Matthew Elderfield: Single Supervisory Mechanism – benefits and challenges from a practical supervisory perspective

Introductory remarks by Mr Matthew Elderfield, Deputy Governor of the Central Bank of Ireland, at the 11th Annual European Financial Services Conference "Reshaping Europe's financial markets", organised by Forum Europe Ltd., Brussels, 31 January 2013.

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My thanks to the organisers for the opportunity to take part in this panel. There are a number of interesting issues presented by the banking union to discuss. The starting point, as we know, has been the desire to break the destructive link between stressed sovereign finances and weak banking systems. Europe is taking measures to establish the single supervisory mechanism, but I think an important issue to discuss today is the timetable and sequencing for the other essential elements of banking union. Establishing operational parameters for the use of the ESM for direct recapitalisation and agreeing a framework and set of national powers for resolution are urgently needed measures to make banking union a success and to resolve the financial crisis. I would argue that these need to be implemented in parallel to preparing for the operation of the SSM, with work on a European-level resolution authority to follow shortly and then European deposit guarantee arrangements to be explored at a later stage.

But as the only supervisor on the panel, let me say a few introductory words about the benefits and challenges of the SSM from a practical supervisory perspective. To my mind, banking union holds out the prospect of strengthening the framework for European banking supervision, if implemented successfully. Creating some distance between supervisors and the banks they regulate (and, indeed, from the political systems of the banks they regulate) can help improve the capacity for challenge and ensure a broader, more detached, perspective on problems. As an Englishman working in Ireland, I need to disclose that bringing in a foreigner to do your supervision is not, alas, the magic solution to all the woes of a banking system. But the single supervisory mechanism holds open the prospect of an institutional framework, a broader skill set and more diversity of experience that should help insulate supervisors from the pressures – subtle and direct, cultural and political – that come from long-time and close proximity to their regulatory charges and their champions.

However, there are some important practical implementation challenges that flow from this new structure. Let me briefly mention three of them.

Firstly, the fact that there will necessarily and correctly be a division of labour between national supervisory authorities and central SSM staff at the ECB raises practical questions of organisation and decision making. The SSM will have a carefully calibrated governance structure, involving a Supervisory Board that interacts with the ECB Governing Council. At the bottom of the system will be the various national supervisors each feeding up dozens if not hundreds of issues and matters for decision and action, with this volume surging in times of stress. My instinct is that the volume of these decisions is considerably greater in supervision than in monetary policy. It will therefore be important that clear and efficient decision-making procedures, with clear accountability, are put in place.

Second, it is important that supervisory practices and procedures converge quickly into a common approach. Such integration is not easy and will take time, as I know from the FSA which involved the merger of nine and then a tenth organisation into one. In the case of the SSM, we will have at least 17 supervisors from different cultures to meld together. Developing a common framework for risk assessment, with a common language for risk and common approaches to inspection and supervisory reviews, will be a process that forges this integration out of necessity and will involve some important early practical design questions.

Third, and closely related to this last point, it will be important to develop a common supervisory philosophy and risk appetite. Will the SSM under the ECB be a principles based supervisor, a rules-based one or some judicious mix of the two? Will staff be encouraged – and firms warned to expect – an intrusive approach or not? It is important to articulate the essential elements of the supervisory approach so that front line staff – and the banks they supervise – have a clear understanding of senior management expectations and risk appetite. I would like to see the new single supervisory mechanism give its front line staff a clear mandate to be challenging and assertive with banks in ensuring that risks are not just identified but are definitively mitigated in a time-bound manner.

Work is underway at the ECB and the national supervisors to start to put these practical building blocks in place. But we have a very tight timeline and much remains to be done. I look forward to the discussion to come on these and the other matters posed by the introduction of the banking union.