Miroslav Singer: European Supervisor Education Initiative "Financial supervision in Europe – on the right track?"

Dinner speech by Mr Miroslav Singer, Governor of the Czech National Bank, at the ESE Conference 2015 "Financial supervision in Europe – on the right track?", Prague, 1 October 2015.

* * *

Good evening ladies and gentlemen,

I am honoured and delighted to be here with you today to share my views on whether prudential regulation and financial supervision in Europe are on the right track. My opinions are based on the Czech National Bank's long and direct experience of supervising the Czech banking sector. I'd like to emphasise that our banking sector was hardly affected at all by the financial crisis. Our banks have consistently been posting high profits in recent years, so recapitalisation has not been on the agenda. This allows me to maintain the necessary detachment when observing current developments in financial supervision.

I believe that three major trade-offs are encountered when developing regulations.

1. A trade-off between the costs and benefits of implementation.
2. A trade-off between complexity and clarity.
3. A trade-off between growth and safety.

Often only the first one, between costs and benefits, is discussed. Mostly lip service is paid to the second one, the trade-off between complexity and clarity. And the third one, between safety and growth, is ignored in many cases. I will deal with all of them in what follows.

In our day-to-day work, be it the preparation and implementation of European regulations or the actual performance of supervision, we run into the problem of overcomplicated and unclear regulations. The modern theory of law accepts that laws conflict. I believe we reached this point in regulation long before the Great Depression. We have made no secret of the fact that we believe the weaknesses in the European banking sector laid bare by the financial crisis should be dealt with by enhancing supervision, i.e. its processes, institutions and culture, rather than by adding more regulations or hastily changing the existing ones.

Yet the regulatory whirlwind we are currently experiencing is far from over. This naturally gives rise to a number of questions. Can we be sure that such regulations will not generate even more problems? How will institutions cover all the costs of implementing the changes to all the regulatory requirements, costs which, even worse, are often hard to predict? Might a situation arise where all financial institutions have implemented CRD, CRR, BRRD, MREL, LCR, NSFR, leverage and so on, but still have little prospect of making the profits demanded by investors? Might the incentive to do business in the banking sector be weakened? Are we contributing to a shift of business not only outside our countries, but, more dangerously, outside the regulated market?

These fundamental questions are not prompted solely by the recently adopted or planned regulatory changes. We also have doubts about the existing deposit insurance system of full cover up to EUR 100,000 adopted at the start of the financial crisis. At the time, this measure certainly helped calm the public and prevent runs on banks. However, we feel that the time has come to consider a return to normal, to reintroduce the system where depositors are not fully covered, at least with respect to non-SIFI banks.

I think the question that forms the title of this conference is very topical and relevant. We believe that the time has come to pause and try to discuss these issues seriously.

As to costs, supervisory authorities are also incurring high costs. On the European scale, we are recruiting hundreds of new employees to be able to meet the challenges of applying the new regulations. Mandatory impact assessments have been introduced, but these often sound like unconvincing or formal justifications for a result known in advance: “There will be costs, but the benefits will outweigh them in the long run”.

As to complexity, we have plenty of evidence that the current sectoral approach to regulation does not make our life as supervisory authorities any easier. We are often creating three parallel but materially identical sets of basic requirements for banks, insurers and investment firms. It would be simpler to have just one set of basic licensing requirements, one set of basic requirements for general managerial skills and one set of basic requirements for the trustworthiness of senior officers for the entire financial market. We would welcome a single, universally applicable set of assessed functions and requirements for sound internal control systems. Examples could include harmonised basic requirements for outsourcing and for the distribution of own and third-party products.

It is impossible, of course, to unify all requirements across the financial market. However, the basic set could, or even should, be unified. Even if we succeeded in harmonising only one-third of all the requirements, the quantity of regulations would decrease sharply. This would substantially reduce the load on financial institutions, which are currently struggling with inconsistencies in the sectoral regulations applying to financial groups and with the sheer number of such regulations. It would also be of great benefit to supervisory authorities. The necessary sectoral specifics could then connect to this single common base.

Let me make one last remark on safety versus growth. In recent years, we have witnessed on numerous occasions just how diverse the impacts of financial sector problems can be on national economies. Generally speaking, the greater the depth of financial mediation, the larger the relative size of the banking sector in the economy and the higher the level of private sector debt, the more vulnerable the economy, the greater costs of any financial crisis and thus the higher the ensuing requirements as regards quality of banking regulation and strictness of supervision. Therefore, effective prevention of financial crises is an increasing priority for economic policy makers of countries with greater depth of financial mediation. Still, the depth of financial mediation differs systematically, for example, between the founders of the EU and recent entrants. For example, in the case of the Czech Republic, if the worst comes to the worst we can revoke the licence of a major bank, take its liabilities onto the government balance sheet and sell its viable business, as we have done in the past, without increasing our government debt-to-GDP ratio above two or three hundred per cent, provoking a sovereign debt crisis and starting the vicious circle known to many European economies. Most developed European countries do not enjoy such freedom. On the other hand, many segments of our financial industries are still underdeveloped and their space for growth is rather high. I do not believe we have reached the point at which one should question the benefits to the economy of increasing the depth of financial mediation. Flexibility within a more unified and integrated framework of financial regulation should allow different countries to choose – within some limits preventing significant cross-border spillovers – different trade-offs between safety and growth of their financial industries and economies in general.

This conference gives everybody room to think. Let’s make the most of it. Europe needs sound businesses, but sound businesses, in turn, need a stable and predictable financial and regulatory environment. Let’s do all we can to foster such an environment.

Thank you for listening. Have a great evening and enjoy the rest of the conference.