

# Transparency and accountability in banking supervision in the Banking Union

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11<sup>th</sup> Banking Union Conference

2 September 2025

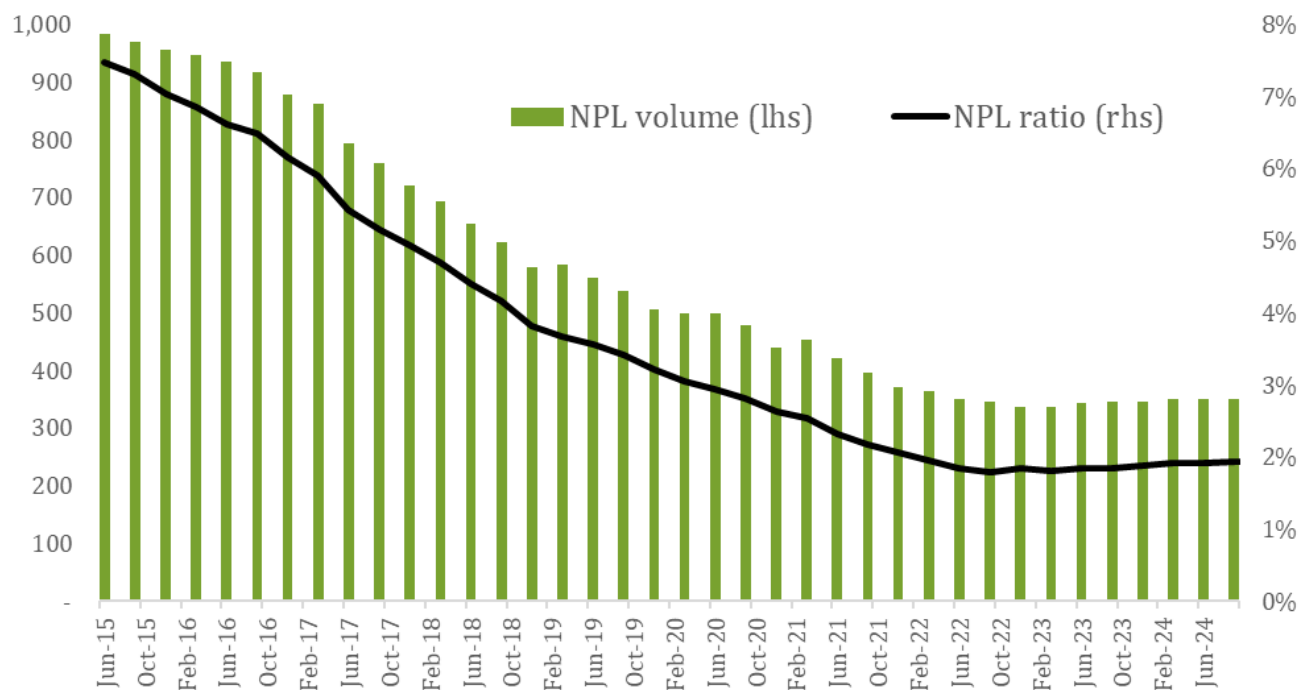


- AFME is a leading trade association that acts as the voice of Europe and the UK's wholesale financial markets.
- We represent over 150 leading global and European banks and other significant market players. Our members play a vital role in Europe's financial ecosystem, underwriting around 90% of European corporate and sovereign debt, and 85% of European listed equity capital issuances.
- AFME works with our members to shape the regulatory environment in order to strengthen European and UK capital markets. Our expertise covers the most important policy areas including:
  - MiFID;
  - Prudential requirements;
  - FX;
  - Digitalisation; and
  - Sustainable finance

- ✓ Supervisory "goldplating"
- ✓ The mechanisms available to banks for administrative and judicial review of supervisory actions
- ✓ The broader implications of the Banking Union's current design and the remaining gaps in the framework



## EU NPL volume and ratio



The EU has successfully reduced the volume and ratio of Non-Performing Loans (NPLs) in banks' balance sheets.

NPLs have fallen from c€1 trillion in 2015 to below €400 billion in 2024, with the NPL ratio dropping from 7% to just 2% in the same period.

The credit risk reduction was largely supported by securitisation and NPL portfolio sales of c€900bn (including secondary transactions), highlighting how capital markets enable banks to free up their balance sheet and contribute to provide further lending to the real economy.

## Key industry concern – supervisory “gold plating”

Supervisory gold plating can include overly prescriptive expectations that go beyond formal regulatory requirements. These expectations sometimes precede or exceed formal regulatory standards or apply in ways that do not fully account for bank-specific risk profiles or business models.

