Andreas Dombret: The SSM – a supervisory level playing field for Europe

Keynote speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at "Frankfurt 120", Frankfurt am Main, 21 November 2014.

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1. Introduction

Ladies and gentlemen

Thank you for giving me the opportunity to speak to you today at the beginning of our panel discussion. It is a pleasure to be here and to be able to share my views with you.

In the following panel discussion, we will speak about the SSM and its consequences for the third parties framework. By way of introduction, I would like to share some of my thoughts on the SSM itself and its implications for a supervisory level playing field in Europe.

2. A new supervisory level playing field for Europe?

The financial crisis has shown that banking supervision failed to keep pace with the increasingly international developments in the banking sector. Instead, banking supervision – and regulation, too – remained confined within national borders. It was the financial crisis that finally underscored the need for harmonisation in the banking supervision sphere and the need for a more harmonised regulatory approach – ideally one which would eventually create a level playing field for supervisors and banks alike.

We have done a lot of work in Europe to meet these requirements – first and foremost by introducing the Single Rulebook. This package, amongst others, implements the Basel III framework and assures the harmonised implementation of the rules throughout all member states.

For me, there are two watchwords for banking supervision and regulation which guide the way to a supervisory and regulatory level playing field: harmonisation and transparency. On the topic of harmonisation, the SSM will ensure that banks throughout the euro area are supervised according to a consistent set of standards. This will also enhance the effectiveness of banking supervision, because a joint supervisory approach can tackle cross-border effects more effectively than a purely national one.

As for transparency, the SSM will operate on the basis of more comprehensive information, and it will benefit from cross-border comparisons and Europe-wide expertise. Pooling insights into different national and regional economic conditions, legal structures, and especially different banks' business and risk profiles, will facilitate a deeper understanding of the European banking sector. Furthermore, banking supervision at the European level will reduce the probability of national supervisors affording preferential treatment to "their" banks, thus contributing to prudential transparency.

But is harmonisation an end in itself? Most certainly not: Harmonisation will always be constrained by the political and legal backdrop in the relevant jurisdiction. And in Europe, we must concede that an ideal world of a fiscal or political union is still some way off, which means that complete harmonisation remains out of reach. Ever since the EU came into being, European integration has proceeded step by step. The next step towards greater European integration was always dictated by what was feasible at the given time. These are the circumstances which all harmonisation projects in Europe need to come to terms with.

3. Implications for supervisors and banks

But what does all I have said about a supervisory level playing field in Europe mean for supervisors and banks?

Let's begin with the supervisors: The introduction of European supervision is an extremely exciting challenge. Ever since our national supervisors began taking part in the joint supervisory teams overseeing significant banks, our tasks and perspectives have been broadened substantially. Alongside our work in the joint supervisory teams, we, as national supervisors, are still responsible for overseeing the remaining 1,800 German credit institutions that are not supervised by the SSM. I am sure that our national supervision will also benefit from the insights we gain from working in the joint European teams. But, for all the benefits it offers, European supervision also means more competition for us as national supervisors – as I mentioned earlier on, the SSM supervisory standards will be developed by cherry-picking best practices from national approaches to banking supervision. And this is precisely where we are challenged to deliver our best practices and strategies in the prudential field.

Banks, too, will certainly feel the impact of the new European level playing field in supervision. First and foremost, the SSM banks will realise that they now operate in a more competitive environment spanning across Europe.

But also non-SSM banks, the so-called less significant institutions, or LSIs, will notice changes based on SSM supervision. Even though their supervisor is still the national competent authority – here in Germany, BaFin and Bundesbank work together in this role – the SSM environment will also influence the supervision of LSIs. The LSI sector as a whole will be overseen by the ECB when it comes to risk concentration. Furthermore, the ECB may also put forward recommendations and standards for LSI supervision. Therefore, I expect a harmonisation of supervisory practices for both SSM- and Non-SSM banks. This will contribute to the supervisory level playing field in Europe and fuel greater competition among credit institutions.

And in this competitive environment, German banks have a great deal of catching-up to do. The IMF's latest Global Financial Stability Report finds that the return on equity in the euro area is relatively low compared with the United States or Asia. And, with a return on equity of 1.26% and a return on total assets of 0.06% in 2013, German banks in particular are underperforming their European counterparts. Their net interest income is likewise weak by international standards.

What is behind these meagre earnings? The main reason is a business model that is relatively dependent on interest income. Running a business model like that certainly poses a challenge in the current environment of low interest rates.

Thus, banks will need to reconsider and adjust their business models if they are to achieve sustainable profitability. It might be worthwhile for German banks to diversify their sources of income beyond interest income. In terms of costs, German banks are faring relatively well compared with those in other countries. That being said, there is still capacity to trim costs. Streamlining branch networks or engaging in mergers might be ways of achieving this. In my view, the German banking market still offers scope for further consolidation.

4. Conclusion

Ladies and gentlemen

In my remarks today, I have explained how the launch of the SSM marks the first step towards creating a supervisory level playing field in Europe. And yet there are still challenges that lie ahead of us:

First and foremost, there is the need for German banks particularly to bolster their earnings in the face of stiff European and international competition. Nevertheless, they have to be careful not to search for yield in overheating markets or to soften their lending standards too far. Other potential risks that need to be addressed are conduct of the banks themselves, which can have financial, reputational and legal consequences; IT risks both internally and from a cybersecurity point of view; losses from large corporate loans, in particular shipping loans; and disruption spilling over from mounting tensions outside the EU. All these are topics that both banks and supervisors have to give thought to.

Of course, the SSM will influence not only banks and supervisors in the Euro area but also third-country banks and rating agencies, for example. In the next months, we will see how the SSM affects third-country banks, especially those European banks whose home countries are not yet participating in the SSM. I am sure that third-country banks establishing subsidiaries will benefit from the level-playing field in the Euro area. This may possibly be even a competitive advantage compared to other financial centers such as the UK. Concerning ratings, I really am curious whether the SSM will provide more confidence in the European banking sector and thereby lead to better ratings for SSM banks. These are only some of the topics I am looking forward to discussing in the following panel.

Thank you.