11th Banking Union Conference

Speaking notes for Adam Farkas

"Transparency and accountability in banking supervision in the Banking Union"

[Opening]

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Good afternoon everyone.

It is a great privilege to be with you today to speak on behalf of the Association for Financial Markets in Europe.

As many of you will know, AFME is a leading financial services trade association that acts as the voice of wholesale capital markets in Europe. We represent over 150 leading global and European banks and other significant market players, including the largest EU, UK, US, Swiss and Japanese banks. Our members play a vital role in Europe's financial ecosystem, underwriting around 90% of European corporate and sovereign debt and 85% of European listed equity capital issuances.

As the CEO of AFME, I am delighted to have the opportunity today to share the industry perspective on a vital topic for the European banking sector: transparency and accountability in banking supervision within the Banking Union. This is a subject that touches on the very foundations of trust, stability, and competitiveness in European finance. It is also timely as today AFME has published a new report on the state of the Banking Union and the further steps the EU needs to take to fully realise its potential.

Since the creation of the Single Supervisory Mechanism (SSM), the ECB has played an unprecedented role in overseeing the largest banks operating in the EU. The ECB's supervisory powers, as we all know, are broad and far-reaching. This mandate is both a strength and a source of complex challenges – not just for supervisors but also for the banks that the SSM supervises and AFME represents.

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Today, I would like to explore these dynamics, focusing on some of the industry concerns relating to supervisory goldplating, the potential implications from the ECB's new "escalation ladder" which could make legal action more likely, the existing mechanisms available to banks for administrative and judicial review of supervisory decisions, and the broader implications of the Banking Union's current design and the remaining gaps in the framework.

[Context – ECB Banking Supervision]

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First, some context.

Since its inception, ECB Banking Supervision has undoubtedly made significant progress in shoring up the safety of the European banking system.

EU banks have substantially increased their capital and liquidity ratios since 2015, while credit risks in the sector have reduced with non-performing loans dropping from circa EUR 1 trillion to less than EUR 400 billion over the last decade – with the NPL ratio dropping from 7% to just 2% over the same period. This improved bank resilience has undoubtedly helped the EU to navigate major challenges that have occurred during that time – including Brexit, COVID and the war in Ukraine.

Within the framework set out in the SSM Regulation, the ECB's supervisory mandate is to ensure the safety and soundness of the banks it supervises, ensuring that prudential rules are enforced and bank-specific risks are identified and managed appropriately. The ECB's approach has also been shaped by the need for harmonisation across a diverse set of supervised entities and geographies.

This is a difficult balancing act. On one hand, it has endeavoured to implement the single rule book consistently and build a common supervisory culture, while respecting the legal frameworks of Member States as well as the individual circumstances of each bank. On the other, it has also sought to provide clear and consistent communication to banks in the form of supervisory expectations which establish the bar that each institution needs to reach in a specific risk area, unless they can satisfactorily demonstrate that their specific circumstances justify an alternative approach.

[Gold plating and ECB approach to enforcement]

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This leads me to a subject that often concerns AFME member firms – the issue of what is widely referred to as supervisory "gold plating".

This term is used to describe supervisory expectations and decisions which appear to be overly prescriptive, going beyond formal regulatory requirements of the single rulebook as set out in Level 1 regulation (and further specified via Level 2 measures) – which can also be an additional source of goldplating). Such supervisory expectations have also sometimes preceded formal regulatory standards or apply in ways that do not fully account for bank-specific risk profiles or business models.

This relates to a well-known debate. Should supervisors make rules or just apply them? In our context, supervisors don't make rules. The co-legislators make them based on the Commission's initiative. The EBA further specifies them. And we recognise that in practice that there needs to be some practical limit to the number of pages of rules we write as they will never cater for every situation, and hence there is supervisory discretion, judgement and yes, expectations.

These are not new debates and they flair up periodically. We are in such a period now.

Let me delve a bit into some of the examples that are typically cited under this umbrella term.

