Carlos da Silva Costa: Why we must complete banking union - financial stability threats would hit citizens' trust

Article by Mr Carlos da Silva Costa, Governor of the Bank of Portugal, in the 100th edition of the OMFIF Bulletin, 21 January 2019.

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Following the 2008 crisis, reforms were needed in Europe's financial sector. The establishment of the single rulebook and the launch of the European Union's banking union with its rules and institutions constitute a commendable success in this regard.

The banking union is currently based on two pillars: the Single Supervisory Mechanism and Single Resolution Mechanism. However, since these were put in place, the political will to complete the banking union has waned.

The banking union is missing critical elements – a fully-fledged European deposit insurance scheme, a backstop to the Single Resolution Fund and the provision of liquidity in bank resolution – which jeopardises its fundamental benefits. As we progressed along the road, new and bigger hurdles emerged. Policy-makers focused excessively on 'risk reduction v. risk sharing' and lost sight of the banking union's overall objectives.

Incomplete setup

In this incomplete setup, banks are 'European in life but national in death'. Supervisory and resolution decisions are mostly taken at the European level, but the ensuing consequences still lie with taxpayers at the national level. This may have a potentially serious impact on national budgets, as the ultimate guarantor of financial stability remains national.

In view of the mismatch between European oversight and national liability, the different stakeholders' objectives and interests are unaligned. It is important to consider who is actually looking after financial stability.

Four years after the SSM became operational, much has been accomplished. Danièle Nouy, the former chair of the Supervisory Board (2014–18), must be praised for her decisive contribution to this success. Her perseverance was essential to establish the mechanism's credibility.

As Andrea Enria takes over Nouy's mandate, now is a good opportunity to reflect on the many achievements of Europe's crisis management set-up and draw some preliminary lessons from the current (incomplete) architecture.

Looking ahead

With the benefit of hindsight, we should reflect on the need to strengthen the SSM's decision-making process, the need to draw a line clearly between regulatory powers and supervisory oversight, and ensuring the application of the principle of EU 'financial stability responsibility, regulatory responsibility and supervisory responsibility'.

Strengthening the decision-making process of the SSM would ensure shared ownership of problems and decisions, encouraging a broader vision on the implications of the SSM's decisions on financial stability. This could be achieved through the establishment of intermediate committees similar to those of the ECB's monetary policy function.

The separation of supervisory functions from regulatory ones is necessary for the political legitimation of regulatory standards. The overlap of regulatory and supervisory territories guarantees compliance with the principle of central responsibility for financial stability. In this context, it is necessary to find ways to ensure and safeguard this basic principle within banking union. It is also essential to determine which coordination and convergence mechanisms between territorial regulatory and supervisory authorities can be established between the banking union and the remaining EU member states.

One should not underestimate how much has been achieved in recent years. Nevertheless, the foundations of Europe’s financial architecture are still not sufficiently robust to withstand the impact of a future crisis. This should be a priority for policy-makers and relevant institutions.

Decisive political will to move forward with the completion of the banking union is required. In the absence of this will, Europe must revisit its existing rules to safeguard financial stability. This is in the best interests of its people as few things can be more destructive to citizens’ trust in European institutions than threats to financial stability.