SESSION SUMMARIES

V

BANKING AND INSURANCE REGULATION

CHALLENGES FOR THE EU BANKING SECTOR IN THE COVID CONTEXT	**91**
POLICY PRIORITIES FOR THE EU BANKING SECTOR	**95**
IMPROVING THE EU BANK CRISIS MANAGEMENT FRAMEWORK	**99**
HOW SHOULD BASEL BANKING STANDARDS EVOLVE NOW?	**103**
KEY ISSUES IN THE INSURANCE SECTOR AT THE GLOBAL LEVEL	**107**
SOLVENCY II REVIEW : KEY ISSUES	**110**
REDESIGNING EU AML POLICY	**114**

CHALLENGES FOR THE EU BANKING SECTOR IN THE COVID CONTEXT

According to the outcome of the discussion, the banking sector has not contributed to the economic crisis and is part of the solution. Due to the support provided by monetary and fiscal policies, loan moratoria and prudential flexibility granted to banks by supervisors, the pandemic has not translated into higher NPL ratio so far. But high uncertainty surrounds economic outlook. NPLs are expected to increase in the coming months as the impact of the COVID-19 crisis on the real economy intensifies and the current economic crisis exacerbates pre pandemic challenges and notably the low profitability of European banks. In such a context, preventing insolvencies of distressed but viable forms and achieving a genuine banking union are essential for preserving economic and financial stability.

1. This time is different, but we are in a situation of high uncertainty

The Covid crisis is very different from 2008, which was a financial crisis. European banks entered this pandemic with stronger capital positions, higher liquidity buffers and better asst quality. So, this time, they have helped to mitigate the impact on households and corporates. But the future is uncertain. We do not know the damage to the banks' balance sheets and the structural changes that will be caused by the present crisis.

1.1 A very different type of crisis

A Central Bank official highlighted three important differences of the current crisis with the 2008 crisis. The first is that the origin of the current crisis is not macroeconomic imbalances in economies; it is a health crisis. The second is that banks' balance sheets are in a better shape. Third, the overall regulatory framework is very different. Much was learned in this respect from previous crises.

1.1.1 The policy response

A Central Bank official stated that the policy response was different. It was much faster, better coordinated and broader. Monetary, fiscal, employment, social, regulatory and supervisory policies were used in hitherto unseen dimensions.

1.1.2 Banks are part of the solution thanks to exceptional support from public authorities

An industry representative noted that credit risk is one of the most important challenges of the crisis. Banks are part of the solution by channelling state-guaranteed loans. Banks need to make full use of their capital and liquidity. We are fortunate the banking system has entered this crisis with quite strong capital buffers. It is also a challenge because the current crisis compounds profitability challenges and increase the sovereign-related exposures.

However, all of the measures have proven to be very effective. Despite the significant drop in gross domestic product (GDP), there is not a surge in bankruptcies or defaults. To the contrary, in some cases there has been a record low number of bankruptcies. The question is whether they have been delayed or avoided. Banks are seeing that the crisis impacts different sectors differently. Companies are being more productive and adapting to digital, and the measures are increasingly targeted rather than being full lockdowns.

A Central Bank official added that the support measures have prevented insolvencies in companies affected by Covid, but also prevented insolvencies by some companies who would otherwise have failed in normal times of market dynamics. A Central Bank official summarised the impact of Covid on the banking system as so far so good. However, the major risk is still ahead with the materialisation of insolvency risk in the corporate sector. The extent of the impact will be a function of public support and the capacity to limit the risk.

1.2 We still do not know what is going to happen

1.2.1 The health crisis is not over yet

A public representative noted we are still in the second wave of the pandemic. The vaccination process is slow, there are some countries with lockdown measures on the table, there is no free movement around Europe and new variants are spreading around the world. Though the European and national answers from an economic policy perspective have been correct and timely, there are many doubts about the recovery.

1.2.2 The extent of economic recovery remains uncertain in Europe

A Central Bank official stated that a weak economy produces a weak banking sector, and vice versa. The dimension of the recovery over the coming two years is quite uncertain. In terms of economic policy, the current year will be more difficult than the previous.

A Central Bank official noted that there are some encouraging experiences. There was a great readiness by citizens and companies to return to a normal situation and to usual behavioural patterns as soon as the virus recedes. Also, when the health situation deteriorated again in Q4 2020 and Q1 2021, it was demonstrated that there is great resilience in the economy, as many companies and consumers have well adapted to the Covid- related constraints. The affected parts of the economy are much smaller compared to the first wave at the beginning of the prior year. Future macro-financial developments crucially hinge on future progress in vaccination, and whether the encouraging data from the past two weeks will continue. If these factors come together, the stress in banks will be relatively manageable.

1.2.3 It is not known what will happen if these massive support measures are phased out

A policymaker noted that the problem is that it is not known what will happen if the massive support measures are phased out. It is now said that the cliff

effect might not be that bad. However, the ratios should be considered. Insolvencies were up to 60% lower in 2020 than in 2019, which is not healthy. There is a risk of fragmentation after the crisis. There is a need to at least be prepared.

2. With extensive support measures, the effects of the crisis on banks' balance sheets, in particular on credit risk, have been limited but visible

While the pandemic economic impact has not resulted so far in an increase of non-performing loans, for SSM banks, an increase in corporate defaults is expected. Credit risk must be therefore proactively managed, and provisioning must remain prudent.

2.1 Banks will inevitably experience increasing non-performing loan (NPL) levels

A Central Bank official noted that a full reflection of the current crisis is not yet seen in banks' balance sheets. The most visible indicators, like NPLs, have not started to deteriorate yet. This is mainly because of the strong monetary, regulatory, and economic policy responses to the pandemic. On the regulatory side, there are capital requirement reliefs, and on the fiscal side there is strong support for citizens and companies. But the early signs of asset deterioration can be seen in the form of the migration of loans from stage one to stage two[1] and some to stage three. In addition, some countries have reported moderate increases in the non-performing exposures (NPE) ratio. Some further deterioration of the situation in the banking sector can be expected in the coming months. Countries that entered the crisis with a higher share of NPLs will probably have more difficulties coping, and this is also true for the mainly smaller banks which are more exposed to small and medium enterprises and sole proprietors.

A policy-maker agreed that a rise in NPLs should be expected. The new action plan tried to focus on the leftovers of the 2017 plan, focusing mainly on secondary markets and insolvency frameworks. An industry representative noted that for the time being there is confidence that companies have been able to adapt and that the measures have been quite effective and well-designed. A public representative emphasised that there must be willingness to review economic policies to solve the health crisis. The size of European help and current measures may be in place for longer than is currently thought. The European Commission's action plan on NPLs is very prudent, although less ambitious than desired. The European response to NPLs may need to be reviewed.

2.2 A cliff effect scenario is not anticipated

An industry representative stated that a cliff effect is not expected at the end of the moratoria. There is not a surge in defaults. NPLs will be around 2-3%. Although the banks have seen a significant increase in the cost of risk, it is not through stage three but mainly through building reserves in stages one and two and forward-looking provisioning. It will all depend on the pace of the unwinding of measures, but the recovery could be swift and strong. Much of the government loans or support measures sits in excess cash and has not been fully used.

2.3 Credit risk management at bank level is key

A Central Bank official noted that from a supervisory perspective credit risk management at bank level is key. The provisioning practices are also important. Nonetheless, the collective reaction to this crisis was good, swift and potent, and each party has to play its part in the next phase.

2.4 The banking sector should be able to adjust to the changing environment

2.4.1 The pandemic may lead to structural changes and a shift in consumer preferences

A Central Bank official noted that the relatively strong decline of insolvencies in many countries shows that, by doing as has been done, part of the normal market mechanism was prevented from functioning. When coming back to markets, which should happen, some pick-up in losses should be expected. Firms need to come back to market conditions for doing business when their activities are no longer restricted. That is not a monetary policy or financial-stability issue in the first place, but it is important for the dynamics of the economy. It is very challenging to assess what a viable non-financial company is. It depends tremendously on the demand, which is affected by the current situation, but there could also be some structural changes and the market should play its role in adjusting to that.

2.4.2 The banking sector should be able to adjust to these changing environments

A Central Bank official stated that there are differences across countries for banks, in terms of public and fiscal interventions and the degree to which banks have added forbearance and the like. Over the next 12 months, it will be seen what happens when returning to market dynamics. In some countries, there is a quite pronounced K-shaped recovery because consumers have been prevented from spending in the way that they normally would. Perhaps the most important issue for the financial system is the housing market, which has been boosted by spending constraints on many services as well as a growing need for quality space for offices, teaching, exercise etc. at home. Over a two-to-four-year period, what is going on in the housing market and what will happen on the other

1. Impairment of loans is recognised – on an individual or collective basis – in three stages under IFRS 9:
Stage 1 – When a loan is originated or purchased, expected credit losses (ECLs) resulting from default events that are possible within the next 12 months are recognised (12-month ECL) and a loss allowance is established.
Stage 2 – If a loan's credit risk has increased significantly since initial recognition and is not considered low, lifetime ECLs are recognised. The calculation of interest revenue is the same as for Stage 1.
Stage 3 – If the loan's credit risk increases to the point where it is considered credit-impaired, interest revenue is calculated based on the loan's amortised cost (that is, the gross carrying amount less the loss allowance). Lifetime ECLs are recognised, as in Stage 2.

side of a potential housing/construction boom should be closely observed.

3. The profitability of European banking institutions remains a source of concern

The pandemic has exacerbated the chronically low profitability of European banks, reflecting ultra-low interest rates and depressed margins, legacy assets from the previous crisis and competition from non-banks.

3.1 The profitability of the EU banking industry is particularly affected by lasting negative interest rates

An industry representative noted that for many banks the interest-rate level is the biggest profitability challenge in the near future, as interest rates were not going up. Indeed, the European Central Bank (ECB) will always err on the side of caution here, given the structural weaknesses in the eurozone economies that have been exacerbated by the Covid crisis.

3.2 Achieving return on equity (ROE) in double-digit figures in the current regulatory context is particularly challenging

An industry representative's firm needs to maintain the position on ROE. Some central bankers say that their ROE levels should come down, but the market still expects ROEs in double-digit figures. The question is how to do that if risk pressures arise, and capital buffers remain. There is an ever-expanding level of regulatory costs (contributions to Funds, costs associated with Know Your Customer requirements…). His firm spends about €1 billion a year on dealing with them, which is largely misspent according to a recent article of The Economist. Then there are taxes, and governments will have to find ways of getting out of their huge debt numbers. In certain countries governments seem to take the view that banks should contribute at potentially double the levels compared to other market players.

3.3 Cross-border mergers and the Banking Union (BU)

According to a leader of the industry, completing BU remains of paramount importance. Cross-border mergers are extremely difficult and largely ineffective as long as the BU is not completed (Home/host issues leading to ring fencing practices…). Covid-19 should serve as a catalyst to complete BU.

4. Supporting solvent firms is crucial

Corporates and SMEs all over the world have suffered from the lockdown and the drop in demand. Bold support measures have been adopted by governments, which postponed payment difficulties. It is crucial in this context to ensure the viability of solvent firms that face temporary problems and/or an increase in debt as a result of the pandemic.

4.1 Banks have a key role to play in distinguishing solvent from insolvent firms

An industry representative explained that there are three types of firms: solvent firms that do not need help, solvent firms that need help and insolvent firms. The second category should be concentrated on. The worst mistake to make is not helping solvent and viable firms. By providing support to firms that are not viable or that do not need help, public resources may be wasted, but not helping solvent and viable firms would provoke permanent and unfair damage to the healthy part of the economy.

Banks have a very important role to play, because they have skin in the game as a result of the lending relationship with the affected companies and therefore can help in distinguishing between solvent and insolvent firms. Tools must be designed that align the incentives of the government, banks and corporates to inject equity into firms that are solvent and inject public aid where it is needed. A last resort is debt-restructuring, with longer terms and conversion to equity loans or debt relief.

4.2 The eventual return to normality of financial regulation should be calibrated carefully

A Central Bank official noted that on the supervisory side the major stance was to provide flexibility to banks to use their buffers to absorb the shock. This capacity has not been used to a large extent and must remain in place. For macroprudential policies, the most important issue is that the risks moved from the banking system to the non-bank financial institutions, so it is important to not focus only on the banking system.

4.3 When returning to normality, the countercyclical capital buffer should fairly quickly be set up again.

A Central Bank official stated that when back to normality the countercyclical capital buffers should get back on track. This is not only due to the housing market but also there being an extraordinary fiscal and monetary situation, plus pent-up demand. In addition, there are underlying challenges in the banking system, including overcapacity legacies. The banking sector should continue to consolidate and there is a need to be able resolve failing banks in an orderly manner, which remains challenging.

