European banking Union: how far from completion?

Panel intervention by Frédéric Visnovsky, Deputy Secretary General, ACPR

Goldman Sachs - Twenty-Third Annual European Financials Conference

Paris – Friday 7 June 2019

The European Banking Union is made of 3 pillars. We have made good achievements on the first two pillars even if there is still place for improvements.

The Single Supervisory Mechanism (SSM) is now well established. Looking at its main objectives, it is clearly a success:

1 - Restoring confidence in the banking sector: bank capital was raised, credit risks are tackled, in particular the large volume of legacy non-performing loans and inconsistency and high variability in the capital requirements are addressed.

2 - Breaking the adverse link between banks and sovereigns: risk reduction has been achieved to a large extent, **however** there is no agreement at international level how to consider sovereign risk and building of an effective area-wide safety framework, including common resolution and deposit insurance frameworks, is lagging behind.

3 - Fostering a level playing field and banking integration: European norms directly applicable to banks (such as the Capital Requirements Regulation, or CRR), **however**, still provisions established by European directives (such as the Capital Requirements Directive) that are not directly applicable but are transposed into

national law and provisions that are purely national and still ring fencing requirement by host countries (Pillar 2).

4 - Exploiting the synergies between the ECB and the national supervisors: the Joint Supervisory Teams (JSTs), which form the operational core of the system in charge of day-to-day supervision, include ECB and national staff; a common supervisory culture among staff of different institutions is fostered; convergence to higher supervisory quality and global standards with a risk assessment methodology established to determine banks' capital requirements (the Supervisory Review and Evaluation Process).

5 - Bringing independence, transparency and accountability up to the best global standards: board's members are independent in the exercise of their functions and are supposed to serve in the European interest; conduct of public consultations for all new regulations and a right to be heard for banks affected by any decision.

The Single Resolution Mechanism (SRM) has made good progress but there is still lot of work to be done.

1 - Strengthening resolvability of banks: drafting resolution plans; identifying impediments to resolvability and making banks address them; binding targets for MREL at consolidated level (2019) and solo level (2020), **however** need to be more bank specific

2 - Fostering a robust resolution framework: development of SRB policies **but** need for more transparency (consultation process is needed); the Internal Resolution Teams (IRTs), which form the operational core of the system, include SRB staff and national resolution authorities.

3 - Preparing and carrying out effective crisis management: simplifications of processes to increase their efficiency; improving and developing ICT solutions for crisis management, optimizing standardization of data request for valuation purposes; drawing lessons learnt from crisis cases and training SRB staff.

However, completing the Single Resolution Mechanism is needed:

First, with the establishment of a backstop to the Single Resolution Fund which is the key and the agreement of 29 June 2018 is a crucial first step, but three key issues remain:

- how to finance the safety net at a sufficiently high level to be credible;
- how to avoid placing too much risk on sound banks;
- how to create a rapid decision-making process to deal with emergencies.

Second, the euro area also needs a system for providing liquidity to financially sound banks after resolution

Third, it is necessary to have a consistent framework of the plans in the event of liquidation.

One of the main challenges is finding solution to a major impediment when looking at the European Banking Union: **the banking system in Europe is still fragmented** with very diverse concentration of banking systems.

There are obstacles related to regulation: applying prudential rules to individual banks and consolidated groups is also a potential obstacle as there are no cross border waivers for capital requirements. Concerning liquidity, it can be hard to meet the conditions required for granting for individual banks whereas centralized liquidity management tends to be safer from a prudential standpoint as it affords better access to financial markets and fosters quicker allocation of funds to groups that need them.

There are obstacles related to supervision: capital allocation flexibility, in the context of a cross border acquisition, is restricted by the Pillar 2 capital requirement calculation (additional capital requirements required by the supervisory authority) in respect of subsidiaries and coming soon internal MREL.

In this respect, clear progresses are needed and to ensure an effective resolution regime in Europe, one should consider possible solutions to **tackle the lack of trust between host and home authorities**. It is necessary, in particular, to tackle the root cause of ring-fencing practices which, in general, lie in the perception that, should a banking group face difficulties, the parent company will repatriate liquidity and capital, at the detriment of subsidiaries in other jurisdictions.

The Banking Union has strengthened the European cooperation (SSMR/CRDIV/CRR for supervision, BRRD/SRMR for resolution). This framework should now fully deliver to make Member States feel more confident that, in times of crisis, there will be no national/home bias. But, confidence of host Member States should be ensured by more robust ex-ante arrangements to upstream losses, especially in the case where subsidiaries face difficulties but the group/parent does not. Intra-group arrangements could be requested by supervisory/resolution authority to reinforce the protection given by parent banks to their subsidiaries in other Member States.

On the third pillar, deposit insurance, a compromise will have to be found in order to make headway on this pillar of the Banking Union. Once we have completed the resolution framework, we will be less in need of a shared European scheme. A pragmatic approach could be to introduce a system of loans between national deposit guarantee schemes (DGS), with guarantee mechanisms to ensure that liquidity advances do not lead to losses for the lending DGS. This would lead to a sharing of liquidity without sharing risks, which would be a first step towards shoring up financial sector confidence and strengthening depositor protection.