The ECB's leverage finance guidelines effectively limit exposures to borrowers whose leverage exceeds a defined threshold. Many internationally active SSM supervised banks regarded this threshold as arbitrary. It was also more conservative than the approaches adopted in other jurisdictions, impacting their ability to do business in what is an internationally competitive market. As I just mentioned, banks have the possibility to justify a certain degree of deviation from expectations such as these. In practice, however, the dialogue between supervised entities and their supervisors was not always straightforward as they sought to reach a common understanding of where this line should be drawn. Fair enough perhaps that banks and their supervisors don't always agree, but the point I want to make is that from a business perspective this is an example of where banks have felt that lengthy dialogues with unpredictable outcomes are in and of themselves a source of uncertainty impacting their competitiveness.

I could also raise the ECB's well known NPL guidance as another illustration of complex interactions between the views of banks and the – at the time still relatively new Banking Union supervisor. In this case, the industry, at least initially, perceived the SSM to be overstepping its powers and exceeding the regulatory framework. I just mentioned the extraordinary progress in the sector's NPL ratios, and this has been widely recognised as one of the SSM's biggest success stories. I don't think it would be controversial to say that this case of supervisory gold plating was, in retrospect, justified. But did some banks miss out on certain business opportunities or have to carry costs that would arguably have been lower were they operating in another jurisdiction? Perhaps.

I now want to turn to the area of climate risk, where the ECB has set a number of supervisory expectations ahead of formal regulatory standards – standards which are still evolving, with an Omnibus package now under consideration in Brussels.

While climate and other ESG risks can manifest themselves in the more traditional risk categories of credit, market and operational risks, and banks should be able to monitor and manage such risks, the issue posed by these ECB expectations is a question of how this should be done when the information for making such assessments is not readily available and is actually in the process of being vastly streamlined in Brussels. The current situation leaves banks squeezed between the expectations of their supervisors on the one hand, and those of their clients on the other, with EU corporates keen to see a meaningful reduction in their regulatory burdens.

Staying with the example of ESG risks, new regulatory provisions will require banks to set out their transition plans. For banks there is a dual purpose to these: the first is to provide information to the market on how they intend to transition, while the second is to illustrate more specifically to their supervisors how they are dealing with the prudential risks related to transitioning. This latter part has its source in the CRD6 and has been elaborated on by the EBA's January 2025 ESG risk guidelines. A supervisory blog post of the ECB earlier this summer noted it will approach transition planning requirements in a gradual and targeted way, focusing on those elements of the EBA guidelines not already addressed by the ECB's aforementioned climate risk expectations. It goes on to give an indicative timeline running up to formal assessments in 2027, referring to this being part of the ECB's prudential transition planning mandate.

The legal specialists here today will be much more qualified than me to comment on whether the ECB has such a mandate or not and we might debate whether it should. For my purposes, I want to use this example to illustrate an occurrence of a supervisory expectation where the rather conceptual consideration of the ECB's supervisory accountability is worth dwelling on. There are very few who argue that the EU banking supervisor is not legitimate to expect banks to have sound risk management frameworks to deal with prudential transition risks. At the same time, there is an ongoing societal and political debate on how to deal with transitioning the European economy. What banks are questioning, legitimately I think, is how much of this responsibility they should and can shoulder and to what extent this is for a supervisory authority to determine.

In addition, I can see banks having questions about what formal assessments in 2027 will mean in practice. One, possibly extreme, view is that this could result in ECB banking supervision not only taking a view on banks' transition strategies but also indirectly guiding their business models towards specific strategies.

While I just used the NPL guidance as an example of a successful way of nudging banks' business practices, I am not certain that interactions between banks and their supervisors will be smoother or more efficient in the area of climate risk than they were in the NPL case. I am concerned that we may be at risk of failing to learn the lessons from previous supervisory experiences and we could all be spending a lot of time on this in this room over the coming years.

In all these cases, supervisors would no doubt point out that the benefits achieved in terms of financial stability outweigh any costs or negative impacts for banks. But I am here today to make the case a pragmatic approach to better balancing these competing challenges.

[ECB approach to enforcement and the escalation ladder]

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This brings me to another related and important issue which is the increasing ECB emphasis on enforcement measures via the so-called "escalation ladder."

Conceptually, I can see the justification for this from a supervisory perspective: failure by banks to make more substantial and rapid progress in areas which the ECB has long been flagging as requiring improvement could well be overcome quickly under the simple threat of penalty payments for non-compliance.

