

Ardo Hansson: Nordic-Baltic financial linkages and challenges

Opening remarks by Mr Ardo Hansson, Governor of the Bank of Estonia (Eesti Pank), at the conference “Nordic-Baltic financial linkages and challenges”, Tallinn, 13 December 2013.

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I am honored to welcome you here in Tallinn at the conference *Nordic-Baltic Financial Linkages and Challenges* jointly organized by the IMF, Riksbank and Eesti Pank.

Jean Monnet once famously said that Europe will be the sum of the decisions taken in crises. We hope to have soon put one of these crises behind us. We now know that inadequate assessment of risks and weaknesses in the regulatory and supervisory framework were among the causes of the crisis. We hope that the lessons learned from the crisis will be profound and lasting enough to provide the energy for us to follow through with the fundamental reforms we have initiated in the EU. We also now understand the need to remain vigilant and ready to act against possible new risks to financial stability.

Today’s conference will take a close look at the challenges and rewards involved in the evolution of a new paradigm in the operation and regulation of the European financial sector. The financial sector in the Nordic-Baltic region is regularly used as an example of regional integration and cooperation. In my remarks, I would like to highlight the key features of the region and put them in the broader context of European developments.

Taking care of the large Nordic-Baltic “home market”

First of all, we should keep in mind that the Nordic-Baltic region is characterized by considerable diversity: diversity in monetary policy frameworks, models of economic development and financial structures.

The second key word of the Nordic-Baltic region is integration – the region is characterized by tight trade and financial ties within the region as well as with Europe and global markets. Therefore, the region’s competitiveness and growth potential are important to each country in the region. The bank groups that finance growth in the region are largely the same in every country. All these groups are currently highly rated and well capitalized in comparison to others in Europe. As a result of mergers and natural growth, the total assets of the larger banks have risen to a high level compared to regional GDP, not to mention their very high level as a ratio to the GDP of their home countries.

The combination of common economic interests and financial sector integration has fostered the emergence of a unique feature of the Nordic banking groups: they have extended the concept of the “home market” well beyond their home country’s borders. For example, Nordic parent banks continued to provide liquidity to their Baltic affiliates even during the years of the deepest crisis in the Baltic economies. In today’s slow growth environment, it remains important for competitiveness and growth that there should be an appropriate level of financing in the whole region. The broader concept of the “home market” should be developed further. One of the challenges will be to ensure strong competition in retail markets so that the benefits of integration could be felt by consumers across the region.

Fostering sustainable growth in the region requires us to take a systemic view when designing harmonized regulation for the financial sector, and this is where the quality and proactivity of macro-prudential supervision becomes so important. The Nordic-Baltic dimension adds two nuances to the design of macro-prudential policies. First, our own experience of the past decade was a stark reminder of the particular challenges of managing capital flows in highly integrated economies and financial sectors. Second, most of the large Nordic banking groups have been considered as too big to fail in almost all countries in the region.

Diversity in the financial sector structures is a challenge for cross-border cooperation

As I said earlier, the economies and financial sectors of the Nordic-Baltic region are diverse as well as closely integrated. Different countries in the region have opted for different policy frameworks; the structure of the financial sector also differs by country. It turns out that in a region of only eight countries, some of which are very small, one needs to tackle very much the same array of problems that make the coordination of financial sector policy and supervision so challenging in Europe. There are home and host countries; there are non-EU member states, EU member states, and euro area member states. There are differences in economic, lending and asset price cycles, and there are also differences in economic history, crisis experience and institutional arrangements. The developments in recent years have exacerbated these dissimilarities and perhaps even created new ones. It appears to me that the success in combining the positive aspects of diversity and integration in the Nordic-Baltic region may serve as a model for the European Union. If cooperation and coordination has been possible in this region, there is reason to hope for the same in the European Union as a whole.

Cooperation between the institutions responsible for financial stability in the region has a history of over 10 years. This cooperation has become considerably closer since the outbreak of the global financial crisis and the reversal of capital flows in our countries. Routine work is done in supervisory colleges, and there are high-level multilateral groups for coordinating macro-prudential supervision and crisis management. It has been very important that trust and open communication as well as mutual support and a willingness to take responsibility have remained in place when the financial stability of a Nordic-Baltic country is really at stake. A shared understanding of the need to deal with macroeconomic and financial stability risks at a national level has provided a solid foundation for Nordic-Baltic cooperation.

2014 will bring new challenges for Europe

The year 2014 will bring new challenges. New financial sector regulation (I am referring to the CRR/CRD and the forthcoming BRRD) and single banking supervision will add new aspects and new partners to Nordic-Baltic cooperation. The goal of harmonisation of cross-border regulatory and supervisory practices is to create an operating environment for banks and other financial institutions that fosters mutual trust and helps ensure that the provision of financial services is continuous and satisfies the needs of the real economy.

When the SSM becomes operational, it will have important effects on the routine supervisory work in the Nordic-Baltic region. The home countries of several subsidiaries that will be included under direct supervision by the SSM/ECB will probably remain outside the SSM. This presents a new challenge for the Nordic-Baltic cooperation framework. In the light of the success of our regional cooperation it is rational that we build the new principles of supervision on the existing foundation wherever possible. I hope and believe that in this new and more complex framework we will be able to preserve an important value – the spirit of cooperation.

In view of the development of the single market it is also important that the building of the banking union be completed – the SSM must be followed by the SRM. Ideally, this would create the balance between rights and responsibilities which has been the guiding principle in safeguarding cross-border financial stability for nearly a decade. There is no doubt that the special features of the Nordic-Baltic region complicate agreements on joint crisis management, and the design of cooperation in this matter will be crucial.

Ladies and gentlemen,

It is a great honour and privilege to host this conference on issues which are highly topical not just in our region but also in Europe and globally. The conference has brought together

prominent speakers and an audience who have great potential to provide different viewpoints in the discussions. In the light of today's topic, let us also consider the values that have made the Nordic-Baltic region so successful. Let us consider how to preserve and build upon these values and possibly share them with the rest of Europe.

And finally, let us not exaggerate the difficulties of cooperation; let us not underestimate the rewards of success or the risks that stem from inaction. Building the foundation for the future of Nordic-Baltic finance is not for the fainthearted.