Sabine Lautenschläger: Interview in Le Monde

Interview with Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank, in *Le Monde*, conducted by Ms Marie Charrel on 3 November 2014.

*   *   *

On 4 November, the European Central Bank (ECB) assumes responsibility for the supervision of the 120 largest banks in the euro area, which account for 82% of European bank assets. Sabine Lautenschläger, member of the Executive Board of the ECB and Vice-Chair of the new Single Supervisory Mechanism (SSM), answers some questions.

The SSM starts operations on 4 November. What is the mission of this new institution?

Our task is to be an intrusive and independent European supervisor which contributes to the safety and soundness of the banking system and the stability of the financial system. Our aim is to identify inappropriate risks as well as procedures within credit institutions well in advance and to act in an efficient and timely manner to mitigate them. With the start of the SSM, there will be one supervisory approach in the 18 countries of the euro area – thus, for the first time, creating a supervisory level playing field for banks in the euro area. In our day-to-day business, we will ensure that banks are sufficiently capitalised, that they have sufficient liquidity, and that they have established a governance structure as well as risk control procedures that are appropriate for their activities.

The ECB has just published the results of the banking stress tests. Is the sector in better shape than it was five years ago?

Yes. European banks have become considerably more resilient as they have increased their capital stock and strengthened their governance and risk controls. While preparing for the comprehensive assessment, they have also consolidated their balance sheets by up to €200 billion in recent months, selling off assets or issuing new capital. It is therefore fair to say that enormous progress has been made. But nevertheless, there is no reason to be lenient. Like an athlete who has to train daily to keep in shape, banks – which operate in a very competitive environment – must permanently work on their business models and strategies to take into account macroeconomic conditions, such as very low interest rates. They need to comply with many new regulatory restrictions, some of them still to come, some of them in transitional periods and not yet fully applicable.

Until now supervision was conducted by the national authorities, such as the ACPR (the authority for prudential supervision and resolution) in France. Did that not suffice?

Banks are highly interconnected. An independent supervisor at the European level gives rise to a number of advantages. First, it reduces the risk of regulatory and supervisory arbitrage as a European supervisor can create a level playing field. Second, it provides a better overview of the activities of large banks, while allowing for a cross-country comparison of their practices and control frameworks with those of other banks. As national supervisors will support us in our forward-looking critical assessment, we take the best of both worlds: the additional expertise of national authorities combined with an independent, strong horizontal view when it comes to the centralised decision-making of the Single Supervisory Mechanism at the European level.

How will you work with the ACPR?

Like the other national supervisors, the ACPR will be actively involved, together with their counterparts at the ECB, in the supervision of the significant French banks. Our French colleagues will familiarise us with the characteristics specific to the French market and legal system. They will inform us of national developments that might influence banks' activities, such as tax laws or laws on loans to enterprises. This expertise, combined with that of the ECB, will put us in the best position to assess banks' risk profile and to judge whether the differences in banking practices between countries are justified or not.

The SSM will supervise the 120 largest European banks, but the other 4,000 will remain under national supervision. Is this not a flaw in the system?

The ECB will supervise the European banking system as a whole, the significant banks with a market share of 82% of total banking assets directly and the less significant ones indirectly. We will set the key principles according to which all of the European banks should be supervised, also at the national level. And we will check that these principles are being followed. What's more, the national supervisors will continuously carry out centrally steered checks to make sure that these institutions, which are often essential to the financing of the local economy, do not as a group pose any relevant risk.

Additionally, we have identified, besides the 120 largest banks, 100 others that we will keep a close eye on. We do so because they are either regionally relevant, in bad shape or have specific business models.

Will restoring robustness and transparency in the banking system suffice to start credit flowing again in the euro area?

With a robust and resilient European banking system, we move a big step forward. Although such a banking system is a necessary condition for sustainable credit growth, it is not the only condition for banks to increase lending to the real economy. At the national level, structural reforms are required that will help firms to regain competitiveness and become sound enough for banks to lend to them.

Banks take credit risk when lending to the real economy. They need to be convinced that their customers, such as small and medium-sized enterprises, will make enough profits to repay the loans they receive. The growth prospects for national GDP as well as economic and structural factors such as labour market rules and sound fiscal budgets are therefore relevant criteria for banks' decision to do business.

The ECB will, from now on, have two missions: steering monetary policy and supervising banks. How will a conflict of interests be avoided?

Monetary and banking supervisory policies can have the same or contradicting objectives. Both policy areas, for example, have a strong interest in a sound banking system. Nevertheless, there may be future conflicts of interest, and in order to deal correctly with potential conflicts, we strictly follow the separation principle. Decision-making related to monetary policy is kept strictly separated from decision-making related to our supervisory tasks, right up to the level of the Governing Council, which will have the decision-making power in both areas. Additionally, the Governing Council will only be able to object to a draft decision proposed by the Supervisory Board. This new Board is the one steering and influencing supervisory policies and decisions.

Supervision is starting, whereas the second pillar of the banking union, namely the rules applicable in case of risk of bank failure, is not yet ready. Is this not dangerous for the ECB?

The Single Resolution Mechanism will be a major step forward in managing the restructuring or resolution of a distressed institution at the European level. And it is true that it will be operational only from January 2016 onwards. But this will not pose a great risk to the ECB as transitional procedures are in place. As of January 2015, all Member States need to have a national resolution authority: they will be our counterparts if a bank finds itself in difficulty. Similarly, the "bail-in" rules will already be partly applied as of January 2015. These rules establish that it will be the shareholders and investors who will bear, in the first instance, the losses of a bank. In 2016 additional rules will come into force, protecting member states and taxpayers from having to pay for systemically relevant banks by establishing a resolution fund paid for by banks.

It will take eight years for the fund to reach its target level of 55 billion euro. Is this not too little, too late?

It will be a quite significant amount, taking into account several other safety buffers. First, banks have considerably increased their own funds in recent years. Second, the resolution fund will only be used after contributions have been made from shareholders and creditors. These could reach up to 8% of liabilities, which is already a significant amount. Thus the overall loss-absorbing capacity of banks has increased considerably. The resolution fund comes on top of this.

The third pillar of banking union, the creation of a European fund to guarantee savings deposits, has come to a standstill. Should we be worried?

Not unduly, because deposits are already guaranteed up to 100,000 euro at the national level. But more importantly: if the first two pillars of the banking union work properly and secure the stability of individual banks and the banking system, the need for a joint fund significantly diminishes.

The stress tests revealed worrying weaknesses in Italian banks. Is Italy the weak link in the euro area?

As supervisors we do not think in terms of countries, but of banks' business and risk profiles. Each bank operates differently and therefore has to face different problems; it would be unwise not to see them individually.