Somewhat unfortunately perhaps, the ECB decided to test the effectiveness of this incentivisation technique in the area of climate and ESG risk expectations. This process started back in 2022. While the specific outcomes in terms of whether any banks will end up paying penalties is not yet public, the ECB has noted important improvements in many banks' compliance with the "foundational" parts of these expectations.

Now, from an industry perspective, testing this technique in an area where banks are engaged in ongoing transformation processes amid an evolving legislative environment has raised concerns. Debates on the trade-off between financial stability benefits and costs to banks have been high on the agenda of many AFME deliberations and it is worth noting that banks are having to contend with these pressures at the same time as facing major geopolitical risks around war, sanctions, Brexit and the changing approach of the US Administration.

Moreover, it has been viewed as unnecessary, particularly when over the years, banks have worked hand in hand with their JSTs to improve supervisory dialogue processes, demonstrated their ability to set up strong risk management frameworks and remedied identified weaknesses *without* the use of enforcement measures.

I would argue that, while sticks are a necessary part of the supervisory toolkit, there is little to be gained by threats that such enforcement actions could become common place. What the industry would like to achieve instead is that constructive, predictable engagement becomes the routine.

Of course, the ECB would likely respond by saying that banks have mechanisms available to them to challenge supervisory decisions that they disagree with.

[The Administrative Board of Review]

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This brings me to another key element – accountability – which is the cornerstone of trust in any supervisory framework.

Under the SSM Regulation, there are two formal mechanisms designed to ensure accountability of ECB supervisory decisions – the Administrative Board of Review (ABoR) and judicial review before the European Court of Justice (ECJ).

On this note, I'm very pleased to see that Pentti Hakkarainen, Chair of the Administrative Board of Review, will be speaking after me and I very much look forward to his remarks.

As Pentti will no doubt tell you, the ABoR is intended to be a quick and efficient tool of recourse – much quicker and more efficient than the European Court of Justice. However, in practice it has some structural limitations that inhibit its ability to perform its core function of holding the ECB to account.

In particular, the ABoR can only review formal ECB supervisory decisions adopted by the Governing Council on the basis of a draft from the Supervisory Board. This excludes the vast array of informal or preparatory ECB supervisory communications which – as we all know – can have just as much of an impact on a firm as any formal ECB decision.

The ABoR is also limited to assessing whether the ECB complied with the procedural requirements of the SSM Regulation and applicable EU law, rather than the merits of any decision, and it ultimately does not publish its opinions.

It is perhaps therefore not surprising that, since it was created, the ABoR has only received a very modest number of requests for review of ECB decisions. Since it was established in 2014, it has finalised only 39 opinions and in 2024 it received just **four** requests for an administrative review of an ECB supervisory decision. This is despite the ECB issuing 2,174 individual supervisory decisions in 2024 alone.

Therefore, we also need to ensure that ABoR has sufficient resources it requires to deal with a potential increase in requests. As I understand it, ABoR currently has just one person working on this which needs to be scaled-up if ABoR is to become more effective.

[Legal challenges and Judicial Review]

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Turning to judicial review

Since the creation of the SSM, numerous cases have been brought before national courts and the ECJ, addressing various aspects of the supervisory framework. These range from actions for annulment against ECB decisions, claims of failure to act by the ECB, or challenges to whether the ECB can be the supervisor (savings banks at the start).

Judicial review is limited to final ECB acts that have binding legal effect – meaning that informal actions and decisions are out of scope despite their very real effect on supervised institutions.

In addition, the ECJ has taken a conservative approach to assessing arguments in these cases – often rejecting claims based on lack of legal standing. The ECJ also tends to focus on whether the ECB has conducted an "individuality assessment" — that is, whether decisions reflect an adequate case-by-case analysis. This principle has been central in several landmark rulings, including those concerning irrevocable payment commitments and leverage ratio calculations.

This jurisprudence illustrates the legal challenges inherent in supervising a complex, multi-jurisdictional banking system under broad discretionary powers – but it further underlines the limited scope that supervised institutions have to challenge ECB decisions.

As a final point, I would highlight that the ECJ's rulings of course take time, which limits its effectiveness when assessing supervisory decisions which often have an immediate impact on banks.

What concerns me somewhat is that if the ECB pursues its new sanction-focused approach we could well be on the cusp of a shift to a style of supervision which is more legalistic than principles-based. In short, where banks end up suing the supervisor as this is viewed as a less costly or painful option than penalties.

