4th Santander International Banking Conference

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Deputy Prime Minister, Ladies and Gentlemen

It is a pleasure to have been invited to address you this morning at the 4th Santander International Banking Conference. Chairman Botin has gathered a very distinguished list of speakers and I am sure that you will have an enlightening debate over the course of the day.

Given the very difficult environment we are facing in the banking sector at the moment and the major decisions that need to be made, conferences such as these provide an excellent forum for dialogue and for all parties to express views on the structures and measures that will shape the banking industry for the foreseeable future. It is, therefore, a good opportunity to give this international gathering some insights into the newly established EBA, the role it plays in the coordination of supervisory practices across the EU and its role in emergency situations. While the immediate challenges are dominating our thoughts at present, it is also important that we continue to develop the structural changes that are necessary to deliver a more secure and stable banking environment.

In the time I have available, I intend to present some views on how international coordination of supervisory practices can assist in this objective.

I will be happy to take your questions on these issues at the end of this short speech

The EBA

The extent of the problems which have beset the global financial system over the last 4 years are unprecedented in modern times and have exposed serious weaknesses in financial regulation and supervision. In his February 2009 report, Jacques de Larosière pointed to the belief that in the run up to the commencement of the crisis in 2007, financial regulation and supervision had been too weak and provided the wrong incentives. Lack of adequate macro-prudential supervision, ineffective early warning mechanisms, lack of frankness and cooperation between supervisors and lack of common decision making process were among the key lessons learned from the crisis. Part of the European response to addressing these deficiencies was the establishment of the European Banking Authority ('EBA') as part of the European System of Financial Supervision. In the insurance and securities sectors corresponding organisations, namely EIOPA and ESMA, were also established, thus further reflecting the broad nature of the institutional changes which have been brought about.

The mandate of the newly established EBA is broad and covers the development of the Single Rulebook – i.e., rules truly uniform throughout the European Union –, overseeing supervisory colleges and tackling consumer issues.

Expectations are intensifying and the process of establishment has not been helped by the very difficult problems the banking sector has faced since we came into existence on 1 January this year. However, we are fully engaged in delivering on the expectations and are rapidly building up human, technological and other necessary resources.

So what are the key differences between the EBA and the Level 3 Committees which preceded it? Well today, I will primarily focus my remarks on our role in supervisory colleges and our work on common supervisory practices. But there are also other important areas which I should briefly mention. One key differentiation is in the area of rule making. The EBA now has the capacity to draft regulatory and implementing standards that will then be adopted by the Commission as EU regulations and thereby become directly binding in the whole EU, without the need for national implementation. This process will give us the mechanism to deliver on the Single Rulebook. This power will help to eliminate many of the inconsistencies which have arisen from options, national discretions, and the different interpretations adopted when previous rules were transposed into national legislation. Materially reducing the fragmentation in the regulatory regime will not alone provide greater certainty to market participants, but will also provide stronger foundations for greater similarity in supervisory practices. At present, we expect to produce over 100 binding technical standards and this number is poised to grow as new legislation comes on stream.

In relation to consumer protection, the EBA is taking a leading role in promoting transparency, simplicity and fairness in the sale of consumer financial products and services across the internal market.

It is currently involved in collecting, analyzing and reporting on consumer trends, reviewing and coordinating financial literacy and education initiatives by the competent authorities, developing training standards for the industry and contributing to the development of common disclosure rules. While we have not done so to date, the EBA has the capacity to issue warnings in the event that a financial activity poses a serious threat to the EBA objectives and we may temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets. We are building up resources in the consumer protection role and the EBA will not hesitate to exercise its powers to protect consumers if the circumstances so require.

However, I wish to focus my remarks today on three particular aspects of the EBA's work that I consider to be essential for effective international coordination among supervisors, that is, supervisory colleges, common supervisory practices and dealing with emergency situations.

Supervisory Colleges

The misalignment between the international nature of the major banking groups and a national system of supervision has been a contentious subject for many years. In the years preceding the crisis and in an effort to improve supervision, colleges of supervisors were established, to varying extents, for major banking groups. However, as the financial stresses developed in 2008, these structures did not work effectively in a large number of cases. The already difficult situation was compounded by the lack of dialogue and information exchange between supervisory authorities, as national priorities took precedent in the decision making process.

