Mario Draghi: Opening speech at the European Banking Congress “The future of Europe”

Opening speech by Mr Mario Draghi, President of the European Central Bank, at the European Banking Congress “The future of Europe”, Frankfurt am Main, 22 November 2013.

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Ladies and gentlemen,

Thank you for inviting me to speak to you today.

While the situation in the euro area has improved greatly over the last year, we are still faced with considerable challenges.

We need to secure the economic recovery, reduce fragmentation in the euro area and continue the process of institutional and structural reform.

To achieve this, it is essential that we do not retreat into purely national perspectives, with a narrow view of our interest. We must keep our European perspective – and stand up for our common interests.

I would like to use my remarks today to highlight two areas where this European perspective is key.

The first is the monetary policy. Monetary policy with a single currency will always have different effects in different places. But it is essential to understand that the ECB, by its mandate, must act for the euro area as a whole. And in doing so, it makes the best contribution to prosperity for European society at large.

The second area is the creation of banking union, notably the Single Supervisory Mechanism (SSM). The SSM will create the first ever genuinely European supervision and we must take advantage of the opportunities this provides.

For banks, it offers a unique opportunity to restore confidence and attract private investors, also through the ECB’s comprehensive assessment. For the wider euro area, it offers a possibility to deepen financial integration and reduce fragmentation. For this process to be effective, a strong Single Resolution Mechanism (SRM) is essential.

The ECB’s monetary policy

Starting with the ECB’s monetary policy, our mandate is inherently European – it is to maintain price stability for the euro area as a whole. And this mandate is symmetric; don’t forget that price stability works in both directions. We need to act as much when there is a risk that inflation in the medium term might become too low as well as too high.

As I had the opportunity to explain yesterday, when we took our recent decision to cut interest rates, we saw a situation where the inflation outlook deviated too strongly away to the downside from our price stability mandate. Our decision was necessary to comply with our mandate.

I also had the opportunity to address some concerns this decision has raised. Let me briefly come back to this.

One concern is that low interest rates erode people’s savings. Another is that low interest rates create risks for financial stability. A third is that they reduce the incentives for governments to reform.

Allow me to address each of these concerns in turn.

First, I understand the concerns about a prolonged period of low returns on savings. But it is important to understand that interest rates are low because the economy is weak. If we raised rates, we would further depress the economy, people would lose their jobs, and then their savings would be lower for longer.

By keeping interest rates at a level that supports the recovery, we should see higher interest rates for savers going forward.

Moreover, the interest rate that matters most to long-term savers is not the main ECB rate, but the rate on safe long-term investments – in Germany, that is long-term Bunds.

It is wrong to think that these rates are solely determined by the ECB. Since the crisis, more powerful factors have been at play. In particular, the low return on long-term Bunds was largely explained by investors seeking safety as other parts of the euro area struggled.

Second, low interest rates can over time threaten financial stability, but we do not see any evidence of this at present.

If we do see low interest rates creating localised risks, then local tools should be used to address them. In particular, national authorities should make full use of macro-prudential tools that they have available.

The third concern is that low interest rates undermine incentives for reform in the euro area. Certainly, monetary policy always has side effects – this is inherent and unavoidable. But one should never forget that the ECB acts for the euro area as a whole in line with our mandate.

I have already reacted to the nationalistic tone that this concern has provoked in some recent commentary. In their deliberations and decisions, Governing Council members are neither German, nor French, nor Spanish, nor Italian but acting as Europeans in pursuit of a European mandate.

To maintain the right incentives for economic policies, countries need to strengthen their frameworks for economic governance. Important steps to strengthen budgetary discipline have already been undertaken. But several countries are further behind in implementing structural reforms. It is therefore high time to bring this area under closer European governance.

The Single Supervisory Mechanism

Let me now turn to the second part of my remarks today – the creation of the Single Supervisory Mechanism.

The SSM offers a tremendous opportunity to move from different national approaches to the treatment of banks to a genuinely European perspective. That is, to take collective responsibility for our banks consistent with the single financial market in which they operate.

The ECB's comprehensive assessment

It is clear that there needs to be much more confidence in banks within and across countries that are joining the SSM.

This is the objective of the ECB's comprehensive assessment. How will the assessment boost confidence?

Primarily, by giving all parties more transparency. Investors should have the facts they need to properly price assets and be assured that banks are sufficiently capitalised.

The exercise aims to achieve this through a supervisory risk assessment, an asset quality review and a stress test. I will not go into the details here as they are being communicated separately, but the key point is that it will be comprehensive and consistent.

Comprehensive because it will cover 128 banks and about 85% of the assets of countries participating in the SSM.

And consistent because it will be centrally led with a rigorous common methodology – there will be no room for perceptions of national bias.

There should be no doubt about the credibility and rigour of the assessment, or the comparability of the results.

