Vítor Constâncio: Implications of the Single Supervisory Mechanism (SSM) on the European System of Financial Supervision (ESFS)

Speech by Mr Vítor Constâncio, Vice-President of the European Central Bank, at a Public Hearing on Financial Supervision in the EU, Brussels, 24 May 2013.

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Ladies and gentlemen,

Thank you very much for inviting me to open this session on the implications of the Single Supervisory Mechanism (SSM) on the European System of Financial Supervision (ESFS).

At present, the only answer that can really be given on this issue is, "*it depends*". While the SSM will in principle be just another supervisor around the table, its impact on the ESFS will clearly depend on how many Member States eventually decide to join. In our view, the more Member States take part, the better it will be for the functioning of the ESFS and the single market more generally.

First, having as many as possible countries in the SSM will reduce the scope for coordination failures. This will in turn facilitate the coordination function of the European Banking Authority.

Second, a larger SSM is the best way to safeguard the single market in financial services. The more membership overlaps between the EU and the SSM, the more consistent will be the application of supervisory and regulatory practices.

Third, broad SSM membership could diminish the distortions to the single financial market caused by the divergent fiscal positions of sovereigns, as Member States that are part of the SSM will also have access to the Single Resolution Mechanism (SRM). This presupposes, however, that the SRM is set up with strong powers, which I consider essential.

At this stage, we expect several non-euro area Member States to join the SSM. The negotiations on the SSM Regulation have satisfactorily addressed most of their concerns. However, some countries seem to require that more clarity on the functioning of the SRM is provided before they reach their final decision, in particular on the issue of a common fiscal backstop and how "out" Member States could contribute to or benefit from it. In my view, this should not be an obstacle to a positive decision because any participant country in the SSM will also participate in the SRM and benefit from it.

From the ECB's perspective, it is essential that the SRM comprises a Single Resolution Authority and single fund financed by ex-ante and risk-based contributions from the banking sector itself. To remove any doubts over resolution financing, the fund should be able to draw on a common backstop if needed – possibly a credit line from the ESM. Any credit would be repaid via additional levies on banks and thus be fiscally neutral in the medium term. This construction raises certain institutional questions which cannot be answered today, not least related to membership of the ESM. But in our view, an approach based solely on coordination between national authorities without a Single Resolution Authority and without a common backstop would clearly not be sufficient. It would make the Banking Union significantly less attractive for non-euro area Member States, and hence less effective for the EU as a whole.

Ideally, we would like non-euro area Member States to make their intentions clear by July 2013 when the SSM Regulation is expected to enter into force.

Interactions with the ESFS

While we cannot say definitively how the SSM will affect the ESFS without knowing its eventual composition, we can identify certain structural ways in which the SSM and the ESFS will interact.

European Banking Authority

Regarding the European Banking Authority (EBA), interactions with the SSM will necessarily be very intense, and in three areas in particular.

First, the single rulebook. EBA will remain responsible for developing regulatory policy and technical standards that will form the basis of a single rulebook for banks across Europe. The SSM will play a key role here, as I noted, in improving coordination between supervisors. It will therefore significantly support the accomplishment of EBA's mandate to establish that single rulebook.

Second, the EBA supervisory handbook. In order to encourage supervisory convergence in Europe, the EBA is currently developing a supervisory handbook which reflects best supervisory practices across the EU. At the same time, the SSM will develop its own more detailed supervision manual, which lays down the supervisory approach to be taken by the SSM including on off-site and on-site reviews, risk assessments and model validations. The ECB and the EBA are cooperating closely to ensure that these two projects are fully consistent. Here again, the existence of the SSM will greatly facilitate the work of the EBA, as all SSM members will naturally converge in their supervisory practices.

Third, the conduct of stress tests. The Council Regulation requests the SSM to conduct a comprehensive assessment of the banks that the ECB will supervise directly. This will have two main building blocks. First, a balance sheet assessment, which is a point-in-time evaluation of the asset side of banks' balance sheets. Second, a forward-looking assessment of individual banks' capital positions and provisioning levels in the form of a stress test. This stress test, and future stress tests undertaken as part of the SSM's regular supervisory functions, will be conducted in close cooperation with the EBA, in particular regarding the design and timing of the exercises.

European Systemic Risk Board

As regards interactions with the European Systemic Risk Board (ESRB), the activities of the SSM will have a clear systemic dimension and so cooperation between the SSM and ESRB will be essential.

In particular, while macro-prudential powers will rest also with national authorities, the ECB will be able to use macro-prudential instruments, either at the request of national authorities or by deciding to adopt stricter measures than the ones adopted at national level. This implies an increased coordination function in the macro-prudential areas for countries within the SSM that will naturally create some overlap with the macro-prudential role of the ESRB for the wider EU.

However, I expect the macro-prudential functions of both institutions to be complementary. The ESRB will play its role in adopting recommendations to help coordinating macro-prudential decisions as provided for in EU Regulation (namely CRR), in particular with the countries that do not join the SSM. In addition, while the SSM will exclusively focus on banking systems, the ESRB has an additional macro-prudential function regarding the non-bank parts of the financial sector, and as such will be well placed to address cross-sectoral issues.

Interplay with the other ESAs

Finally, let me be very brief regarding the SSM's interaction with ESMA and EIOPA. Although the supervision of markets and the insurance sector will remain with the national authorities, ESMA and EIOPA will play important roles in the coordination of information sharing between the SSM and the national authorities. In particular, cooperation with EIOPA on the bank-led conglomerates will have to be very close given that the SSM is expected to take over their supplementary supervision. Memoranda of Understanding regulating these interactions will be prepared in the coming months.

Conclusion

To conclude, it is unavoidable that the existence of the SSM will alter the functioning of the ESFS. This is, after all, the most significant development in financial supervision in the history of the European Union. However, I am confident that the changes brought by the SSM will strengthen the ESFS, and will overall enhance the quality and consistency of supervisory and regulatory practices across Europe. The more Member States that are involved in Banking Union, the greater these positive effects will be.

Thank you for your attention.