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Banking Union: best thing that happened to us

Panel intervention at the Eurofi conference
"Banking Union: how to make existing pillars more effective?"

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I would like to start by saying that, when it comes to the Banking Union, in my view the glass is more than half full. I truly believe that the Banking Union is the best thing that happened to Europe in the last decade. And, coming from Poland, I regret very much that none of the non euro EU member states have joined the Banking Union so far. I remember, I think it was June 2014, the opinion of the national bank of Denmark recommending the entry. Nothing happened so far.

Esther de Lange spoke about the need to complete the Banking Union. To have the third pillar in place is crucial for the effectiveness of the whole system. But equally important is to continue working on making the existing two working better. The sense of urgency should be with us, in particular in the context of external challenges, Brexit, transatlantic uncertainty, risks of global fragmentation. I am also convinced that bringing more trust, between regulators and supervisors, between national level and the European one, as well as working on better exchange of information and good implementation of the existing laws, all that is of fundamental importance.

I would like first to focus on improving the existing pillars and then on timing and sequencing for the future.

So first the issue of improving the existing pillars. In order to achieve this, we actually need to dig further into the daily implementation of the rules we agreed and the daily operation of the institutions we created. Let me underline here that the regular exchanges we as European Parliament have with Elke Koenig and Danielle Nouy have been of enormous value in that regard. The further we observe the Banking Union in operation, the more we discover details, or specific elements, on which a common approach is needed. The situation of the Banking Union is actually a textbook example of functionalist spillover: the more you integrate in one area, the more you will need to integrate in related areas as well. This comment concerns all pillars of the Banking Union.

We have been investing a lot for nearly a decade now in addressing the problems of too big to fail while avoiding fragmentation risk. Sometimes I have the impression that we are at the stage now when more integration might be needed within a good regulatory and policy framework.

On supervision, we have made great strides with establishing a single supervisor and a single rulebook, but we see that there are still many national options and discretions. And we see that we cannot have a really single supervision if the single supervisor is obliged to exercise its powers in different ways in different Member States. Mrs Lautenschlaeger will for sure speak about that. A lot of good work has been done by the ECB banking supervision there. They issued last year a regulation closing some Options and National Discretions and, where they were dealing with ONDs that could not be closed because they required case-by-case analysis, they issued a guidance for joint supervisory teams to conduct their work in a harmonised way all over the banking union. However, the first best option would of course be for the relevant legislation, the Capital Requirements Regulation, to include fewer ONDs. Now that we have a proposal to review this very CRR, the Commission has considered many of the ONDs too complex to really tackle them. This is a heavy task for sure and we were probably not fully expecting to have to dig into such details when launching the Banking Union project.

With resolution, we have similar issues. We now have a European system that has reasonably passed its first tests, with apparently good cooperation between the Single Resolution Board and the ECB. However, now we see that we still need to do more for bank creditors to be treated the same way in all countries of the Banking Union. A good news is that we will soon have a more harmonised hierarchy of bank creditors in insolvency.

However the legislation that we will pass will harmonise only the ranking of some debt, not the whole of the hierarchy of claims.

Crucially, insolvency regimes are not identical across Member States. In banking we have only one old high-level directive, the directive on the reorganisation and winding up of banks from 2001, and some common state aid principles. The recent cases have shown what the coexistence of two regimes, one being integrated at the EU level while the other is not, can lead to: a possibility of arbitrage. In Italy, the insolvency route was chosen and it allowed to avoid imposing losses on bondholders. Whether using insolvency instead of resolution was justified or not, you see that creditors have been treated differently in Italy than in Spain and this was because of the existence of two systems and the lack of harmonisation of one of them. Also, if we take harmonisation of bank insolvency seriously, the issue of harmonisation of corporate insolvency will sooner or later arise in connection with it. And corporate insolvency harmonisation is an even more complicated matter.

On deposit insurance, we all agree that we need some form of common insurance or reinsurance system. This would avoid misaligned incentives between supervisors and resolution authorities and make failure a more credible option.

