Pentti Hakkarainen: Banking Union – the "game-changer" in the European financial Markets

Speech Mr Pentti Hakkarainen, Deputy Governor of the Bank of Finland, to Ambassadors and representatives of the EU-countries in Helsinki, Helsinki, 11 December 2014.

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Accompanying slides can be found on the Bank of Finland's website.

Your excellences, it is a great pleasure for me to tell you today about the Banking Union and give a short overview on where we are today.

The Banking Union creates a comprehensive legal and institutional framework providing authorities powers and tools to deal with ailing banks. Major steps have been taken already, but there is still some work ahead.

The key lesson we have learnt is that economic dislocations without proper arrangements to tackle troubled banks have devastating effects on the real economy, taxpayers and the whole society. And regaining growth proves to be painfully slow and long-lasting.

The Banking Union is the game-changer and it will bring a new culture into the financial markets.

The Banking Union

The Banking Union is comprised of three different, although integrated, parts.

The Single Rulebook provides a foundation for the Banking Union. It is based on the idea of harmonised regulatory requirements, such as capital adequacy rules for banks. These are achieved through European legislation and lower-level technical standards.

The second main pillar of the Banking Union is the Single Supervisory Mechanism which started its practical operations just over a month ago in the beginning of November.

The third important pillar is the Single Resolution Mechanism. The SRM will gradually start its practical operation in the beginning of 2015.

The Banking Union will help us prevent banking problems. I would argue that there will be fundamental cultural change not only in the supervisory crisis management and regulatory framework for banks but also in the banking industry. In the future we avoid use of taxpayers' money as a rule and bail-out would be only as a rare exception. This in turn means also correct incentives in banking and hence a more stable financial system.

The Single Supervisory Mechanism

After the successful comprehensive assessment process, the SSM is up and running. The SSM was established to ensure that strong supervisory standards are applied in a consistent manner across the euro area. And the fundamental goal is to strengthen the confidence and resilience in the banking sector. To achieve these goals, the SSM, with the ECB at its centre, has been entrusted with an extensive set of micro- and macro-prudential powers, covering all key tasks relating to the prudential supervision of credit institutions.

The SSM possesses also early intervention powers in accordance with the Bank Recovery and Resolution Directive. The early intervention powers are significant and make it possible to take action with respect to banks which are approaching the point of non-viability i.e. before a bank is too deeply in trouble to be saved by ordinary supervisory measures.

Governance of the SSM

The governance structure of the SSM has been designed to separate the ECB's monetary policy and supervisory roles, and it also makes the position of different participating countries as fair as possible.

The Supervisory Board is responsible for the supervisory functions of the SSM. While the decisions are formally and finally adopted by the Governing Council of the ECB, the Supervisory Board is, de facto, the main decision-making body in supervisory matters.

The Governing Council cannot alter the decisions of the Supervisory Board, but only prevent their entry into force. Such a veto power could be exercised when the decision is seen to be in conflict with monetary policy.

New macroprudential role

The crisis has shown that micro-prudential supervision at individual bank level is not sufficient, and that macro and micro risks can actually be mutually reinforcing. This calls for very close cooperation between the macro- and micro-prudential functions. The ECB has powers also in the macro-prudential area, which is a shared competence with national macro-prudential authorities.

The ECB will be consulted on national measures and it has the possibility to tighten national measures if they are deemed inadequate. Macro-prudential instruments could also be applied to the euro-area financial system as a whole. This is completed and supported by the work of another macro-stability authority, the European Systemic Risk Board (ESRB). While the ESRB doesn't have as directly impacting tools, it covers all EU member states and the whole financial system rather than only the banking sector.

Bank resolution

The Single Resolution Mechanism (SRM) begins its operations as of 1 January 2015. The SRM creates a single authority alike the SSM. It consists consisting of the Single Resolution Board and the national resolution authorities. The SRM is responsible for swift and orderly resolution of banks in the euro area and participating member states. The SRM includes also the Single Resolution Fund at the Banking Union level.

The SRM ends the era of the bail-out and moves us to the culture of the bail-in. Bail-in will be the rule, bail-out a rare exception. As from the beginning of 2016, or in some countries even earlier, the BRRD requires bail-in of shareholders and creditors equal to at least 8% of the total liabilities of a bank. The new powers to bail-in bank debt holders are a crucial, element of the future resolution mechanism, which should limit the use of bail-outs significantly.

The SRM with its supranational decision making body and resolution powers, ensures efficient decision making procedures, adequate resolution financing arrangements and equal treatment. It has the same institutional and geographical scope as the SSM.

Single resolution board

The regulation provides for a single resolution board with broad powers. Upon notification by the European Central Bank that a bank is failing or likely to fail, or on its own initiative, the board would adopt a resolution scheme placing the bank into resolution.

The board will consist of a Chair, a Vice-Chair, four full-time appointed executive members and the representatives of the national resolution authorities of all the participating countries. It will exercise its tasks in either a plenary or executive format.

It will determine the application of resolution tools and the use of the single resolution fund. Decisions by the board will enter into force within 24 hours of their adoption, unless the

Commission or the Council, acting by simple majority on a proposal by the Commission, objected or called for changes. The national resolution authorities will be responsible for the practical implementation of the resolution schemes. However, the board ensures that there is no national bias and the identical cases are treated identically.

Single Resolution Fund

The SRM includes a special resolution fund to provide resources for implementing resolution tools. The Single Resolution Fund will be financed via levies on the banking sector itself.

The fund will ensure the availability of medium-term funding to enable the bank to continue operating while it is being restructured. It has a target level of €55 billion and can borrow from the markets if decided by the Single Resolution Board. It will reach the target level over eight years, starting in 2016. During that transitional period, there will be national compartments which will be progressively merged.

The fund makes banks not only less likely to fail but also safe to fail – meaning that they can be resolved without cost to the taxpayers and without significant disruption to the financial markets or the economy at large. The fund is not to capitalize banks but ensures ability to implement restructuring and other resolution tools.

Conclusion

The Banking Union corrects flaws we have had in our internationally integrated financial markets. And in doing that, national interests, and I argue that banks' interests as well, are taken care of when matching regulatory and supervisory institutions with the reality of banking business.

A structure which for the first time in the history of the European Union will allow the banking supervision and resolution mechanism to be based on a truly European mandate. By giving up a small part of the national sovereignty, the countries belonging to the Banking Union have gained an access to the European level decision making on key areas of supervision, crisis prevention and management as well as regulation of European banks.

The Banking Union, with its SSM and SRM and their broad powers will not only give tools to handle problems but it will also have a powerful preventive effect. It enhances responsibilities of banks themselves and reduces moral hazard. I foresee such a change in the financial markets which takes place only once in a generation.