Sabine Lautenschläger: European banking union - the place to be?

Speech by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the European Central Bank, at the Biannual high-level networking seminar on economic and financial issues, organised by Danmarks Nationalbank, Copenhagen, 14 May 2018.

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"Getting to Denmark" has become a catchphrase among those who study how societies and economies develop. And indeed, for many countries around the world, Denmark is the place to be – or rather the place to become. After all, Denmark stands for a stable democracy, sound institutions and a strong economy.

And that's not all. Denmark also stands for happiness. The United Nation's world happiness index shows that, on top of all this, Denmark is also home to a very happy people. This has not gone unnoticed; indeed, there are many who strive to follow your example. Your idea of hygge has become a huge trend in countries as close by as Germany and as far away as the United States.

So on many counts, Denmark is the place to be. And I for one am very happy to be here today. But I'm not here to talk about Denmark. I am here to talk about Europe, or rather the European banking union. In my remarks, I will argue that the banking union is also the place to be.

Its beginnings, though, were not exactly hyggelig. In 2012, things were not going well in the euro area. Banks were ailing, some governments were struggling to obtain the funding they needed, markets were in turmoil, and there were fears that the euro area might eventually break apart.

Well, it didn't break apart. In fact, the crisis triggered a chain of reforms, and these reforms have made the euro area more stable. One of the boldest steps was taken at the peak of the crisis. On 28 June 2012, EU leaders decided to move towards a European banking union.

And move they did. Two years, four months and six days later, they had turned their political pledge into reality. On a rainy day in November 2014, banking supervision was taken to the European level. Another year later, the same was done for bank resolution. And there is an ongoing debate about whether and how all this should be supplemented with a European deposit insurance scheme. In my view, it should be, and I am certain that, at some point, it will be.

From the start, the banking union has covered the entire euro area. But its boundaries are not set in stone. The banking union is not an exclusive club; it is not limited to those countries that share the euro as their common currency. In fact, any EU country can join the banking union through an arrangement known as "close cooperation". I know that many in Denmark are very much aware of this. But, as I said, I'm not here to talk about Denmark. I am here to talk about the banking union.

The place to be

So what's the point of the banking union? Why did policymakers feel the need to take banking supervision and resolution from the national to the European level? What benefits does it offer to its members? Well, the easy answer is that it allows us to gather some of the high-hanging fruits – fruits that are out of reach from the national level.

Let me give you an example. In politics they say: he who knows only one country knows no country. The same can be said about banks. The more banks a supervisor covers, the more they can learn about each of them and, thus, about all of them. They can compare, and they can benchmark.

And European banking supervision does cover a lot of banks, many more than any national supervisor. Instead of covering just one global systemically important bank, for instance, we cover eight of them. This helps us to understand much better how these gigantic banks work, what standards and best practices they apply for different business lines and where special risks might be hidden. We do this, for example, by comparing how they set up their risk management and their governance to deal with cross-border issues. The same applies to banks with unusual business models such as specialised lenders. All in all, our broader comparative reach helps us to know and assess all the banks better and thus supervise them better.

And we also benefit from our broader view when we analyse horizontal issues. A lack of profitability is one of these issues. Here, we can pool insights from a large sample of banks, and this improves our analysis. And it’s the same with other issues, such as governance, cyber risks and the use of internal models. These models in particular are notoriously difficult to supervise, so a broad yet in-depth knowledge of industry standards and practices comes in handy.

But it’s not just that we benefit from a broader view. We also benefit from a broader set of views. Supervisors from across Europe work together day in day out, pooling their knowledge and their different experiences. And at the end of the day, it is the ECB’s Supervisory Board and its Governing Council that take decisions. In other words, each decision reflects the views and opinions of 26 national supervisors from 19 countries. There is less room for national bias and less room for supervisory capture.

Finally, we benefit from economies of scale when it comes to employing specialists for certain topics. If you supervise just a handful of banks, it might not be efficient to have specialists for each and every topic. But if you supervise the 118 largest banks in the euro area, it does become efficient. This is another huge advantage of European banking supervision.

