The Four Cs of European banking and supervision

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Four Cs, for Challenges or major Concerns, are central to Europe's banks these days.

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Culture

First, Culture. The banks' culture, reflecting that of society at large but magnifying its defects, has for too long been dominated by greed and a self-serving attitude. Last week's mega fines in the settlement between the European Commission and major financial institutions in the rate-rigging scandal (Euribor, Yen Libor) was another reminder of this behaviour.

The crisis has shown that a different approach is called for. The client needs to get central place again. A major overhaul of banking culture is underway. In recent speeches, Martin Wheatley, chief executive of the UK's Financial Conduct Authority has made clearwhat is needed(less regulation and more ethics) and what is already happening at British banks.

Elsewhere, the same call for a moral compass of bankers is heard. Bankers need to return to love for their craft. You may ask: What's love got to do with it? The answer is: when carrying out an activity with love –love for the profession, concern for the client, the interest of the company – the inner compass shows how to proceed.

Capital

Capital, of course, is the second challenge. The deleveraging process in which banks deflate to get rid of bad exposure requires additional capital and provisioning. The ECB's comprehensive review of Europe's 125-odd systemically significant banks which it will undertake before assuming direct supervisory powers over them will undoubtedly and intentionally show up deficiencies in capital in some banks. These will have to be made up by capital injections from private sources. Failing those, public sources of capital will become inevitable.

The first source of capital which cannot be found in the markets will be national resolution funds to be established under the BRRD, a directive currently in the legislative process. A secondary source may be the ESM, although certain States are adamant that legacy problems (capital shortfalls identified before the assumption of supervision by the ECB) cannot be remedied by this permanent Euro Area bailout fund.

The discussions on the European Resolution Authority and its accompanying resolution fund will come to a head these days. The level of capital required may be higher than expected: Basle and the EU set one level, independent outsiders call for far more.

Credit

The third challenge is Credit: banks should resume lending to SMEs and individuals for economic growth. Various schemes have been deployed to assist in the resumption of this traditional bankers' role, from oversight by authorities whether banks fulfil a pledge to lend at certain previously agreed overall amounts to specific projects involving the European Investment Bank.

Competition

The fourth challenge is Competition. Competition has decreased with the balkanisation of the Euro Area's financial markets where banks have retreated to national turf under the influence of deleveraging, supervisory nudging to focus on their home market and government pressure to serve national markets first and foremost. Out-of-State providers of credit have gone out of business or left for their home markets. Increasing competition in a manner that does not undermine financial stability will be a major challenge.

Challenges

These four challenges are also that of Europe's supervisors. Working effectively towards a culture change, identifying capital shortfalls and overseeing a restoration to safe levels of cushioning against loss and, at the same time, fostering competition in the banking markets are major challenges for supervisors. The role in the resumption of credit flows to the real sector is more a central banker's one; it is the ECB that can influence the interest rate and the translation of monetary policy decisions across the Euro Area.

Coherence

There is a fifth challenge for Europe's supervisors: coherence in their approach to banking supervision. Translating the institutional changes that banking union brings, however imperfect these may be, into a coherent and consistent approach to banking supervision will require innovative approaches and combining the best practices of the hitherto dispersed supervisory authorities. If giving up their traditional ways can be asked from bankers, it's fair to request the same of their supervisors.

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