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Opening remarks

The world looks different now. We have lived through COVID-19, this global pandemic that has created a dividing line for the modern era: pre-COVID and post-COVID. This is the first FIN-FSA conference since the start of the pandemic, and it's my great pleasure to see so many of you here in person. I wish you all – whether here or following our live webcast – a very warm welcome to the conference!

The world does indeed look different now, both in general terms but also from the point of view of a supervisory authority. Although it is still too early to draw final conclusions, it looks like the global economy and financial sector have weathered the COVID-19 storm better than was expected in spring 2020.

In Finland, the recession was shallower than most forecasters had projected even in their benign scenarios in early summer 2020. And the Finnish financial sector has faired the crisis well so far. In the banking sector we have seen only a minor increase in NPLs. However, having said that, neither we as supervisors nor financial sector participants should be too complacent, as the situation could deteriorate at short notice. One of the most obvious downside risks is related to the virus itself. If the vaccines are less effective against a further virus mutation, the situation could become much bleaker again.

It is often said that the generals fight the last war. In our case, as financial generals, the last war was the global financial crisis of 2008 and subsequent European sovereign crisis 2010–2015. We then built our new defence lines based on the lessons of those crises. Even though this time the war was very different than anyone expected, our new defence lines did actually work. More and better capital, and more and better liquidity is a robust formula against most types of hazard.

We were also equipped with better tools than in the previous crisis. The new regulatory framework allowed us to react in a more flexible way, and we have made use of those flexibilities. We used both the carrot and the stick. The carrot being the release of macro buffers, permission to use capital and liquidity buffers, the issuance of further guidance on loan provisioning under IFRS 9, and relaxation of the reporting requirements. The stick comprised the recommendations on restricting dividend payments. Of course, supervisory policies were not the only game in town. Both monetary and fiscal policies have been very active, both when compared to the previous or almost any other modern crises.

So far, these policies have been effective. Banks have supported the real economy by granting payment holidays. In many countries such holidays have been granted under legislative and non-legislative moratoria. This has helped to preserve liquidity by providing flexibility in

default classification in the worst days of the crisis. However, that came with a price tag. Currently, loans under support measures – both the moratoria and public guaranteed loans – have shown a deteriorated asset quality outlook, and the share of stage 2 loans benefitting from moratoria is clearly higher than for the total loan stock.

Another – albeit different – medium-turn risk is related to the normalisation of economic policy. This needs to be done in carefully considered, synchronised steps, to avoid unnecessary negative outcomes. It will be a demanding process to calibrate policies to the new normal, which is at least partially unknown and different than before.

Last week we got the European Commission's proposal on finalising the implementation of the Basel III agreement in the EU. Here in Finland, banks have been criticising the proposal, as they expect it to hit them more than banks in some other countries, where the share of mortgages and the use of internal models is less significant. Most important right now is that Europe is finally implementing the global capital standards, because otherwise there would be the prospect of a regulatory race to the bottom. According to the new proposal, there will be a long transitional period, which will give more time for the banks to adjust to the changes. My personal view is that the solution after the transitional period could have included more elements that better maintain the risk sensitivity of the capital adequacy framework. But as I said, the main goal now is to get Europe to be Basel compliant.

Since our distinguished speakers here at the conference include Andrea Enria, John Berrigan and Leena Mörttinen, it would be good to hear their thoughts on the way forward.

We don't yet know what the new normal will look like, but we do know about some of the drivers of change. One of the major driving forces is technology and digitalisation.

COVID-19 has accelerated many existing trends, and most of these are related to digitalisation. Just to give an example, the lockdowns and modern technologies have enabled many of us to work remotely. And many of you are attending this conference remotely – and across borders.

Digitalisation is fostering innovation and efficiency in the financial sector, and will continue to do so. This will bring the sector new revenue and value-producing opportunities. From the point of view of a supervisor, one of the major questions is how digitalisation will change the production and supply of financial services. What will be the future role of fintech or big tech companies in the value chain? Digitalisation as such will not change the essence of the core financial services. We will still need to be able to make deposits, use payment services, get a consumer loan and a mortgage, buy insurance cover against loss or damage, and buy different kinds of savings products. But digitalisation will change the way these services are produced and distributed.

According to a study by the BIS, during the early days of the COVID-19 pandemic, the financial sector was the second biggest target of cyber attacks, after the health sector. A supervisory authority naturally expects supervised entities to take this threat seriously and to intensify their efforts in managing ICT security risks and in countering cyber attacks. As we have seen, this can affect the whole of society. I am not fully convinced, that we – regulators, supervisors, the financial sector – have all the tools and knowledge needed to combat these threats.

