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Implications of the Single Supervisory Mechanism on the European System of Financial Supervision: the EBA perspective
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Intervention of Andrea Enria, Chairman of the EBA

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Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

The construction of the Single Supervisory Mechanism (SSM) and the whole project of the Banking Union are usually justified on the basis of the shortcomings of the institutional framework for the Single Currency, which have been so clearly exposed during the sovereign debt crisis. However, I would like to start from a different observation point, that of the Single Market. During the last three years we have witnessed a dramatic process of renationalisation of banking business, which has deeply damaged the functioning of the Single Market.

As a result of the political decision to rely exclusively on the national safety nets to provide solvency support to the banks, both market participants and national authorities have taken actions that have segmented the Single Market along national lines. Bank capital and liquidity are now allocated on a country basis and cross-border groups have achieved a much closer matching of assets and liabilities in each jurisdiction. The strong reduction in cross-border banking has been driven in particular by the collapse in exposures to banks in other jurisdictions. This partly reflects the reluctance of banks to lend to each other and the emergence of sovereign risk as a main element in banks' behaviour. But although I lack robust empirical evidence, I am fairly sure that an important driver is also a sharp contraction in the transfers of capital and liquidity within cross-border groups, from the parent company to subsidiaries in other Member States and the other way round.

We are witnessing what I would call a "soft break-up" of cross border groups along national lines. This means that cross-border groups are not functioning anymore as channels for integrating the retail banking market, recycling savings from countries in surplus to meet the financing needs of small and medium enterprises and households in other Member States. The Single Market is failing to fulfill its main function.

The SSM is providing a prompt and strong institutional response, and the right one. If properly completed with effective and integrated mechanisms for resolution - the so-called Single Resolution Mechanism - the new institutional framework could go a long way in establishing a European safety net and cutting the link between banks and their sovereigns. I do not think that the Europeanisation of deposit guarantee schemes in their paybox function is essential to move forward, although some mechanism for the integration of national schemes is essential in a longer term perspective, also via reinsurance obligations for local schemes, as recently suggested by Daniel Gros. But we surely need a European authority which can mobilise pooled private resources contributed by the banks themselves and rely on the liquidity support and the fiscal backstop of the European Stability Mechanism (ESM), to ensure that effective restructuring and resolution can occur at the European level.

However effective this response, though, it will only cover the banking business within the Member States that will join the SSM. The responsibility for supervision and resolution, and the connected mechanism for support, will not cover all the Member States. Repairing the Single Market, and avoiding a rift between Member States that will join the SSM and those that will not, requires that a number of additional steps are taken, all strengthening other components of the European System of Financial Supervision (ESFS), for which at the moment I do not see the necessary political commitment.

First, we need a renewed and enhanced effort for the **Single Rulebook**. Truly unified rules are the necessary conditions to restore trust amongst competent authorities and allow joint execution of supervision on cross-border groups. A wide degree of discretion left to national authorities could open the room for the use of rule-making to *de facto* ring fence national markets.
A lot of progress is being made in establishing a Single Rulebook in banking, and the EBA is close to finalising a significant number of standards linked to the new legislation on capital requirements (the so-called CRD4-CRR). But there are still important areas of flexibility that need further action.

There is the flexibility granted for the exercise of macroprudential responsibilities. This is huge - up to 500 basis points in the capital ratio, with further room allowed in defining the liquidity buffers - but warranted, to tackle bubbles that could develop in national markets. Here it is essential that EU-wide mechanisms are devised to constrain the exercise of this discretion and make sure that it is effectively employed to contrast macroprudential risks, and not aimed at trapping capital and liquidity in domestic jurisdictions.

Moreover, there is the flexibility granted to address smaller institutions operating on a local basis, especially savings and cooperative banks. Also this type of flexibility is warranted, as the rules should abide to the principle of proportionality and reflect the specificities of different business models. But the principle of proportionality should be applied on an EU-wide scale and in no case should simply offer carve-outs to common rules for certain categories of intermediaries, in order to avoid generating *de facto* barriers to entry in local markets.

There are the elements of flexibility granted just to reflect different policy stances of Member States. For instance, I am particularly concerned of the discussion of the draft Directive on Bank Recovery and Resolution, where the request for flexibility could have two very detrimental effects: (i) it could put at risk the level playing field in the treatment of different classes of creditors, thus allowing for the use of the regulatory lever to reduce the cost of funding for domestic players; and (ii) it could maintain differences that could turn out to be an obstacle in interconnecting national resolution regimes and ensure a smooth and joined-up approach to cross-border groups.

In all these areas the introduction of the SSM should be a positive force, pushing for greater uniformity of the regulatory framework. The EBA has already developed its advisory role, identifying areas where truly common rules are warranted. Perhaps this role should be further codified, to provide a stronger underpinning to the EBA as the guardian of the Single Rulebook.

The second area in which the SSM calls for further action at the Single Market level is the **convergence in supervisory practices and cooperation between authorities**. Steven Maijoor has already mentioned the need to step up the efforts for supervisory convergence in the previous session. The urgency is even higher in banking, where the staff of the ECB and all the national authorities joining the SSM will have to conduct their supervisory tasks according to a common manual. The task to develop a Single Supervisory Handbook for the whole EU, attributed to the EBA, recognises the importance that key chapters of the manual are truly common across the Single Market. The EBA has already started to work to some of these chapters of the Handbook, in the area of supervision of business models, and will soon move to the methodologies to conduct risk assessments, asset quality reviews and attribute scores to recovery plans. The discussion on the Handbook has focused mainly on the legal nature, and the draft legislative provisions point out clearly that it will not be legally binding. However this misses the point, which is the actual commitment of all competent authorities to define jointly the methodologies and apply them in their day-to-day practice.

Having common rules and common supervisory practices will not rule out the possibility for tensions between home and host supervisors. The introduction of the SSM will significantly simplify home-host relations, but we have to remind ourselves that almost all large cross-border groups have establishments both inside and outside the euro area. The EBA has so far conducted a major effort, within supervisory colleges, through formal and informal mediation, and also via investigations on breaches of EU law, to push forward stronger cooperation and joint decisions. This strand of the EBA work is somewhat obscure, but essential for the repair of the Single Market.

Finally, the greatest challenge will be in the construction of a comprehensive and credible **framework for cross-border bank resolution**. If the SRM covers only the countries joining the SSM, as it is likely, the challenge will be to avoid that some degree of segmentation remains in the Single Market, as a consequence of the divergent underlying safety nets on which European cross-border groups will rely. Once completed, the Banking Union should thus contrast this trend of national segmentation and provide a robust underpinning for an integrated European banking market. To this end, the SRM should be accompanied not only by a common resolution toolkit for the whole Union but also by clear and binding criteria, agreed among the parties involved, for smoothly manage the crisis and resolution of cross-border groups. Recent experience shows that voluntary agreements are not enough: when a crisis materializes the strong incentives to diverge from the original agreements need to be set-off by credible, binding arrangements. For this purpose, a European Authority should ensure that these agreements are put in place under a common umbrella and are effectively enforced in a crisis, for the whole Single Market.