

Elisa Ferreira: From repair to vision - conceptions for a common beneficial and resilient financial architecture and institutional framework in the EU

Address by Ms Elisa Ferreira, Vice-Governor of the Bank of Portugal, on the panel "From Repair to Vision: Conceptions for a common beneficial and resilient financial Architecture and institutional Framework in the EU" at the "Financial Stability Conference 2018", Lisbon, 31 October 2018.

* * *

The setting up of the Single Rulebook in the European Union (EU) and the launch of the Banking Union (BU) with its rules and institutions constitute a commendable success of the post-crisis financial sector reforms in Europe; however the lack of political will to complete the architecture seriously jeopardises its key benefits.

Recent cases highlighted what I would call an 'accountability conundrum'. Banks nowadays are mostly 'European in life but remain national in death'. This means that, while supervisory and resolution decisions are mostly taken at European level, the ensuing consequences still lie with taxpayers at national level, with potential serious impacts on national budgets. As the ultimate guarantor of financial stability remains national, but with limited tools to act, this 'accountability conundrum' needs to be solved.

This unstable balance that emerged in the EU prevents economic agents from fully reaping the expected benefits of economic integration. Europe needs concrete plans going forward, and must address pressing questions on what is still missing to safeguard financial stability. Absent a fully-fledged European Deposit Insurance Scheme (EDIS) in the short to medium term, a plan is urgently needed for the interim period (until the BU can be completed).

Among the possible topics for debate, I would suggest:

1. First, the development of a specific institutional regime to address Member States' concerns over the risks of potential failures of cross-border banking groups: host Member States within the BU need tools to address financial stability risks arising from locally systemic undertakings; the absence of such instruments currently hinders progress on issues such as:

- (i) the adoption of waivers on liquidity and capital, and
- (ii) the removal of options and national discretions (ONDs)

which are in close connection, among others, with:

- ♦ *the rethinking of the Single Point of Entry (SPE)/Multiple Point of Entry (MPE) resolution models*; in particular, the generalisation of the SPE model within the BU requires that both the concerns at group level (home) and at subsidiary level (host) are addressed; and
- ♦ *the choice between subsidiaries or branches*, together with the supervisory powers of host national competent authorities (NCAs).

In this context, the transformation of subsidiaries into branches has emerged as an answer to the host responsibility for covered deposits – however that implies, at least, when local undertakings are of systemic relevance to the concerned Member State, that:

- ♦ domestic supervisors should have a say in the day-to-day supervision and should have the capacity to react to strategic decisions affecting branches as they would have had

had it been a standalone entity;

- ♦ national resolution authorities are adequately involved and empowered in the definition of resolution plans and in the resolution action when it occurs.

2. Second, solutions need to be found for the orderly exit of traditional medium-sized deposit-taking banks without disrupting financial stability. Whereas MREL and bail-in requirements may work for larger banks, there may be no clear room for a ‘middle class’ of institutions whose business model may be incompatible with MREL requirements; institutions that may be of no public interest at EU level but still have systemic relevance at local level.

Instead of moving immediately towards a further straitjacketing of Member States’ room for manoeuvre with the harmonisation of EU banks’ liquidation regimes, efforts must be made towards the establishment of an enabling framework for the “orderly” winding-down of locally systemic relevant banks, combining elements of the resolution and liquidation frameworks, while preserving value and protecting creditors and non-financial borrowers. Possible paths to be explored might include:

- ♦ the establishment of special insolvency proceedings, with recourse to administrative options, attributing some of the instruments currently envisaged in the BRRD for banks in resolution to a liquidating authority, as an alternative to the ‘atomistic’ court-led liquidation regime. (The liquidating authority and the funding sources available would need to be identified.)
- ♦ ensure effective financing of the deposit insurance systems for deposit transfers abiding by the least cost principle with the liquidating authority having the option to offer guarantees or enter into profit and loss sharing regimes. (For that, a revision of the applicable state aid rules would be required.)

Recent calls to form a sort of European FDIC, merging the Single Resolution Fund and EDIS into one single entity, merit our attention in this regard in the medium-term, provided that the legal framework is fixed and that financial stability – both at European as well as at national level – is enshrined as the first and fundamental objective of any intervention.

3. Let me conclude. What we have achieved in terms of the architecture of the BU is astonishing but the entire project remains fragile. Europe has stopped moving and currently stands in the middle of a very sensitive and unstable ‘bridge’.

If, realistically, sufficient progress cannot be expected in the medium term to establish EDIS and fine-tune the existing framework, then let’s concentrate on preserving the great value of the project.