Andreas Dombret: The role of national supervisors in European banking supervision

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at Chatham House, London, 30 January 2015.

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1. Introduction

Ladies and gentlemen

Thank you for this opportunity to speak at Chatham House today. It is an honour for me to speak at such a distinguished institution and to share my thoughts with you. The topic of my speech today is European banking supervision, but the underlying theme, of course, is integration.

Since the Treaties of Rome were signed in 1957, the history of Europe has been characterised by ever-deepening integration. Once it had been set in motion, European integration proved to be a steady process marked by a number of leaps. One such leap was taken in 1999. In that year, 11 European countries adopted the euro as their common currency. Today, the euro is shared by 19 countries and more than 300 million people.

However, as you know, the sun does not always shine in the euro area. In the wake of the global financial crisis of 2008, the euro area slid into a crisis of its own. In 2010, Greece stumbled into a sovereign debt crisis. This led to a rapid loss of confidence in other countries at the periphery of the euro area and eventually brought the euro area to the brink of collapse. Extensive rescue packages provided by the member states of the euro area as well as non-standard measures taken by the ECB helped to calm the markets and prevented the crisis from escalating.

To some, the present situation might look familiar. Greece is again capturing the headlines, since last week's elections put into power a party which is set to derail the train of reform. And just three days before the Greek elections, the ECB again decided to take non-standard measures in order to address the risks of too prolonged a period of low inflation – as you know, the Bundesbank takes a rather critical view of these measures.

But even though some might be reminded of 2010, it is obvious that the situation has improved over the past five years. And at some point, the focus should shift from managing the current crisis to preventing future crises. With regard to the European banking sector, the focus shifted in mid-2013 and, once again, the response was a leap in integration.

2. The idea behind European banking supervision

About a year later, on 4 November 2014, the first pillar of a European banking union was erected. On that date, the ECB assumed responsibility for supervising the 120 largest banks in the euro area – with the accession of Lithuania, the number of supervised banks has risen to 123. These 123 banks account for more than 85% of the aggregate balance sheet of the euro area's banking sector, making the ECB one of the biggest banking supervisors in the world.

The idea of European banking supervision was undoubtedly born out of the crisis. The crisis lent new urgency to something that had already been obvious before: in banking and finance, national borders are far less relevant than in other areas of life.

Such an integrated financial system is certainly desirable for all the well-known reasons, including efficiency gains and risk-sharing. However, that which distributes gains among all of us in good times, forces us all to share the pain in bad times. In an integrated financial system, problems in one country can quickly spread to others.

This is what happened during the recent crisis and it made us realise that banking supervision had to adapt – with international banks that operate across borders, isolated supervision was not so "splendid" after all. To quote the IMF, the European banking union is the "logical conclusion of the idea that integrated banking systems require integrated prudential oversight".

To be sure, there was a certain amount of cooperation in supervisory matters before the crisis. There was an exchange between home and host supervisors of internationally active banks. And there were supervisory colleges in which supervisors of global banks convened and shared their insights. However, this was not enough. An integrated financial system cannot be supervised through cooperation, it requires an integrated approach.

Taking banking supervision from the national level to the European level has three specific benefits.

First, European banking supervision makes it possible for banks in the entire euro area to be supervised to the same, high standards. These standards will emerge from sharing insights and empirical findings internationally and taking the best from each national approach to banking supervision. Germany, for instance, could benefit from a more quantitative-oriented approach, which has already been adopted by other countries.

Second, European banking supervision makes it possible to effectively identify and manage cross-border problems. This is essential, because, as I have mentioned, large banks are usually active in more than one country. The failure of the Franco-Belgian bank Dexia in 2011 is a classic example of a case where banking supervision with a cross-border focus could have improved crisis management. Another example is German Hypo Real Estate, which failed in 2009.

Third, taking banking supervision from the national to the European level will add a layer of separation between supervisors and the banks they supervise. This will prevent supervisors from treating their banks with kid-gloves out of national interest.

You see that we have come to expect a lot from European banking supervision. But even though I am extremely optimistic, we have to bear one thing in mind: European banking supervision is an immensely complex operation that has been put together in a very short space of time. We should not expect everything to run smoothly from day one. It will certainly take some time before every detail is sorted out deep down in the engine room of actual banking supervision.

