Embargo: 4 May 2015, 11:50 am (CEST)

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The first six months of European banking supervision
An NCA's perspective

Speech at the ILF Conference on the Banking Union
in Frankfurt
5 May 2015

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1 Introduction

Ladies and gentlemen

Thank you for inviting me to speak at today’s ILF Conference on the Banking Union. It is a great pleasure to be here. And again, the ILF has shown impeccable timing: it is six months to the day since we erected the first pillar of the European banking union.

For on 4 November 2014, the ECB became the direct supervisor for the 123 largest banks in the euro area. Together, these institutions account for more than 85% of the aggregate total assets of the euro area’s banking sector. That makes the ECB one of the world’s biggest banking supervisors.

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Yet the ECB is not walking alone; it is being accompanied by the national supervisors. Ultimately, European banking supervision rests on the shoulders of both the ECB and the national supervisors.

Let me therefore share with you my view, as a national supervisor, of the first six months of European banking supervision.

2 The benefits of European banking supervision

Shifting banking supervision from the national to the European level harnesses three specific benefits.

First, European banking supervision makes it possible for banks throughout the euro area to be supervised according to the same high standards. These standards will emerge from sharing insights and empirical findings internationally, and from adopting best practices from each national approach to banking supervision. The option of conducting cross-border peer reviews is another way in which the goal of establishing a common set of high standards can be achieved.

Second, European banking supervision makes it possible to effectively identify and manage cross-border problems. This is essential, because large banks usually operate in more than one country. The failure of the Franco-Belgian bank Dexia in 2011 is a classic case in which banking supervision with a cross-border focus could have improved crisis management. Another example is Germany’s Hypo Real Estate, which folded in 2009.

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Third, shifting banking supervision from the national to the European level adds a layer of separation between supervisors and the banks they supervise. This will prevent domestic supervisors from handling their banks with kid gloves out of national interest.

At a more general level, the ultimate *forte* of European banking supervision is that it blends a comprehensive and impartial European perspective with the expertise and experience of national supervisors. That being said, we need to strike a balance between harmonisation, subsidiarity and proportionality if this combination is going to work.

We have to embrace the benefits of supervising banks throughout the euro area according to a set of harmonised standards. At the same time, we have to implement supervisory practices that are proportionate to the special characteristics of individual institutions, and we have to build on the experience and expertise of national supervisors.

With that balance in mind, let us take a tour through the day-to-day operations of European banking supervision and see where we stand.

3 Supervising "significant institutions"

The banks most immediately affected by the new system are the 123 banks that fall under direct ECB responsibility. The ECB has 1,000 employees, most of whom are located in Frankfurt, to supervise these mostly very large and complex banking groups. Since these institutions are located in

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19 different countries, the ECB has to rely on the support provided by the national supervisors, on their expertise and experience, on their resources, and on their presence on the ground.

That is why ongoing banking supervision is the responsibility of joint supervisory teams, or JSTs for short. JSTs are headed by ECB staff but mainly comprise national supervisors. The Bundesbank, for instance, is represented in all the joint supervisory teams for German banks as well as in a number of teams for foreign banks. Altogether, supervisors from the Bundesbank are represented in 34 of the 123 joint supervisory teams.

You can imagine that all this requires national supervisors to adjust – not just from an organisational point of view, but also from a personal standpoint. Supervisors who, for years, were responsible for national banks have suddenly been thrust into an international working environment. This is exciting and challenging at the same time, and it will take some time for everyone to adjust to their new surroundings. What we have seen in the first six months has been quite encouraging, though.

From an organisational point of view, the Bundesbank has already adapted. Altogether, we have established three new organisational units. First, we have set up a staff unit to coordinate those colleagues from the Bundesbank who work in the JSTs. Second, we have created a new division to analyse the foreign banks which fall under European banking supervision. Third, we have established a secretariat to prepare the meetings of the Supervisory Board, the decision-making body of European banking supervision. This

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organisational set-up will ensure that the Bundesbank can contribute to European banking supervision in an effective and efficient manner.

As for the banks falling under direct ECB responsibility, we can conclude that national supervisors nonetheless still have a major role to play. Here, we have succeeded in striking a balance between harmonisation and subsidiarity.

We still have some way to go as far as proportionality is concerned, however. In my view, we have to tailor supervisory processes to better suit the size of individual banks – and their joint supervisory teams, too, for that matter. The largest and smallest JSTs differ quite substantially in size – the largest comprise around 70 full-time supervisors, the smallest just 5. Past experience has shown that JST workloads often exceed capacities, particularly so for the smaller teams.