Given the problems which this lack of cooperation presented, there was a clear need to radically overhaul the voluntary structures which existed. This need has manifested itself in legislative changes to the Capital Requirements Directive (CRD) and in specific provisions incorporated into the mandate of the EBA. Supervisory colleges are now required for cross border banking groups operating in the European Economic Area and the EBA have been granted full participation rights as a competent authority. The EBA staff are now attending supervisory colleges of the major systemically important groups in Europe and go to these meetings with a clearly defined goal of promoting and monitoring the efficient, effective and consistent functioning of colleges as well as fostering the coherent application of Union law by supervisors. It should also be noted that since the beginning of 2011, European colleges are the forum in which the consolidating supervisor and the competent authorities responsible for the supervision of subsidiaries are required to reach a joint decision on the capital of the group and the relevant subsidiaries. The formal system of joint risk assessments which underpins this process and the drive to make the core supervisory decision on capital represents a major step forward in the coordination of cross border supervisory processes. The EBA actively participates in college meetings bringing its unique perspective across a diverse range of institutions and countries.

I am glad to say that in many of these meetings, including Santander, consolidating supervisors will often invite supervisors from countries outside the EU so that they can give a firsthand account of the risks being run in the entities they oversee.

The global dimension of these meetings adds significantly to the effectiveness of the analysis of risks and the interconnections which exist within the group. The EBA encourages a continuation of these arrangements as we strongly believe it improves the effectiveness of supervision. There are of course benefits for the banks in the new arrangements. The outcome should be a more coherent analysis of the business, better and consistent understanding of key risks at holding company and subsidiary level and ultimately a fully reasoned decision for the capital requirements that are imposed.

So what is the overall assessment of the EBA in terms of how colleges are delivering on their role of improving the supervision of cross border banking groups? At this point, our overall assessment is that good progress has been made in many quarters but there is still a long way to go to reach the consistency which is necessary and adequate levels of information exchange and cooperation, to drive efficient and effective supervision.

The progress I mention comes from the success in making a joint decision on the capital of the group. Competent authorities are coming to their decisions using the common structures and templates set out in guidelines issued by the EBA. This consistency of approach has benefits which extend beyond the immediate facilitation of the decision making. For instance, the development of relationships, mutual trust and better understanding. It is also clear that many authorities are putting significant effort into the supervisory colleges they hold and they are devoting material resources to the process.

But we need to push ahead from where we are now. Where are improvements needed? I have already made public statements reflecting the fact that EBA considers that the level of information exchange between supervisory authorities was not sufficient in recent months, as liquidity stresses in the system increased. The EBA has been clear to supervisors on the need to provide other college members with timely and sufficiently granular information concerning the liquidity and financial position of banking groups so as to ensure that home and host authorities have a clear and current understanding of the risks. In addition, college members should be informed on corrective actions, both undertaken by the credit institutions and the competent authority, to address the risks being run. It is our intention to monitor the nature of the information exchange which takes place in the coming months in response to the position expressed by the EBA.

We would also like to see more substantive and risk-based engagement and challenge between supervisory authorities, a greater focus on linking the assessment of the macro prudential environment with supervisory action and more time devoted to a forward looking analysis of risks that institutions are likely to face in the future. The EBA will continue to produce regular analysis of the risks and vulnerabilities in the system for the benefit of national supervisory authorities and expects to see the outputs from this process, as well as those from the ESRB and other international bodies, reflected in the joint risk assessments and in the coordinated planning of supervisory actions within the colleges of supervisors. This in turn needs to lead to clear supervisory actions to mitigate the risks arising. Achieving cohesion in this process will materially assist the development of common international standards of supervision.

Supervisory Practices

There is, however, another important feature of supervisory coordination which needs to be addressed. It is evident from our participation in colleges that even where authorities meet on a regular basis and assess risks robustly, there is still the fundamental problem that the supervisory practices, methodologies employed and culture within individual supervisory authorities exhibit material differences. These differences which are borne out of practices developed over any years can be deeply engrained in the DNA of the organisations and their representatives and, therefore, are difficult to change.

So, where do we see these differences and how do they impact on international cooperation among supervisors in different jurisdictions? We see these differences in our daily engagement with supervisory authorities across the EU. Our experience in supervisory colleges have, for instance, shown that these differences can range from technical issues such as scoring scales used to measure and categorise risks to more fundamental distinctions such as in the methodologies used to define capital requirements. In terms of practical impact, you will have noted that several market analysts have published reports this year showing material differences between risk-weighted assets across banks with similar portfolios. While differences will exist because of idiosyncratic features of different business models, it would be expected that the outputs should remain within a reasonable range. I believe that one of the likely contributors to this occurrence is the extent of the analysis and challenge engaged in by supervisory authorities. This can in turn reflect supervisory culture.

The process of harmonising supervisory culture is not something that will be achieved overnight. However, the EBA acts as a focal point for supervisory convergence and harmonisation of cultures. The EBA achieves this on a daily basis through a range of structures from the meetings of the Board of Supervisors drawn from the senior management in national authorities, the regular hosting of meetings of national experts on technical issues and from the employment of many seconded staff who will return to their agencies over time with a firsthand knowledge of the EBA and its policies and approaches. Through the issue of binding technical standards in key areas of prudential supervision, the promotion of consistency in supervisory colleges and the provision of regular training programmes for national authorities, the EBA can help in expediting change.