In short, supervising banks at the European level takes us a long way towards making banks safer and sounder. And in my view, it takes us further than purely national supervision. But I would like to clarify one thing that is often misunderstood. The best supervisors in the world cannot guarantee the success of each and every bank. Banks compete in a market. Some will do well and thrive; others will do less well and fail. They will make way for better business models, for stronger banks.

What I want to say is this: sometimes banks just have to fail. And when that happens, the European resolution mechanism kicks in, the second pillar of the banking union. It ensures that banks can fail in an orderly manner.

And here too, the European approach has many benefits. Let me mention just two of them.

First, over time, the European resolution mechanism will gain much more experience than national mechanisms. Why is that? Well, for the simple reason that it covers a much larger pool of banks and so, statistically speaking, will have to deal with a larger number of banks exiting the market.

Second, there is the Single Resolution Fund, which can step in under certain conditions to carry some of the costs of bank failures in order to support financial stability. Since it is a European fund, it has much more firepower than any national fund. And that firepower would be even greater if a common backstop for the Single Resolution Fund were to be set up. In my view, that should be done as soon as possible.

To summarise, European banking supervision allows us to take a broader view, which gives us deeper insights and improves our analysis. At the same time, there are more views around the table, which helps to counter biases, including national ones, and leads to better decisions. Banking supervision improves. And if a bank should fail, European resolution helps to deal with this in a way that preserves financial stability and saves taxpayers money.

So, the banking union stands for more stability. It might thus enhance the trust markets have in banks, which in turn might lower funding costs.

But there is more to it than that. The banking union also stands for consistency. We have harmonised many of the tools that we supervisors use, most notably our main tool, the Supervisory Review and Evaluation Process. So when we supervise banks, we apply the same high standards across the entire euro area. And when systemic banks need to be resolved, this too is done in a consistent manner.

In other words, the banking union helps to level the playing field for banks in the euro area in terms of supervisory practices and approaches. When banks operate across borders, they do not need to adapt to 19 totally different forms of supervision, for instance. At the same time, they can engage in fair competition. They need not fear that their competitors have an edge just because supervisors in another country are more relaxed. And they can be sure that their business partners are as well supervised as they themselves are.

So, the playing field has become more even, which is essential if we are to achieve a truly European banking market. And that is our vision: a banking market that seamlessly covers the entire banking union; a market in which banks can offer their services to customers from all over Europe; a market in which they can compete on even ground. The benefits of such an integrated market are well known: it is more efficient, it is more innovative, and it is better able to support growth. This is true for the entire union as well as each country.

Are we there yet?

As I said, this is the vision. But are we there yet? No, not quite, but we are getting closer. The banking union has brought its members closer together; it has lowered some of the barriers that were standing in the way of a potentially seamless market. But it has not entirely removed them.

While supervision has been harmonised, the regulatory framework in Europe remains somewhat fragmented. And this applies not just to minor details but also to big things. It runs counter to the idea of a single market and fosters regulatory arbitrage; and it violates the principle of same business, same risks, same rules. Every day we supervisors struggle to maintain the equal treatment of banks that have to comply with different rules even though these differences are not justified by national specificities with regard to risks.

That said, where we do have scope to act, we have made use of it. We have, for instance, agreed to exercise options and discretions contained in European law in a harmonised manner. This was a huge step, but more could be done. That, however, is up to the legislators. And there are indeed a few areas where further harmonisation would help the single market to progress: the fit and proper assessments of banks' board members, the liquidation of banks, large exposures and the supervision of branches of non-EU banks.

Now, don't get me wrong: what has been achieved so far is truly remarkable. No large reform project has ever been perfect from the start, so it is only natural that more remains to be done. And it is worth putting our achievements into perspective. A lot has been done in a short time.

The banking union is a project that is unprecedented in scope and scale. Just look at its first pillar, European banking supervision. It involves 26 authorities from 19 countries plus the ECB. This sometimes prompts questions about how efficient it can really be. Did we, in the end, just build a huge and overly complex bureaucratic machine?

Well, I'm not giving away any secrets if I tell you that it is kind of complex. And to countries that are thinking about joining the banking union through close cooperation agreements, it might look even more complicated.

