EBI European Banking Institute

Conference Report

on the

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“Recovery and Growth in a Post-Pandemic EU”

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A. Introduction

The work of the European Banking Institute (EBI) has been divided into two key elements: On the one hand, academic work and, on the other hand, policy work. On the academic side, the Academic Board of the EBI has expanded its work on the Working Paper Series, published the second edition of its EBI eBook ("Financial Stability amidst the Pandemic Crisis – On Top of the Wave" (2021) *Gortsos* & *Ringe* (eds.)), added an Academic Debate to the conferences it already organises, which is taking place on a regular basis and deals with current issues of academic interest, and initiated the "EBI Studies in Banking and Capital Markets Law", in which the first book has already been published.

More recently, a third element has been added to the work of the EBI. The EBI has widened its teaching work by launching the EBI Master Program on Banking and Financial Regulation alongside the master "Law and Practice of the Banking Union" at the University of Bologna. The new master is organised jointly with the Frankfurt School of Finance and Management. The EBI Academic Board develops the curriculum, and the teaching is carried out by many experienced scholars from the EBI Academic Board.

In terms of policy work, the EBI Policy Conference is the annual highlight taking place every November. In last year's conference, the initial response of the EU to the Covid-19 Crisis was discussed.[2] This year's conference focused more on the bigger picture of recovery and growth after the Covid-19 pandemic. The EBI was again able to attract high-level and distinguished speakers and discussants for this conference.

B. First Day – 3rd November 2021

The first day of this Policy Conference started with introductory remarks by the President of the EBI, Dr **Thomas Gstädtner**. In his introductory speech, Thomas Gstädtner looked back at the pandemic and drew comparisons with the previous Global Financial Crisis and Euro Crisis. In the pandemic, he argues, we have seen a paradigm shift in many respects. For the first time in decades, monetary and fiscal policies across advanced economies are working together to stimulate demand. The pandemic has led

[2] See the conference report drafted by Lukas Böffel, which was published with EU Law Live (see here) and by the EBI (see here).

governments to adopt policies that better meet the needs of macroeconomic stabilisation. It is the combination of monetary and fiscal policy that made this policy mix successful.

However, in his view, fiscal policy faced a difficult trade-off between business cycle stabilisation and debt sustainability, in particular in a situation with high legacy debt. Risk premia on lower-rated sovereign bonds skyrocketed in March last year, impairing monetary and fiscal policy transmission. Two decisions were necessary to break this vicious circle. On the one hand, the launch of the Pandemic Emergency Purchase Programme (PEPP) by the ECB and, on the other hand, the lifting of state aid requirements by the European Commission and the launch of the EU Recovery and Resilience Facility by the Member States. Together, the PEPP and the Recovery and Resilience Facility created the conditions for national fiscal policies to mitigate the dramatic social and economic costs of this crisis. As a result, Thomas Gstädtner described the economic policy response in the euro area to the Covid crisis as very strong. He argued that the policy response to the pandemic is a remarkable showcase for the power of monetary and fiscal policy interaction to boost confidence, stabilise aggregate demand and avoid a persistent destabilisation of medium to long-term inflation expectations.

Thomas Gstädtner also highlighted a major difference from previous crises: unlike in the Great Financial and Euro crises, this time, banks have not only weathered the pandemic but have even been successful in helping the economy to absorb the shock of the pandemic and have helped mitigate risks to financial stability. Thus, in stark contrast to the Global Financial Crisis, banks have helped cushion the economic impact of the pandemic rather than exacerbate it.

Ultimately, Thomas Gstädtner argued that the public sector measures taken in response to the pandemic have helped mitigate the recession and limit divergences between the euro area members. Nonetheless, differences persist and the euro area remains divided between a North, where inflationary pressure may arise earlier and where an increase in interest rates may be welcome at an earlier stage, and a South, where an early rise in interest rates, as well as an early withdrawal of fiscal stimulus, would have severe consequences for economic and financial stability. Against this background and despite growing optimism, EU Member States still face important risks and continue to grapple with the long-run structural challenge while also achieving a sustainable improvement in their legacy debt. Given these challenges, government measures need to be targeted, cost-effective and focus on longer-term growth. Next Generation EU rightly fosters competitiveness and investments while supporting the greening and digitalisation of the economy to create a more innovative and sustainable EU.

