Sabine Lautenschläger: Taming the fire

Statement 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 Credit Risk 2017 forum, Vienna, 23 March 2017.

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Theodore Roosevelt is supposed to have said: “Risk is like fire: if controlled it will help us; if uncontrolled it will rise up and destroy us”. I think that describes quite well the modern financial world and its risks. Managing financial risks is a bit like controlling a fire.

It’s the job of chief risk officers, the CROs, to constantly remind decision-makers about the “fire safety rules”.

The recent financial crisis showed how important that job is. It’s a job that requires CROs to be steadfast and to speak unpleasant truths from time to time – just like banking supervisors have to do.

It’s regulation that helps us to do our job. Regulation seeks to control risks as well. Following the devastating “fire” of the financial crisis, we have overhauled the rules for banks. We have mended them, strengthened them, and expanded them.

That was the correct and necessary thing to do. But now it is time to finish the job. More than eight years after the crisis, banks need regulatory certainty.

But the job needs be finished at the global level. The financial system is global and so should be the rules that govern it. You cannot enjoy fresh air on your patch of land while there is a fire raging on your neighbour’s – sooner or later the wind will blow smoke and sparks over the fence.

Against that backdrop, I welcome the fact that, last weekend, the G20 have confirmed their support for the work to finalise Basel III.

But there are still some voices who question the general extent of the regulation. To be crystal clear: it would be wrong to soften the rules. This would just prepare the ground for the next crisis.

I cannot deny, though, that rules put a burden on those who have to comply – the banks, that is. In that regard, it is often claimed that the burden on banks translates into a burden on the economy.

It’s said that banks could no longer pursue their traditional business because the capital requirements are too strict. It’s also said that new business models would not make economic sense because of the regulatory cost. All that would hurt the economy.

There are two things I can say in response.

First, I do not see that regulation keeps banks from their traditional business of financing the economy. Loans to private households and smaller companies are treated very favourably when it comes to capital requirements. Think of the support factor in Article 501 of the Capital Requirements Regulation. This factor was introduced to facilitate the financing of small and medium-sized enterprises.

I also do not see that regulation keeps banks from developing new business models – those, for instance, that follow from digitalisation.

Second, critics neglect the benefits of strong rules. Strong rules prevent crises, and crises hurt the economy.

At the end of the day, it is only well-managed and well-capitalised banks that are able to finance the economy – even when the going gets tough. They can finance the economy throughout the entire business cycle.

Poorly capitalised and poorly managed banks, on the other hand, cannot support the economy during downturns – they get into difficulty themselves. Strong rules therefore help the economy in a sustainable way.

And even if we only consider the banks, we still see benefits. Stronger rules increase trust. And as a result of the crisis, a great deal of trust was lost. And that's a problem for banks because trust is a crucial asset for them.

Trust has a positive impact on funding costs for banks, and it determines how attractive a bank is for business partners who think long-term.

Strong rules thus help the banks, too.

Altogether, I am convinced that the benefits of regulation are greater than the costs. But rules can only take us so far.

Ultimately, it is people who make good or bad decisions. And this is where banks' risk managers come into play. They are the first line of defence against excessive risks.

Thank you for your attention.