In order to take a decision, we have to follow a finely balanced procedure. One of the reasons is that two bodies are involved which have to interact in a careful manner. The first one is the ECB's Supervisory Board, which brings together the ECB and all the national supervisors. The second body is the ECB's Governing Council; it brings together all the national central banks and acts as the ultimate decision-making body.

While both bodies play a role when it comes to taking decisions, they are, at the same time, subject to what is known as the separation principle. This principle was put in place to deal with potential conflicts of interest between monetary policy and banking supervision. It does so by ensuring that these two functions of the ECB remain independent from each other. You can imagine that this results in a complex set-up.

In very broad terms, first the banking supervisory arm of the ECB prepares draft decisions, then the Supervisory Board approves and submits these draft decisions to the Governing Council. If the Governing Council does not object to a draft decision, the decision is adopted. But even if the Governing Council does object, it cannot change the decision, but has to send it back to the Supervisory Board, which can either change the decision or call upon a mediation panel to resolve the difference of opinion.

I can see that countries which join the banking union from outside the euro area might have some concerns. While they would have their seat on the Supervisory Board, they would not have a seat in the Governing Council. So, would they lose control over decisions that might directly affect their banks? Well, that would certainly not be in the spirit of the banking union. There are thus safeguards to avoid just that.

Let me give you an example. If the Supervisory Board drafts a decision which affects a member from outside the euro area, and if that member disagrees with the decision, it can formally state its objection. Thus, the Governing Council is made aware that there are diverging views and has to take them fully into account.

Now, what if the Governing Council objects to a draft decision, and the affected country does not agree with the objection? In such a case it could, for instance, call upon the mediation panel to resolve the issue.

What I want to say is this: if a country from outside the euro area were to join the banking union, its voice would be heard at all stages of the decision-making process. And the other thing to note is this: so far, not a single draft decision made by the Supervisory Board has been challenged by the Governing Council.

But I admit that the decision-making process is complex. This, however, does not limit our ability to take decisions. In 2017 alone, we took a total of 2,308 decisions. On average, that amounts to more than six decisions a day, weekends included. So if something needs doing, it gets done.

Ladies and gentlemen, the banking union is the place to be. There is a lot to be gained from going there. And if those who come bring along a stable and resilient banking sector as well as a tradition of strong banking supervision, the gains will be mutual.

But let's be honest. As any economist will tell you, there's no such thing as a free lunch. Surely all this must come at a price? Well, in my view, the price of being a part of the banking union is low compared with the benefits it offers.

Is it a free lunch?

If you are part of the banking union, you need to share. You need to share control over banking supervision and resolution. That is the price to be paid. Now, I understand that it is often seen as vital to have total control over sensitive policy areas. And I understand that there is a feeling that if you want something done well, you must do it yourself.

But is that really true? I don't think so. If we work together, we are still in control and we can still do things well. The history of the EU is a case in point. When European countries signed the Treaty of Rome 61 years ago, they chose to work together instead of working alone. Today more than ever, this choice is also a reaction to a changing world. Some of the current changes are beyond any single government's control, and are better managed with the help of strong allies and good friends.

The world of banking is no exception. Our financial systems have grown closer together and have become much more complex than they used to be. Large banking groups now cover many Member States. We have all benefited from this. But if we want this trend towards integration to continue, we must make sure it does not come at the cost of greater instability and more crises. We need rules that apply across borders just as banks operate across borders. And we need supervisors who have the power to see and act across borders. In short: we need to cooperate.

And when I say cooperate, that's what I mean. I know that some may think we have created a system in which the ECB and the Single Resolution Board hold all the power. I think otherwise. The banking union is very much a joint project.

Just look at banking supervision. We at the ECB cannot act alone. Instead, we work closely together with the national supervisors. We also rely on their national expertise, and we rely on their experience. After all, they know a lot about the local circumstances, such as specific covered bond frameworks. Without them, European banking supervision would not work. In my view, working together, and placing our trust in each other, is a small price to pay for a safe and sound banking sector.

