Pentti Hakkarainen: Welcome more common and integrated financial markets

Opening remarks by Mr Pentti Hakkarainen, Deputy Governor of the Bank of Finland, at the Nordic Capital Markets Forum seminar on European Banking Union, Helsinki, 5 October 2015.

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Ladies and Gentlemen

Welcome to the Bank of Finland's Money Museum. It is a great pleasure for me to open and participate in your seminar on the European Banking Union.

Without going into detailed argumentation, it is quite an indisputable view that fully integrated financial system would bring invaluable benefits to the real economy in Europe. The banking union is an essential part of the financial system. However, there are also capital markets and payment services, clearing and settlement systems and other finance market functions, which are elements for further integration. In these fields a lot of progress has been made in Europe in recent years.

I would like to share with you some experiences of the Banking Union and then some views on the new Action Plan of the Capital Markets Union.

Banking Union

The latest financial crisis made it very clear that interconnected banking and financial markets require a better and stronger institutional framework that we had in Europe. New institutional arrangements for bank supervision and resolution were needed to match the integrated structures of banking business.

As a part of the economic and monetary union and as a remedy for future financial crisis, the EU leaders agreed in June 2012 on creating the Banking Union. In the future, the Banking Union will help us resolve banking problems while avoiding using taxpayers' money for bail-outs. The Banking Union also means a more stable financial system in Europe as the likelihood of problems is reduced.

The Single Rulebook provided the foundation for the Banking Union. It is based on the idea of harmonised regulatory requirements, such as capital adequacy rules for banks and supervisory practices.

Single Supervisory Mechanism (SSM)

One of the main pillars of the Banking Union is the Single Supervisory Mechanism (SSM). It ensures consistent, non-biased supervision in all Member States. The Single Supervisory Mechanism started supervision nearly one year ago and its work is independent and separated from the ECB's central banking activities.

From the banks' perspective, the introduction of the SSM means numerous changes. I will mention only a few of them.

For cross-border banks, operating in multiple countries within the Banking Union, the SSM effectively simplifies their contacts with the authorities. A bank will work with a single supervisor and operate following a single rulebook. This implies also lower costs for the bank in complying with regulatory requirements.

Common rules and methods of supervision have a broader impact on competition among banks. Banks are treated equally in supervision and regulatory capture can be avoided, thereby ensuring a level playing field.

The Single Resolution Mechanism (SRM)

The second important pillar of the Banking Union is the Single Resolution Mechanism (SRM), which is a necessary complement to the Single Supervisory Mechanism. Single Resolution Mechanism creates a single authority, which is responsible for swift and orderly resolution of banks in the euro area and participating member states.

The SRM is a game-changer in the European bank resolution, as it is designed to end bank bail-outs. The new bank recovery and resolution framework ensures a uniform European approach where identical cases are treated identically.

The Single Resolution Mechanism is complemented by the Single Resolution Fund (SRF) which is financed via levies on the banking sector itself. The Fund (EUR 55 bn) starts from national compartments but it will gradually, in eight years, be mutualised to become a single European Fund.

Underlying the new regime is the Bank Recovery and Resolution Directive (BRRD) which changes the culture in the banking markets. Bail-in will now be the rule, bail-out a rare exception. As of the beginning of 2016, the BRRD requires bail-in of shareholders and creditors equal to at least 8 % of the total liabilities of a failing bank. Only after the threshold of 8 % bail-in can money from the resolution fund be used and only at the very end of the process can public money be used. It is notable that public money can only be used to facilitate resolution, not to save non-viable banks.

Macroprudential policy

Alongside the changes in microprudential supervision due to the establishment of the SSM also a macroprudential policy is becoming effective.

While the macroprudential policy lies in the first place with the national authorities, the SSM Regulation assigns macroprudential tasks also to the ECB. In particular, the ECB may decide stricter measures than national authorities, using the counter-cyclical buffer or other macroprudential tools provided with the European legislation. The role of the ECB in making macroprudential decisions within the Banking Union can be seen as a useful complement to national frameworks so as to avoid the so called inaction bias in macroprudential policy.

