Sabine Lautenschläger: Single Supervisory Mechanism – Single Supervisory Law?

Keynote speech by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism, at the workshop of the European Banking Institute (EBI), hosted by the European Central Bank, Frankfurt am Main, 27 January 2016.

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Ladies and gentlemen,

Thank you for being here today to participate in the first conference of the European Banking Institute (EBI). It is a great pleasure for the European Central Bank (ECB), and for me personally, to host this conference. We look forward to fruitful discussions and exchanges – not only today, but also in the future.

The EBI is a very new undertaking – it was set up just at the end of 2015 as a counterpart to the Single Supervisory Mechanism (SSM) in the academic world. It represents a network of universities that extends across national borders, and we hope that it will eventually encompass the entire euro area. It should provide a good opportunity for academics and practitioners to meet regularly to exchange views on issues around supervisory and banking law.

Will it be difficult for us to find topics for these in-depth discussions? I don't think so! After one year of "living the SSM", I can assure you that we have more than enough legal topics to discuss and enough difficult questions to answer!

The advent of banking union has brought with it a myriad of legal questions with a unique European perspective. I would therefore like to open the discussion by raising a legal issue in my speech today.

The crisis in the euro area has taught us many lessons. And among these, a fundamental one might be this: a single European currency requires a European banking supervisor. In the euro area, we cannot have 19 different national banking supervisors; we need a single supervisor that transcends national borders. Only then can we avoid national bias in the regulatory and supervisory treatment of banks; only then can we improve risk-sharing in the euro area; only then can we ensure a level playing field where the general principle of "same business, same risks, same rules" applies; and only then can we guarantee a proper transmission of monetary policy.

Establishing European banking supervision has been a significant step towards a more integrated European banking system. Throughout the entire euro area, the SSM provides tough and fair-handed banking supervision by using the entire range of supervisory discretion to establish a harmonised, risk-orientated and proportionate supervisory approach. At the same time, it contributes to the Single Market by levelling the supervisory playing field for all banks, while acknowledging the boundaries of national law.

Nevertheless, banking supervision is just one side of the coin; the other is banking regulation. A truly single supervisor requires a truly unified regulatory framework. Banking supervision can only be as harmonised as the rules and regulations that govern it. And against that backdrop, the regulatory playing field in Europe is not as level as it should be.

Out of kilter – supervisory and regulatory harmonisation in Europe

Now you may ask: "hasn't much been done already to harmonise the regulatory framework?" And the answer, most certainly, is "yes". Much has indeed been done to harmonise regulation, both in Europe and worldwide. Just think of Basel III and the single European

rulebook. Particularly in Europe, the European Commission and the European Banking Authority (EBA) have also contributed to a harmonised regulatory framework by adopting Regulatory Technical Standards and by issuing guidelines and opinions. However, these attempts have not been sufficient to fully erase national differences.

Take the Capital Requirements Directive (CRD IV) for example. As this is a directive, Member States are free to choose the form and method of implementation. Consequently, not all Member States opted for a word-for-word transposition of the relevant norms. Several provisions of CRD IV have been transposed differently across the euro area. This is certainly not a problem in itself as long as the differences are rooted in country-specific risks.

But then there are many unjustified differences. Let me give you an example: as you know, members of banks' management bodies have to fulfil "fit and proper" requirements. And here, we see very diverse rules across Europe. In some countries, for instance, the supervisor assesses not only appointments of members of management bodies, but also appointments of "key function holders". As regards the fit and proper assessment itself, there are further differences: some national authorities make use of questionnaires to be answered by the candidates, others do not. Some national authorities conduct face-to-face interviews with new members of the board, others do not. In some countries, there are timelines for conducting the fit and proper assessment with specific, rather short deadlines, whereas in others there are no such timelines. Even the criteria for assessing the suitability of candidates are implemented and interpreted differently across the various euro area countries.

Another source of regulatory fragmentation is the supervisory powers under national law that are not explicitly mentioned in CRD IV. This concerns, for instance, major transactions which can be very relevant for the risk profile of a bank: for example, a bank acquiring a non-bank, or mergers and de-mergers involving a bank or transfers of assets. In some Member States, these transactions need to be approved by the competent authority (and rightly so), in others they do not.

And such regulatory fragmentation is not just a legacy we inherited from former times. Even today, there are cases where fragmentation is actually being increased. In some countries, national legislators are converting non-binding supervisory practices into binding legal acts, thereby making it harder for the ECB to harmonise these practices. A recent example is the German law on bank resolution. This law delegates to the Ministry of Finance the power to issue regulations in areas such as internal governance and risk management.