4.4 Member States should improve their national insolvency framework to facilitate orderly winding-up of non-viable banks/firms

An industry representative noted that non-viable firms require an efficient and quick resolution framework that facilitates a fresh start. The latter requires making the insolvency framework swifter and more efficient. A policy-maker added that banks and fiscal authorities need to work together to identify debtor distress early and engage in timely and appropriate restructuring to prevent insolvencies of fundamentally viable firms. Without this, banks' asset quality could deteriorate sharply. The preventive restructuring framework would be very useful. Unfortunately, only a few member states have transposed this 2019 directive.

A Central Bank official stated that the issue is how long the support should be prolonged for. The quick answer is: long enough but not too long. There is a need now to move to a more targeted and equity-focused type of support. A Central Bank official noted that supervisors should have an active role in guaranteeing that banks reinforce their efforts in the timely identification of situations where borrowers are facing financial difficulties, and the setting up of sustainable solutions for viable customers that allow them to continue their activities while recovering their ability to repay debts.

5. The crisis highlights the need for completing the BU

The Banking Union (BU) remains fragmented and incomplete, which weakens the global competitiveness of European banks and raises the risk of dysfunction in the event of a future shock. The asymmetric impact of the Covid crisis makes it all the more urgent to achieve an EU agreement on a credible way forward to complete the Banking Union.

5.1 The crisis has increased fragmentation across the BU area

An industry representative indicated that the crisis has increased fragmentation, but this is masked by the massive support measures. The risk is that once all these measures start to be unwound the underlying fragmentation will appear. The fragmentation has been masked by the massive liquidity injection by the ECB and the coordinated regulatory response from the European authorities in terms of regulatory, supervisory, and accounting flexibility, as well as the fiscal support measures at the EU level. As a result of this, sovereign spreads remain low. Most of the funding of EU Treasuries has been provided, directly or indirectly, by the ECB, but there are some indicators that home bias has increased with an increasing concentration of sovereign debt in the hands of domestic banks. This implies a latent increase in the doom loop between banks and sovereigns that potentially works in both directions.

A Central Bank official noted that all EU countries promptly adopted measures to support firms and households. However, the design of these measures varied widely. In terms of fragmentation, the implications of the support measures depend on their impacts on banks and sovereigns, and, ultimately, on borrowers. The European banking sector is now in a much more favourable situation than before the previous crisis, with a significant improvement in banks' capacity to absorb the potential losses of the crisis. However, the risk of a less pronounced recovery until vaccination allows for more definitive withdrawal from lockdown measures, and may lead to more acute solvency issues that, if not addressed at the non-financial sector level, will lead to a significant increase in losses in the financial sector

5.2 The crisis highlights the need for a single banking market

An industry representative warned that the risk is that the underlying fragmentation is exacerbated when support measures are unwound, especially if countries exit the crisis at different speeds and with different measures, and there is divergence in the degree of Government support in the exit of the crisis. This is because there is an incomplete BU that is intrinsically unstable. There is no rationale for having an incomplete BU. The review of the crisis-management and deposit-insurance framework that has been put forward by the Commission is an excellent opportunity for completing the BU, and to address the weaknesses of the crisis-management framework seen in recent years.

A Central Bank official stated that regarding the fully mutualised European Deposit Insurance Scheme (EDIS), completing the third pillar of the BU is necessary but not sufficient. There should also be further improvements to the crisis-management framework. More work is now needed on the management of crises for small and medium-sized banks that will fall outside the resolution.

A public representative added that a proposal is expected from the Commission to review the crisis management framework. The dual system of EU resolution and national liquidation needs to be reviewed. There is a need to be better prepared to intervene in order to solve banking problems in the future if the health crisis lasts for longer than expected.

A policy-maker emphasised, regarding the EU crisis management framework, especially the Bank Recovery and Resolution Directive (BRRD), there is a need for a more general overhaul, but not now. Currently it is fit for purpose. Macroprudential policy has worked to some extent. The countercyclical buffers have been released and dividend restrictions imposed.

BU is key and this fragmentation has to be overcome. A single market for banks is needed. The key is to build sufficient trust among all member states for the remaining issues, in particular on EDIS and the crisis-management framework. The same holds for the macroprudential framework. There is no need to react immediately. But there is a question of whether things are good enough countercyclically and whether there is something that needs to be changed in the overall setting of macroprudential tools. The review of this framework is coming at the end of 2022. Next Generation EU is also important when coming out of the crisis.

POLICY PRIORITIES FOR THE EU BANKING SECTOR

European banks have shown resilience during the pandemic but suffer from a persistent low level of profitability. Pre existing vulnerabilities, such as banking overcapacity, lingering cost inefficiencies and increased competition from non banks, particularly fintech and big tech firms, are forcing banks to adjust their business models and make themselves more sustainable in order to continue to support the post Covid recovery. The solutions to the profitability challenge are well known but often difficult to implement. Digitalisation enables banks to improve cost efficiency and offer better products to customers while facilitating the integration of the European banking sector, but these innovations raise new regulatory challenges around level playing field and consumer protection.

1. Improving the competitiveness and profitability of the EU banking sector remains challenging

The EU banking system faces a lack of competitiveness and structural under profitability, which disrupts on bank valuations. The low profitability in European banks is caused by a range of factors, including lasting low interest rates, excess capacity, low cost efficiency, the high cost of regulation and a lack of scale.

1.1 The European banking industry is not profitable

An industry representative mentioned several key factors concerning competitiveness, highlighting the importance of overcapacity. There is still overcapacity in some areas of banking. The cost income ratio is an important subject, but in the last seven or eight years the European banking sector has demonstrated its ability to tackle costs. The European banking sector – whether in wholesale banking, retail banking or asset management – is a broadly a low margin environment compared to the US, which benefits from a large domestic base. There are many parts of the US banking sector where margins are simply higher than in Europe. Lastly, the cost of regulation is very important here. It is clear that the US banking sector and US regulators are more sensitive to the cost and effectiveness of regulation, whereas Europe is only now starting to consider this.

1.1.2 Low profits and high costs remain a key challenge

A regulator agreed that the first challenge for the EU banking sector is profitability. For many years, the banking sector has been unable to obtain a return on equity commensurate with the expected cost of equity. Last year, return on equity was around 2%. Given the macroeconomic environment, the European Banking Authority (EBA) considers cost to be the key component of profitability which could be adjusted going forward. An industry representative agreed on the need to tackle low profitability in the banking industry. The main reasons for low returns are: low interest rates; non bank competition, especially new digital entrants; the cost of regulatory compliance; and the expected increase in non performing loans (NPLs) resulting from the pandemic. There may or may not be overcapacity in the industry, but there is a lack of scale in some areas. Low profitability becomes a prudential issue, however, because the industry cannot grow and support economies.

1.1.3 The weak prospects for profitability continue to weigh on valuations

An official considered that it is extremely challenging to have such a low ratio of average valuation compared to book value. Average valuation compared to book value is approximately 0.6 compared to the US, where it is perhaps more than double. The challenge of bank profitability incorporates a number of issues. First, there is the technological challenge concerning how people buy financial services and execute payments. There is also a challenge concerning scale. Those who are technologically better prepared will 'win the race'. There is also a discrepancy between the profitability of the sector and the risk perceived by stock market investors.

1.1.4 A comparison between the EU and US: profitability, capital and the cost of equity

An industry representative described how the European banking sector has been very resilient throughout the pandemic. There are three interesting comparisons to make between the EU and US banking sectors, based on profitability, capital and the cost of equity. In 2019, the US large banks' return on equity was 14.2%; the European Union banks' return on equity was only 7.4%. One reason is a larger net interest margin (NIM), but the other principal reason is more scale and greater efficiency. US banks have a cost income ratio of around 60%; in the large European banks it is around 70%. In terms of capital, US and EU banks have exactly the same Common Equity Tier 1 (CET1), but the US banks have a much better leverage ratio. In terms of the cost of equity, the US banks have a more attractive revenue mix, better efficiencies, and more sustainable and higher margins. This clearly leads to a lower average implied cost of equity for large US banks of 9% to 11% versus 11% to 13% for the large European banks.

1.1.5 A monetary profitability loop in Europe

An industry speaker noted the loop between the European monetary context and the constraint on profitability. Indeed, interest rates and bank profitability are connected. Lasting negative interest rates in Europe are pressurising net interest margins and weakening the profitability of EU banks. The monetary situation is very different in the US, where interest rates are higher, which helps explain why the European banking sector is less profitable than its US counterpart.

1.1.6 Persistent low bank profitability is accompanied by excess capacity

A regulator noted that excess capacity is another important challenge. The sector will need to restructure

in order to enhance efficiency. It is important for banks to favour sustainable business models in the future. The authorities must take action to allow this restructuring to happen in the smoothest and most efficiency enhancing way possible. An industry representative stressed that there is no consensus on the concept of overall capacity. In France, for example, there is an ongoing debate about banks' ability to maintain a network of branches and ATMs. Indeed, the availability of cash was one issue which contributed to the famous 'yellow vests' movement in France. There is a well known conundrum around maintaining profitability without a physical presence. The usual suggestion is that a bank can cut costs by adapting its footprint, but there is a clear link between the amount of physical infrastructure owned by a bank and the profitability of its client base. Without a physical presence, it is difficult to serve clients. Cutting costs by adapting a bank's footprint will never be the whole solution.

2. Solutions for addressing the profitability challenge are well known but difficult to implement

There are established ways for EU banks to return to sustainable profitability. Banks must continue to make efficiency gains by cutting costs and making more intensive use of new technologies. Improving the EU crisis management framework and increasing consolidation in the sector would help address excess capacity. Banks should be able to consider the Banking Union as their domestic market. Completing the Banking Union is therefore vital; it would notably favour the emergence of effective transnational banking groups. But this is difficult to achieve: solving the home host dilemma and achieving agreement on a common deposit insurance framework remain controversial issues.

2.1 Policymakers need to avoid cliff edge risks

An official highlighted the extraordinary role that the banking system has played in handling the crisis in coordination with central banks and public authorities. It will be crucial to see what happens to the unprecedented public guarantee schemes, which are a shared responsibility between states and banks. There will have to be restructuring in some of the most affected sectors, and it is important not to create a cliff edge in the economy by not supporting these sectors and the viable companies that were particularly affected by the crisis.

2.2 Making efficiency gains by further cutting costs

2.2.1 There is further progress to be made on cost reduction in Europe

A regulator agreed that overcapacity is an important issue in European banks. While there has been some progress, cost income ratios in EU banks remain broadly higher than those of their global peers. Additionally, performance on cost income ratio remains extremely uneven across Europe. Even banks with the same business models have very different cost income ratios. From a supervisory point of view, revenues are also concerning. Banks have very few sources of revenue and the cost of risk has been very low lately, which means that margins in Europe remain very weak. At these low levels of revenue, one of the key issues is diversification. National consolidation creates more synergies, but cross border consolidation provides more diversification.

2.2.2 Reducing cost and exploiting synergies in a cross border banking group

An industry speaker described how their institution, a cross border banking group, has the benefit of both in country scale and scale across Europe, with 25 million active customers and around 70,000 employees. Even without consolidation, it is possible to find cost savings on a pan European and cross border basis, even in retail banking. The institution is seeking to develop a common operating model and has announced €1 billion of cost savings, which is roughly 13% of their cost base. Additionally, this institution also has scale in country. Increasing profitability cannot only be about shutting down branches and reducing its physical footprint. Instead, there must be a proper transformation of the banking model in Europe.

2.3 Improving the EU crisis management framework to address overcapacity

A public representative stressed the importance of crisis management. Europe needs a credible system and reliable system for banks to exit the market, while the current bailout intensive system (e.g., NordLB, Veneto Banca, Banca Tercas…) does not encourage them, and instead keeps many banks in and out of the 'bailout hospital' for many years. The precautionary capitalisations (e.g., Monte Paschi) cannot continue. In the US, the Federal Deposit Insurance Corporation (FDIC) is a well-funded and independent body, which has managed the consolidation of thousands of banks and hundreds of billions in assets. The FDIC's resolution process has been a massive success, and Europe does not yet have anything like this. To promote banking consolidation, we must also solve the home host issue and deposit insurance is critical for this endeavour. Europe needs a commitment not just to consolidation but to forcing bank exits if a bank is unable to compete. A regulator agreed that EU institutions should improve the process of an orderly exit for players without a sustainable model, thus helping to reduce overcapacity and unhealthy competition and promote thus financial stability.

