Andreas Dombret: Six months of European banking supervision – what does this mean for "less significant institutions"?

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the "Verbandstag der Sparda-Banken", Frankfurt am Main, 22 May 2015.

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1. Introduction

Ladies and gentlemen

Thank you very much for inviting me to speak here at the "Verbandstag der Sparda-Banken". I am very pleased to be here.

The first Sparda Bank was founded in May 1896. This means the Sparda Banks can look back on nearly 120 years of history, during which their regionally oriented business model has enabled them to more than hold their own. It is safe to assume that the Sparda Banks can view the rest of the world from a certain position of experience. This is certainly helpful since the banking world, in particular, is currently in a state of upheaval.

A new age – that of banking supervision – began a little over six months ago. On 4 November 2014, we established the Single Supervisory Mechanism (SSM) for banks in Europe, the first pillar of a banking union. On that day, the ECB assumed responsibility for directly supervising the 123 largest banks in the euro area. It thus now supervises over 85% of the euro-area banking sector, measured by total assets.

However, the situation is different if we look not at total assets but at the number of institutions. In terms of the number of institutions, only around 3½% of the European banking sector is being supervised directly by the ECB. National authorities continue to supervise all other institutions. Which means some 3,400 banks in total, including 1,600 German banks.

Are these 1,600 banks therefore completely beyond the scope of the SSM? Is it true of these banks that "after 4 November" is "before 4 November"?

2. Smaller institutions – limited impact?

Indeed, not much will change at first for Germany's 1,600 smaller banks. Their primary points of contact will still be the Bundesbank and BaFin. Off-site supervision will continue to be performed by the Bundesbank's nine Regional Offices. This means we will remain your point of contact in future. Direct communication with the ECB will be restricted to exceptional cases – for instance, relating to issuing or revoking banking licences, or examining the acquisition of qualifying participating interests. But apart from all that, the ECB will receive information on every "less significant institution" (LSI) in annual reports produced by national supervisors.

This approach upholds the principle of subsidiarity, which I believe to be the sensible and correct approach. For instance, most smaller banks apply regional, relatively low-risk business models which do not necessarily require European supervision. National supervisors will be able to appropriately supervise and classify the special features of these banks in future, too.

Nonetheless, smaller banks, too, are affected by the SSM. In future, these institutions are also to be supervised under harmonised European standards. In order to ensure such consistent supervision, the ECB can give national supervisors guidance on how to design the supervision of smaller institutions. For instance, it can set supervisory focal points or define principles for the assessment of certain issues. In individual cases, however, the ECB does

not have the power to order national supervisors to take specific supervisory actions or to issue specific decisions.

The ECB and the national supervisors are currently setting the relevant guidelines and revising the Supervisory Manual. The challenge here is to strike the right balance between harmonising supervisory practice, which is a desirable objective, and the principles of subsidiarity and proportionality. The harmonisation of supervisory practice in Europe must not lead to supervision of materially different issues under the same standards.

With regard to a bank's risks, size does indeed matter. Of course, small banks are also capable of entering into bad deals, of taking bad decisions and failing. However, if a small bank fails, the implications for the financial system are much less severe than if a bigger bank fails. In addition, they are likely for the most part to remain nationally or even regionally restricted. Small banks are not "too big to fail" and thus do not have an implicit guarantee by the state that they will be rescued; they therefore have from the outset less incentive to take particularly high risks. Supervisors should address these differences in their requirements. The principle of proportionality needs to be upheld.

3. Indirect impacts on smaller institutions

However, subsidiarity and proportionality notwithstanding, smaller banks should not complacently assume that the direct impact of the SSM on them will remain contained. It is quite conceivable that the change in the structure of supervision will also have indirect effects across the entire banking landscape. The road is clearly leading towards greater harmonisation – across all areas of the banking sector.

One example is the review of supervisory options and national discretions. European supervisory legislation still offers some 150 options from which supervisors can choose. And, at the national level, these options are actually being exercised in a multitude of ways. Of course, it sometimes makes sense to interpret rules against the background of national special features – but sometimes it doesn't. We therefore have to review all these options very carefully and keep only those options which truly reflect the peculiarities of various markets and banks, while allowing all others to expire. The ECB and the national supervisors have just begun their review of national options and discretions.

Even in the area of accounting standards, there are calls for further harmonisation. In mid-March the ECB adopted a new regulation on prudential reporting requirements for financial data. This regulation applies to all institutions not covered by the already-harmonised reporting requirements for IFRS institutions.

June 2017 is the final deadline, therefore, for all institutions which prepare their financial statements under German GAAP to submit their prudential returns on the basis of the ECB regulation. The ECB must generally also accept national accounting standards within the context of the SSM. Against this background, we will do all we can to ensure that German accounting standards continue to apply – barring any changes to the relevant legislation.

4. Conclusion

Ladies and gentlemen, the Single Supervisory Mechanism will have many advantages. It will allow all euro-area banks to be supervised at consistently high standards; it will make it easier to deal with cross-border problems; and it will mitigate the influence of national interests on banking supervision. On the whole, it will create a single European supervisory culture which will also cover those banks that are not directly supervised by the ECB. It will make the entire banking sector safer, and that will be good for all banks.

However, all supervisors and regulators do is create a framework. The market functions within this framework, and each individual bank has to hold its own in a competitive environment. There are therefore several challenges: the persistent phase of low interest

rates, which is putting pressure on profits; the trend towards digitalisation, which could fundamentally alter the structure of banking business; and more intense competition from new players in the market.

In view of the low interest rates, on 19 May BaFin and Bundesbank launched a second survey on German credit institutions' earnings and resilience in a low-interest-rate environment. This survey is important because it will give us an exact picture of the impact of various interest rate scenarios and short-term shocks. The survey will run until 28 June.

To sum up: not only the big banks, but also smaller institutions, will have to face the challenges presented by the market and the challenges presented by the Single Supervisory Mechanism for banks in Europe. The words of William Shakespeare are apt here: "The fault (...) is not in our stars, But in ourselves (...)."

Thank you very much.