And in the end, sharing control does not mean losing control – it may even mean the opposite. As members of the banking union, countries might actually gain control and influence. Together, they may be able to shape policies and rules which have an impact beyond the banking union itself. And they can also contribute to discussions at the global level, such as those of the Basel Committee on Banking Supervision.

So, within the banking union, we share control over banking supervision. But the quest for a stable financial system does not stop there. It is crucial for financial stability that each bank is as safe and sound as it can be. But this alone is not enough. The health of each bank is not sufficient to ensure the health of the system. Things are a bit more complicated than that. When it comes to financial stability, the whole is more than the sum of its parts.

If we want to limit risks in the whole system, we must do more than just monitor each part in isolation. We must cooperate. Microprudential policy, which addresses risks in individual banks, interacts with macroprudential policy, which aims to address risks in the whole system.

In both micro- and macroprudential policy, the national and European levels must work in tandem. And in the banking union, they do. While it is the national authorities that take decisions in the first place, it is the ECB that assesses these decisions.

And if it sees a need to take stronger measures, it can do so; it can "top up", as we say. For this to happen, the ECB's Governing Council would act on a proposal from the Supervisory Board. So, the Supervisory Board is again strongly involved. In addition, the Supervisory Board and the Governing Council meet regularly to discuss macroprudential issues. Again, everything is done to avoid a situation where a Member State disagrees with a decision taken by the Governing Council.

Now, in order to work together, we must apply common standards and approaches. As I have already said, I see such harmonisation as a major benefit of the banking union. It helps to level the playing field, and it ensures strong and consistent supervision.

But I know that some see this from a different angle. They feel that harmonisation is more of a threat than a benefit. They fear that it will lead to a uniform banking sector, which leaves no room for diversity – either for banks, or in terms of supervision and regulation.

Well, we do aim to achieve a level playing field. But we do not seek to flatten the landscape. We do take into account country-specific circumstances that warrant specific supervisory treatment.

And this is the case not only when we act as macroprudential overseers, but also when we act as microprudential supervisors, in particular when we assess the business models of banks. Here, we are even bound by law to "have full regard to the different types, business models and sizes of credit institutions".[1] We understand the value of diversity, and for good reason.

Imagine that all banks had the same uniform business model. What would that do to innovation? What would happen to progress? And, equally importantly, what would it mean for financial stability? If all banks had the same business model they would all be exposed to similar risks. If that model was faulty, or were to be hit by an external shock, all banks would suffer.

So, as any risk manager will tell you: diversification pays off. For that reason, we value diversity and account for it. We follow the principle of "same risks, same rules, same supervision" – which also means that different risks have to be treated differently – and we take a proportionate approach to supervising banks.

So, the banking union is not at all about centralising power or doing away with diversity. The banking union is a joint project, and it follows the motto of the EU: united in diversity, or forenet i mangfoldighed as you would say in Danish.

Conclusion

Ladies and gentlemen,

I would like to end by coming back to the concept of hygge.

According to the Cambridge dictionary, hygge describes a quality of cosiness. It's about feeling warm, comfortable and safe.

Isn't Europe also a bit hyggelig, then? Isn't it also about being together? Isn't it also about feeling comfortable and safe? From my point of view, there is much that speaks for a closer European Union.

And the banking union is all about helping Europe to grow closer together. It helps to make the single market more single; it contributes to safer and sounder banks by making them more resilient; and it helps to foster financial stability by enabling banks to fail in an orderly manner. It takes things such as banking supervision and resolution from the national to the European level. And in doing so, it offers many benefits that would not be available if we kept everything at the national level alone.

Now, I am sure that each and every one of you is fully familiar with the complexities of today's financial system. Each of you has a lot of insights and experience. But still, on occasions such as this, surrounded by leaders from the public and private sector, I feel I must stress the importance of cooperation. For all our insights and experience need to be shared.

You are all familiar with the challenges we face. But alone, none of you, none of us, would be able to find the perfect solution for regulating and supervising the financial system. No single person, no single institution and no single country has the perfect solution. We can and must learn from each other. And we can and must work together.

The banking union now allows us to do so – effectively and efficiently.

Thank you for your attention.

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[1] Article 1 of the SSM Regulation (Council Regulation (EU) No 1024/2013).