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“A banking sector framework fit for the future”

Panel “The impact of the Covid-19 crisis on the banking sector”

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I hope that what we are discussing today is part of a long-term vision that the Union needs for its financial markets. A vision that is responding to the needs of the citizens and businesses, that is fit for global competition, and is not captured by national interests.

I would say that the short answer to the question on whether enough has been done after the global financial crisis is the typical Brussel's moto: “a lot has been done but much remains to be done”. Indeed, there has been huge progress in building our financial markets' resilience. Nevertheless, on reforms, we are only half way through. As Andrea Enria said today in the ECON Committee of the European Parliament: it is too early to declare victory.

The EU banking sector is not yet perfect, in terms of the regulatory environment in which it operates, its resilience to risks, and the achieved level of integration. Uncertainty is still ongoing regarding new risks that have either already manifested or are only looming on the horizon. There may be not only positive consequences of rather strong banks search for yield. Inflation expectations in the context of ongoing discussions on whether the observed spikes are temporary or not can lead to changes in assets prices. And that is not an exhaustive list of what we must be aware of and monitor closely.

Despite improvements in the protection of depositors and the reduction of risk to financial stability stemming from bank failures, we did not manage to create the conditions for breaking the bank sovereign loop. It continues to haunt us. Breaking the loop cannot be done, in my view, on the basis of national deposit insurance schemes, but requires European Deposit Insurance Scheme (EDIS) covering liquidity and loss sharing models. Similarly, the prudential treatment of sovereign debt also still requires solution.

In this context, the process of reforming Crisis Management and Deposit Insurance (CMDI) framework launched by the Commission is fundamental. The European Parliament strongly endorses the ongoing work in the Commission that has been largely supported with the outcome of public consultations. But, unfortunately, on the Member States' side, we continue to lack the will to compromise on many issues. Progress was halted in June this year.

Without any doubt, European banks have entered the COVID-19 induced crisis in a much better condition compared to 2008. Two functioning pillars of the Banking Union, state of the art work of supervisors and regulatory institutions, robust regulatory framework, quick fixes where needed, supportive measures deployed at national level, temporary regulatory and supervisory relief granted to banks - all that increased banks' capacity to continue financing the economy. It is legitimate to say that in spite of relatively low profitability and competitiveness of European banks this time around banks were not a problem but rather a solution.

There are broadly expected risks that with the full withdrawal of public support emergency measures not only in banking sector but in the real economy, banks' asset quality might deteriorate, NPLs' share might increase - in some banks substantially, insolvency cases might grow - especially related to sectors in vulnerable situation, considering that some of them were already vulnerable before the pandemic.

Against this background, focus on strong governance, credit risk management and control, adequately addressing FinTech and Big Tech related risks, mitigation of NPLs' building up, integration and consolidation of the sector continue to be important.

I think we understand that one is never fully prepared to a new crisis. However, without doubt, we can deliver reforms that would provide a better outcome in a crisis situation.

One additional factor that cannot be ignored is that we are in a territory where strong interdependencies and trade-offs exist, which requires a comprehensive, holistic approach to reforms.

The list of issues to look at is not at all a short one. It seems that consensus is growing on the need to create more space for resolution, catering for different business models, ensuring that outside the resolution framework banks are treated in a more streamlined and consistent way. The approach to mid-sized deposit funded bank is a very pertinent issue in this context. Banks that do not pass the public interest assessment (PIA) are treated today in an ununified way under national insolvency procedures. We all heard about the limbo situations. Consequently, the issue of achieving a certain level of harmonization of national

insolvency proceedings continues to be a high priority. We need to look again at the American FSI approach as a source of good practice, even if we remain with resolution and insolvency in the system.

So, yes, indeed, even though the single resolution mechanism is overall fit for purpose, and fortunately, the early backstop will be operational next year; there is value in aiming to ensure that resolution can be applied more broadly, also to mid-size banks. The framework was designed with systemic banks in mind. As I said there are banks that do not pass the PIA test and we need more alignment and consistency of incentives.

We considered in the Parliament an expansion of the use of resolution, which would require changes to the PIA, providing greater flexibility at national level, and ensuring that when a bank enters the resolution it can truly use it.
As I said before, everything in this area is linked to everything else, so it has to be taken into account that in view of the limited capacity of mid-sized banks to build MREL, those banks should have a proportionate access to funding in resolution.

Among other big issues worth mentioning is the open issue regarding the risk for national deposit Guarantee Schemes (DGS) to be depleted of liquidity. DGS are national, so we have different frameworks, often with inconsistencies, and we have depositors enjoying various levels of protection across EU. Hybrid EDIS could provide liquidity allowing banks to avoid bailing in deposits.

On my list there is also the need of adjusting the way banks buy sovereign debt. Or, indeed, the home host balance requiring adjustment in a way aiming at reassuring the host that in an event of need, losses will be covered. There is, actually, a sense of urgency regarding the consideration of the role of group recovery and resolution plans in the context of the crisis management framework.

From a mid-term perspective, we could also dig more deeply into the impact of FinTech and Big Tech on the banking sector and consider whether handling it through consumer protection perspective, which seems now a good approach, is sufficient or whether it should rather be incorporated into the Crisis Management framework.

And we probably all agree that once we know the outcome of the reform of CMDI framework, we should look at necessary changes to State Aid rules.

The issue here is that on certain elements that belong to the CMDI framework requiring reform there are strong divergences among member states. This, to say the least, slows down any potential move forward.

Moving forward depends on the willingness to compromise; there is currently not much or at least not enough of it. You might remember that before summer all those working parties, task forces and high-level working groups on the Council side did not manage to agree on a work plan. We have important election behind us but political turbulences are not over, and other important elections are ahead of us.

The good news is that the Commission continues working on CMDI. Also, at the European Parliament, we managed to find political will to produce rather ambitious report on the Banking Union. Political processes in Europe mean that we can see the outcome of the work of the European Commission most probably around summer next year.

This is not good because it is not only about being prepared for next crisis, it is also about building competitiveness of the financial sector. A resilient banking sector could provide a boost to the Capital Market Union, ensure necessary funding for the sustained growth in the years to come, build trust and strengthen Europe as a growing financial center.

We have to explore all possible ways for a successful, fit for purpose reform of CMDI. The best approach that will bring more effectiveness and efficiency into the system would be a holistic one, including a reformed crisis management framework, introducing EDIS, breaking the sovereign loop and enhancing market integration. Therefore, indeed, we have to explore all possible ways for a successful, fit for purpose reform of CMDI, in line with a long-term vision on the European financial markets.

We need to relaunch negotiations on EDIS. No action on EDIS is not an option. A hybrid EDIS could address many issues, including supporting alternative and preventive measures in resolution.

The absence of EDIS means that incentives of decision-making power at European level could be misaligned with the use of financing tools at national level.

Let me again refer to what Andrea Enria said. We live in an environment of muted risks. There is evidence of mispricing of risks. We have to monitor the growing share of loans with higher risk. We cannot trust the inflation path or the interconnectedness between banks and non-banking sector.

We need a framework that is not just fit for the past or even the current situation; we need framework for the future.