# Intervenção da Vice-Governadora Elisa Ferreira na "CIRSF Annual International Conference 2018": "Banking Union at a crossroads" (apenas em inglês)

**06 jun. 2018**

***Banking Union at a crossroads***

**Keynote Speech by Elisa Ferreira, Vice-Governor of Banco de Portugal** [i]

Good morning ladies and gentlemen,

It is a great pleasure to close this morning's sessions by addressing you on a topic that is so dear to me: Banking Union.

We are at a crossroads, and with the experience we have already gathered, all the pro-Europeans, among whom I include myself, have the duty to address the outstanding critical questions of Banking Union.

And for that, there is nothing better than to go back to the reasons behind putting it in motion and ponder whether we are moving closer to or drifting away from our original goals.

The post-crisis financial sector reforms were designed to strengthen financial stability by focusing on improving banks' resilience, ending too-big-to-fail, breaking the sovereign-bank loop and reducing financial fragmentation.

Efforts were put into developing a harmonised regulatory framework with stricter requirements on capital and (private) loss-absorbing capacity to protect taxpayers, while reinforcing risk prevention and reduction.

In the European Union (EU), the Single Rulebook and the European System of Financial Supervision were introduced. The euro area went further, launching Banking Union and its institutions, namely the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) at an amazing speed – a commendable success.

The firm, cohesive European commitment towards Banking Union helped counter financial fragmentation and, as stated in the 2012 Roadmap, aimed to reassure citizens while building the necessary trust between Member States.[ii]

However, as the first two pillars of Banking Union were put in place, the political will to build the third pillar – a European Deposit Insurance Scheme (EDIS) – and complete the Banking Union waned. New and bigger hurdles emerged as we moved closer to a finish line that was agreed many years ago. Policymakers got stuck in the risk reduction vs. risk sharing debate, losing sight of the overall objectives.

This lack of determination in completing Banking Union in accordance with the agreed timelines has seriously jeopardised its key benefits. Today, as we speak, Banking Union means that supervisory and resolution decisions are mostly European, whilst the ultimate guarantor of financial stability remains national, with limited tools to act.

This asymmetry might have had serious consequences in a series of recent cases, in which decisions were ultimately redirected to individual nations.

Financial stability is the central objective of Banking Union. Few things can be more destructive to citizens' trust in the European Institutions than threats to financial stability, perceived as risking their savings.

In view of the existing mismatch between European oversight and national liability, the objectives and interests of the several stakeholders involved are not aligned. So we need to ask: who is actually looking after financial stability? And which institution is capable and actually equipped to safeguard it?

With the benefit of six years of hindsight, it is now clear that several links and stabilising elements are missing in the Banking Union. These need to be urgently tackled.

At the current juncture, policymakers and co-legislators need, at least, to fine-tune the regulatory framework, and deliver on what was agreed.

## Some concrete examples:

In view of the absence of EDIS, if Banco Popular Español had actually failed, the Portuguese Deposit Guarantee Scheme would have had to reimburse depositors in the Portuguese subsidiary, even though Portugal was neither supervising nor resolving Popular.[iii]

As banks are to a large extent still "national in death", this example shows us that we need to rethink the Single Point of Entry (SPE)/Multiple Point of Entry (MPE) resolution model in tandem with the strengthening of the supervisory powers of host national competent authorities (NCAs).

Additionally, a generalised entry into force of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR), irrespective of the banks' business models, has meant that, as of today, many institutions would only be deemed resolvable if bail-in would be extended to the level of senior debt or even deposits.

This, in turn, can have destabilising effects, by amplifying the incentives for a bank run at the earliest sign of distress.

It is worth recalling that, in this regard, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) recently published a joint statement encouraging institutions, market and resolution authorities to properly consider retail holders of debt financial instruments subject to the BRRD when carrying out their respective tasks.[iv] We still need to evaluate its implementation.

Although one may support and push for credit institutions to increase their loss absorption capacity, it is simply not reasonable to expect that compliance with Minimum Requirements for own funds and Eligible Liabilities (MREL) can be achieved by all credit institutions in the short to medium term without seriously aggravating their financing costs and profitability.

Resolution authorities therefore need to be able to rely on alternative sources to support resolution actions, such as resolution funds, especially in the current period of transition during which loss-absorbing capacity is not yet available. However, as some had already predicted, the current internal loss absorption requirements (8% of total liabilities and own funds) and limitations on the amount of the resolution funds that can be used (5% of total liabilities and own funds) prevent this, by subjecting senior debt and even unsecured deposits to risks incompatible with financial stability.

Moreover, the decision to establish a wider scope for MREL than for TLAC (Total Loss Absorbing Capacity) cannot be ignored. Whereas TLAC applies only to G-SIBs (Global Systemically Important Banks), MREL applies to all credit institutions in the EU, regardless of their size. Proportionality and flexibility are thus crucial, in order to maintain the level playing field and avoid distortions in banking businesses.

Regulatory-driven consolidation has become an imminent risk: if only larger banks are able to comply with increasingly complex regulation and potentially disproportionate requirements, we could be fostering the comeback of too-big-to-fail – which we were trying to avoid in the first place – while threatening the survival of traditional deposit-taking banks.

A key principle of the EU post-crisis regulatory reform was the preservation of different business models – this is evident in multiple references in the Single Rulebook. MREL and other regulatory requirements were not thought of as a way to promote consolidation.

