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Chairman of ESBG Banking Supervision Committee takes part in Hearing at European Parliament

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Erkki Raasuke, CFO at Swedbank and Chairman of the ESBG Banking Supervision Committee was invited at the Public Hearing on Financial Regulation and Supervision, organised by the Special Committee on the Financial, Economic and Social Crisis of the European Parliament on 25 February 2010.

Read here the main points of his intervention:

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The current discussions on the reforms to financial regulation and supervision are of great relevance to ESBG, whose members represent approximately one third of the European retail banking sector. Against this background Mr. Raasuke described which 'real life' concerns banks envisage as the result of the upcoming regulatory tsunami:

On reforms to financial supervision

- As regards the discussions on the supervisory *framework*, progress is made in the right direction. Especially banks operating cross-border appreciate consistency in supervision and according to a coherent set of rules – i.e. a Single Rulebook.

- However, one should highlight that the European retail banking market is of great diversity, which especially during the crisis has proved to be a strength and benefited the wider economy. This needs to be recognized and accounted for in the debate on the *structure* of supervision: Supervision should not be moved 'too high' or become too centralised as reforms should not override diversity.

  In addition it should be kept in mind that retail banks played only a fairly small role in the crisis. Even for those banks which were caught in the financial crisis, this usually happened due to real economic developments.

- Swedbank's own experience with supervision during the crisis is a good *'real life' example*. Swedbank, with its activities in Sweden and in the Baltic States, found that the cooperation among the different national supervisors worked very well. An extensive exchange of information and its effective updating, as well as the willingness to avoid a duplication of work, brought great consistency to the different supervisors' approach towards the banks concerned - supervisors were indeed speaking with 'one voice'.

  When developing a new supervisory structure, policy makers should therefore also look at those positive examples where cooperation and processes in place worked well.

In reference to the current proposal of a European Economic Risk Board, in retrospect it is obvious that macro-prudential supervision could have been helpful and could have alerted supervisors and market players alike to the building up of macro-economic bubbles in the Baltics.

On reforms to financial regulation

- Concerning the current work on regulatory reform by the Basel Committee, at a high level these reforms are largely adequate and needed.

  For instance, increasing transparency and quality of capital is the right way forward. In broad terms, steps designed to ensure liquidity over a survival period in times of stress and to match banks' funding with their asset structure is much welcomed.

  However, before the proposals on the table become regulation, the following concerns need to be addressed:

- For the rules on *banks' capital,* one needs to recognize that introducing a 'leverage ratio' clearly constitutes a large step backwards (by about 20 years). Even if Basel 2 has shown its weaknesses, it should not be abandoned. Here the issue is that a 'leverage ratio' is not risk sensitive – and hence contrary to the spirit of Basel 2. This is dangerous, since it leads to moral hazard and creates an incentive to take disproportionate risk.

  Rather, instead of diverging from the Basel 2 idea, much more could be achieved by further developing the Basel 2 framework.

- Turning to the proposals brought forward in order to ensure more stable *liquidity* and better matched funding, on overall these ideas go in the right direction. However, the currently presented proposal is worrisome, since it is poorly calibrated and hence misses its target.

  For instance, the imposition of a Net Stable Funding Ratio in its current form would be counterproductive, as illustrated by the following example:

  A traditional bank, relying strongly on domestic customer deposits for funding and focusing on comparatively low risk activities would still need to borrow approximately 20% of its balance sheet on the international capital market - just in order to be compliant with the new regulation!

  Also taking a practical view, such a proposal would lead to unintended consequences. It is expected that after the implementation of the NSFR (Net Stable Funding Ratio) there will be a significant deficit in long-term funding on European markets (estimated between 1.5 and 3 tr. Euros). Faced with the present proposal, banks would have a strong incentive to run-off parts of their loan portfolios. Namely, they would consider not renewing long-term commitments and loans to corporate customers. Such loans and commitments carry low risks and have played at most a small role during the financial crisis, but they are harshly treated by the new regulation.

***To sum up*:**

For the reform of both financial supervision and regulation, the messages are clear:

The approach taken to supervision is the right way forward: consolidation and coherent rules are good, while sector diversity is important and should be held high.

The approach by the Basel Committee is welcomed, but a lot will depend on the results of the Impact Studies and ultimately on the 'final numbers' in the regulation. It is essential to keep in mind consequences for the real economy and for retail banking and SME financing. Current reform should not trigger the next crisis!