Pentti Hakkarainen: Supervisory policies after the start of Banking Union – initial experiences and outlook for CESEE countries

Speech by Mr Pentti Hakkarainen, Deputy Governor of the Bank of Finland, at the ECB conference "CESEE – old and new policy challenges", Frankfurt am Main, 10 June 2015.

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Accompanying slides can be found on the Bank of Finland's website: Slides (PDF).

It is a great pleasure for me to participate in this conference here at the ECB. And I'm particularly pleased to speak to you about the first experiences gained of the Banking Union, which is the most important step in the European integration since the introduction of euro.

The recent crises have made it very clear that international, highly interconnected financial markets require a stronger institutional framework than what we have had in recent years. 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.

In response, the EU leaders agreed in June 2012 on creating the Banking Union which consists of three main pillars: (1) the Single Supervisory Mechanism and (2) the Single Resolution Mechanism and (3) harmonized deposit protection systems. The focus of this session is on the first pillar, i.e. on the new arrangements for the conduct of supervisory policies and actions.

The establishment of the SSM is not only a game-changer in the European financial market, but also very interesting and challenging from the perspective of the Nordic banking sector. As a euro area country, Finland automatically participates in the Banking Union. The Finnish banking market is integrated both within the Banking Union and across the Nordic area, with subsidiaries of large non-euro area banking groups playing an important role. Our banks are strongly connected to the other Nordic countries. We also have a highly concentrated banking market in European comparison.

My views will be given with this background in mind, plus the fact that, some years ago, I have worked as a banker in the private sector myself. In my intervention, I would like to highlight three points particularly.

First, we have gained a lot of information and valuable expertise.

The Comprehensive Assessment, as a precursor for the start of the SSM supervision, was instrumental in many ways – not only in ensuring the health of the banks to be taken under direct ECB supervision, but also in providing an intensive "prep course" for the SSM supervision.

The Comprehensive Assessment was a laborious joint exercise and generated a lot of useful experience for those involved. In Finland, and in other countries in which the assessment was carried out largely based on the existing staff of the national authorities, the exercise built up valuable human capital that bears fruit in the years to come – not to mention the fact that the assessment could be carried out with relatively low costs.

The exercise also made very clear from the beginning what the SSM supervisory model is about: joint work, using best local knowledge, with a clear lead by the ECB. The SSM operates as a system, gathering all the expertise of national supervisors and at the same time having a strong decision-making centre. The natural justification for the two-tier system is that local supervisors have an information advantage with respect to local banks. The centralised decision making is required to address cross-border issues and to minimise the risk of excessive forbearance on the part of local supervisors.

Common methods and processes, relying on an integrated and harmonised information base, have been – and are being – developed for carrying out SSM supervision. The SSM goes considerably deeper than the work of the EBA in adopting the Single Rule book and harmonising supervisory practices, also reflecting the different mandates of the two bodies.

The ECB's overall responsibility for supervision is matched by controlling powers over the system as a whole. The ECB has the power to overtake direct supervision of any bank or group of banks, if this is deemed necessary in order to preserve financial stability and confidence in the institutional framework. The centre monitors also that adequate supervisory quality prevails in national competent authorities.

Second, we are getting uniform rules and supervisory practices.

The SSM was established to ensure that strong supervisory standards are applied in a consistent manner across the euro area. We also needed the SSM to strengthen the confidence and resilience in the banking sector which has been shaken quite severely over the past few years. 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.

Moreover, it is expected that the SSM adopts a European approach to decision-making without any national bias. The ECB, as an established and strong European institution, is well placed to tackle the emergence of national interests in supervision. It is therefore imperative that the structures and the processes of the SSM support a European perspective and interests.

So, how does the SSM measure up in this respect? Joint Supervisory Teams, led by the ECB, have been established for carrying out the day-to-day supervision of significant banks. They integrate the ECB and national authority staff into single supervisory units. It is fair to say that full harmonisation in the supervisory approach has not yet been reached, but significant progress can already be observed. Going forward, the work on establishing clear principles and criteria to guide SSM supervisory decisions needs to be further prioritised.

As regards the elimination of national biases in supervision, in my view, the functioning of the SSM so far points very clearly to this direction. In fact, in the current global banking environment, it may be better to aim for a level playing field internationally and enhance competition in the national market than look after the interests of domestic banks. Frankly speaking, the elimination of the old habit of defending one's "national champions" may turn out to be more challenging in the crisis resolution pillar of the Banking Union than in bank supervision.

Third, the preconditions for the ECB to be a world-class supervisor are in place.

The SSM aims at adopting best supervisory practices to conduct high-quality supervision with no biases. The SSM, as a system, has the necessary skills and resources to live up to the high expectations placed upon it. It is a strong, independent and multicultural supervisor with the ability to attract highly skilled staff.

The participating national authorities get all the information and take part in all supervisory decisions. Particularly the smaller national supervisors benefit from the SSM, since on their own they would not be able to participate in all relevant work in an increasingly complex world. Through the SSM, they stay up-to-date and can take part in regulatory developments at the global fora. I am convinced that the SSM will soon establish itself among the leading global banking regulators with high demand for its best practices.

Obviously, as with any new institution, getting up to full speed will take some time. Among other things, the increased demand for skilled supervisors needs to be matched at the SSM area, and there are a number of practical issues related to day-to-day supervisory work, including language issues, yet to be fully ironed out.

As a conclusion, let me recognise the very good progress made in SSM supervision and Banking Union more generally. The Banking Union corrects a basic imbalance we had between nationally fragmented supervision and internationally integrated banking markets. And in doing that, national interests, and I would argue that banks' interests as well, are taken care of while matching regulatory and supervisory institutions with the reality of banking business.

We now have a structure which for the first time in the history of the European Union will allow the supervision and resolution of banks to be based on a European mandate. By pooling a part of the national sovereignty, weak when separate, strong when united, the countries belonging to the Banking Union have gained access to the European level decision making in the key areas of supervision, crisis resolution, as well as in the regulation of banks.