### Key examples



**ECB Leveraged Finance Guidelines** – which set a borrower leverage ratio many firms regarded as arbitrary and insufficiently tailored to their risk management frameworks



**Climate risk** – the ECB has set out expectations ahead of formal regulatory requirements and while the regulatory framework remains uncertain due to the EU Omnibus Package



**NPL provisioning** – ECB 2017 Guidelines effectively created hard requirements before Pillar 1 backstops were finalised

- Recent ECB communications suggest an increasing willingness to deploy enforcement tools more widely – representing a significant change in supervisory approach.
- Moving too quickly towards enforcement measures, such as periodic penalty payments, when banks are engaged in ongoing transformation processes in an evolving legislative environment is challenging for both supervisors and industry.
- **Enforcement should ultimately be reserved for persistent failures of institutions against measurable and quantifiable requirements.**

- The ABoR is a quasi-judicial safeguard within the ECB's supervisory architecture. It can be a quick and efficient tool of recourse.
- However, the ABoR has some important limitations:
  - ☒ It can only review formal ECB decisions – not informal ECB communications that still have a major impact on firms;
  - ☒ It is limited to assessing whether ECB complied with applicable EU law, rather than merits of a particular decision; and
  - ☒ It does not publish its decisions.
- Since it was established in 2014, the ABoR 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.
- **The ABoR process should be reviewed and strengthened**, to ensure that it is as an accessible and effective as accountability mechanism as possible.

- Judicial review before the ECJ remains the ultimate recourse to challenge ECB banking supervisory decisions.
- Just as with ABoR, the ECJ route has certain limitations:
  - ❌ The ECJ will only review formal ECB acts that have binding legal effect – meaning informal actions (JST letters, OSI reviews) are out of scope;
  - ❌ The ECJ takes a very conservative approach to such cases – often rejecting them on the basis of a lack of legal standing; and
  - ❌ ECJ rulings take significant time, which limits their effectiveness in assessing supervisory decisions which have an immediate impact on banks.
- Jurisprudence further underlines the limited scope that supervised institutions have had to challenge ECB decisions to date.



- The European economy faces a competitiveness challenge, especially as it strives to finance the digital and green transitions.
- We therefore welcome the ECB and SSM focus on simplification across regulatory, supervisory and reporting frameworks including:
  - ✓ Recent reform proposals to the SREP that aim to apply proportionality more consistently;
  - ✓ The ECB's intention to make supervisory methodologies more stable and transparent (including the Pillar 2 methodology); and
  - ✓ The proposed risk-based approach to findings and more comprehensive supervisory planning
- We urge the SSM to avoid any overlap between Pillar 1 and Pillar 2 that may result from Basel implementation.
- We also encourage the SSM to review its approach to supervisory activities including on-site inspections, targeted and horizontal reviews.

Completing the Banking Union is also critical as significant fragmentation persists. There is a view that EDIS is all that is required – but significant additional gaps in the framework must also be addressed.

## Key examples of continued fragmentation from AFME Report



**National ring-fencing of capital and liquidity** – lack of cross-border waivers trapping between EUR 225bn – 250bn of liquidity in large subs.



**Unharmonised prudential buffers** – O-SII buffers differing across Member States and CCyBs applied inconsistently with different methodologies.



**Inconsistent intra-group large exposure limits** – NCAs using their discretion to set varying limits on intra-group exposure, leading to inconsistent criteria in capital allocation.



**Unpredictable contributions to the SRF** – making it difficult for banks to predict future SRF commitments.

## Trapped capital

€225bn

Total capital held by the largest BU banking groups (assets >€500bn) at their cross-border BU subs.

2024 AFME estimate

## Trapped liquidity

€250bn

HQLA to meet LCR requirement of 100% and large exposure regime for cross-border subs.

2021 ECB estimate

**In theory:** Supervisors can, to some extent, waive banks' liquidity requirements for cross-border subsidiaries within the BU and meet these requirements at the group level.

**In practice:** No waivers have ever been approved and over €225bn of capital and €250bn of liquidity are trapped in subsidiaries of large cross-border banks.

This is further exacerbated by internal MREL requirements to all subsidiaries and cannot be waived cross-border.

The absence of waivers is often attributed to a trust deficit between national supervisors (Home-Host issue).

For the BU to function effectively, national supervisors must develop trust and recognise the structural progress made over the last decade in the BU, including the revised resolution framework.

ECB Banking Supervision has made remarkable progress in securing financial stability. Industry concerns on the risks of supervisory prescriptiveness and limited avenues for effective challenge deserve careful reflection by policymakers.

- ✓ Through close collaboration between supervisors, policymakers and the industry we can strengthen the Banking Union
- ✓ We call for a constructive dialogue about how to address the remaining gaps in the Banking Union framework
- ✓ Together we can build a supervisory system and regulatory framework that is rigorous but also supports the EU's broader objectives on competitiveness and sustainable growth.