[Balancing Resilience and Competitiveness] - the current simplification debate

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Returning to the bigger picture, the European economy faces a competitiveness challenge, especially as it strives to finance the digital and green transitions.

The recent European Council call for a Competitiveness Deal and the increased focus by the European Commission on simplification reflect the urgency of this issue. We therefore very much welcome that the ECB and the SSM are also assessing simplification, for regulatory, supervisory, and reporting frameworks as part of its High-Level Taskforce on Simplification.

In the area of supervisory simplification, recent reform proposals to the SREP rightly aim to apply the principle of proportionality more consistently. Other welcome changes include a risk-based approach to findings, and more comprehensive supervisory planning.

We also welcome the ECB's intention to make supervisory methodologies more stable and transparent, including by revising the Pillar 2 methodology. Of course, you will not be surprised that I will be arguing for ensuring that any overlap between Pillar 1 and Pillar 2 due to Basel implementation is avoided. And that I make the point that it is also important that the industry is consulted on the changes to the SREP, or where they have been implemented already, that the industry and SSM come together to jointly discuss lessons learnt, and work towards improving the SREP even further.

Most of the proposed changes are either in process of being implemented or are yet to start in earnest, and therefore the expected positive impacts in terms of improved planning and burden reduction are yet to be felt by supervised entities. We also urge the SSM to review their approach to supervisory activities – on site inspections, targeted or horizontal reviews – to ensure that they remain proportionate and relevant for each supervised institution.

[Completing the Banking Union]

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Completing the Banking Union is also critical and here I want to draw on the key conclusions from AFME's new report which shows that the Banking Union is still being significantly held back by regulatory fragmentation. The impact of this fragmentation is clear to see – with minimal cross-border banking services within the Banking Union, and only marginal increases in cross-border bank lending and deposit taking. The IMF has estimated that fragmentation and the numerous intra-EU financial services barriers are equivalent to a 100% internal tariff on its own EU financial services – this is a self-imposed handicap that only harms EU competitiveness.

As we argue in our report, there is a view held by some that all that needs to happen to address this fragmentation is the addition of a European Deposit Insurance Scheme (EDIS) and the Banking Union will be complete. However, the reality is that there are multiple other implementation gaps, stemming from Member State discretions embedded into the EU's single rule book, that market participants continue to encounter and which also need to be addressed before banking groups can truly benefit from a single market in banking.

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I would highlight four key examples of this fragmentation:

- **First - National ring-fencing of capital and liquidity** – with the lack of cross-border waivers causing between EUR 225bn – EUR 250bn of liquidity to be trapped in subsidiaries of large banks**;**

- **Second - Unharmonised macroprudential buffers** – with O-SII buffers differing across Member States and Countercyclical Capital Buffers inconsistently applied with differing methodologies;

- **Third – Inconsistent intragroup large exposure limits** – with National Competent Authorities making use of their discretion to apply varying limits on intra-group exposures, leading to unharmonised and inconsistent criteria in capital allocation.

- **Fourth – opaque and unpredictable contributions to the Single Resolution Fund** – which makes it difficult for banks to predict future commitments.

We encourage the ECB to continue its efforts to address these issues within its mandate and foster cooperation among Member States. AFME and our members stand ready to support initiatives aimed at overcoming fragmentation, boosting scale, and ultimately enhancing the EU's competitiveness.

[Conclusion]

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To conclude, ECB Banking Supervision has made remarkable progress in securing financial stability in a complex and challenging geopolitical and macroeconomic environment.

From the industry perspective, the supervisory framework's breadth and depth bring both benefits and challenges. The risks of prescriptiveness, expectations that are not risk-based, and limited avenues for effective challenge deserve careful reflection and consideration by policymakers.

Nevertheless, we approach these from a constructive point of view with a shared commitment to improvement of the supervisory and regulatory framework.

Through close collaboration between supervisors, regulators, policymakers, and the banking industry, we can strengthen the Banking Union's governance and accountability frameworks – and I hope we can have a constructive discussion about how to address the remaining gaps in the Banking Union framework.

By doing so, we will deliver a supervisory system and regulatory framework that is not only rigorous and credible but also fair, transparent, and adaptable – one that supports the EU's broader objectives of financial stability, competitiveness, and sustainable growth.

Thank you.