Deposit Guarantee System

A common Deposit Guarantee Scheme can be seen as a completion of the Banking Union. The planning of such a scheme is still in a very early phase and would require harmonisation of the national schemes as a first step. The European Commission is mandated to revisit the issue in 2019. But I assume that the European wide deposit guarantee system will be promoted earlier than 2019 since it would fit naturally inwith the SSM and the SRM.

A Capital Market Union for Europe

Following the initiation of the European Banking Union, Commission President Juncker promised in July 2014 to create a European "Capital Markets Union". As he explained it, "To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the costs of raising capital, notable SMEs, and help reduce corporations' high dependence on bank funding".

Last week, The European Commission launched the Action Plan on Building a Capital Markets Union (CMU). The Capital Markets Union is a good initiative. The ECB and the Bank of England have already been active in some capital markets issues, especially reviving the EU market for a high-quality securitization. The CMU should help mobilise more capital in Europe and especially channel it to financing of the corporate sector. By opening up a wider range of funding sources for investments the CMU can reduce the bank-dependency of European finance and thus the vulnerability of the EU economies and corporations to banking shocks. The CMU can also deepen financial integration and increase competition in the EU financial markets.

Conclusions: some enhancements

Ladies and Gentlemen!

To conclude, I would like to express some additional views on the Banking Union and the Capital Markets Union, as I think that some enhancements would be needed.

The Capital Markets Union needs robust banks. The Banking Union was a major step in the right direction. The BU is mandatory for the euro area countries, while the other member states can join the BU on a voluntary basis. It is important to strive for an as unified approach to bank supervision as possible in the whole EU and including also the EEA countries and others. This is so because banks are and will be of high importance for the SME financing, and the future playing field may not become quite level in the SME financing in the future Capital Markets Union without some extra efforts.

Moreover, for ensuring financial stability and capital market integration, the bank-sovereign-nexus has to be in the future. The bank-sovereign-nexus is a two-sided problem. The nexus from banks to sovereigns is dampened through the introduction of the SRM and the Bank Restructuring and Resolution Directive. However, the dampening of sovereign risks to banks has not been resolved yet. Up to now there have been some discussions about potential risk-sensitive capital requirements regulation for sovereign bonds. That is s one way forward, but I would also support the five Presidents' initiative to review the treatment of bank exposures to sovereign debt, for example by setting large exposures limits[1].

As I said in the beginning, well functioning integrated financial markets are invaluable for the real economy and there is a lot of preparation underway. As you all here present are in important, key positions in financial markets, I call for your active participation in and providing your valuable contribution to these consultations. With your input we can improve our work in creating deeper, more liquid, better integrated and increasingly safe capital markets.

Thank you for your attention!

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[1] Completing Europe's Economic and Monetary Union. Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz. European Commission, 2015.

Banking Union
Single Supervisory Mechanism (SSM)

- Single Rulebook provides harmonised regulatory requirements and practices

- Single Supervisory Mechanism (SSM) ensures consistent, non-biased supervision for all Member states
  - No national bias
  - Independent and separated from the ECB central banking activities
  - Joint supervisory teams in charge of day-to-day supervision
  - New macropridential role

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Banking Union
Single Resolution Mechanism (SRM)

- SRM started a new era of no bail-outs
  - Complements SSM
  - Game-changer in bank resolution – ends bail-outs
  - Bail-ins without taxpayers' money
  - New bank recovery and resolution framework
    - Single Resolution Fund (EUR 55 bn) to facilitate resolution, not to save non-viable banks

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Capital Markets Union (CMU)

- Commission launched the Action Plan on Building a Capital Markets Union last week
- Strenghtening the role of capital markets alongside bank financing would diversify European bank-based financial markets and thus contribute to a more stable EMU
- CMU is an EU initiative and it needs robust banks
  - Banks are important for SME financing and the future playing field may not be even in SME financing the future CMU
  - It remains possible that some loopholes exists between BU and non-BU member states. It is important to discuss possibility of unified approach to bank supervision to all EU banks

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