2.4 Completing banking union is of the essence

2.4.1 Addressing the issues around ring fencing

An industry representative suggested that there is a need for the regulatory toolbox to be amended to avoid trapping liquidity and capital inside national barriers. This goes against the principles of the single market and does not help to foster economic growth in all member states. A deposit insurance programme is only one element of this; Europe also needs a harmonised set of rules to enable large European banks to compete.

2.4.2 Settling the home host dilemma

An industry speaker outlined the significance of the home host dilemma. This explicitly adds a substantial amount of cost to European regulation in terms of liquidity requirements and capital allocation. Everybody agrees that there is a problem, but now there is a need to develop solutions to ease the mistrust between

home and host states. The industry should seek to tackle the European Deposit Insurance Scheme (EDIS) over the next few quarters; progress on EDIS could unblock much of this mistrust.

2.4.3 Achieving consensus on a Banking Union remains difficult

An official agreed on the importance of achieving a genuine Banking Union. Hopefully, by the end of the first half of 2021 there will be a roadmap for a Banking Union, though this will not be an easy task. It is important for the industry to reflect on the schedule for a Banking Union and determine the appropriate milestones. Banking union compromises many different elements – such as EDIS, cross border integration and the management of sovereign risk exposures in different geographies – which makes it extremely difficult to find consensus between member states. The industry and the public authorities should consider how valuable it would be to make a Banking Union happen in one go. This would create value and employment for the whole economy, not merely the banking sector. An industry speaker welcomed the suggestion that a Banking Union could be achieved in one step but is sceptical that this can be achieved in light of the progress made over the last few years.

2.4.4 There is a window of opportunity on EDIS after the elections in Germany and France

An industry speaker described how their institution is already engaging on EDIS schemes with member states, the Commission, national governments, and national banking associations and banking sectors in EU member states. There will be a window of opportunity next after the elections in Germany and France to try out EDIS and hopefully to unblock some of the issues around the home host dilemma.

2.4.5 Breaking the deadlock on the Banking Union

A regulator suggested that benefits of a Banking Union have not yet been realised, especially in the eurozone, where there is no longer a division between home and host but a single supervisor. It could be a game changer merely to send the signal that the issue of a Banking Union is unblocked, even if not everything is resolved. There might not be a complete upheaval of the market, but it is important for the industry to explore all of the possibilities here, including consolidation, branchification and the free provision of services, building on digitalisation.

2.5 Banking consolidation

2.5.1 Banking consolidation requires progress on a Banking Union and the home host dilemma

A public representative noted that the European Central Bank (ECB) has been trying to encourage consolidation with its new guide on the supervisory approach to mergers, cross border liquidity management and intragroup financial support agreements. These measures are welcome, but there will not be further cross border mergers and consolidation until there is progress on banking union. Some issues in the banking sector could be addressed regulatorily, such as the home host issue. This discussion often focuses on liquidity waivers and so on, but fundamentally the issue is about the fact that regulators force banks to have duplicated capital at the consolidated and subsidiary levels.

2.5.2 Completing the Banking Union would lead to more consolidation

An industry speaker agreed on the need to complete the Banking Union. Europe must align policies, remove additional barriers, and create a single rulebook and a single deposit insurance scheme. That will naturally lead to more consolidation, including across borders.

2.5.3 Consolidation is only a solution for wholesale banks

An industry representative distinguished the situations of retail banks and wholesale banks in relation to consolidation. There is no clear evidence on building cross border synergies in retail activities due to the specificities of different banks. In addition, there are specific tax regimes, cultures, and savings habits in different countries, all of which reduces the prospects for eliminating overcapacity in EU retail banking.

A regulator highlighted the specific need to increase efficiency across the EU. Technology and digitalisation might be able to assist the process of a Banking Union. There are difficult questions here such as the home host issue, but there are also interesting mechanisms such as the provision of services via branches, the cross border provision of services and digitalisation. In the area of payments, there is a broad degree of cross border provision. As this technology is introduced to a wider set of services in the banking sector, it could enhance these services and realise some of the cross border benefits of the single market by making banks more effective and profitable.

3. A harmonised legal and regulatory environment for a digital banking sector

Digitalisation is becoming an integral part of banks' business models. Of course, digital transformation has important upfront costs in IT infrastructures and new skills, but in the medium term it provides clear opportunities to increase cost efficiency. Regulation and supervision should be technology neutral, and tackling fragmentation is critical. Europe will not be able to compete globally with a fragmented legal and regulatory environment that stifles innovation or allows regulatory arbitrage. Above all, Europe must harmonise protection rules and Know Your Customer (KYC) standards and promote a level playing field around innovative technologies, ensuring that the principle of 'same activity, same risks, same rules' remains the norm throughout the digital transition.

3.1 Digitalisation can facilitate the integration of the EU banking system

An industry representative agreed that technology will enable the industry to make greater progress in the future. For example, anti-money laundering (AML) laws are an excellent example of an area where greater harmonisation could be realised through technology. The efficiency of technology could be leveraged to a far greater extent if there were the same rules in all EU jurisdictions with combined supervision to ensure that the application and interpretation of the rules was aligned. A regulator stressed that the ECB is seeking to invest in digitalisation. It will not happen immediately,

but there is potential to optimise the interactions between supervisors and banks.

3.1.1 Open finance responds to consumer needs

An official highlighted the importance of open banking, which was introduced by Payment Services Directive 2 (PSD2). This enabled the entry of players that were able to innovate in the market and exploit their superior technological 'know how'. EBA observations suggest that this was positive for the development of market participants' business models. The Commission will propose legislation on a broader open finance framework by mid 2022.

3.1.2 EU regulation should promote innovative technologies in financial services

An official stressed that regulation should focus on what is substantial. It is important not to hinder innovation and to accept that the technological revolution is about demolishing the borders between sectors. It is important for the public authorities to keep pace with innovation, not to prevent innovation and not to try to regulate everything. This should be achievable, for instance, with the Regulation of Markets in Crypto-assets (MiCA) regulation. Additionally, the Consumer Credit Directive (CCD) review, which was postponed until the third quarter of 2021, will be important in addressing the consumer protection issues which arise from the emergence of new operators and new forms of consumer credit.

3.1.3 The EU regulatory regime for crypto assets could be adopted quickly

An official noted that Portugal is somewhat positive about the MiCA regulation. This process will hopefully be concluded during the first half of the year. This is very important, because there is currently no legal certainty for crypto assets. Considering the trends in this space, this is very necessary. This work should progress in the first half of the year, but it involves complex technical issues.

3.1.4 Digitalisation is becoming an integral part of banks' business models

An industry representative welcomed the European Commission's drive to foster innovation and a more competitive and diverse ecosystem for finance, particularly digital finance. Parts of the digital revolution have happened already, and this process was accelerated by Covid. It is very positive to see regulators encourage digitalisation. The same rules and the same supervision must apply to the same activity. An industry speaker agreed that it is essential for the industry to keep pace with innovation. There is increased competitive pressure from new entrants and Google, Apple, Facebook and Amazon (GAFA), who are building amazing customer experiences.

3.2 Key success factors for increasing the digitalisation of the banking sector in Europe

3.2.1 Harmonising consumer protection rules and KYC standards

An industry representative reiterated his belief that scale matters. Given the size of the challenge facing Europe, it is extremely important to ensure that there is less overcapacity, more consolidation and bigger scale. The industry representative's institution is able to achieve this because of its scale. Even if a bank creates one app for all of its markets in Europe, there are still many barriers around consumer protection and KYC standards. Removing these barriers would have substantial benefits in terms of overall scale, technology and the investments necessary to better serve customers.

3.2.2 Developing EU solutions to ensure data protection and increase European data sovereignty

An industry speaker explained how data is an important matter for the European sovereignty. Some actors are extremely predominant in areas such as the cloud. If Europe wishes to move towards open banking and banking as a service, the use of public cloud infrastructure is almost compulsory, but there is no credible alternative in Europe. If Europe wishes to keep pace with its competition, there is a clear need to develop practical solutions while protecting client data.

3.2.3 A level playing field for incumbents and new entrants concerning innovation and access to data

An industry speaker highlighted the importance of the level playing field. If operators are in the same industry, using the same kinds of models with the same kind of risk, they should apply the same rules and the same supervision. Some new entrants may be seen as 'free riders' in the system.

3.2.4 Europe should aim to be a single prudential and regulatory jurisdiction

An industry representative observed that the consolidation of the US banking industry did not happen overnight; rather, it started 30 years ago. Frankly, it is not realistic to expect that Europe will be able to replicate what happened over 30 years in a short period of time. Clearly, there is a need for greater support from the regulators. There should be one supervisory body, the ECB, and much greater harmonisation. In the US, there is one counterparty that looks over the industry, which makes the banks more efficient. Efficiency comes not only from the banking system but also from the regulators and central bankers with oversight of these banks, who can accelerate change and transformation.

IMPROVING THE EU BANK CRISIS MANAGEMENT FRAMEWORK

An official described how the European Commission announced reviews of the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR) and the Deposit Guarantee Schemes Directive (DGSD). There is a new acronym in the world of banking union: CMDI, which stands for Crisis Management and Deposit Insurance. Since the introduction of the Single Resolution Board (SRB) and Single Supervisory Mechanism (SSM), there has only been one resolution case, which raises questions about the effectiveness of the system and the scope for further refinement.

The discussion focused on the resolution framework, the State aid framework, the review of the deposit insurance framework and the potential for a common European Deposit Insurance scheme. It emerged from the discussion that the review of the EU crisis management framework requires a comprehensive approach. Defining and implementing the public interest criteria in a single way, addressing differences in national insolvency laws and aligning state aid rules with the EU crisis management framework will make it more effective. The discussion also highlighted the specific challenges and potential solutions concerning crisis management for small and mid sized banks. The European Deposit Insurance Scheme (EDIS), however, is still a controversial subject.

1. A holistic approach to addressing the weaknesses of the EU crisis management framework

A policy-maker emphasised that Europe has a very sophisticated crisis-management framework that does not seem to be suitable for all types of bank. This creates risks around circumvention, raises level playing field issues, and does not create confidence within the Banking Union. Regulators must take a comprehensive approach and ensure that the 'pieces of the puzzle' are connected. The Commission's analysis includes BRRD and SRMR, but it will also need to consider DGSD, national insolvency rules and coordination with state aid rules. The Commission sees EDIS as central to an optimal outcome, but no decision has been taken on whether or not to table a fresh EDIS proposal. As a concrete priority, the Commission wants to ensure that EU resolution and national insolvency rules apply to the right institutions and form a coherent framework with the right incentives in a level playing field. The industry must develop solutions that allow flexibility in insolvency and determine whether there is a need for more harmonised tools.

An industry representative stated that the crisis management framework has improved and strengthened the resilience of banks. The 'proof of the pudding' is the fact that there have been very few challenges to individual banks. The industry representative stated that it is rare to agree entirely with a legislator, but there was very little to dispute in the policy maker's (Martin Merlin) comments.

1.1 The CDMI review should define clear rules to avoid any increase in the sovereign bank loop

An industry representative described how the crisis management framework has helped reduce the sovereign feedback loop, noting however that there are banks in many member states with considerable levels of public debt. This is aggravated by the fact that in some member states these dependencies have increased as deposit guarantee scheme (DGS) funds have been transferred to national treasuries to lower indebtedness. This is not always a bad investment in terms of credit risk, but it increases the sovereign feedback loop. The review should provide clear rules to avoid this.

1.2 The European banking industry needs evolution, not revolution

A regulator agreed that the resolution framework works, adding that there is nothing, however, that cannot be improved. What is needed is evolution rather than revolution; revolution always ends in chaos. There is a need to have a clear view on the end goal, including EDIS and an update of the Banking Communication in the CMDI review. Then policy makers would agree on a clear and time-bound calendar for the transnational period towards the steady state.

1.3 Taking a step-by-step approach

An industry representative noted that the Banking Communication could be rewritten or at least clarified in terms of how it works with the resolution regime. Indeed, 'the pieces of the puzzle' need to come together, but this is complicated by the fact that the pieces are all moving at the same time. It would be better to take a step by step approach rather than trying to do everything at the same time.

2. Defining and implementing the public interest criteria in a single way

2.1 A European approach to the Public Interest Assessment (PIA)

Banks without a positive PIA should exit the market in the most efficient way possible. An industry representative stated that the resolution process begins with the independent and serious decision of the PIA at the European level. There is a need for a European component to this decision or European supervision of the way the decision is made. This could be handled by the Single Resolution Mechanism (SRM) or the SSM, because they have an opinion on whether a bank is viable or not. Ultimately, that is the relevant question. The national decision is not always as independent and cool headed as it could be.