As we stand, the approach adopted in the EU regarding MREL, combined with a set of other regulations, may challenge the sustainability of the business model of medium-sized institutions predominantly financed by capital and deposits.[v] The financing of small and medium-sized enterprises (SMEs), which are the core of the EU economy and job creation, may thus become harder – with the ensuing social and political consequences.

Ultimately, the incomplete set-up of the Banking Union and the full implementation of the resolution regime are a dangerous combination. One that calls for a comprehensive rethinking of the existing framework of safety nets[vi] – especially when monetary and fiscal policy have limited room for manoeuvre.

As often in the past in the case of the European project, now, in the current context, bold decisions are more needed than ever. The completion of Banking Union is in many aspects a way to restore European citizens' confidence in the European institutions, build the necessary trust between Member States and address the rise of Euroscepticism.

This starts by putting aside the risk reduction vs. risk sharing debate that is preventing the establishment of a fully-fledged EDIS. EDIS is a necessary risk reduction instrument that reduces moral hazard[vii] – and should be recognized as such. Recent research by the ECB has shown that with proper risk-based banks' contributions, an almost negligible cross-border subsidisation occurs.[viii] The fear that EDIS could imply significant transfers across countries in case of a new banking crisis is therefore unjustified.

But establishing EDIS in isolation is not enough. Recent experiences put the topic of harmonising EU banks' liquidation regimes on the agenda of policymakers. But what does bank liquidation mean? And do we have the tools to ensure its orderliness in the current context?

Before jumping into the harmonisation of liquidation regimes, it must be acknowledged that this is not a silver bullet. Indeed, the considerable social and economic impact ensuing from the failure of a bank with systemic relevance at local level would remain.

Recent calls to form a sort of European FDIC (a version of the American Federal Deposit Insurance Corporation), merging the Single Resolution Fund (SRF) and EDIS into one single entity, [ix] are welcome in this regard, provided that the legal framework is fixed and that financial stability – both at European level as well as at national level – is enshrined as the first and fundamental objective of any intervention.

In fact, the establishment of Banking Union was inspired by the American FDIC. However, it fell short of providing the SRF or EDIS with right instruments and means to guarantee financial stability.

For this to happen, a clear definition of what constitutes public interest and critical functions is required. In view of recent cases, it has been argued that public interest is likely to be a variable of time and geography, "one at the EU level and another one by national authorities".[x]

This discussion cannot be taken only at technical level as its consequences are at the core of Banking Union's credibility. European citizens expect this from us.

## Let me conclude.

One should not underestimate how much has been achieved in such a short period of time. Nevertheless, the foundations of the European architecture are still not sufficiently robust to withstand the impact of a future crisis. This should be the focus of policymakers and relevant institutions.

Decisive political will to move forward with the completion of the Banking Union is therefore required, accompanied by a proper evaluation of the underlying implications for banks' business models.

If the necessary political will is insufficient, then, ladies and gentlemen, allow me to say this openly: instead of putting 'Band-Aids' in the framework to compensate for the lack of crucial instruments, let's collectively recognize that it is urgent, and in the best interest of European citizens, that we revisit the existing rules now. If it turns out that it is not possible to complete the Banking Union, we must structurally revisit the project.

Otherwise, we risk both fragmenting the single market and realising we missed this opportunity when the next crisis hits. In that case, we cannot expect European citizens' forgiveness.

Thank you for your attention.

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[i] As prepared for delivery.

[ii] Communication from the Commission to the European Parliament and the Council – A Roadmap towards a Banking Union, COM/2012/0510 final.

[iii] Nouy, D. (2017), "Banking union, three years on – has it lived up to its promises?", statement at the Single Resolution Board Conference, Brussels: "Banks are supervised and resolved at European level, but in the event of a failure, the negative consequences are felt mainly at national level. (…) If, for instance, the Spanish Banco Popular had actually failed, Portugal's deposit insurance scheme would have had to refund depositors in the Portuguese subsidiary. That is a consequence of having supervision and resolution at European level. The Portuguese authorities would not have been involved in either process."

[iv] EBA, ESMA (2018), "Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments subject to the Bank Recovery and Resolution Directive", EBA/Op/2018/03, available at: http://www.eba.europa.eu/documents/10180/2137845/EBA+ESMA+Statement+on+retail+holdings+of+bail-inable+debt+%28EBA-Op-2018-03%29.pdf

[v] Restoy, F. (2018), "Bail-in in the new bank resolution framework: is there an issue with the middle class?", speech at the IADI-ERC International Conference "Resolution and deposit guarantee schemes in Europe: incomplete processes and uncertain outcomes", Naples, 23 March.

[vi] Geithner, T. (2016), "Are We Safer? The Case for Strengthening the Bagehot Arsenal", Per Jacobsson Lecture, IMF–World Bank Annual Meetings, 8 October.

[vii] Smaghi, B. (2018), Financial Times Op-Ed "European banking union needs its final leg", 21 October 2017.

[viii] Carmassi, J., Dobkowitz, S., Evrard, J., Parisi, L., Silva, A., Wedow, M. (2018), "Completing the Banking Union with a European Deposit Insurance Scheme: who is afraid of cross-subsidisation?", ECB Occasional Paper 208, April.

[ix] Constâncio, V. (2018), "Completing the Odyssean journey of the European monetary union", remarks at the ECB Colloquium on "The Future of Central Banking", Frankfurt am Main 16-17 May.

[x] Enria, A. (2017), "Q and A with Andrea Enria of European Banking Authority", Interview with Politico published on 4 July 2017.