European bank supervision and its new challenges

Editorial by Denis Beau, First Deputy Governor of the Banque de France, and Joachim Wuermeling, Member of the Executive Board of Deutsche Bundesbank

Five years ago, in a short press release, the ECB opened up a new era by announcing that it was officially taking over the responsibility of banking supervision within the euro area. The Single Supervisory Mechanism (SSM) was born. Drawing an important lesson from the financial crisis, Europe was thus providing an essential response that Member States alone could never have supplied in an interconnected European financial system. What has become of the SSM and what will its next objectives be? Here are a few Franco-German thoughts on this subject.

Over the past five years, 1,200 ECB supervisors and around 5,000 bank supervisors from France, Germany and the 17 other euro area countries have worked daily to enhance the stability and soundness of our banks. All decisions are taken by the Supervisory Board, a joint body where all competent national authorities are represented.

The transition from national supervision to European supervision proved rapidly successful. An example of this success is the reduction in non-performing loans. During the financial crisis, they totalled approximately EUR 1 trillion in the balance sheets of European banks, compared to EUR 600 billion today. This amount is no doubt still too high, but it has declined very significantly and continues to do so. The success of this European approach is based on a joint supervisory strategy and a firm implementation.

The SSM brings together the experience and expertise of the supervisory authorities of the euro area countries. It supervises many more banks – including 116 large-sized ones! – than national authorities, which are entrusted with overseeing small and medium-sized institutions, under the control of the SSM. Thanks to this wide scope of supervision, risks can be detected earlier, better assessed and contained in a more targeted manner.

Our priority is to ensure the stability of the whole of Europe. This is an essential achievement of the SSM: national interests have been relegated to the background in the context of European decisions.

And tomorrow, what will be the challenges facing the SSM? According to us, there are three essential ones: first, **we need to develop instruments to manage the new risks in the financial sector**. The digitalisation of banking transactions, the tokenisation of money and securities, the use of blockchains, etc. represent as many opportunities as new risks! However, regulation and supervision must also enable banks to innovate in the digital field and facilitate their management and consolidation at the European level.

Our second challenge consists in capitalising on digitisation to better identify risks and optimise banking oversight. We need to use our resources more efficiently, and generalise our digital approaches! Our instruments and indicators must be constantly reviewed with pragmatism, in terms both of their costs and their efficiency.

Finally, **the SSM must place ever greater emphasis on supervisors' assessment and on the understanding of the specificities of national banking markets**, within the framework of a body of common rules and practices which guarantees an exacting and fair supervision, vector of healthy competition.

Following the 2008 financial crisis, the banking sector entered a phase of transformation as it faced new economic models. Traditional institutions are subject to sharp competition from "BigTechs" which are engaging in financial services, and "FinTechs" which are shaking up traditional patterns. The competitiveness of the traditional banking sector could be durably challenged.

Let’s hope that we won’t have to face another crisis in the next few years. **However, even without a shock, banks must rise to a large number of challenges, whether they are posed by their new competitors, or whether they result from a series of vulnerabilities** that we are closely monitoring: a cyclical downturn could increase losses on loans, a sudden rise in interest rates could result in losses on market activities. Not to mention that continental banks will have to take on new tasks after Brexit…

The first five years of the SSM have shown that European cooperation can work for the general interest. Everyone benefits from stable and sound banks, be they households, businesses, investors and government. While our track record is positive and instructive, one thing is certain: the challenges facing banks and their supervisors are increasing rather than decreasing. Given this fact, the future of supervision will be European or will not be.