Let me add here that, by end-January, we expect to announce the key parameters of the stress test exercise together with the European Banking Authority (EBA).

We have recently been meeting with bank top management along with their national supervisors. We have emphasised in these meetings that to make the exercise a success we need to have high-quality information. In fact our first data request, called the "portfolio selection", has just been issued.

We are aware that gathering this information requires an extraordinary effort for national supervisors and especially for banks. But it is important to note that this is not a permanent or recurrent feature of the SSM.

Since last year banks have been improving the robustness of their balance sheets by increasing capital and provisions. In this sense, the exercise is already producing results – and I encourage banks to continue. Given the improvement in market conditions, market-based solutions should be more feasible than in the recent past.

If private sector solutions cannot be achieved in a timely and realistic manner, there is also a responsibility for the public sector. To ensure the credibility of the exercise, we need clear public backstops at the national and European levels. If they are drawn upon, the Commission has clarified that the state aid rules will provide for a level playing-field in terms of burden sharing, while financial stability will be fully safeguarded.

The ECB's comprehensive assessment therefore provides the first step towards building confidence in euro area banks, and between euro area countries and their competent authorities.

I call on all banks covered by the SSM to join our effort in the coming months by supplying the necessary information to the ECB and the national authorities, by undertaking prior actions where needed, and by proactively responding to the conclusions of the exercise.

Fostering financial integration

Once the SSM is established, it offers a real possibility to take a new, European approach towards governance of the financial sector – and hence to reverse the harmful financial fragmentation we have seen during the crisis.

There are three ways in which I see that the SSM can help.

First, the SSM can supervise in the European interest. As European supervisor it has no incentives related to national champions and its mandate is fully aligned with its European financial stability objective.

The fact that the new European supervisor is not only legally independent but also independent of any single government or national financial system facilitates the pursuit of its objective.

Second, the SSM can increase confidence among supervisors. During the crisis, some supervisors, motivated by uncertainty, engaged in defensive actions such as national ring-fencing of liquidity and national asset-liability matching. This may have been rational given their mandates, but it reinforced fragmentation.

Under the SSM, all supervisors will have the same rules, standards and decision-making procedures. As such, a supervisory assessment from the SSM that a bank is healthy will be a "seal of quality" that is valid from one country to the next.

Third, the SSM can foster trust between banks.

European supervision should make banks more confident to lend to one another across borders, in particular in the interbank market. And it could also make banks more willing to engage in cross-border mergers and acquisitions. This would deepen financial integration and make the euro area more resilient to fragmentation.

Our long-term vision for the SSM involves an environment where a creditworthy firm or household can get a loan from any bank in Europe at comparable conditions – and where location considerations would not be predominant.

Yet, further improvements will be needed in other domains. It is not only different supervision that holds back cross-border banking integration and activity. Also different national legal frameworks, different tax regimes and different rules for corporate governance contribute to fragmentation. These issues warrant consideration to facilitate financial reintegration.

The Single Resolution Mechanism as an essential complement

Another essential element in building a more integrated European banking market is greater harmonisation of how non-viable banks are resolved.

This requires a consistent legal framework between countries and a single resolution mechanism to enforce that framework. The first part has already been agreed by governments; the second part, the SRM, needs to be pursued as a matter of urgency.

A robust SRM would encompass all banks established in member states participating in the SSM. It would have at its centre a strong and independent single resolution authority that can act evenly across countries and take decisions in the European interest. And it would have adequate powers, tools and financial resources to resolve institutions swiftly and effectively.

The key to an effective resolution regime is that it creates legal certainty, consistency and predictability, thus helping to avoid *ad hoc* solutions. To this end, there are two points where I think more certainty is needed.

First, while the new EU resolution framework provides the appropriate resolution toolbox, it would be better to have it available right from the start of the SRM. I therefore support implementing the bail-in tool well before 2018.

Second, to price risk properly, investors need to see a clear pecking order in resolution financing – running from capital write-downs and bail-in to use of a bank-financed single resolution fund.

However, it would be difficult to make such a pecking order credible without a public backstop for the single resolution fund for exceptional cases where its resources are exhausted. Otherwise, investors may suspect that governments would at some point be forced to step in again.

Such a backstop would still result in the private sector paying as any borrowing by the fund would have to be repaid, if needed through *ex post* levies on the banking sector. In other words, the future system would not be about bail-outs or mutualisation – it would be fiscally neutral; the taxpayer would not pay.

Conclusions

Let me conclude.

I have discussed today the benefits of a European perspective to our current challenges. This is not the perspective of idealists. Rather, in a closely integrated monetary union, it is the perspective of realists.

A European perspective is firmly enshrined in monetary policy. And it is equally enshrined in our approach for establishing the SSM. We will overcome fragmentation to create a truly integrated financial market. There is still much more to be done to overcome the challenges that we face, but we have the right orientation.

Thank you for your attention.