Consequences of an imbalance between supervisory and regulatory harmonisation

The regulatory landscape in Europe is still fragmented. And from my point of view, many variations in national legislation can no longer be justified now that we have European banking supervision.

Imagine being a referee in a football match; your main task is to administer the rules of the game. But what if the individual players adhere to different rules? In such a game, you as the referee would be forced to apply different rules depending on the player in question. You would have to judge similar situations in a dissimilar way – a foul by one player might warrant a penalty kick; a foul by another player might not.

In a sense, the SSM is that referee. Article 1 of the SSM Regulation requires the ECB to carry out prudential supervision "with full regard and duty of care for the unity and integrity of the internal market". The Article also refers to the "equal treatment of credit institutions with a view to preventing regulatory arbitrage". A fragmented regulatory framework makes it difficult for the ECB to meet these requirements.

In extreme cases, we are faced with 19 different legislations. And in many cases, we indeed have to judge similar situations in a dissimilar way. Taking decisions under such

circumstances is complicated and time-consuming. It requires substantial resources and is at odds with the idea of having a single European supervisor and a Single Market in banking.

In cases where national legislation goes beyond CRD IV, regulatory fragmentation also raises complicated legal questions: what powers does the SSM have in applying national law that goes beyond European norms?

Under Article 4(3) of the SSM Regulation, the ECB must apply all relevant EU law. And where EU law is composed of directives, the ECB has to apply the national legislation transposing those directives. The question is therefore: what does "transposition" mean? Does it just cover national provisions that strictly implement CRD IV word for word? Or does it cover any national provisions that are rooted in CRD IV?

In the context of our football match, these two cases might be compared to the following situation. The general rule – i.e. "CRD IV" – would be that a foul in the penalty box would require a penalty kick. Now there might be some players for whom an additional rule would apply: if they were to commit a foul in the penalty box, they would also immediately be handed a red card. That rule would go beyond a strict implementation of CRD IV; but it would still be rooted in it, in the sense that a foul in the penalty box requires sanctions.

So, depending on the interpretation of "transposition", two supervisory approaches might emerge. The first approach would render the ECB directly competent to apply national legislation. The second approach would require it to apply national legislation indirectly by issuing instructions to national authorities – which, of course, then raises the question of who would be held responsible if such an instruction were to lead to a legal decision by the national competent authority?

In my view, the first approach – the direct competence of the ECB – might be warranted when two conditions are met. First, when the power in question falls within the tasks conferred on the ECB under Articles 4 and 5 of the SSM Regulation. Second, when the power in question is linked to relevant EU law: that is, the supervisory framework as defined, in particular, by relevant EU directives and regulations, such as CRD IV, the Capital Requirements Regulation, and the Bank Recovery and Resolution Directive. In any case, we need a consistent approach towards applying national legislation that goes beyond European norms.

Returning to our football match, fragmented rules clearly pose a problem for the referee. But they are also a problem for the players and for the game itself. Banks in the euro area still do not compete on an entirely level playing field. They might have to implement different regulatory regimes for group entities in Member States with different national legislation. This is certainly at odds with the idea of having a banking union.

Certainly, much has been done to harmonise regulation – through the single rulebook, through the work of the European Commission and the EBA, and through the ECB's work on options and national discretions, for instance. Nevertheless, the Single Market for banking is still divided by differences in national legislation.

And as I mentioned before, in some cases, new differences are being created right now. With regard to newly minted national laws, I would therefore like to state this: national banking legislation adopted after the establishment of the SSM should facilitate the exercise of the SSM's responsibilities – and that includes the ECB's capacity to enhance the consistency of banking supervision across the SSM. In any case, Member States should balance the alleged benefits resulting from converting non-binding guidelines into binding legal acts against the objectives of the banking union.

Conclusion

Ladies and gentlemen, I have made the point that the regulatory playing field in Europe is not as level as it should be. And I have argued that this state of affairs hampers the work of

European banking supervision, that it is at odds with the objectives of banking union, and that it inhibits the establishment of the Single Market.

To me it is obvious that we have to level the regulatory playing field. Nevertheless, this is certainly an issue for legislators and not for supervisors. And national laws are the prerogative of national law-makers.

But still, we have to acknowledge that circumstances changed when the SSM came into play. There is now an imbalance between the harmonisation of banking supervision and banking regulation. In order to fully exploit the potential of the banking union, and to reap its benefits, we should restore that balance.

The De Larosière report, published in 2009, provided a blueprint for harmonised banking regulation and supervision in Europe. On Page 49 of that report, the authors state that "there is no point in converging supervisory practices, if the basic financial regulations remain fragmented". I fully share that view and I urge legislators to reassess the necessary degree of regulatory harmonisation against the backdrop of the European banking union.

Thank you for your attention.