2.2 Harmonising the rules related to the PIA

An industry representative noted that the landscape is much more diversified for smaller EU banks, which complicates the application of resolution and liquidation rules. Therefore, the SRB's work to further

refine the PIA is welcome. The SRB is better placed than member states' competent authorities to apply this test. The BRRD should also be clarified to better define this element.

2.3 Clarifying the existing legal provisions concerning the PIA

A regulator agreed on the need to clarify the legal provisions concerning the PIA, though this speaker is cautious regarding the legal amendments, as the SRB is already carrying out policy work in this regard. The SRB is in the process of expanding the PIA to an assessment of how to manage a system-wide stress scenario. The scope of this should be broadened for a positive result. The logical consequence of a positive PIA is that banks need to be resolvable. These banks need some Minimum Requirement for own funds and Eligible Liabilities (MREL) and they need to be operationally resolvable. The legal framework is adequate, but there is work to be done.

2.4 Ensuring a smooth exit for banks that do not pass the PIA

A regulator described how there is both one European resolution regime and 21 plus insolvency regimes within the Banking Union. If the industry seeks a more European approach, national procedures must be harmonised. Banks without a positive PIA must exit the market in the most efficient way possible. An industry representative noted that the Banking Union is not complete, because the market is not sufficiently integrated. Resolution procedures at the national level are producing 'zombie banks', which increase national fragmentation, are bad for domestic consolidation – and therefore profitability – and make the European banking market less attractive to investors.

2.5 A wider approach to the PIA

A policy maker considered that a wider approach to the PIA will ensure that resolution is applied in all cases where insolvency under national law is not appropriate. The more that can be done through EU wide harmonised rules, the easier it will be to achieve a level playing field and to enhance confidence. However, expanding the application of the PIA is not sufficient. Having more banks in resolution means that resolution must be a credible and feasible strategy. If a bank is put in resolution and requires funding from the Single Resolution Fund (SRF) or a DGS, the conditions of that funding should not be an insurmountable obstacle. While there should be strict conditions attached to funding, those conditions must be realistic.

3. Challenges and possible solutions for medium-sized banks

3.1 To be resolvable, banks need to have enough loss absorption capacity (MREL)

An industry representative suggested that, following a PIA, if a bank is in scope of resolution, the bank should need some MREL. Business model, size, country, local market and rating must be taken into account. If flexibility is applied, it should happen at EU level. National competent authorities (NCAs) must apply the rules if they wish for financial institutions to be covered by the BRRD.

3.2 A way forward for medium-sized banks

A regulator explained that mid sized banks are generally equity and deposit funded. There cannot be a group of banks for whom resolution is too cumbersome and insolvency also does not work. To solve this problem, these banks should be made resolvable. It is useful to consider the best use of a DGS in this process. When seeking to resolve a bank, there will either be a transfer strategy, which is a resolution strategy, or a plan for the bank to exit the market, in which case the DGS safeguards depositors. If the bank must be sold, it is important to consider the franchise being sold. It is not a good idea to bail in the customers who want to sell. This raises questions about whether the transfer should be supported. Transfer tools are not a 'free lunch'; they have a cost. In the current system of super priority, the DGS will not experience many losses. If Europe wants to move to a US style system, it should reassess depositor preference to ensure we make the best possible use of DGS funds.

3.3 The importance of the funding side to support early intervention

A policy maker highlighted the importance of funding. The Commission considers that EDIS would make the industry more effective. EDIS is a natural complement to the crisis management framework. The liquidity support in a 'hybrid EDIS' could minimise the risk of shortfalls and an overreliance on taxpayers' money. A hybrid EDIS providing liquidity to support DGSs could use some of the tools in the current framework, including DGSs in resolution and well-framed preventative measures and alternative measures. The industry must consider the synergies that could be created between a sufficiently ambitious EDIS and the SRF; the smart use of these instruments could lead to flexible and balanced funding solutions.

Broader use of DGS resources in liquidation and resolution would facilitate the use of transfer tools but this proposal is not consensual.

3.3.1 Apart from resolution, deposit guarantee schemes should not be used for purposes other than guaranteeing deposits

An industry representative cautioned that Europe should be very careful about deposit guarantee schemes to be used for purposes other than guaranteeing deposits following negative PIA. The industry must 'go back to basics'. In the case of resolution, the question is whether this is being handled properly at the national level. Another industry representative agreed that it is not a good idea to use a DGS for preventative measures. A DGS is for liquidation. Other measures exist for this purpose; they are clear, and they have been applied in the past.

3.3.2 DGSs could support the wind down of non-systemic banks, given the prior establishment of strict least cost tests and adequate loss sharing

A regulator highlighted the issue concerning failing small and mid sized deposit funded banks which do not pass the PIA. Reformed DGSs could form one important part of a possible solution, but the Banking Union should strive for EDIS as a European solution. It is important to be realistic: neither the European nor the banking Union are clearly at this point yet,

which is why it is essential to address the issue within the current framework. However, allowing member states to implement diverging setups for DGSs would be a step towards fragmentation. The banks being discussed almost entirely fall under the competence of national resolution authorities and not the SRB. DGSs are national financial instruments. In any near term solution, resolution will have to occur on a national level or be embedded in a harmonised European framework. Currently, a DGS mostly has a paybox function in a bank's insolvency: it pays out covered deposits and then seeks to recover funds as a super senior creditor. This approach is not always the most cost efficient or the cheapest, however. There could be cases where a more flexible usage of a DGS could be beneficial. Contributing to a standardised P&A tool could be more efficient and less costly than paying out covered deposits and then recovering funds. Moreover, continued access to accounts and deposits could positively contribute to financial market stability.

The regulator suggested that, if DGS funds were also used for such transfer operations, the same strict conditions for accessing the SRF should hold true for the use of DGS funds. Furthermore, a comprehensive implementation of a least cost principle should be a key element of any DGS intervention. The criteria for this test must be harmonised within the EU. Any DGS contribution must be conditional on the market exit of the bank. In order to prevent moral hazard and excessive losses for the DGS, additional safeguards for DGSs will be required. A dedicated mandatory layer of gone concern instruments above the regulatory capital requirements could be one way forward. A side effect of this would be an increased level playing field between these resolution banks and liquidation banks. A maximum threshold introduced to limit the financing of a transfer tool via DGS funds is another feature which should be evaluated.

Two regulators mentioned the need to set down adequate rules for access to funding in resolution. This would require revisiting the conditions that limit the uses of DGS in resolution, especially the current super priority of covered deposits.

4. Aligning State aid rules with the EU crisis management framework

4.1 Reviewing the state aid rules for banks in the context of the broader CMDI review

A policy maker considered that any reform should include a consideration of state aid rules, particularly the use of liquidation aid. There is a need for a careful evaluation of the requirements to access funding under the resolution and state aid frameworks in order to assess whether further alignment and coordination is appropriate. The Commission's current plan is to present a proposal concerning the resolution and the deposit insurance framework at the end of the year. First, the Commission will draw out lessons from the ongoing consultation and political discussions between member states. There is also a commitment in the Eurogroup to come forward with a work plan for a Banking Union by June, the content of which will have to be taken into consideration before a proposal can be tabled.

A regulator noted the importance of addressing the Banking Communication. It is a difficult proposition to have a clear framework for burden sharing and creditor hierarchy while creditors are still able to get a better result from the insolvency process if they are convincing. It is vital to eliminate the existing loopholes in the framework and ensure that the Banking Communication is aligned. An industry representative highlighted the tiny number of resolution cases. The Banca Tercas case shattered the industry's ideas about the process. In that case, judges said private money is not public money. On the other hand, the money from the DGS comes from the compulsory contributions of banks and is then passed to customers to serve the public interest, which is not very different from a tax.

4.2 A holistic review of State aid rules and the crisis management framework will ensure a coherent set of rules for both frameworks in the future

A policy maker explained that state aid control comes directly from the Treaty. Its function is to assess injections of public money to private entities. The 2008 Banking Communication – as expanded in 2013 – specified the minimum requirements for aid to banks to be compatible with the internal market: aid to banks must remedy a serious disturbance in member states' economies and prevent distortions of competition. The Banking Communication was a realisation of the State aid regime as it exists in the Treaty.

The policy maker stated that the Commission is evaluating, among many other issues, the suggestions of perceived inconsistencies around the burden sharing requirement. The Commission has also noticed the suggestions of inconsistencies between the PIA and the concept of serious disturbance. However, the PIA comes from the BRRD and is a relative test; it assesses whether the resolution objectives would be better achieved in resolution rather than liquidation and insolvency proceedings. The serious disturbance test, however, is an absolute test in the EU Treaty, which assesses whether such aid could remedy a serious disturbance or not. The European Commission regularly evaluates and reviews State aid rules in the light of new market and regulatory developments. European policy makers are reconsidering its regulatory framework in the context of the COVID crisis and the potential effects of this crisis on the real economy. The European Commission will review the Banking Communication at some point, but reviews and evaluations should be carried out consistently – and in a holistic fashion together with the BRRD and the entire crisis management framework. For instance, the bail in rules in the BRRD came after the bail in rules in the Banking Communication. The Commission considers it essential to take a holistic approach on these issues. The policy maker explained that, while the outcome of the Banca Tercas case does not seem to please many stakeholders, the solution could not consist in simply qualifying these situations as incompatible aid: consistency with previous case law needs to be ensured. Moreover, contrary to banking legislation, state aid principles apply to all sectors of the economy, hence cross sectoral consistency needs to be ensured when exercising state aid control. For the time being, since the EU legislator has chosen to respect national specificities in the design and functioning of

national DGS the the Commission will carry out case by case assessments to assess whether an operation by a DGS is imputable to the state or not. If all DGSs were subject to the same rules, the Commission could judge whether there is imputability to a public budget. As long as there is a choice between a private or public DGS, the Commission will have to proceed with this case-by-case assessment.

5. EDIS remains a contentious issue

5.1 EDIS is what is missing from the EU crisis management toolbox

A regulator suggested EDIS is a necessary third pillar of the Banking Union to ensure financial stability and to overcome the sovereign bank loop. However, there have been innumerable attempts to create a roadmap for EDIS. Europe must 'hit the road' at some point. There will need to be interim steps on this journey, but these steps should contain a clear idea of the ultimate destination. While the SRB is committed to making banks resolvable and to broadening the PIA, the industry must work to achieve resolvability. There is a need to align the insolvency framework and ensure there is room to manoeuvre for the use of DGS funds, but ultimately EDIS is the best option.

5.2 Clinging to the idea of EDIS is an impediment to reaching an optimal European solution

An industry representative stressed that, outside the virtual debate on the 'acronyms invented in Brussels', banks are coping with the fallout from the COVID crisis. In all likelihood, the industry will have to overcome an increase in non performing loans (NPLs). It is therefore a particularly bad time to consider replacing the EU's well-functioning Banking Union and harmonised deposit guarantee scheme with EDIS. It is not a sound argument simply to repeat the mantra that the third pillar of the Banking Union must be EDIS. The industry could address some of the real shortcomings here without the introduction of EDIS. On the home host issue, a less restrictive allocation of liquidity within a banking group could be reached without endangering the deposit insurance system in the host country. Responsibility for deposit insurance should lie with the parent company's deposit guarantee scheme. Second, to foster cross border consolidation, the industry needs a system of adequate premium refunds when an institution leaves as a result of a merger. Ultimately, the inflexible focus on the EDIS model is causing the deadlock. Principally, the Commission is not open to the idea of changing or withdrawing its EDIS proposal. The so called hybrid model is not fundamentally new; a fundamentally different proposal would ensure the continuation of well functioning Institutional Protection Schemes (IPSs). EDIS would prohibit the use of funds for preventative measures, which would eliminate this effective toolbox.

The Commission should build on the subsidiarity inherent to the CMDI framework: a clear distinction between systemically important banks under the direct responsibility of EU institutions and non-systemically important banks under national responsibility. Changing this foundation cannot be justified economically or politically. It would contradict the idea of a diverse Europe and undermine local responsibility. The European Court of Justice's recent ruling in the Banca Tercas case highlighted the validity and importance of using preventative and alternative measures to support troubled members of a guarantee scheme from within their respective peer group. By definition, these measures must be economically more advantageous than mere reimbursement of depositors in the event of liquidation. Following the reasoning confirmed by the Union's highest court, the CMDI review should seek to strengthen the role of existing DGSs and IPSs within crisis management by committing to preventive and alternative measures. In addition, national authorities should be provided with additional tools to deal with banks going into insolvency. This would improve the proper functioning of the banking union and maintain the diversity of the EU banking system at the same time.