So bearing this in mind, there are two lessons we can learn from the first six months of European banking supervision. First, the joint supervisory teams need to be of a sufficient size to be able to perform their supervisory duties in an effective manner. Second, the size of a joint supervisory team should be proportionate to the size and significance of the supervised institution. In other words, we have to emphasise proportionality as a guiding principle in organising the JSTs for differently sized banks.

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4 Supervising “less significant institutions”

Now, what about the other banks? What about banks that do not fall under direct ECB supervision? These less significant institutions, as they are known, or LSIs for short, account for less than 15% of the aggregate total assets of the euro area’s banking sector. In terms of quantity, however, they account for the bulk of the banking system. Across the euro area, around 3,400 institutions are classified as “less significant”; 1,700 of them are located in Germany.

And it is with regard to these institutions that harmonisation, subsidiarity and proportionality have to be balanced with particular care. As a general rule, LSIs continue to be directly supervised by the national competent authorities, although the LSI sector as a whole will be overseen by the ECB in matters of risk concentration. Furthermore, the ECB and the national supervisors are currently developing joint standards for the supervision of these smaller banks. And again, harmonising standards up to a certain degree is a necessary and welcome measure.

That said, it is particularly important with regard to less significant institutions that we give national supervisors sufficient scope to account for the particular characteristics of individual institutions. Supervising LSIs should be a matter for national supervisors. This would conform with the principle of subsidiarity and represent the most effective and efficient solution.

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5 Taking decisions

Ladies and gentlemen, striking a balance between harmonisation, subsidiarity and proportionality is a prerequisite for reaping the full benefits of European banking supervision – and it is certainly a formidable challenge. Yet there is another challenge we have to master if European banking supervision is to work. The challenge I'm talking about now has to do with decision-making processes.

Since the ECB is responsible for European banking supervision, the Governing Council is the highest decision-making body, not just for monetary policy issues but also for matters of banking supervision. These two areas of responsibility intersect at the banks. Besides being a crucial element in the monetary policy transmission process, banks are also the object of banking supervision. This, of course, gives rise to conflicts of interest, as it creates a banking supervisor with access to central bank liquidity.

In practice, a situation may arise in which the Governing Council might be tempted, out of monetary policy concerns, to alter decisions that the Supervisory Board proposed from a supervisory perspective.

To minimise such conflicts of interest, a governance structure has been put in place to limit the Governing Council's involvement in supervisory decisions. Time will tell whether this structure truly helps to avoid conflicts of interest between monetary policy and banking supervision, or whether it might have been better to create an independent banking supervisor.

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6 What about regulation?

Supervisors can only ever be as effective as the rules and regulations they apply. And in this regard, the financial crisis has exposed a number of shortcomings in the regulatory framework. Amongst other things, the crisis underscored the need for a more harmonised regulatory approach – ideally one which would eventually create a level playing field for supervisors and banks alike.

In Europe, we have done a lot of work to meet these requirements – first and foremost by introducing the Single Rulebook. Amongst other things, this package implements the Basel III framework and assures the harmonised implementation of the rules throughout all member states. Nevertheless, there is still room for further improvement.

Today, European supervisory legislation offers around 150 options to choose from. And at the national level, these options have been exercised in many different ways. To be sure, sometimes it is reasonable to interpret rules against the backdrop of specific national circumstances, but sometimes it is not. So we need to analyse all the options and discretionary scope provided at the national level very carefully. Those that reflect the diversity of different markets and different credit institutions, we should keep. Those that do not, we should phase out. The ECB and the national supervisors have just kick-started this evaluation process.

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7 Conclusion

Ladies and gentlemen, I think it is fair to say that European banking supervision has got off to a clean start. But if it is to be a lasting success, we still have to overcome a number of challenges. In my speech today, I outlined the need to strike a balance between harmonisation, subsidiarity and proportionality; I highlighted the challenge posed by decision-making processes; and I discussed the challenge of addressing the harmonisation of options and national discretionary scope within the regulatory framework.

A lot of work still lies ahead of us. But as Jean Monnet, one of the founding-fathers of the European Union, once said: "to make all men work together, you have show them that, beyond their divergences or over and above frontiers, they have a common interest". Bearing this in mind, let us all work together in order to achieve our common goal of a stable financial system that serves the real economy.

Thank you for your attention.

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