Thomas Gstädtner concluded that over the longer run, the process to strengthen institutions and governance in the euro area should be continued. This could require strengthening the enforcement of fiscal rules in good times, possibly through an increased role for the independent European Fiscal Board, and completing the Banking and Capital Market Unions.

I. Session 1: Post-pandemic fiscal priorities for the euro area

The first session was kicked off with a keynote speech by Dr **Rolf Strauch**, Chief Economist of the European Stability Mechanism (ESM). He started his speech by drawing a bigger picture describing the current situation of the EU. The conclusion of this overview was that despite the Great Financial Crisis, the sovereign debt crisis and the pandemic, the Euro is stronger than ever. Mr Strauch explained that this success is closely linked to the institutional deepening of the Economic and Monetary Union that we have experienced over the last decades. However, the pandemic has also exposed old and new challenges for the EU. Mr Strauch identified four elements: 1. sufficient fiscal buffers to counter upcoming crises; 2. convergence and risk sharing; 3. climate change as the key challenge of the modern world; 4. digitisation to enable growth, strengthen competitiveness, and ensure technological sovereignty.

To be able to tackle these challenges effectively, Rolf Strauch elaborated on a few points in the following. First, the interaction between monetary policy and national fiscal and structural policies: he stressed that once monetary policy normalises after the crisis, it is within the responsibility of the states to initiate structural, fiscal, and macroprudential reforms. These are necessary to ensure that financial help in the future can be provided by the EU, particularly the ESM, based on conditionality.

Second, the fiscal framework currently under discussion should be reformed, taking into account a number of aspects. The fundamental goal of any reform must be to maintain sustainable public finances. This means not only that spending should be limited, but also that sustainable growth of economies is supported by giving states the opportunity to invest in the transformation of their economies. It is also important to note that the debt bearing capacity of Member States increased, as it is unlikely that interest rates on sovereign bonds will return to the high levels seen in recent decades.

Third, as Next Generation EU is only a temporary program, follow-up programs need to ensure high convergence and promote the transformation to more sustainable and digitalised economies. These future reforms should take into account two important features that have proven to be a strength of Next Generation EU. First, in Next Generation EU, the EU worked with positive incentives instead of sanctions, and second, the planned financing of the EU took into account the environmental challenge and is supposed to be based on funds closely linked to the EU mandate of managing the EU internal market, which adds legitimacy.

Fourth, the private sector will have to finance a large part of the recovery. This is only feasible if the EU achieves better integration of the banking and capital market, thereby fostering the cross-border flow of financial services and capital, which ultimately aids to absorb idiosyncratic shocks better.

Rolf Strauch concluded that actions by the EU can make a real difference: they help overcome situations of crises and create trust in the euro area by providing support and strengthening the economies of the Euro.

This keynote speech was followed by a stimulating discussion, which was moderated by Thomas Gstädtner together with **Nejc Smole**, Director of the Policy Center of the EBI. Moreover, **Nicolas Véron**, Senior Fellow at Bruegel (Brussels) and the Peterson Institute for International Economics (Washington DC), joined the debate as a discussant. During the debate, many interesting points were raised and discussed in depth. Among the issues discussed were whether the EU needs a permanent mechanism for joint debt issuance, whether the credibility of the Eurozone has increased or decreased in the post-pandemic environment, and whether the structural reforms implemented by the Member States so far have been successful. Nicolas Véron also brought up the question of what such a permanent mechanism would mean in terms of the interplay between the Eurozone and the rest of the EU. In addition, long-term problems were discussed, namely, whether there are alternatives to debt-financed aid and who should be responsible for repaying the debt – the EU or the Member States – and from which resources.

