Mario Draghi: One year of ECB banking supervision

Speech by Mr Mario Draghi, President of the European Central Bank, at the ECB Forum on Banking Supervision, Frankfurt am Main, 4 November 2015.

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Ladies and gentlemen,

Back in 2012, when it was decided to establish a single supervisory mechanism (SSM), many a critic claimed that either it was impossible, or that it would take forever. And yet here we are, marking the first anniversary of the SSM with this conference, reflecting no longer so much on the structure of supervision, but on its content.

Now, the critics tell us that other necessary improvements to the institutional architecture of the euro area, and of the EU, are either impossible, or will not happen during our lifetime. You will forgive me for not being convinced.

The establishment of the SSM was neither the start, nor the end of the suite of institutional reforms that we must undertake to restore in Europe the stability that is the premise for a return to prosperity. But it was a crucial step and in many ways it was the key to going further.

Let me put the SSM’s significance in a broader perspective:

In the early years of the euro, we lived under the illusion that we had established a full-fledged monetary union. There can, however, only be a single money if there is a single banking system. For money to be truly one, it has to be truly fungible independent of its form and independent of its location. In particular, deposits, which are the most widespread form of money, have to inspire the same level of confidence wherever they are located.

To ensure that deposits are truly as safe everywhere across the euro area, the likelihood that a bank fails has to be independent of the jurisdiction where it is established. Resolution has to follow the same process in the event that a bank fails. And, when push comes to shove, depositors must be afforded similar protection wherever they are located.

Fundamentally, this was and remains the agenda of Banking Union. And it is why Banking Union was conceived with three pillars: a single supervisory mechanism, a single resolution mechanism, and a uniform deposit insurance scheme, which remains to be specified. For money to be truly one, we need all three. Supervision had to come first, not because it was the easiest to establish, but because it was the necessary condition to proceed with the other pillars of Banking Union.

That the SSM was established at the ECB owes much to circumstances. There are benefits in the current set-up, but that was not of vital importance. What was of absolutely vital importance, however, is that the SSM was established. In a fiat money system with fractional reserves, sound and uniform supervision is essential to there being a sound and single money.

It is now high time that these other aspects of banking union are also completed. Otherwise, we would make the same mistake that was made when the euro was introduced. Back then the consequences of having a single currency were not fully reflected in the Union’s institutional design. Internal inconsistencies made our union much more vulnerable than it needed to be when an external shock hit it.

If the SSM is of great importance to the singleness of money, it is also greatly important to the singleness of the market. The single market is, as the euro, a central and irrevocable creation of the European Union. But, as is the case for the euro, its irrevocability, to remain unquestionable, needs being buttressed by appropriate and credible institutions.
The SSM is one such institution. And that is why it was – and remains – open to participation by countries which are not in the euro area.

Before the crisis, the free passporting of banking services across borders relied on the principle of home supervision, host recognition. This principle, however, requires equal standards of supervision across borders, and mutual trust in the quality of supervision. That trust did not always stand the test of the crisis. A single supervisor, applying homogenous methodology across institutions, internalises mutual trust. Its establishment was thus one answer, and certainly an effective answer to this challenge. A single supervisor builds trust not only between supervisors, but also with shareholders and other stakeholders, including the fiscal authorities that, in the past, were too often assumed to be the shareholders of last resort of their national financial system.

The importance of the SSM to uphold the single market serves as a reminder that the objective of having a robust supervisor is not just to make banks safe. The objective is to make banks safe so that they can safely access resources and use them to fund innovation, investment, and growth. Similarly, creating a single supervisor was not an objective per se. But it was necessary so that the integrity of the single banking market is not questioned.

What I have said of banking can be extrapolated to other areas of finance, which is one reason why, alongside Banking Union, the Capital Markets Union, championed by Commissioner Hill, also needs to be implemented fully and as quickly as practical.

I am not saying “as quickly as practical” for no reason. If we want to restore in Europe the stability that is the premise for a return to prosperity, we need to consider the economic costs entailed by recurrent uncertainty over the operating environment of European firms. Not only does it cause a loss of growth today, but by impeding investment, it may also weaken our potential in a more lasting way. Increasing the horizon of visibility is desirable generally, but it is true that an apparently never ending train of reform is not greatly conducive to reducing uncertainty.

There is a simple solution to that: specify what we want to change, clarify the calendar to do it, and then just do it. This is exactly how the SSM was established. And that is perhaps the last area of significance of the SSM that I have not yet mentioned: it is the yardstick against which we can now judge other achievements.