5.3 Making full use of the Banking Union as a single jurisdiction could break the current deadlock

An industry representative stressed that there are still issues to address concerning capital movements, liquidity and the cross border elements for cross-border banking groups. Considering that from a supervision perspective the Banking Union is a single jurisdiction, such obstacles are not justifiable. This underlying flaw of the banking union's first pillar (supervision) also undermines the functioning of the second pillar (resolution). This issue should be addressed as the policy makers and the industry should consider the move to EDIS. These two pillars must be very stable. The current dynamics in Pillars 1 and 2 undermine the acceptability of any EDIS-like structure as a Pillar 3. As long as the Banking Union is not a single jurisdiction, solutions – i.e. the sale of a business – will be found at the national level. This holds back future integration, risks amplifying domestic issues and hinders any way forward on EDIS.

HOW SHOULD BASEL BANKING STANDARDS EVOLVE NOW?

1. The Basel reforms already in place have proved effective

A Central Bank official described how the Basel III reforms are the policy response of the Basel Committee to address the weaknesses exposed by the great financial crisis of 2008 09. The recent Covid crisis dramatically showed the importance of having a robust financial system which acts as a shock dampener when unexpected events occur. With many elements of the Basel reforms already in place – such as the new capital framework and the new treatment of credit risk – banks faced last year's crisis in a much better position than 10 years earlier. As a longstanding member of the Basel Committee, the Central Bank official emphasised that it is pleasing to see that the work of the Basel Committee does not appear to have been in vain. Another Central Bank official suggested that the EU banking sector has shown significant resilience in recent times because of the improvements observed over the last decade, particularly in terms of solvency, liquidity, and asset quality. Indeed, the work of the Basel Committee has certainly not been in vain.

1.1 The temporary adaptation of transitional periods for implementing international banking and accounting standards was essential to weather the crisis triggered by the pandemic

A Central Bank official explained that the timetable for the implementation of the last parts of the reforms was agreed by the Basel Committee and confirmed by its oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS). When the Covid crisis hit, GHOS postponed the deadline for implementation to January 2023. This one year postponement was needed to free up operational capacity in the banking system and it helped support the real economy during the crisis.

Another Central Bank official agreed that the broad and timely fiscal and monetary measures that were implemented during 2020 were well complemented by the measures taken by financial supervisors and regulators, including the Basel Committee. These actions guaranteed that institutions could continue to finance the economy and absorb losses, which so far have not been very significant. There have been some changes to the timeline, but the Basel Committee took great care to find alternative transitional periods for the implementation of expected credit loss from the IFRS 9 accounting framework. The Capital Requirements Regulation (CRR) 'Quick Fix' was also important in ensuring that banks could manage the crisis.

2. Policy makers consider it necessary to complete the implementation of the international banking standards in the EU

2.1 There is a need for caution on the timing of the withdrawal of regulatory relief measures

An industry representative agreed that, during the Covid crisis, banks have been part of the solution together with monetary, regulatory, and fiscal policies. The impact of the economic crisis on banks' balance sheets has so far been limited because public institutions absorbed most of the shock. Banks will also absorb some of the shock eventually, but the materialisation of this risk depends on public policy. The pandemic is not over. There is still a need for the public authorities to support the economy and the most affected businesses. If this support is given, casualties will be limited.

However, the industry representative cautioned that procyclical regulations such as 'Basel IV' could 'derail the train'. At a time when Europe wants to support businesses and encourage a green and digital recovery, 'Basel IV' would freeze hundreds of billions of euros, which represents a financing capacity of thousands of billions of euros. The implementation should respect the political mandate not to increase significantly overall capital requirements or cause significant differences between different regions of the world. Another industry representative agreed, warning that the implementation of Basel III risks choking off the supply of capital to the banking industry in Europe and further distorting a playing field which is already balanced away to the detriment of the European banks. A Central Bank official noted that the pandemic is not yet over and there is still uncertainty about the pace of recovery and whether the effects of the crisis are temporary or permanent. It is important to evaluate carefully the timing of the withdrawal of relief measures to avoid cliff edge effects and permanent damage to households and companies.

2.2 Policy makers expect that the Basel framework will make the EU banking market more efficient

A Central Bank official stressed the importance of ensuring a gradual return to normality in regulation. The long transitional arrangements should allow a smooth adoption of the latest Basel reforms. For example, the 2028 deadline on the output floor will give banks enough time to rebuild their capital buffers. Implementing the Basel III standards will demonstrate the resilience of the EU banking sector to the market and will surely result in better and cheaper funding. The implementation of the Basel III standards is also about the level playing field between banks inside and outside the European Unio. The regulatory stability and comparability ensured by common standards will attract investors and further strengthen the EU banking sector. A Central Bank official agreed that the timely and consistent implementation of the remaining Basel III reforms would ensure a global level playing field and further strengthen the regulatory framework. As a first step, regulators should phase out the COVID 19 relief measures carefully and return to normality, which means restoring the pre Covid regulation standards. A public representative emphasised that global banking standards are essential for promoting financial stability and enhancing the quality of banking regulation and supervision in a multilateral world.

2.3 However, the effects on the lending of increased capital requirements are restrictive

An industry representative stated that, after years of endless academic debates, it is now well understood that higher capital requirements translate into less lending capacity in the real economy. €200 billion corresponds to roughly €2.1 trillion of loans being prevented by the need to freeze additional capital in the balance sheets of banks. €2.1 trillion is roughly three times the €700 billion in the European recovery plan. It is exactly because of this fact that regulatory flexibility was provided by regulators and supervisors at the onset of the COVID crisis: to free up capital in order to allow banks to lend more to the economy.

3. Key objectives for EU policy makers: taking account of European specificities and ensuring that there is no significant overall increase in capital requirements

3.1 The political debate on how to implement the last batch of regulations will start in Q4 2021

A public representative explained that a proposal is awaited from the Commission to start the political debate with the European Parliament and the Council on the remaining Basel III reforms. The Commission will table a proposal in September. Implementing the Basel regulations is not a question of 'if' but 'how'. This must also be the message to the public: it is not a question about whether global regulation is implemented in Europe; it is only a question of how this is done.

3.2 The Basel framework is confronted with the many specificities of banking in different regions globally

An industry representative emphasised that Basel III is not sensitive to the structure of the European banking sector in respect of factors such as the large level of unrated corporates, the structure of mortgage lending and how derivatives are managed. Basel III is misaligned to the financial structure of Europe, especially given the degree to which the economy is financed on banks' balance sheets. Today, the European banking industry faces regulatory challenges which create subtle disadvantages, including the treatment of derivatives; the implementation of the Fundamental Review of the Trading Book (FRTB), which may be different in the US and in Europe; the securitisation markets in the US and Europe; and the distortive impact of Freddie Mac and Fannie Mae on balance sheet structures. Additionally, there are subtle differences in the pillar 1 and pillar 2 implementations, for example around PruVal, which does not exist in the United States, or the treatment of capitalised software intangibles. The treatment of domestic systemically important banks (D SIB) in Europe also has several distortive effects, including in the treatment of transnational assets and liabilities in the D SIB calculation, which harms intra European financial activity.

3.3 It is important to ensure a level playing field between banks in Europe, the US and Asia

The Basel III framework will further distort the competitive differences between the European and American banking sectors, to say nothing of any future competition from Asian banks. An industry representative thought that the framework will exacerbate existing distortions and level playing field issues between the US and Europe. In relation to the level playing field, a Central Bank official noted that the implementation of FRTB would very much depend on accounting standards. A public representative emphasised that the European Parliament is keenly aware of these issues. It is important not only to discuss the level playing field between the EU and US, but to understand the level playing field between the different banking companies and sectors inside the European Union. However, an industry representative suggested that the idea of the unlevel playing field between large banks and smaller banks in Europe is a myth, because large banks have additional buffers. For instance, there are special buffers between 1% and 3% for large global systemically important banks (G SIBs), additional buffers for systemic risks and an additional buffer on the leverage ratio for G SIBs.

3.4 EU banks' capital requirements could increase by 25%, while US banks' capital would remain flat or decrease

An industry representative outlined how the Basel III final framework is intended to apply to banks' capital on a neutral basis, but quantitative impact studies have indicated that the European banks' capital requirements would increase by 25% while US banks would be largely flat or even decrease. The European banking sector would require another €350 billion of capital. Leveraged on balance sheets, this represents as much as €8.5 trillion of lending capacity to the economy.

3.5 Additional objectives for EU policy makers

A public representative emphasised that the European Parliament and the Council adopt legislation, not the Basel Committee. Europe accepts the common goals of the Basel Committee, but Europe must European ise the Basel rules. It is important to consider Europe's structural specificities and the consequences for institutions, users and citizens. There should be no significant increase in overall capital requirements. Some elements are essential for an effective financing landscape, such as a stronger small and medium sized enterprise (SME) supporting factor and the credit valuation adjustment (CVA) exemption for corporates. On the output floor, Europe must find a Basel compliant solution that implements the common goals of reducing the variability of risk weighted assets (RWAs) and ensuring better comparability. The Banking Union also needs capital and liquidity waivers in order to improve the integration of cross border groups. Based on the Commission's proposal and impact assessment, there should be progress on this subject in the summer, thanks also to the contributions from the European Banking Authority (EBA) and the affected authorities, central banks and stakeholders, and the experience of COVID 19.

An industry representative noted that there are some solutions involving the output floor and its implementation, agreeing that there are many vital topics for discussions about the output floor such as how unrated corporate treatment is implemented, how to consider mortgage lending on bank balance sheets and derivatives. A Central Bank official considered there to be a problem concerning the level of the output floor. Yet Europe should be cautious about not meeting international standards, because there might be issues

concerning competition if European banks are seen as less regulated or as having less strict regulation.

An industry representative stressed that there exists now an opportunity to fine tune the European solution. This should be achieved through detailed technical work before launching a public debate. However, it is important to consider what happens when a public debate is launched. In the years after Europe officially endorsed Basel III in 2010, there was a decrease in the amount of loan funding in Europe because the banks were forced to deleverage. This will happen again if the banks prepare themselves for the next part of Basel III.

A Central Bank official suggested that the full effects of the current crisis are yet to unfold, and many challenges lie ahead. Not less importantly, the final part of the Basel framework that has not been implemented concerns financial risks. This was fixed with what was called Basel 2.5, but there is a general view that it is not satisfactory that there was no comprehensive review.

3.6 The private sector still considers the policy targets to be ambiguous

An industry representative clarified the issues concerning the technical measurement of capital impact in the consideration of having no significant additional capital requirements. In the EBA's EU adapted scenario, there is a reference to a 13% increase in capital requirements. Adding 13% to the current capital requirements is an addition of €200 billion. At the same time, the EBA quantifies the additional capital required as €17 billion. This is a very significant difference. The EBA explains the figure of €17 billion by stating that they are only measuring the shortfall, i.e., the gap between the capital ratio of the bank and the minimum requirements once 'Basel IV' is implemented. Implicitly, this means that the EBA considers that after implementing 'Basel IV' the only requirement that would be imposed on banks would be the level corresponding to the minimum distributable amount, which is in the regulation. This means, for example, that there would be no additional Pillar 2 guidance (P2G) and no management buffer added to that. The Commission's impact study must clarify this subject so that policymakers can make well informed decisions.

3.7 The banking industry considers the idea of a progressive implementation to be illusory

Turning to the question of timescale, an industry representative considered that, as long as the Covid crisis prevents a return to normality, it is probably too early to discuss additional constraints and capital requirements. This is especially the case because the framework proved to be effective when the crisis came. When a reform is proposed for discussion, the markets immediately anticipate the final stage of the reform and ask all the banks when they are going to comply with the final rules. There is an idea of progressive implementation, but in reality, the banks rush to implement the final stage of the regulation.

4. The output floor is a hotly debated subject

4.1 The output floor penalises decentralised banks and banks with a low risk profile

An industry representative explained how the output floor measures the difference between the standard and the RWAs as measured by models. He reminded the audience that these models were introduced not by the banks but by supervisors at the end of the 1990s, because they considered that the standard was not a good measure of the risk. The output floor is highly detrimental for corporate banks using models for two reasons. First, the more decentralised a bank is the more it is penalised by the output floor. Corporate banks are very decentralised and therefore heavily penalised. Second, the lower the risk of a bank, the more it is penalised by the output floor. Corporate banks have low risks and are therefore heavily penalised. Indeed, in a centralised bank, different risks are mixed into the same structure. Because the average risk is closer to the standard, the impact of the output floor is reduced compared to the individual risk of each entity. When the output floor is applied to low risk retail banks in a banking group, there is a huge difference between the real risk and the standard. When these risks are added together, it gives a huge amount which cannot be averaged with the higher risk of the entity dealing with market financing, for instance. This is the mathematical consequence of averaging the whole risk or counting each risk separately. In each case, the averages are different.