II. Session 2: Banks after the pandemic crisis

The second session on banks after the pandemic crisis started with a keynote speech by **Kilvar Kessler**, Chairman of the Board of the Estonian Financial Supervision Authority Finantsinspektsioon and a member of the SSM Supervisory Board. Mr Kessler began his presentation with some interesting insights into his experiences from supervisory practice. He then structured his speech as follows: first, he assessed the effectiveness of Covid measures and the lessons we should learn from them; second, he focussed on the future risks; and third, he examined the challenges of digitalisation.

Kilvar Kessler noted in the first part of his speech that Baltic banks have weathered the crisis well. Besides fiscal aid and monetary policy support, he identified two elements in particular as being responsible for this result: first, the sufficient capital buffers that the banks had from the earlier good days, and second, the moratorium on private loans that the banking sector had agreed to under the EBA model. With regard to the capital buffers, Estonian banks were capable of building such buffers because they were rather profitable compared to other banks in the EU before the pandemic. By blocking the issuance of dividends, the buffers could be protected. Due to the good starting position of the Baltic banks, they hardly had to resort to capital and liquidity buffers during the crisis; on the contrary, they even remained profitable. In terms of the moratoria, Estonian banks used these a lot. At the peak, 11 % of the total loan portfolio were subject to moratoria. This figure dropped in the course of the crisis to just 1.8 % today. That is why, Mr Kessler concluded that the moratoria had an important bridge function in the crisis.

Second, Mr Kessler turned to future risks. While he does not fear a sudden increase in non-performing loans (NPLs), as the vaccination campaign is already underway and economies are recovering, he pointed to the risk that there continues to be a concentration of loans with outstanding moratoria, which could be of lower quality. In addition, structural deficiencies remain: one of the main shortcomings, in his view, is the low profitability of many EU banks.

Third, Mr Kessler focused on the issue of digitalisation. He pointed out that Estonian banks were already highly digitalised before the pandemic. More than 92 % of all payments by private individuals initiate in e-channels, and 87 % of those payments travel instantly. This makes Estonian banks among the most digitalised in the EU. At the same time, this digitalisation increases the risks of cyber-attacks. Mr Kessler expressed the fear that the supervisory authorities have not yet grasped the impact of this digitalisation on the supervision of banks. As an example, he mentioned the question of how authorities should monitor risks in the public blockchain. Another problem is that there are currently not enough IT experts working in supervisory authorities.

Kilvar Kessler concluded his keynote speech by stating that the pandemic did not have the drastic impact on the banking market that was feared at the beginning, also due to the well-coordinated response of the supervisory authorities. Nevertheless, some challenges remain in terms of asset quality that need to be addressed. He also stressed that Covid has greatly fostered the digitalisation of banks. But again, there are still challenges in terms of digitalisation that need to be addressed now, especially through the digitalisation of supervisory processes that need to make greater use of automated data processing. Finally, he concluded with the words of Elvis Presley: “A little less conversation, a little more action, please”.

The following discussion was moderated jointly by two members of the EBI Academic Board: Prof. Irene Kull from the University of Tartu and Prof. Bart Joosen from VU University Amsterdam. First, the discussion delved into the further digitalisation of banks as well as the risks posed by cyber-attacks. It was pointed out by Kilvar Kessler that cyber risks are often hybrid risks, which affect a variety of agencies and areas and are not limited to the financial market. The discussion then dived deep into stress tests conducted by the ECB and EBA and whether these stress tests have sufficiently taken account of a “protected crisis”. In his response, Kilvar Kessler emphasised that stress tests are one important tool, but that supervisors have a number of tools at their disposal that they should use more often.