To close this protection gap, at least partially, the European legislative proposal on a Digital Operational Resilience Act (DORA) is a step forward and will help to strengthen the operational resilience both at the systemic and individual level. Closing a gap requires good data, and DORA will provide timely and comprehensive ICT risk data through harmonised incident reporting. Reporting, operational resilience testing and oversight of critical ICT third party providers are examples of the supervisor's new tasks of improving the robustness of digital finance services.

The new risks that we are facing also require insurance protection. Can the insurance industry provide cover for these? When underwriting new risks, the question of where to get the necessary data arises. EIOPA has highlighted this on several occasions, for example in its cyber underwriting strategy. On the other hand, insurance cover for pandemic-related risk might be something that the insurance industry cannot handle on its own without private-public partnership. Maybe Torbjörn Magnusson will touch upon the topics of insurance penetration and protection gap during his presentation.

We have seen a surge in cross-border retail trading during the pandemic. A new, younger group of investors is involved in higher risk investments through electronic platforms like investment apps. We have seen that retail investors have faced significant risks when investing in stocks characterised by very high price volatility. This is compounded when the investor has a lack of reliable information for making investment decisions. It seems that many newcomers are doing their own research on digital platforms and social media. Events like the GameStop episode urged ESMA to publish a warning that retail investors should be careful when taking investment decisions exclusively on the basis of information from social media and other unregulated platforms. The panel here today will discuss the risks of this kind of behaviour.

The pandemic has also brought increased indebtedness, both for governments and households. For governments this is the outcome of economic policies to counter the crisis. For households the story is partially the same, but only partially. The main driver seems to have been housing investments. Low rates have been a stronger force for households than the fear of COVID-19.

Before the pandemic, the main economic risk was secular stagnation, a prolonged period of low growth. The reasons behind this were demographics and weak productivity growth. But the demographics have not changed, and there are no clear signs of a revival in productivity. So, secular stagnation is still on the cards. And this time, it would be combined with even higher indebtedness. This is unfortunately a bleak picture, but it is more a baseline than a risk scenario.

Slow growth, weak demographics, low rates and high asset price valuations is a difficult environment for long-term low risk investors like life insurance and pension funds. Pay-as-you-go pension systems face difficulties if the working age population becomes smaller one generation after another. Long-term saving, such as pension saving, is getting more challenging in the low rate environment. Attaining return targets that underpin pension systems' sustainability calculations would require higher risk levels in portfolios than before. This would raise the systemic risks embedded in the pensions systems and financial markets at the time of the next inevitable crisis.

A third longer term risk is related to climate change, but of course climate change is also an immediate challenge.

The ECB published on 22 September 2021 the results of its economy-wide climate stress test. These indicate that companies and banks will suffer severely if climate change issues are not addressed. On the other hand, the transition to a greener economy is also an economic opportunity. The results of the stress test show that the benefits of early actions on climate change outweigh the initial costs in the medium and long term.

The banking and insurance sectors need to look at their risk management thirty years ahead to be fit for a carbon-neutral economy in 2050. But as my colleague from the ECB Supervisory Board, Vice-Chair Frank Elderson, noted a few weeks ago, this will not be enough. He says banks need to develop transition plans compatible with EU policies on implementing the Paris Agreement, which means they should include concrete intermediate milestones from now until 2050, and disclose progress towards these goals on an annual basis.

The insurance sector has, of course, long been familiar with weather related catastrophe risks, but it is now also facing new types of sustainability risks and requirements. Investment portfolios will have to be screened for potential climate change risks, both transitional and physical. Various possible climate scenarios will have to be implemented in companies' own risk and solvency assessments.

We all know that a growing number of citizens and investors are eager to contribute to sustainability and there is a growing demand for ESG products. However, as the markets adjust to this rapid change, there is also an increased chance of greenwashing, mis-selling of ESG-labelled products to investors. It is therefore important to ensure that retail investors have access to adequate and understandable information on

the greenness of investments. A step forward in combatting greenwashing has been the implementation of the new disclosure requirements at EU level.

As regards completion of the EMU, there are two major projects still to be finalised: the banking union and the capital markets union. The banking union is still lacking its third pillar, the EDIS pan-European deposit guarantee scheme, as the necessary political agreement has not yet been reached. The capital markets union, for its part, has various initiatives under way, the most important being, in my opinion, facilitating access to capital in order to finance the green and digital transition and the funding of SMEs. So, how will this be achieved? We need to ease issuers' disclosure requirements and ensure the availability of good research and advice to retail and other investors. But naturally that is not enough. Maybe Andrea and Leena will touch upon the banking union issue, and the CMU question will be discussed by John and the panellists. I would also like to hear Gabriel Bernardino's thoughts on whether an ECB type supervisory authority is also needed for the insurance sector.

To conclude, may I wish you all a very pleasant and informative conference day, whether here at the conference venue itself or joining us virtually. Thank you, and welcome!