisis. NPLs are a drag on banks’ profits and they keep the banks from lending to the economy.

The issue needs to be resolved, but it cannot be resolved overnight. Getting rid of NPLs takes time and effort. In March we published guidance for banks on how to deal with NPLs, and our supervisors are monitoring closely the strategies banks devise and the progress they make.

Still, resolving NPLs as quickly as possible requires the right structures. And here, governments could help by improving the legal and judicial systems. The price of NPLs depends largely on whether these systems are effective and efficient.

The fourth item on my list is risk management. And in a broad sense that also covers internal models. After all, banks use these models to calculate risk weights for their assets, which then serve as the starting point for determining the right amount of capital.

I think that risk sensitivity should be central to calculating capital requirements. But I also see that internal models have become very complex. And that makes them prone to error or even manipulation.

Against that backdrop, we have launched a major project; the targeted review of internal models, or TRIM, as we call it. With TRIM, we want to achieve two things.

First, we want to harmonise the supervisory treatment of internal models and ensure a level playing field.

Second, we want to ensure that the results of internal models are conservative and driven by actual risks, and not by modelling choices. This will strengthen trust in the banks' calculation of risk and, ultimately, in the adequacy of capital buffers.

Thank you for your attention.