III. Conclusion

The first day of the policy conference ended with some closing remarks by the President of the EBI Academic Board, **Prof. Christos Gortsos**. After thanking all contributors to what he referred to as a “very interesting and very intellectually challenging day”, Christos Gortsos highlighted that we still have an asymmetric EU: On the one hand, monetary policy and banking supervision have been harmonised and centralised, although there is still room for more centralisation for the latter. On the other hand, fiscal policy is still in the hands of the Member States and centralisation is not foreseeable in the near future. This stark asymmetry between a harmonised monetary policy and a national fiscal policy remains a striking feature of the EU. Christos Gortsos also emphasised that it is the Member State's responsibility to implement structural reforms now and thus use the money given by the EU wisely.

C. Second Day– 4th November 2021

The second day of this Policy Conference opened with introductory remarks by the President of the EBI, Dr **Thomas Gstädtner**. In his introductory speech, Thomas Gstädtner summarised the topics presented, and discussions held on the first day of the Policy Conference. With regard to the first keynote speech on post-pandemic fiscal priorities in the euro area and the Next Generation EU, he noted that there was an agreement on the need for a thorough implementation of all the requirements accompanying the Next Generation EU programme, specifically the requirements referring to the way that funds should be spent and to the proper implementation of the reforms that have been agreed upon by the EU Member States and the EU Commission. He then briefly turned to the second keynote speech on Banks after the pandemic crisis and noted that some capital and liquidity measures adopted were beneficial, whereas others need to be reconsidered, like the use of buffers. He finally referred to the steps that need to be taken in the future, mentioning the credit risk banks are exposed to and the issues related to loan moratoria.

Following this short overview, Thomas Gstädtner introduced the keynote speakers of the second day of the Policy Conference. Before the speeches commenced, **Mr Michael Boddenberg**, Finance Minister of the German State of Hessen, addressed welcome remarks through a pre-recorded video.

I. Session 1: Post-pandemic recovery and growth models

The first session was kicked off with a keynote speech by Ms Dr **Elke König**, Chairwoman of the Single Resolution Board (SRB). She started her speech by drawing a comparison between the financial crash of 2008/2009 and the Covid-19 crisis, concluding that regulatory infrastructure and capital levels across the banking sector are far more robust currently compared to the past.

The crisis of 2008/2009 was a financial one, striking the core of the banking system and affecting the Member States to very differing degrees. The latter aspect impacted the EU response as it made it hard, if not entirely impossible, for the EU to react in a unified manner. The EU response was further hampered by a lack of regulatory oversight at the EU level. The Covid-19 crisis differs from the financial crash in three respects: (1) it is the economic impact of a health crisis, which (2) affected all Member States and triggered fiscal support measures in all of them. (3) However, the stark contrast is that currently the EU benefits from the required regulatory architecture, albeit this is not complete yet, while this time, the banks have been part of the solution, providing credit to the economy.

Throughout the pandemic crisis, the SRB has continued to run operations smoothly, and banks have continued to work well in this more demanding environment. However, although the common backstop agreement is a positive development, Ms König gave a clear warning that banks will face an increase in NPLs post-pandemic and that the time for banks to ensure adequate provisioning is now.

Ms König then explored the way to emerge from the crisis. In a post-pandemic world, regulation will play a prominent role to achieve economic recovery and growth. In this regard, she noted that a major regulatory priority will be the development of a common deposit protection scheme with the ultimate objective to complete the European Banking Union. In this regard, Ms König positively referred to the Federal Deposit Insurance Corporation (FDIC) example in the USA, which combines the resolution, insolvency, and deposit insurance function. She concluded that the EU could draw inspiration from the FDIC model, which works exceptionally and combines deposit insurance and resolution funds to reduce costs to all stakeholders.

An additional regulatory reform is the harmonisation of the EU liquidation regime and insolvency procedures in view of the challenges currently posed to the banking resolution due to the different national insolvency frameworks in the Banking Union. In this respect, Ms König referred to a potential two-tier system of applicable EU and national rules based on the size of the banks. She also welcomed the Commission's initiative on the bank crisis management and deposit insurance (CMDI) review and urged for improvements of the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation, and deposit guarantee schemes (DGS), while she cautioned that national insolvency solutions should not be an excuse to continue implementing bailouts.