Let us take a tour down into that engine room and see how European banking supervision is organised and what that entails for the national supervisors.

3. The role of national supervisors

A question I often heard during the run-up to European banking supervision was: "Aren't national supervisors digging their own grave? Now that supervision has been transferred to the European level, where will that leave you as national supervisors?"

First of all, we should certainly not succumb to the illusion that European-level supervision is going to spell the end of national supervision. In the entire euro area there are about 3,400 banks, of which only 123 are directly supervised by the ECB – the rest remain the responsibility of national supervisors. In Germany, for instance, about 1,800 credit institutions are still being supervised by the Bundesbank and BaFin.

Nevertheless, the ECB will certainly play a part in harmonising the supervisory approaches to all banks in the euro area. Consequently, national supervisors will have to take a more European perspective in supervising those banks which remain within their direct sphere of responsibility.

But what about those banks which are directly supervised by the ECB? Are national supervisors being pushed to the sidelines in these cases? Well, let us consider the facts. The ECB has to supervise 123, mostly very large and complex banking groups, which are located in 19 different countries. To do so, the ECB has a staff of 1,000, most of whom are located in Frankfurt. There is no other option for European banking supervision than to rely on national supervisors.

The role of national supervisors builds on their expertise and experience, as well as their resources and their presence on the ground. The Bundesbank, for instance, has decades of experience in banking supervision, has nine regional offices and about 1,300 supervisors.

Consequently, the ongoing banking supervision lies with "joint supervisory teams". These teams are headed by ECB staff, but are comprised mainly of national supervisors. The Bundesbank is represented in all the joint supervisory teams for German banks and also in some teams for foreign banks. Altogether, about 300 supervisors from the Bundesbank work in the context of European banking supervision.

And here, I am just talking about ongoing supervision. In addition to that, all the national supervisory authorities are represented on the Supervisory Board, the decision-making body of European banking supervision. For the Bundesbank that means we are ceding, in whole or in part, responsibility for supervising 21 German institutions, but becoming involved in the supervision of 102 foreign institutions.

You can imagine that all this requires national supervisors to adjust – not only from an organisational point of view but also from a personal standpoint. Supervisors who, for years, were responsible for national banks are suddenly being pushed into an international working environment. This is exciting and challenging at the same time, and it will be some time before everyone has adjusted to the new circumstances. Experience of the first few weeks is rather encouraging, though.

From an organisational perspective, the Bundesbank has already adapted. We have changed our structure to allow us to play an efficient and effective role in European banking supervision: we have set up a new Secretariat to prepare the meetings of the Supervisory Board, we have set up a new department to analyse the foreign banks which fall under European banking supervision, and we have set up a staff unit to coordinate those colleagues from the Bundesbank who work in the joint supervisory teams.

All this requires great effort and represents a formidable challenge. However, the real challenge does not lie in organising day-today supervision in the new system. In my view, the real challenge lies in the decision-making processes.

Since the ECB is responsible for European banking supervision, the Governing Council is the highest decision-making body not only for monetary policy issues but also for matters of banking supervision. These two responsibilities converge on the banks. Banks are a crucial element in the transmission process of monetary policy, while, at the same time, being the object of banking supervision. This, of course, gives rise to conflicts of interest, as it creates a banking supervisor with access to central bank liquidity.

To minimise such conflicts of interest, a governance structure has been created that limits the Governing Council's involvement in supervisory decisions. Time will tell whether this structure truly helps to avoid conflicts of interest between monetary policy and banking supervision or whether it might have been better to create an independent banking supervisor.

4. Conclusion

Ladies and gentlemen

European banking supervision certainly represents the biggest step towards financial integration in Europe since the launch of the euro. And, to me, it is the most logical step to take. Single monetary policy requires integrated financial markets – which includes, without doubt, European-level banking supervision.

And for anyone who has gained the impression that we have transferred responsibility for banking supervision to an institution with no previous experience of supervising banks, rest assured: that is not the case. National supervisors will continue to play an important role in supervision within the new system.

For us, as national supervisors, this is an extremely exciting challenge. Since colleagues from the Bundesbank began taking part in the joint supervisory teams, our tasks and perspectives have been broadened substantially. I am sure that our national supervision will also benefit from the experience we gain by working in the joint European teams. And I firmly believe that European banking supervision will benefit from the involvement of national supervisors.

Thank you.