Sabine Lautenschläger: Risk reduction in the euro area – how low can you go?

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The financial crisis demonstrated that risks need to be kept in check, both at bank level and at systemic level. To that end, the euro area has taken many steps over recent years. It has grown closer together and this has helped to reduce risks.

The European banking union is the centrepiece of these efforts. The first pillar, European banking supervision, was set up in 2014 to ensure that banks across the euro area are supervised to the same high standards. To that end, we have harmonised the supervisory approach applied to the 118 largest banking groups. In the process, we made use of the discretion contained in both the European and the national frameworks. This enabled us, for example, to move in 2014 from 19 different Supervisory Review and Evaluation Processes to a single harmonised one. This and many other changes in day-to-day supervision help to reduce risks and ensure that banks remain both safe and sound.

The second pillar of the banking union was established in 2016: the Single Resolution Mechanism. This ensures that banks can fail in an orderly manner. The failure of a bank must not pose a threat to financial stability or to public funds. Recent bank failures have shown that the new system works; supervisory and resolution authorities have cooperated smoothly and effectively.

This new institutional set-up is a good basis for reducing risks, but it needs further refinement. Regulation, for instance, needs to be further harmonised. To reap the full benefits of the banking union, we need a harmonised regulatory framework.

First, there is the issue of options and national discretions (ONDs). While some of these ONDs have been harmonised by supervisors, others lie in the hands of national legislators. Waivers for large exposure limits, for instance, are still fragmented across the euro area. This in turn affects other cross-border waivers, such as that on liquidity requirements. More generally, it stands in the way of a truly European banking market, as do the other ONDs that fall within the competence of national legislators.

Second, recent bank failures have shown that we need to further harmonise the tools for crisis management. We need to remove the overlap between standard supervisory measures and early intervention measures, for instance. As we are obliged to apply the least intrusive tool, the overlap often prevents us from taking early intervention measures. We also need to expand our toolbox to include a harmonised moratorium tool. Finally, national insolvency laws need to be aligned. All this would make the Single Resolution Mechanism even more effective.

These measures will help to better contain risks in the future. However, we also have to reduce the risks we face today. Non-performing loans (NPLs) currently pose one of the biggest risks to the European banking sector. They need to be dealt with first and foremost by the banks themselves. Some progress has been made on this front, although more needs to be done. In addition, supervisors need to play their part. European supervisors closely monitor how banks approach NPLs, and in 2017 and 2018 the ECB published guidance on the subject. The aim is not only to resolve the current NPL problem, but also to keep it from recurring in the future. Finally, legislators also need to address the issue of NPLs. Across the euro area, legal and judicial systems differ substantially in terms of effectiveness and efficiency when it comes to dealing with NPLs. The time and resources required to resolve NPLs thus differ from country to country. National legislators should strive to improve legal and judicial frameworks. In the end, tackling NPLs requires a joint effort by banks, supervisors and legislators.

To sum up, there are still things we can do to reduce risks in the euro area. In doing so, we will grow closer together, and that in turn will help to reduce risks further; European banking supervision is a prime example of this. We must thus be careful not to reach a point where we neither reduce risks nor grow closer together. We have to keep moving on both fronts; only then will we reach our destination of a more stable and prosperous European Union.