BANK SUPERVISION IN THE TIME OF COVID-19

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GREAT FINANCIAL CRISIS VS. GREAT LOCKDOWN

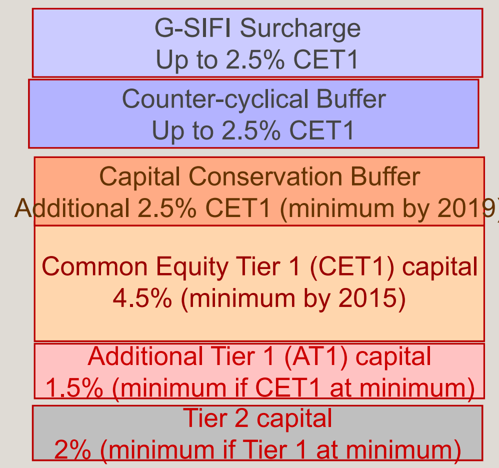
- This crisis did NOT start in the financial sector, but financial sector will be affected negatively as many/most other sectors
- Financial sector can be catalyst for recovery or for prolonged crisis
- Quick monetary and prudential policy reaction reflects better preparation
  - Regulatory reforms have strengthened capital buffers in banking system (but maybe not sufficiently)
  - More data available to monitor situation
  - Experience with crisis management enabled quick policy reaction
  - Framework for international cooperation as good if not better (but is it being used?)
- Biggest risk: economic crisis turns into a financial (e.g., banking or sovereign debt) crisis

THE ROLE OF BANKS AND THEIR CAPITAL

- Banks serve as transmission channel for monetary and fiscal policy actions
  - Higher liquidity needs due to draw-down of credit lines
  - Keep lending flow
  - Help transmit support payment by government
- Bank lending is procyclical
  - Due to higher information asymmetries and lower collateral values in crisis
  - High uncertainty increases risk premium
  - Losses and higher risk weights result in capital depletion
  - How to avoid deleveraging?

EUROPEAN BANK REGULATORS IN THE TIME OF COVID-19

- Immediate response of prudential authorities to looming pressures (and losses) in banking during and after the Great Lockdown
  - Release capital conservation buffer
  - Reduce counter-cyclical capital buffer to zero (where positive)
  - Allow banks to reduce capital below pillar 2 guidance
  - Easing on provisioning rules to mitigate their procyclical effect
  - Moratorium on implementation of further regulatory reforms



PAY-OUT RESTRICTIONS

- Late March/early April: A number of regulatory institutions (EBA, EIOPA, ECB and many national authorities) encouraged banks and (re) insurers in the EU to restrain voluntary pay-outs.
- Maintain capital buffers
- Avoid risk-shifting by shareholders and management after capital relief
- Avoid stigma effect
- BUT: investors' reliance on dividends, reallocation function, investor relationships?
- Notable difference between EU and US

CROSS-BORDER BANKING AND CHALLENGES FOR SINGLE MARKET

- Single Market includes principle of free capital movement
  - There should be no profit distribution restrictions within banking groups
  - Banks should have right to allocate resources where needed most and where highest return
- Several EU countries have imposed restrictions on sub-consolidated level:
  - Fear of capital outflows, especially in countries heavily reliant on cross-border banks, negatively affecting financial stability and real sector lending
  - Support policies mostly national
  - No perfect risk-sharing in EU, not even in banking union
- Risk of broader regulatory ringfencing actions; flashback to post-2008
- Need for Vienna Initiative 3.0 or a similar framework
- Broader implications for developing/emerging world

LOOKING FORWARD TO THE AFTERMATH

- Losses will incur
  - Recovery will be uneven across sectors and countries (e.g., varying with containment policies)
  - Losses will thus vary across banks and countries
- Capital relief and changes in provisioning standards cannot prevent losses!
- Further sources of bank losses:
  - Low for longer
  - Stronger competition from BigTech companies, which will come out well from crisis with big cash piles
- How to deal with losses
  - Bank resolution frameworks post-2008 (BRRD) can deal with idiosyncratic risks
  - Unlikely that they can deal with systemic crises
  - Incomplete banking union
  - Possibly need for bad bank/recapitalization, but on EU/euro area level

IN SUMMARY

- Crisis did NOT start in the financial sector, but financial sector will be critical in determining how this crisis will play out
- Initial policy reaction by monetary, fiscal and prudential authorities very welcome
- Hard work still ahead: how to allocate losses; how to restart economy
- There will be hard political choices coming up:
  - Bail-outs (didn't we say: never again?)
  - State aid for firms headquartered in tax havens?
  - (Indirect) transfer payments across countries?
  - Higher income/wealth taxation?
- Important: decisions to be taken by politicians, as accountable directly to people

THANK YOU

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