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Speaker: Erik Thedéen
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Introductory Statement by Erik Thedéen, Director General, Swedish FSA

Dear Members of the ECON Committee,

Thank you for inviting me and my counterparts from the EBA and SSM to this session focusing on the new Banking legislation package put forward by the EU Commission. The package proposes amendments to the Capital Requirements Regulation, as well as both the Capital Requirements and Bank Recovery and Resolution Directives. I very much appreciate the opportunity to provide a supervisory perspective from a deeply financially integrated, yet non-Euro area Member State. As you know, Swedish banks are systemically important in at least six EU Member States and offer cross-border financial services in almost all EU Member States.

To start with, I would like to express my appreciation for the work that has been done by the European Parliament in repairing the European banking sector. Nine years after the crisis, European banks are better capitalised than when the crisis struck, are better governed, and have made great strides towards being more resilient and resolvable. The EBA has made good progress towards the harmonisation of supervisory practices as well as the transparency of the EU banking sector. Additionally, the establishment of the Single Supervisory Mechanism has achieved a significant strengthening of supervisory practices; a very welcome development.

But we are not yet at the end of our journey to repair the banking system. Important regulatory reforms still need to be completed – the Banking legislation package being just one such example – and more work needs to be done to bridge the gaps in the regulatory framework. From the Swedish perspective, we welcome the Banking legislation package, but **see considerable problems with the limitations to supervisory flexibility and in particular the capacity of supervisors to address systemic risks that the legislation package proposes**. I will address this issue later in my comments, but I believe its root cause is **an aspiration to restrict supervisory powers in the name of "maximum harmonisation"**. I want to argue that this approach – which in my view is mistaken – rests on the false assumption that supervisory

flexibility and the harmonisation of rules are incompatible. This is not the case, and I will endeavour to explain why.

Supervisory flexibility and harmonisation are two co-existing concepts. Both are necessary to ensure the smooth functioning of the common market and the effective handling of prudential risks which can threaten banks and spill over into the rest of the economy as well as into other jurisdictions.

Flexibility allows supervisors freedom to effectively deal with the risks in their own jurisdictions without having their hands excessively tied regarding the options available. To clarify, I am not advocating the flexibility to set lower-than-minimum standards. A so-called 'race to the bottom' is clearly not in the interest of EU financial stability.

Harmonisation, however, is a means to increase predictability and ensure common minimum standards across jurisdictions. It does not envision that the calibration of tools in each jurisdiction should be the same - each jurisdiction faces its own idiosyncrasies, which mean that whilst the minimum rules will be the same across the EU, the "regulatory medicine" in each jurisdiction will be unique. This is especially true when it comes to macro-prudential supervision, which is continually evolving and where experience of best practices is still being built up. Therefore, a degree of flexibility must be retained in order to ensure that all identified risks are fully addressed. This is the case today, and we should not introduce changes which reduce the possibility to fully address identified risks in the future.

This approach is important not only on a jurisdictional level, but also to ensure financial stability at a regional level in order to guard against spill-over risks. In the Nordic-Baltic region, for example, Swedish banks have systemically important operations in seven EEA jurisdictions.

That is not to say that there are no downsides to this type of flexibility. We all know that there is the potential to exploit flexibility for national gain, but the costs of doing so are high and public. The various mechanisms in place on supervisors protect this flexibility by discouraging its misuse. Such mechanisms for checks and balances include limits on reciprocity, as well as the tools available to the EBA: the breach of EU law mechanism and its powers to issue guidelines, opinions and promote best practices, to name just a few.

To sum up my argument about harmonisation and flexibility: both are necessary, and they are complements to each other, rather than incompatible extremes. Ignoring this insight may result in excessively rigid rules which could help pave the way for the next crisis. As most financial sector law is formed at the EU level, individual Member States have limited scope to react if these pan-EU laws are inadequate to ensure financial stability in their Member State.

In the current political climate, with the basis of the European project under threat, such potential criticisms directed at EU-level regulation could jeopardise the very project we all want to build – an open, competitive and well-regulated common market for financial services.

Now let me focus on why I see elements of the Banking legislation package as stretching the concept of "maximum harmonisation" too far. Clearly, no two jurisdictions are identical and all have their own idiosyncrasies. These jurisdictional differences can be quite stark. For example, looking at the size of the banking system at a consolidated level relative to the size of the economy, the Swedish system is over two times larger than in Belgium and over three times larger than in Finland. This means, all other things equal, that there is a greater need to address systemic risk in Sweden than in Belgium or Finland.

Another example is credit growth. In Sweden this is particularly important, as we are presently experiencing a credit boom in our housing market, and are concerned about the continuous build-up of systemic risk stemming from household indebtedness. Housing loans are growing at a rate of over 7%, and house prices are increasing by over 8% per annum. But in many other jurisdictions this is not the case. In the Euro-area, the housing loan growth is about 2%, and house price growth about 3%, with significant regional variations.

This means that the impact and severity of future risk scenarios are intrinsically jurisdiction-specific, often also region-specific, and flexibility in dealing with them will allow for better crisis management in ***each*** Member State and reduce the risk of spill-over effects for ***all*** Member States. **Such measures to deal with systemic risk can be addressed today through systemic risk capital add-ons in Pillar 2.** But the proposed Banking legislation package reduces this possibility[1]. Were it to be implemented, we would be forced to eliminate Pillar 2 requirements for systemic risk in Sweden in an environment where systemic risks continue to increase. Such an outcome is detrimental to financial stability and appears to undermine the intention of the new package.

In light of that, the possibility to build a completely harmonised framework that works equally well for all is impossible. As such, it is absolutely necessary that the regulatory framework allows supervisory authorities the flexibility to set sufficient prudential requirements, in order to **fully address risks** in their

[1] Competent are authorities could still use the tools provided in Pillar 1 as an alternative, but there are significant limitations imposed by the legal framework. The current procedure for the sign-off requirements of certain Pillar 1 macro-prudential tools is not designed for addressing systemic risks of a more structural nature and thus incentivises the use of Pillar 2 tools to confidently ensure that such risks are being sufficiently covered. In particular, setting a Systemic Risk Buffer (SRB) in excess of 3% of Risk Exposure Amount at group level requires consultation with multiple EU authorities and bodies. As far as we are aware, this process has been tested in very few cases. One explanation could be that few countries had made this assessment that it was necessary to set SRB in excess of 3% level, in view of the prevailing macro-economic conditions.

respective banking systems. And risks which are not fully addressed have the potential to spill over into other jurisdictions as well.

To conclude, I want to underline that we are very supportive of further strengthening of the EU banking sector, but **want to highlight that one aspect of the proposals – in respect of supervisory flexibility in relation to systemic risk – represents a step backwards, and could in fact achieve the opposite effect, and therefore should be reconsidered**.

Thank you!