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SAFE Finance Blog

Desirable in banking supervision: a culture of enhanced communication

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In a new SAFE White Paper, Martin R. Götz, Tobias H. Tröger, and Mark Wahrenburg analyze the supervisory challenges ahead for banking regulation in Europe



The financial crisis and the European sovereign debt crisis highlighted severe deficiencies in the regulatory framework for the European banking sector. To harmonize regulation and strengthen the resilience of financial institutions in Europe, the European Union undertook various initiatives, culminating in the Banking Union and bringing about a supranationalization of banking regulation in the participating member states. Most notably, the supranationalization of supervisory powers and the direct supervision by large European banks in the Single Supervisory Mechanism (SSM), which came into force on 4 November

2014, represents a major change in the European banking sector.

In the White Paper “The Next SSM Term: Supervisory Challenges Ahead”, the authors Martin R. Götz, Tobias H. Tröger, and Mark Wahrenburg briefly reflect on these first five years of direct supervision by highlighting differences in the development of directly supervised banks and note areas for further improvement. The paper was prepared at the request of the European Parliament’s Committee on Economic and Monetary Affairs and in preparation for the regular public hearing with the new Chair of the Supervisory Board of the European Central Bank (ECB), Andrea Enria on 21 March 2019.

In a first step, they examine publicly available data for the fiscal years 2014 and 2017 on balance sheet items for European banks under direct supervision by the ECB. The authors find that banks that entered direct ECB supervision with weaker capital buffers after the Asset Quality Review (AQR) do not seem to have increased their resilience a lot. While all directly supervised banks reduced their share of bad loans on average over the period 2014 to 2017, the analysis highlights some differences across banks. Specifically, banks with relatively low levels of capitalization in 2014 (and thus with a potentially greater supervisory focus) had a large share of bad loans in 2014 and still have a relatively high share of non-performing loans in 2017. This is all the more troubling as particularly banks with low levels of capital buffers seem to be afflicted with elevated levels of non-performing loans – even though the ECB repeatedly stressed its focus on credit risk over the last years and thus put particular emphasis on the need to reduce the level of non-performing loans.

Exchange of information about details of internal models

The authors encourage supervisors to engage in a culture of enhanced communication with banks and the public. They argue that banking supervision has the potential to increase its benefits to society by expanding supervisory disclosure to the public and engaging in supervisory feedback with banks. According to the authors, examples of such improvements in communication may be supervisory benchmarking surveys in areas such as the evaluation of cyber risks or anti-money laundering practices, expansion of supervisory research and exchange of information about details of internal models.

To foster financial stability, supervisors and resolution authorities need to interact in a smooth and consistent manner and establish reliable practices. The authors argue that the most prominent need for continuous coordination exists in the area of resolution planning and the minimum requirements for own funds and eligible liabilities (MREL). This shall ensure that a failing bank can be resolved at all times without resort to taxpayer money and without perils to financial stability. The constant and time-consistent prescription of loss-bearing capital is also of critical importance to establish market discipline, leading to a more stable banking system. Investors will only price bank risk accordingly if they have skin in the game and will bear potential costs in times of bank failure.

Read the full paper here (<https://safe-frankfurt.de/policy-center/policy-publications/policy-publicationview/publicationname/the-next-ssm-term-supervisory-challenges-ahead.html>).

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