Peter Praet: We need to complete the Banking Union

Speech by Mr Peter Praet, Member of the Executive Board of the European Central Bank, at the EUROFI Conference, Malta, 6 April 2017.

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The EU moved in less than five years from decentralized banking supervision and resolution to the Single Supervisory Mechanism and the Single Resolution Mechanism, based on the Single Rulebook. This is part of an overarching effort to create a sound institutional framework for financial integration in Europe. But there still are a number of legal, institutional and political problems to overcome before a European bank can operate in the Banking Union as it operates in its domestic market. Several dimensions need to be taken into account:

- First, private risk-sharing. The financial system is a private risk sharing device, but we have learned the lessons from the financial crisis in terms of budgetary costs, when excessive risk-taking by the private sector was eventually borne by the public sector. We do not want to revert to the old world of implicit government guarantees for risky behaviour of financial institutions. This entails making banks equally liable across countries for the amount of risk they want to take into their respective balance sheet. The general principle of the new European rules such as the Bank Recovery and Resolution Directive is to absorb bank losses by bailing-in shareholders and uninsured creditors. The new rules contain sufficient flexibility to deal with exceptional situations where public money may be required to ensure financial stability.
- Second, public risk sharing. A certain level of public risk sharing is necessary to create confidence in the overall financial system. Even well-capitalised banks can fall victim to runs and contagion. This is why central banks act as lender of last resort and fiscal backstops should be in place to ensure trust in the stability of the financial sector.
- In the Banking Union, both supervisory responsibility and the fiscal backstop need to be at European level, to underpin durably confidence in the area-wide financial system. Just as necessary is the establishment of a European Deposit Insurance System (EDIS). The current situation, where supervision is common, but the consequences of potential bank failures are still predominantly national, should not last. In such an incomplete framework, national considerations inevitably continue to affect supervisory decisions. This is not without consequences for the incentives for banks to become more European. Concrete examples include a lack of fungibility of liquidity or capital. The fact that the euro area is not considered as a single jurisdiction may result in applying higher capital buffers to euro area G-SIBs.
- While the institutional underpinnings of the Banking Union do not yet meet the requirements of a genuine single financial market, the creation of the SSM has been a leap forward in the establishment of a coherent regulatory framework. One of the first priorities of the Supervisory Board has been to promote integration through harmonized implementation of Options and National Discretions (ONDs), thereby evening the level playing field in the euro area. Regarding liquidity requirements, the Single Supervisory Board can grant waivers at national as well as cross-border level on a case-by-case basis. In the current institutional context, where the free flow of liquidity within the same banking group but across border could be impeded, a prudent supervisory approach has led the ECB’s Supervisory Board to still maintain a floor on the liquidity requirements of significant subsidiaries.
- Overall, the banking landscape still resembles too much a collection of banking systems highly exposed to their domestic economies, with limited cross-border private risk-sharing. At the same time, one should recognise that the Banking Union is both an objective and a process of fundamental structural changes in the euro area’s financial architecture. The next steps are clearly set out in the ECOFIN roadmap to complete the Banking Union. It is now urgent to agree on an ambitious timetable for its implementation.