Sabine Lautenschläger: Four years of Banking Union - where do we stand?

Opening statement 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 Banking Supervision, Resolution and Risk Management conference during the 21st Euro Finance Week, Frankfurt am Main, 13 November 2018.

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It's a pleasure to attend Euro Finance Week again this year.

This is a good opportunity to reflect on the state of the banking union and the Single Supervisory Mechanism, or SSM.

Four years ago, at the start of this ambitious project, scepticism was rife. Despite the general consensus that European supervision and a banking union were necessary complements to a monetary union, many questioned whether this was a realistic goal.

Without wanting to sound overconfident, I believe we have largely proved the sceptics wrong.

Tough and fair European supervision, backed by tougher regulation, has contributed to making our banking sector significantly safer and sounder. I will highlight just two of many relevant issues:

- In general, banks now hold more and better-quality capital than in the past. The fully-loaded CET1 ratio of significant institutions was 13.8% in the second quarter of this year, up by 2.6 percentage points compared with the last quarter of 2014[1]
- We have also made significant progress with something that each and every supervisor is concerned with: non-performing loans, or NPLs.

Banks are holding significantly lower levels of NPLs on their balance sheets. For banks under direct ECB supervision, the gross NPL ratio fell from €958 billion when the SSM was launched to €688 billion in the first quarter of this year. There is still some work to do here, and it should be done quickly while the sun is still shining.

Of course, the SSM is not the only pillar of this banking union. Tougher supervision does not mean that there will never be another bank failure. It is neither our task nor our objective to prevent each and every bank from exiting the market.

Banks can and should exit the market if they are managed in a risky and unsound manner, or if they are structurally incapable of maintaining their competitiveness based on a sound business model. But they should do so in an orderly fashion. And thanks to the second pillar of the banking union, the Single Resolution Mechanism, we are now better equipped to ensure this.

Having briefly looked back, let me now look to the future. I would like to stress two points.

First, while the banking sector is more resilient than it used to be, I am not fully satisfied with the current situation.

And second, I would like us all to keep in mind that, while a resilient banking sector is a necessary condition for financial stability, it is not enough on its own. In other words, increased resilience does not mean we will never see another crisis.

Supervisors must continue to be tough on banks. And legislators should support them.

As memories of the crisis fade, I see a high risk of complacency. Not only has there been a slowdown in the momentum for reform and further harmonisation of unjustified differences in national supervisory law, in some countries we have even started going backwards.

We should all remember that the lesson of the crisis was clear: light-touch regulation and supervision of the banking sector does not work. Any short-term gains will be more than offset by the damage to the economy caused by the resulting financial instability.

So banks must continue to improve in several areas. And now is a good point to stress that financial stability is also good for the banks themselves. For a start, many banks should take advantage of the good times to continue cleaning up their balance sheets and adapt their business models to face upcoming challenges – the current economic environment is as good as it gets!

All banks also need to further strengthen their risk management frameworks, IT systems and internal capital and liquidity management.

But not only banks still have work to do. In this vein, I would like to mention several points that will be relevant to the discussion later on:

1. There are still approximately 30 microprudential national options and discretions addressed to Member States.
2. Many important European tools, such as fit and proper assessments and the early intervention measures, are covered by directives which have to be transposed into national law. This adds to the fragmentation and leads to an uneven playing field.
3. We still lack harmonised supervision of third-country branches and investment firms.
4. For some important directives, such as the anti-money laundering one, transposition into national law has been held up or hasn’t even started.

But as I promised to keep this statement short, I will stop here for now. Thank you for your attention, and I look forward to our discussion.

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[1] Constant sample of significant institutions which reported the ratio in all periods