A Central Bank official stated that there is a question of scope when dealing with the output floor. There had been a discussion of whether the output floor should apply at the consolidated centralised level or the individual unconsolidated level. Smaller banks have lower portfolio risk, but in some countries small banks tend to use the standard approach. The output floor might also be better for competition for small banks, because they stick to the standard approach due to its ease of implementation.

4.2 It is essential to address the variability of risk assessment approaches

An industry representative considered the output floor to be particularly impactful in Europe, given the structure of European balance sheets. While there is variability in the implementation of the risk weighted models across the sector, the output floor would be particularly impactful for companies with relatively low risk weighting on their balance sheets. A Central Bank official suggested that it is inherent in the concept that the output floor bites more for banks with a low risk-weight.

An industry representative stated that there is a myth concerning the so called variability of RWAs, which is the origin of the output floor. There are reports from the EBA which indicate that there is no greater variability of models in Europe than the variability of the standard approach. The solution to these issues is simple: first, apply the output floor at a consolidated level to neutralise the impact of differences in banks' structures; and second, apply the output floor as a backstop, as mentioned by the Basel agreement, using the 'parallel stack' approach to determine the minimum capital requirement without changing the solvency ratios. An industry representative noted that this assessment could be carried out as a quantitative impact study using a model portfolio. This would lead to a proper assessment of variability.

However, a Central Bank official stressed how banks have an understandable incentive to minimise their capital requirements, but at the same time this can be a source of concern for supervisors. There is clearly some variability, including variability based on the standard

model, and variability is the essence of risk weighting. It is obvious that banks with different risk profiles should have different risk weights. That is achieved by using both standard models and advanced internal models. The point is not to avoid variability across banks; rather, there is variability when the same standard portfolio of assets is put through different models used by different banks. Another Central Bank official suggested that the alternative to the output floor would be regulatory convergence of the internal models of banks. It is incongruous for models to be used for regulatory issues but also as a true and fair view of risk for the purposes of steering and control. The perfect model must be flexible and to the point. If there is variability between models, there must be some form of standardisation. The output floor is the solution to this.

5. The future of international banking standards

5.1 International banking standards must still address emerging challenges

A public representative stressed that global banking standards should evolve in parallel to the implementation of Basel III. The sector must be able to respond to common global challenges such as climate related risk, digitalisation, cyber risk, operational resilience and increasing debt levels. These risks exist across borders and sectors, and they have broad financial stability implications. Given its taxonomy and the environmental, social and governance (ESG) factors, there is a huge opportunity for Europe to be a rule maker rather than a rule taker of global standards. A Central Bank official noted that the pandemic has accelerated digitalisation and new ways of doing business in the financial sector, which should be reflected in future banking regulation and supervision. It is important for supervisors to ensure the accurate inclusion of ESG risks in existing risk models.

5.2 Achieving effective and systematic countercyclicality within banking standards

A Central Bank official emphasised the importance of seeking to learn lessons from the pandemic regarding the effectiveness of the implemented elements of the framework. This assessment could focus on the useability of capital buffers and avoid short term quick fixes. Europe should conduct an evidence based evaluation and implement rule based stabilisers which are available but not subject to excessive discretionary action. Micro buffers will only be effective if they follow a strict risk by risk approach.

KEY ISSUES IN THE INSURANCE SECTOR AT THE GLOBAL LEVEL

1. How the insurance sector has been impacted by the crisis on solvency and profitability

An expert stated that the insurance sector faced two shocks in 2020. The first was a long-term shock coming from increasing natural disasters. The second was COVID-19.

The Global Insurance Market Report of the International Association of Insurance (GIMAR) indicated that the insurance sector has mainly been affected on solvency and profitability, and less on liquidity and asset exposure. Most reinsurance companies suffered from heavy losses due to claims. The most striking shocks have been in the economic branches of services to industries and transportation.

The lines devoted to household insurance, especially casualty, have been hit less. Sometimes the combined ratio improved. For the reinsurance sector, the consequences were seen at the beginning of the year. Most of the threats have been removed with an increase in tariffs. The solvency ratios have been affected by the financial results in the low interest rates environment. In addition, at the end of the year the various values of the listed companies followed the economics of the sectors to which they belong.

On the solvency side, the sector has been resilient and even if the ratios have diminished the amount of security is there. The real problem faced has been the pressure on costs. It resulted from the digitalisation imposed to deal with the changes in distribution channels and the subsequent evolutions of the organisation of companies, in a context of fast development of remote working due to the pandemic. In addition to cost-cutting, some attention has been given to liquidity. On the asset side, attention has been given more to downgrades of certain corporate portfolios.

An industry representative confirmed that capitalisation is still high. Solvency II regimes worked as intended in helping to preserve the bulk of capital.

2. One challenge going forward is to close the resilience gap in the societies

2.1 Modelling pandemics is challenging

An industry representative stated that much of the data in pandemic models is based on past pandemics. Each pandemic will evolve differently. It is important to note that this pandemic is still ongoing, which means that it is important that the risk of mutations as well as the risk that the pandemic lasts for longer than expected are taken into account when looking at the pandemic.

2.2 Claims regarding business interruption was an unexpected challenge

An industry representative stated that the biggest element of the pandemic that took the industry by surprise is the non-damage business interruption. This followed the decisions by governments to enact lockdowns. These varied greatly from country to country. Even Western, liberal democracies went into severe lockdowns. Non-damage business interruption claims were consequences of lockdowns on the insurance industry.

Public private partnerships are one way of helping society remain resilient when faced with large risks that are very difficult to diversify. Continuous efforts should also be made with regards to the closing of the protection gap.

3. The Insurance Capital Standard (ICS) and the holistic framework for the assessment and mitigation of systemic risk

3.1 The first year of the monitoring period of ICS

An official confirmed that, based on the experience of the previous year, the first of the ICS monitoring period, progress is on track. There was strong participation from volunteer groups and engagement in the first year of monitoring. There was also engagement with supervisors. COVID-19 provided a real-life lens through which to look at the performance of the ICS under a global stress situation.

The prior year taught the importance of having global solutions to global challenges, which the ICS aids with. It helps to provide a common language for supervisory discussions of group solvency and internationally active insurance groups and it enhances global convergence of group capital standards. There is a gathering momentum for increased participation from insurance groups in all parts of the world. Engagement and interaction are needed to ensure that ICS is designed to best capture a range of business models and market characteristics.

3.2 The implementation of Holistic Framework

A regulator explained that one impact of COVID-19 was that the holistic framework was not fully implemented during the year. Nonetheless, the holistic framework was very useful for assessing the impact of COVID-19 globally on the insurance sector. The holistic framework is not a set of rules but more of a process. It is a framework to take supervisory actions.

3.3 Three key ICS building blocks

A regulator stated that there are three main challenges for the success of the framework. The first is the setup of a proper macroprudential assessment at national level. This is the basis for having a clear idea about the sources of systemic risk at the national level and bringing them together at the global level.

The work of IAIS on the application paper on macroprudential supervision is very useful in this regard. The paper includes a number of clarifications on many critical aspects. There may be improvements to make when assessing at jurisdictional level how

the sectors could impact the system individually or collectively.

The second critical aspect is having tools that are not only effective but are harmonised in order to measure the sources of global systemic risk. The work of IAIS on the liquidity metric is very important. A liquidity requirement is not needed for insurance; rather, a metric is needed: something that allows measurement of the exposure to liquidity risk at global level. In the future ICS could also be a way of measuring risk.

The third point, which is the most critical, is related to the ability of supervisors to work together and to bring all of the results of the national analyses together to discuss what, globally, the main exposures and the main threats coming from the sectors are.

4. The challenge of the global standards is to achieve comparability and address the various stakeholders' needs beyond supervisors

An industry representative indicated that their firm, as a global company, encourages global standards because it makes life easier to have proper decision-making and comparability. The principle of global standards, whether they are reporting requirements or capital requirements, makes a great deal of sense.

With Solvency II and the Swiss Solvency Test the idea is to have something that reflects the risk profile of the firm the firm thereby providing information that can be used, not just to manage the company but also by stakeholders. It has to be similar to what competitors are doing in order to see how resilient the industry is overall.

4.1 Key points of attention during the monitoring period to achieve comparability: improving the representation of the reinsurance sector, internal models, reducing national fragmentation

An industry representative noted that the holistic framework and ICS need to be well thought through so the comparability makes sense. The reinsurance industry is, on the ICS side, not sufficiently well represented in order to have a risk profile that reflects their firm properly as a global player. The firm also worries about the use of internal models. Over the years it has tried to develop internal models to reflect the risk profile more accurately, thereby helping the decision-making of senior leaders and providing comparability for the shareholders.

The other challenge is fragmentation. There is a counterbalancing of local jurisdictions wanting to stick to what they know because that is how they work, whether it is on the regulatory side or the industry side.

4.2 Producing global standards-related data is burdensome and they pose confidentiality and cybersecurity concerns

An industry representative noted that there are large amounts of data to deliver, and sometimes it is not known where that data will go. There are therefore various risks around confidentiality and the hacking of regulators' or international trade associations' systems. The firm, as a risk knowledge company, is aware that it cannot always completely mitigate everything. These risks are however, weighed to determine whether the effort really is worth the expected outcome. The internal model or the comparability between national jurisdictions, if they apply the ICS, will be key to believing that this will help the industry.

5. Trends shaping the insurance industry

5.1 Assessing and supervising the impact of climate change on the global insurance sector

A public decisionmaker noted that there are huge ongoing projects that will shape the insurance industry. There are emerging risks and issues that need to be dealt with sooner rather than later, for example cyber risk, digitalisation and sustainability. The IAIS is involved in those key challenges.

An official stressed that for climate risk, the insurance sector needs to be front and centre in helping to manage a smooth transition to net zero, and that insurance supervisors also have a key role to play.

This has thus far been achieved through the work on risk assessments and assessing the impact of climate change on the global insurance sector, as well as through the work on developing supervisory practices. An application paper is being finalised, which will be a comprehensive guide for insurance supervisors on how to build climate considerations into their day-to-day supervisions.

On the asset risk assessment, there is already good work looking at climate risk to insurers' investment exposures. It would be interesting to look at the liability side as a next step. There are many scenario analysis and stress-testing exercises being undertaken in different jurisdictions. If it is possible to contribute to global convergence or standardisation around that, that would be very helpful.

IAIS will also have a stocktaking of its principles and standards to identify any gaps. The IAIS' work is being carried out in coordination with the Financial Stability Board, which is looking at a cross-sectoral assessment of stability risks from climate change. The IAIS is contributing an insurance sector perspective to these discussions.

5.2 Sustainability risks: addressing both the physical and the transition risks requires insurance companies to reinvent themselves

An industry representative noted that for sustainability as a bucket it is important to understand the difference between the physical risks and the transition risks. Transition risk is reasonably new. Many in the industry also subscribe to the Paris Agreement and net zero by 2050, but it is a huge challenge across the globe. For the industry, it is important to not only start stepping out of certain areas and industries, but also to encourage them to reinvent themselves and to look at the opportunities available.

6. Key supervisory and regulatory challenges for the coming years for both the sector and the supervisors

6.1 A combination of traditional risk exacerbated and new risk emerging challenge the industry and the supervisors

A regulator stated that the current risk context is very complex because there are traditional risks, such as those connected to the low interest rate environment,

the exacerbation of credit risk due to COVID-19 and other still important traditional risks like the ageing population. In addition, new risks are now increasing in their relevance. There is for example the market conduct, operational and reputational risks coming from digitalisation, , cyber risk, climate risk. For supervisors, the problem is keeping up with this risk development. Supervisors should be well equipped and well-resourced to deal with this new context. Europe has the added value of Solvency II, which is already a risk-based system, and so could be used for dealing with the new risks without changing the framework.

6.2 Digitalisation is changing business models in the insurance sector

A regulator stated that digitalisation is a reason for changing the business model of insurers. This will be an important challenge for supervisors who, at a national level, do not always have the relevant expertise and knowledge. The challenge is to promote the development of digitalisation within a safe context, because it presents an opportunity for companies and consumers.

6.3 Technology is where the new area of risks is coming

An industry representative stressed that with cyber-attacks it is a matter of when an entity will be attacked and how they can protect themselves. For companies going into the public cloud there is only a handful of suppliers which are very concentrated, so there is concentration risk. Technology is also evolving very quickly, so there is upskilling risk.