But I believe further efforts are needed in identifying best supervisory practices, at the European as well as at the international level. The work on effective supervision coordinated by Julie Dickson at the Financial Stability Board has opened an important strand of work. We have the duty to deepen the debate in the supervisory community with a view to identifying and spreading best practices, whilst also establishing effective peer review processes which ensure adherence to the standards.

In a longer term perspective, in the EU we should aim at developing a "Single Guidebook" for the supervisors, to complement the Single Rulebook and ensure that the same rules are also applied in a consistent fashion, delivering broadly similar supervisory outcomes.

Crisis Management

It is at these times of intense challenge that structures and relationships are most tested and we actually see how well coordination of supervision works at an international level- and see most clearly where fault lines continue to exist.

Before I give you some views on what is happening within the regulatory community and given the audience here today, I need to forcefully make the point that primary responsibility to enhance preparedness for a crisis situation lies with the banks themselves. Banks must learn the lessons of the crisis and materially improve their risk management processes. They must embed into their processes the capacity to perform real stress tests and make sure they are well equipped to withstand severe adverse market developments. Part of this process will involve the development of effective Recovery and Resolution Plans (RRPs) and identification of the steps to be taken when the crisis puts the viability of the firm at risk. The recent work of the Financial Stability Board and the publications by national regulatory authorities, European and non-European, of their thinking in this area, brings home, quite rightly, the emphasis that is being placed on this aspect of risk management.

For cross-border groups in the European Union, colleges of supervisors will develop plans for the coordination of supervisory action in emergency situations. Colleges are supplemented by the Cross-Border Stability Groups (or "crisis colleges"), which bring together fiscal authorities, central banks and supervisors. But the lesson of the crisis is that voluntary cooperation arrangements are not enough. Stronger legal and institutional underpinnings are needed to enforce effective crisis management and resolution tools in the Single Market.

An important step has already been taken to strengthen the institutional setting with the provisions set out in our founding Regulation, which gives the EBA responsibilities in areas such as the monitoring of colleges, the development of Recovery and Resolution Plans and the conduct of EU-wide stress tests. In addition, when an emergency situation is declared by the Council, the EBA has been given the power to address specific recommendations to national supervisory authorities with a view to coordinating their actions and, if necessary, apply European decisions directly to individual institutions in case of inaction by national authorities.

Nonetheless, the structures are not complete and a more formal role for the EBA in crisis management will depend on the outcome of the European Commission's work on new legislation for bank recovery and resolution. This is of key importance and is eagerly awaited. The legal underpinning for crisis resolution needs to be fully harmonised in order to allow for an integrated process, with close cooperation between the authorities involved. This should allow interconnecting national resolution procedures so as to ensure an integrated approach for cross-border firms, ensuring an equitable treatment of creditors in all jurisdictions. At the same time, mechanisms should be in place to constrain the actions of national authorities and drive towards coordinated, firm-wide solutions. Over time the EBA's role in this area is likely to grow substantially, including its role in mediating between conflicting interests of national authorities as serious problems emerge.

Final Remarks

Important decisions have been taken by policy makers for a coordinated response to the financial crisis. The regulatory reforms endorsed by the G20 have now to be implemented in a consistent fashion across the world; supervisory convergence and cooperation must be strengthened; a more effective framework for crisis management and resolution needs to be established.

There is of course a clear expectation that the major changes which are being introduced in the European Union and elsewhere will be matched by corresponding mindset changes in the way that management in banks conduct themselves and adapt to the paradigm shift which is necessary in banking. When I hear some of the commentary and resistance to changes which have already been agreed, I begin to doubt that this is the case, but time will tell in this regard.

I would like to stress that national decisions to step back from the global agreements would just lead us to an environment in which regulations are segmented across national borders and races to the top in strengthening the rules are likely to be followed by new waves of regulatory competition.

While we are busy building the new regulatory and supervisory framework, addressing the problems of the current crisis is dominating the thoughts of the EBA and all the authorities. The sovereign debt crisis in the euro area has heightened systemic risk for the banking sector. The EBA is developing technical proposals to favour a reopening of the term funding markets for EU banks and to strengthen their capital position in front of the current risks.

Exercising our role at this time and in this way highlights the importance of a firm and coordinated response to the problems that exist. The EBA will continue to work on this objective in all aspects of its mandate and will work with colleagues outside the EU to foster strong and practical solutions to supervisory problems.

Thank you for your attention and I am open to questions you may have.