We have single supervision but if the consequences of a failure remain too largely national, then the national level will push for leniency while the supervisor will want to be tough and this will create difficulties when facing bank failures. In addition, banks will be aware of the situation described and resolution or insolvency will not be felt a credible enough threat to incite them to manage their risks properly.

However, we start building a common deposit insurance scheme in a context where there is little harmonisation of national schemes. We now have a better situation than what existed prior to the Banking Union, thanks to the Deposit Guarantee Scheme Directive. However, situations are still extremely disparate. I remember what I heard from Esther when she started to work on her report and complained that it was extremely difficult to know how the DGSD was implemented in Member States.

All these issues are work in progress and they show how much we need to dig into the details if we want to make the existing pillars of the banking union truly successful.

So let me sum up this point and I am sure all of us here will have a similar list of issues to address. Concrete actions to make existing pillars more effective include:

- exploiting the review of the CRR in order to reduce, where possible, national options and discretions further. A lot has already been done on those issues but we can for instance simplify the framework for large exposures.
- The Bank Recovery and Resolution Directive is being reviewed as regards the alignment of Minimum Requirement for own funds and Elligble Liabilities with Total Loss Absorbing Capacity but it does not seem, according to researchers (Nicolas Veron from Bruegel) that its provisions on precautionary recapitalisation need a change. However, what has proven to be no longer fit for purpose is the state aid rules applying to insolvency cases as they are stated in the 2013 communication. And we need, as said above, to work on harmonising insolvency regimes for banks. This is the regime applying to small banks and as such it might actually be used quite often.
- On deposit insurance, in parallel with the European Deposit Insurance Scheme and pending its completion, we need to keep pushing for harmonisation as much as possible, not least with proper implementation of existing European Banking Authority guidelines on calculation of contributions, stress testing and cross-border cooperation.
- And we also need to keep watching carefully how the institutional set-up operates and whether it is satisfactory, in particular how the cooperation between the ECB and the SRM works in practice and whether it can/should be improved.

All this will take time. However work on all those fronts is essential and needs to be kept up, in parallel with the creation of the missing elements that we all know about and on which we need to progress. They are the deposit insurance scheme and the fiscal backstop for the single resolution fund, in whatever shape both of these pieces come. Then we will need to finalise the elements that pertain both to the Banking Union and to the architecture of the euro area: ESM, possible fiscal instrument, economic policy coordination rules.

The second issue I wanted to raise was this of timing and sequencing for the future. With the Banking Union, as with the broader issue of euro area governance, we have one set of policies which is easy to implement and brings immediate benefits, namely risk sharing, and one set of policies that is long-term oriented and takes time to bring tangible results, that is, policies aiming to reduce risk. This creates different and I would say independent incentives for each set of policies. This is problematic because all these policies are complementary and interdependent.

To give very concrete examples: you can easily, almost overnight if there is political will, mutualise risk and create a common fund, and then once the fund is there, there will be a risk of moral hazard and no more incentives to reduce risk.

Conversely, almost symmetrically, you may want to avoid moral hazard by focusing on the long term. So you start by reducing risk through appropriate legislation and surveillance mechanisms. But then, precisely, this takes time, a time during which unfortunately financial stability concerns may still arise. And at the point in time when risk is reduced enough, there will be no specific incentive for those Member States that perceive themselves as standing to lose to start pooling resources. So risk sharing might never happen.

In both cases, you end up with suboptimal policies because you have only provided one part of the necessary response. So we always need to be very careful about incentives and about timing. Policies that are complementary should be reflected on jointly and be implemented hand in hand. We need a firm commitment to link those policies because incentives are pushing us to keep them separate. We need to complete existing pillars, but without forgetting the need to put in place the big missing pieces of the jigsaw and without losing sight either of the broader reflection on the European economic governance. This is why it is so important to have a roadmap in mind, and this is exactly how we started the Banking Union: with a roadmap.