6.4 Addressing the protection gap in a changing world

A regulator noted that, as the COVID-19 crisis has stressed, the protection gap is a major issue for households, companies, and society in general. It is important to take care of aspects like the prevention of risk and the possibility to cover catastrophic events. Supervisors are not the main actors in this regard but should be part of the solution.

SOLVENCY II REVIEW: KEY ISSUES

1. The current context

1.1 Solvency II has proven to be a robust framework, but it must evolve to address emerging challenges

The review of Solvency II is particularly relevant in the current unprecedented economic context that has resulted from the pandemic, as well as in the context of emerging risks arising from climate change and low-for-long interest rates.

The robustness, strength, and flexibility of the supervisory framework has been demonstrated considering the current crisis. Countercyclical mechanisms provided by the current Solvency II regime were helpful in dampening the effects of market volatility. The framework has also helped to avoid procyclical behaviours.

However, some aspects of Solvency II still need to be improved upon in order to take into account the current economic environment as well as upcoming challenges. In particular, the current pandemic and the climate-related risk context have unveiled challenges for the insurance sector related to business interruption protection and the existing insurance protection gap. Considering this, the European Insurance and Occupational Pensions Authority (EIOPA) delivered its final piece of advice on the Solvency II review in December 2020.

1.2 The EU insurance sector has demonstrated its solvency and flexibility in the current challenging context

An industry representative stated that the insurance sector is often not given enough credit for being flexible, and yet it demonstrated flexibility in coping with the pandemic and subsequent economic crisis, which has been a real stress test for the insurance business across almost all business lines. Thanks to the massive application of digital technologies, the industry was able to maintain business continuity and offer services to its customers while simultaneously protecting agents and employees.

The internal capital position and the initial level of solvency allowed the industry to cope with the short-term volatility caused by the deterioration of the financial market at the beginning of the pandemic. In the first and second quarter, internal operating profits and a well-diversified portfolio allowed for the compensation of higher claims or less premiums in some lines of business with reduced claim frequency in the other lines. By demonstrating stability in the face of Covid, the insurance sector is still perceived as a safe place to invest money in the long-term.

1.3 The review should address various emerging challenges

A regulator stressed that the main challenge in relation to the Solvency II review is reality, be that the reality of many years of low interest rates, of the ongoing Covid epidemic or of climate change, which has a particular impact on insurers given their role as risk managers for the whole economy. The challenge for EIOPA and the 27 national supervisors is to consider what changes to Solvency II should be recommended considering these realities.

A regulator commended EIOPA's technical advice on the Solvency II review as a 'very good starting point', noting that it is now for the European Commission to come forward with its official proposal, which is expected to be adopted in July. In preparing that proposal, the European Commission should take into account the range of different issues such as: an ageing population; the role of institutional investors in achieving political goals such as the Capital Markets Union and the European Green Deal; the risks attached to equity and debt instruments; and policyholder protection.

1.4 Fundamental changes are not necessary

A regulator stated that fundamental changes to Solvency II are not required, particularly in light of the strength that has been demonstrated in coping with the current adverse realities. EIOPA's approach to Solvency II is therefore 'evolution, not revolution'.

Another regulator concurred that Solvency II has proven to be an effective tool and an effective framework in the wake of the Covid crisis, bolstered by the lessons learned from the financial crisis at the beginning of the decade. Evolution is therefore preferable to revolution, with fine-tuning and completing the framework where necessary in order to, for example, take account of the current environment of negative interest rates, and deepen the integration of the insurance sector across the whole European Union.

An industry representative stressed that all participants share a common goal, which is to make this review a success. There is a consensus among the community of both insurance undertakings and supervisory authorities that, while the Solvency II framework is not perfect, it is working, and it is important not to break what is actually working. The implementation of Solvency II has helped EU insurers to better align the capital level with risk, to build up resilience and to enhance risk management practices. Crucially, the framework has allowed insurers to withstand the Covid crisis without suffering damages that the current level of capital would not allow them to support, and to do so without calling for public support.

Another industry representative agreed that no fundamental changes are needed, and that adaptation is preferable to revolution, notably with regard to long-term business models. The ability of insurers to take risks and to invest in the economy with long-term strategies needs to be recognised and facilitated rather than impeded.

2. The main issues to be solved

2.1 Specific changes

2.1.1 Addressing the low-for-long situation specific to interest rates

A regulator noted that EIOPA has identified the need to change the treatment of interest rate risks to cater for the environment of negative interest rates and to ensure that enough capital is held by insurers against this risk.

Another regulator added that the way in which capital requirements for interest rate risks are calculated should be corrected in order to take account of the changes in the economic environment and the appearance of negative interest rates. A question that remains unresolved is where the cap should be in the downwards scenario.

2.1.2 Regulatory phase-in periods to dampen the impact of the Covid-19 crisis in the short term

A regulator stated that the long-term perspective of EIOPA's advice needs to be disentangled from the short-term impact of the current Covid-19 situation. An 'emergency brake' has therefore been proposed to the application of the extrapolation of interest rates when interest rate levels were below that of the end of 2019.

2.1.3 Fine-tuning the volatility adjustment

A regulator called for the volatility adjustment (VA) to be fine-tuned so that it can be better applied to longer-term and illiquid liabilities. A permanent VA component would be applied to these illiquid liabilities because the short-term volatility is not relevant since assets are being held that are intended to be kept. The macroeconomic component of the VA also needs to be fine-tuned. In particular, the VA tool needs to provide adequate relief where market fragmentation arises because of divergent economic realities across the different countries in the euro area.

2.1.4 Attention is required on possible asset bubbles

A regulator noted that EIOPA has provided a cautious position on a so-called 'green supporting factor' in a separate 2019 opinion. EIOPA is also proposing to move the frontier here in areas such as the inclusion of climate change risks in the own risk and solvency assessment (ORSA).

Another regulator noted that the insurance sector is a fundamental player in the post-Covid economic recovery and in the green and digital transformations. The policies that need to be in place to ensure that the insurance sector can play its role do not arise simply from the prudential regime, but, as a prudential regime, Solvency II must remain risk-based and evidence-based. Where uncertainty remains about the risks stemming from new assets, Solvency II needs to fully reflect appropriate risk-sharing mechanisms.

2.1.5 A macroprudential approach to recovery and resolution provisions to address notably systemic risks

A regulator highlighted the need to supplement the current microprudential framework of Solvency II with the macroprudential perspective, both in relation to systemic risk and recommendations on recovery and resolution, as well as minimum harmonised insurance guarantee schemes.

Another regulator stated that the recovery and resolution element, together with the insurance guarantee schemes, are fundamental pieces to add to the regime.

2.1.6 Cyber-risk

A regulator noted that digitalisation provides opportunities in terms of new products such as cyber-risk insurance and autonomous driving liability insurance, but that it also increases the possibility of cyber-attacks and insurance fraud.

2.2 The framework requires more proportionality

A regulator stressed that the Solvency II review should make proportionality a practical reality rather than just a theoretical principle, so that the regime is more fit for purpose, particularly for small- and medium-sized insurers.

Another regulator noted that a more risk-sensitive regime can lead to greater complexity, and that the appropriate balance therefore needs to be struck. The measures need to be logical and understandable with outcomes that can be anticipated in different scenarios.

2.3 The framework should accentuate the role of the insurance industry as a long-term investor

A regulator highlighted EIOPA's advice, which concluded that a more favourable but still prudent treatment of long-term investments is possible, as reflected in the recommendations for changes to the VA, to the risk margin and for equities that backed long-term and illiquid liabilities.

An industry representative stressed that excessive conservatism is a threat to the whole sector as it brings prohibitive costs. For these reasons, the VA and the long-term equity reduced shock need to work effectively as they represent key elements for the long-term investments in bonds and equities.

Another industry representative stated that, although market and asset prices are volatile, the fact that insurers are long-term asset holders needs to be reflected.

2.4 Addressing the remaining factors of procyclicality that prevent insurance companies from fully behaving as long-term asset holders

An industry representative stressed the need for the Solvency II framework to reflect the economic reality of low, or negative, interest rates, which are set to last. Furthermore, weaknesses in the current framework have been magnified during the financial turmoil, which mainly revolve around the excessive volatility left in the framework.

Another industry representative added that the low interest rate environment is probably the biggest challenge facing the industry. Low rates are putting pressure on the European life insurer where products with guaranteed returns in the past still represent the lion's share of the total portfolio.

An industry representative stated that the prolonged low interest rate environment is the key economic issue that needs to be addressed under the current

review. Although Solvency II is strongly supported by the insurance industry, some excessively conservative elements remain.

Solvency II already comprises several mechanisms to address the low interest rate environment, such as stress testing in ORSAs. EIOPA is also performing sector-wide stress tests, checking the industry's resilience against further declines in interest rates. Most importantly, insurers are required to hold risk capital against a further decline in interest rates. For internal models, this capital is calculated based on forward-looking assessments of implied price information. For the standard formula, negative rates have not been adequately tackled so far, so the changes suggested by EIOPA are supported in principle, although the calibration may still be too conservative.

The current extrapolation methodology defines an interest rate curve beyond the last liquid maturity, defined as the last liquid point at the 20-year mark up to the ultimate forward rate at the 60-year mark. There is no reliable market for very long maturities, and objective definitions of very long-term rates are not possible. Any type of extrapolation method therefore includes subjective elements. Excessive market volatility driven by short-term events should not be transferred to the valuation of long-term stable insurance liabilities. Under EIOPA's new proposal, the starting level of the extrapolated part of the interest rate curve is dependent on swap rates beyond 20 years, now up to 50 years. These are not liquid and therefore are prone to excessive volatility. EIOPA has also introduced a new parameter that extends the maturity of the ultimate forward rate up to 100 years. As a result, a substantial decline in the solvency ratios for insurance companies can be expected, alongside an increase in solvency volatility.

There is also ample evidence that long-term forward rates are poor forecasts for actual future rates. The situation is aggravated by the current environment where interest rates are being distorted by unparalleled asset purchase programmes of central banks.

2.5 Conservative calibrations and inaccurate risk assessment approaches hamper the ability of the sector to invest

2.5.1 Inappropriate regulatory treatment of the low-for-long context risks further reducing insurance undertakings' long-term guarantees offerings and related investments

An industry representative stated that an 'emergency brake' is proposed to dampen the implications arising from proposed extrapolation methodology. It is phased out until 2032 but it also comes with a range of restrictions regarding capital distributions in combination with specific reporting requirements. To mitigate the resulting solvency effects, issuers will be pushed to divest from real long-term assets, relinquish the long-term offering of guarantees or increase costs to customers.

2.5.2 An over-calibrated risk margin reduces investment possibilities

An industry representative stated that there is currently excessive conservatism in calibrating the risk margin, which deters long-term investments. EIOPA has acknowledged one of the three strong justifications for lowering the risk margin, which is the introduction of a factor to recognise that the risk is not constant over time. Nevertheless, the risk margin represents €160 billion for the entire European insurance industry. It also introduces volatility in the framework because the risk margin increases when interest rates get lower. Other changes are needed to get to an appropriate level, and the cost of capital embedded in the risk margin should also be in the works.

2.5.3 The proposed liquidity ratio does not yet reflect the ability of insurance undertakings to avoid forced sales

An industry representative disagreed with the excessive conservatism and elevated procyclicality of EIOPA's proposed liquidity ratio, which does not assess whether the product features and the associated risks are indeed under control. Where an asset and liability management (ALM) policy ensures the availability of sufficient levels of asset inflows to avoid cases of forced sales, there is no reason to reduce the compensation of artificial volatility. The ability to earn risk-corrected spreads needs to be fully recognised, and an adjustment makes sense only if it is based on an actual risk of forced sales.

2.5.4 Spread behaviours do not appropriately capture the probability of counterparts' default

An industry representative maintained that the risk of default that the risk correction is meant to encapsulate can only be derived from historical data series. No one point in time of spread behaviour is an adequate estimate of defaults. The proposed new calibration would therefore be highly procyclical where there are exaggerations of spreads. In addition, there is an overstatement of the credit risk in the Solvency Capital Requirement (SCR).

2.6 The likely future cashflow gaps and the risk of forced sales are not appropriately captured

An industry representative stated that EIOPA's opinion is reflective of how long-term equity investment strategies are put in place and greatly improves the eligibility criteria of article 171a. However, an unwelcome change is envisaged under the demonstration of the actual resilience of the investment portfolio to short-term losses, where there is a punitive liquidity ratio for non-life portfolios. Changing eligibility criteria to long term equity investments as suggested by EIOPA would further impede long term investments. Any liquidity ratio approach should be based on cash flows rather than stocks and on an adequate liquidity monitoring horizon (1 year to 5 years maximum).

