EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Danièle NOUY
Chair of the Supervisory Board

COURTESY TRANSLATION

Ms Paloma López Bermejo
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 12 January 2018

Re: Your letters (QZ-111 and QZ-112)

Honourable Member of the European Parliament, dear Ms López Bermejo,

Thank you for your questions regarding potential sources of systemic risk in the European banking sector raised in your letters QZ-111 (last question[1]) and QZ-112, which were passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 4 December 2017.

Regarding your question on concentration risk, as you rightly point out, concentration in the banking sector can be a concern for financial stability. This is why the ECB closely monitors, among other things, potential risks stemming from banking sector developments. In this context, I refer to the ECB's "Report on financial structures" published in October 2017. The data presented in the report suggest that concentration in the euro area banking sector increased slightly following the pre-crisis period and appears to have peaked in 2014. Concentration is however rather heterogeneous across the countries in the banking union, reflecting a number of structural factors. At the end of 2016, market concentration (measured by the share of assets held by the five largest banks) ranged from 97% in Greece to 31% in Germany and 28% in Luxembourg. In particular, banking systems in many of the larger EU Member States are more fragmented and include strong savings bank or cooperative bank sectors, which reduce concentration levels. By contrast, banking systems in smaller euro area countries tend to be less fragmented and more concentrated.

In our view, banking concentration is currently not a source of systemic risk concern for the euro area, as overall it is still rather low when compared with banking systems outside Europe. On the contrary, the euro area banking sector could more appropriately be characterised as being "overbanked" and greater

[1] Regarding the answers to the other questions raised in this letter, which deal with the European supervisory framework and the role of national supervisors, please refer to the dedicated reply letter QZ-111.

concentration could bring benefits also in terms of financial stability.[2] Nevertheless, we will continue to monitor developments in the banking sector from a concentration perspective.

Furthermore, you raised the question of whether a strong international presence has negative consequences for banking supervision. In principle, it is true that the larger and more internationalised a banking group, the greater the challenge of supervising it effectively. However, it is no less true that there are important safeguards in the supervisory framework that help counteract the greater complexity of supervising such institutions. The foreign activities of Spanish banks are primarily conducted through subsidiaries that fall under the supervisory authority of the host country. However, there are also an effective framework of Memorandums of Understanding and a system of supervisory colleges in place, which ensure that the supervisory information is shared and the decision-making process is coordinated by supervisors in the host country and the country of the parent bank.

As regards the risks to which Spanish banks are currently exposed through their international business, the following is worth highlighting. First, the subsidiaries through which Spanish banks primarily conduct their international activities are responsible for managing their own financing and capital needs in a self-sufficient manner. This financial independence, which is not available in the case of branch structures, is an important risk control tool for the parent bank during crisis periods. Second, Spanish banks' international business consists mainly of retail activities conducted in the local currency of the host countries, which also helps reduce their overall risk profile and facilitate their risk management. Third, the experience of the most recent financial crisis shows that those Spanish banks with the most geographically diversified portfolios were better able to withstand the negative effects of the crisis than those that concentrated their activities in Spain. It is true that adverse economic developments in some countries have also affected Spanish banks on account of their relatively high exposures. However, the impact has been rather limited. It is in fact noteworthy that the non-performing loan ratios of the Spanish banks in these countries have remained low, also relative to the average for the banking system in the countries and compared with exposures in Spain. Moreover, data published by the Banco de España in its November 2017 "Financial Stability Report" show that, in most third countries, the non-performing loan ratios of Spanish banks are declining.

As regards risks arising from the interconnectedness of insurance companies and Spanish banks, the IMF report you cite in your letter shows that the exposures of insurers to Spanish banks are significant. The same report also concludes that, at present, Spanish banks have: "… strong capital and funding positions, reduced problem assets and improved profitability." We share this fundamental conclusion and therefore we do not see evidence of any significant risks for insurance companies that could, at present, arise from the banking sector. At the current juncture, we also do not see major risks for banks arising from the insurance sector. This is because, compared with the other euro area countries, the size of the Spanish insurance sector is relatively small (around 30% of GDP)[3]; and the insurance companies have one of the highest headline Solvency II ratios (a median solvency capital requirement ratio of around 249%)[4].

2 For further information on the issue of overbanking, please refer to my speech "Too much of a good thing? The need for consolidation in the European banking sector", which I gave in Madrid on 27 September 2017, or the ECB report "Financial Integration in Europe" published in May 2017.

3 See Chart 3.3 in *Report on financial structures*, ECB, October 2017.

4 According to EIOPA's Insurance Statistics for the first quarter of 2017 (see Table 2), the median solvency capital requirement (SCR) ratio stood at around 249%.

At the more general level, in relation to financial contagion, the ECB monitors and assesses risks due to financial sector interconnectedness on an ongoing basis as part of its macroprudential analysis. For an overview of our work in this regard, see for instance Chapters 12 and 13 of the ECB's recent publication "Stress-test analytics for macroprudential purposes in the euro area".

Yours sincerely,

[signed]

Danièle Nouy