2.7 The need to reflect the specificities of the insurance business model

A regulator noted that the review provides an opportunity to improve the efficiency and effectiveness of Solvency II so that it better reflects specific features of the insurance sector. The regime needs to reduce existing protection gaps, foster innovation, protect the international competitiveness of the European market, and protect policyholders.

2.8 The proposed macroprudential measures do not account for the recently demonstrated soundness of the sector or the efficiency of the regulatory framework

An industry representative disagreed with the macroprudential policy in EIOPA's proposal, which may have been taken from the Global Systemically Important Institutions (G-SII) framework since the existing Solvency II framework had allowed for a high level of protection, and additional capital buffers would only be detrimental for competitiveness.

2.9 The proposed regulatory treatment of systemic risks increases the nexus of the insurance sector with the banking system

An industry representative noted that EIOPA's proposal would coerce insurers to increase the use of derivatives in their asset liability management and hence increase the nexus to the banking system, which is problematic from a prudential perspective.

3. Additional policy objectives

3.1 Regulatory uncertainty

An industry representative stressed that there is no need for additional uncertainty or volatility arising from regulation, particularly in the current difficult context where the Solvency II framework has worked rather well. Care must be taken not to introduce too many addendums or capital burdens that could undermine the Solvency II approach.

3.2 The appropriate level of regulatory capital

An industry representative stated that the solvency ratio should not be substantially affected in the long term or the short term. In addition, the rules for setting and updating the calibration in the legislation should be clearly specified. Ultimately, there is an opportunity to better align the framework with the underlying economic risk, which should not be missed.

A regulator stressed the importance of balance. The goal of the Board of Supervisors was to deliver a balanced package. With the figures at the end of 2019, there was no desire to have additional capital requirements or additional volatility, per se, because the system worked well and there is no need to go beyond the capital requirements as such.

EIOPA's goal was to have this balanced package without considering the interest rate risk calibration and to do so only at the European level. It can be questioned whether this is the right definition of balance or whether such a definition should do without the interest rate risk. In addition, it can be questioned whether such a definition should take account of the member state level, product levels and the future needs of society. In terms of extrapolation, it can be argued that the right balance has not been achieved with regard to all these aspects. Ultimately, a focus on the term 'balance' could lead to a better outcome.

REDESIGNING EU AML POLICY

1. General background

1.1 Anti-money laundering (AML) has been a hot legislative and regulatory topic

A policymaker described how anti-money laundering (AML) has been a hot topic ever since the appearance of large-scale money laundering activities both internationally and within the European Union. The European Union has responded with targeted legislation in the form of the 5th Anti-Money Laundering Directive (AMLD5). Starting in 2020, EU legislators have also given extra powers to the European Banking Authority (EBA). However, more action is needed to address illicit and criminal activities. Therefore, in the last year the European Commission announced an action plan and a package of legal proposals. The policy maker considered that a more forward looking view should be taken on this issue.

1.2 The banking industry is challenged by the size and complexity of the problem

An industry representative acknowledged that the banking industry had been somewhat ineffective in its attempt to handle the size and complexity of this problem. This criticism applies equally to banks, the authorities, and the European system. CEPS published a paper on AML indicating that European firms spend over €110 billion on AML compliance each year but only 1.1% of illicit funds are interdicted. It is no surprise that only two days prior The Economist called the system 'hugely expensive and largely ineffective'.

The industry representative described how thousands of employees in Europe manually check alerts which have a 95% to 98% false positive rate. The recent CEPS paper indicates that only 10% of the 1.1 million annual SARs (Suspicious Activity Report) are investigated, although the industry representative considered that the true figure could be well below 10%. One Nordic country sees 75,000 SARs a year and has 32 people to handle them, which equates to over 2,200 SARs per person. This overwhelming volume demonstrates the need for more resources.

A public representative explained that after the pandemic there will be a huge effort for recovery. Given the amount of money that will be needed, it is important to avoid the perception that some people are escaping their obligations in terms of paying tax or declaring their financial movements.

1.3 There is an existing political impetus on AML

The public representative reiterated the need for Europe to deliver on AML. The Parliament is prepared to deliver in terms of legislation here. A policymaker noted the substantial degree of harmony between the panellists regarding the priorities around AML despite their different backgrounds, adding that the Commission is currently working on an AML package. This package will hopefully be finalised in a few weeks' time, and then the Commission will move into intense negotiations. The policymaker suggested that there is a considerable degree of convergence between the views of the panellists, albeit with some entirely legitimate nuances. There is a substantial problem around money laundering within the Union and beyond, which demonstrates the importance of continuing to work on this issue. When the Commission publishes its proposal, it will be important to move forward quickly on AML with all the relevant stakeholders.

2. Challenges and potential solutions

2.1 Additional regulation should help to address an inconsistent implementation of AML legislations

A public representative stressed the existence of significant divergence in the implementation of AML directives across member states. The public representative supported the idea of moving towards regulation to address the aspects of AML policy that are currently being insufficiently implemented by some member states.

2.2 Improving supervision still requires unprecedented structural efforts at both national, EU levels on a cross sectoral basis

The public representative emphasised that the integration of the national Financial Intelligence Units (FIU) remains insufficient.

The ultimate problem is that efficient money laundering is usually conducted on a cross border basis. Money laundering cannot be addressed adequately by national authorities, which means there is a need for increased and effective cooperation on this at the European level.

An official stressed the importance of reducing regulatory arbitrage and creating a level playing field. It is important to avoid a race to the bottom, which could be created by an insufficiently harmonised implementation of the existing legislation. At the same time, it is essential to avoid creating an unnecessary bureaucracy which increases the overall workload but does not contribute to the prevention of money laundering. The official stressed the importance of allowing space for digital solutions when designing rules.

An official though that rules and harmonisation alone will not prevail against money laundering, if entities concentrate solely on following the rules without considering the bigger picture. Apart from better legislation, the three crucial elements in this fight are more resources, more digitisation, and more cooperation. The official explained that the idea of more cooperation means enabling a better exchange of information. In the financial sector, data sharing only takes place to a very limited extent. More extensive forms of data exchange such as the pooling of transaction data could help prevent the exploitation of information gaps, which enables arbitrage by

criminals, and would also result in more accurate suspicious transaction reports.

However, an official stressed adherence to data protection rules as another important public objective. Digital tools and solutions will reconcile the two important objectives of AML and data protection, which should demonstrate why digital transformation is a priority for the Financial Action Task Force (FATF) under the German presidency.

A regulator stressed that AML must be considered both as a prudential risk factor and in terms of consumer protection and consumer experience. While there is a trade-off between proper AML protection and proper data protection, this should not hinder effective collaboration and data sharing.

A public representative stressed the importance of effective supervision. The EBA has been given a larger role here, but the Council has recently suggested that the EBA might also need additional competences.

The public representative supported this proposal, although there is a potential problem due to the fact that the EBA's focus is the banking sector. There is a question as to whether the most effective way to supervise the non banking sector is through an entity that is particularly focused on the banking sector. An industry representative suggested that, until a credible EU authority is established, the de facto regulator of financial crime in Europe is the United States, because the US authorities have the most power and force in this area.

Another industry representative agreed on the need to focus on banks, noting that the banks are eager and willing to contribute on AML, but stressed the fact that recent developments have demonstrated that the topic is much broader than banking. AML efforts must include funds, brokers and family offices, for example.

A regulator stressed the importance of understanding the diversity and size of the pool of obliged entities: the EBA estimates that 160,000 financial institutions are subject to AML regulation in the European Union, which means this is a very large and diverse universe. It is also important to consider harmonising supervision because there is also diversity in terms of the regulatory authorities. For example, there are 57 AML/CFT supervisors from across the European Union represented on the EBA's AML supervisory committee. There must be collaboration across regulatory institutions within and between member countries.

2.3 An effective AML policy requires combining various essential elements: an EU AML authority, facilitated information sharing, extensive use of technology, further harmonised regulation, ...

An official pointed out three key areas of focus: the need for a well-designed European AML supervisory authority; further harmonisation of substantive law; and a low threshold exchange of information between all relevant parties.

The UK has a model called the Joint Money Laundering Intelligence Taskforce. The UK has torn down the barriers to information sharing between banks, regulators, and law enforcement authorities. Nordea has been involved in pilots of this model in Sweden. The model would enable an EU level approach with better resourced FIUs, more information sharing and targeted data intelligence led efforts, for example on human trafficking.

An official reiterated the importance of harmonisation, considering it essential to transfer parts of the directive to a regulation in order to reduce national divergence. A regulator agreed on the need for a more harmonised regulatory framework in certain areas, as the EBA had outlined in its response to the call for advice on the Commission's proposals to enhance the regulatory framework. The EBA's key areas of focus included customer due diligence, the list of obliged entities, the determination of beneficial ownership, and increased powers and a harmonised regime for sanctions.

2.4 Permanent technology investments are required

An industry representative stressed the need for public authorities to be better resourced and better coordinated in order to combat fragmentation, which argued in favour of the Commission's proposal for the establishment of an AML authority and further assistance for FIUs.

The industry representative considered that the mere existence of an EU authority would not be enough, however. One other necessary measure would be a better use of technology and data. It is vital to ensure better public private collaboration between banks and public authorities, and the area of transaction monitoring is a useful case study here.

A regulator considered the impact of technology an important challenge. Technology could be better utilised to facilitate AML/CFT, but it also provides new means for criminals to commit crimes. This means the industry must enhance the range of obliged entities and ensure it remains up to date with technological developments. As the regulation is reformed, the industry must enhance the coordination between parts of its regulatory framework. It is vital to ensure that AML is an important part of any new regulation, technology or finance structure. From this perspective, AML is also relevant to the prudential framework for banks.

2.5 Europe requires a single formal KYC process delivering quality assured data

An industry representative considered that KYC processes are very formulistic and negatively impact clients, highlighting the example of Austria, which has built an environment where clients upload KYC relevant information to an appropriate system through their tax or legal advisers or full year auditors. This enables the entire industry to know that the information is quality-assured while only having one formal KYC process. Currently, if a client interacts with five or 10 banks, the KYC process must be carried out five or 10 times.

An official suggested that Know Your Customer (KYC) standards are one area in need of harmonisation. There is a need to regulate for standardised data sets for national and legal persons as well as for identification processes, including the means for remote identification. To enable the more effective prevention of money laundering, Europe should

consider creating a KYC utility for onboarding, i.e., a database from which obliged entities could quickly and inexpensively retrieve identification data in compliance with data protection law. However, there must be high standards and a certain degree of flexibility because it is important to enable the application of a risk based approach here.

3. There is a need for a single supervisory authority with oversight of the full string of payments

A policymaker informed them that the Commission will write a report on the possibility of public private partnership on AML in the current year. This might not be part of the package currently being prepared, but it will set the scene and consider what more can be done in this area. In any case, the policy maker agreed on the importance of information sharing, which the previous speakers had stressed.

A policy maker noted that an industry representative had commented on the need for European supervisory initiatives to focus more on managing AML risks in partnership with banks. The industry representative described how there is a string of payments involved in money laundering. The only way to tackle money laundering is to make this full string of payments available to a single authority. The industry representative suggested that therefore their institution supports the introduction of a supervisory authority.

The two most important aspects here are to make AML comprehensive and to have a single supervisory body with oversight of the full string of payments, enabling a network analysis of the patterns involved in money laundering. If there is a faulty payment, the authorities must provide feedback on it. This is the only way to enhance the industry's ability to attack different patterns. In order to do this, it will also be essential to calibrate the industry's models. An industry representative echoed the importance of cross border cooperation and collaboration. The speaker's institution is ready to contribute and collaborate; the industry will find the means to achieve this.

A regulator stated that, as the private sector representatives outlined, the authorities' collaboration with the private sector is also weak and must be enhanced. It is important to create new ways to enhance this collaboration. As one small example, in the last year the EBA established AML colleges for the largest financial institutions, which is a concept borrowed from the prudential supervisory framework. The AML/CFT authorities sit down together and discuss the AML behaviour of a single institution operating across different countries.

4. The main priorities for progress

A policymaker invited the panellists to outline their number one priority for the Commission's package on AML. A public representative stressed the need for a regulation to limit the arbitrage between member states. An official suggested Europe should create an AML supervisory body based on a harmonised law. An industry representative considered that Europe could create a gateway to facilitate better information sharing and strike the balance between the General Data Protection Regulation (GDPR) and financial crime, which would facilitate more collaboration between the public and private sectors. An industry representative stated that the most pressing need is to equip EU supervisors with the ability to access the full string or network of payments. A regulator agreed with these priorities and added that, from the EBA's perspective, the industry will only ever be as strong as its weakest link, which demonstrates the need for a high minimum common denominator.