In the context of the regulatory reforms, the SRB's Chairwoman also welcomed the banking package measures announced by the EU Commission and emphasised the need for a meaningful Capital Markets Union, along with supporting other regulatory reforms.

As regards the immediate SRB priorities for 2022, these include – *inter alia* – liquidity and funding in resolution, separability and reorganisation plans, and information systems and Management Information Systems (MIS) capabilities. In view of the increasing digitalisation of the financial markets, information and communication technology (ICT) and cyber risks should also be identified as key priorities for banks. In particular for mid-sized banks, the SRB prioritises include the work on transfer tools, separability and adjustments of Minimum Requirement for Own Funds and Eligible Liabilities (MREL) for such transfer tools. Although "sale of business" is a valid tool available in the resolution toolbox, Elke König claimed that we should be mindful that it is "not a magic wand". Therefore, while SRB's policy work continues, banks should also continue building up their MREL targets.

Ms König concluded that work must resume in a consistent and coherent manner towards ensuring financial stability in the banking sector with the objective to benefit the people and businesses of the EU.

This keynote speech was followed by a thought-provoking discussion moderated jointly by Prof. **Christos Gortsos**, President of the Academic Board of the EBI, and Prof. **Wolf-Georg Ringe**, Member of the Academic Board of the EBI. Among the issues discussed was how Brexit affected the SRB's day-to-day work and collaboration with the Bank of England, the common backstop agreement, and the heat-map. In addition, the questions touched upon the different national insolvency regimes and how to overcome their challenges. In this context, Ms König highlighted the different burden-sharing regimes under the BRRD and the SRM Regulation. Finally, major impediments to resolvability and the no creditor worse off (NCWO) principle were discussed.

II. Session 2: Post-pandemic regulatory reforms to completion of the Banking Union

The second session kicked off with the keynote speech of Mr **François-Louis Michaud**, Executive Director of the European Banking Authority (EBA). Two considerations underpinned his remarks. First, the lessons learnt from the pandemic and risk aspects; and second, how these lessons can guide the EU to future reforms, including completing the Banking Union and the Single Market more generally.

Regarding the lessons learnt from the pandemic crisis, Mr Michaud noted right from the beginning of his remarks that the institutions and rules in place seemed to have worked quite well overall. He then provided four observations on how the EU regulatory framework worked during the pandemic to support his assessment. First, he pointed out that the banks continued their credit provision activities despite the upheavals in the economy thanks to their solid capital and liquidity levels built up over the last ten years, as a result of both the banks and public authorities' efforts.

Second, he noted that the response of the EU legislator was smooth (e.g., Capital Requirements Regulation (CRR) quick fix), whereas at the same time, the EU regulatory framework allowed for swift adjustments in the capital and liquidity buffers. However, when considering future steps, we should be mindful of the fact that banks were reluctant to use these buffers, even though they were encouraged by the supervisors and regulators to do so.

Third, he highlighted that the pandemic crisis proved that the EU currently benefits from a full kit of public sector tools that can be quickly mobilised. He referred to the loan moratoria as an effective tool. In this context, he did not omit to refer to the different national insolvency regimes as a field requiring more harmonisation in the future.

Fourth, it was the flexibility that the regulators alleviated pressure on banks by postponing the EU-wide stress tests by one year, suspending on-site inspections etc. This, however, implied the loss of valuable information from the banks.

Following these observations, Mr Michaud turned to the risks and vulnerabilities banks are exposed to by raising considerations related to asset quality and asset valuation. In his view, the most prominent risks are linked to the digitalisation era and the fundamental transformation of the financial intermediation in view of emerging FinTech companies.

The banks should not underestimate the significance of these trends as they impact their profitability. Finally, the rise of NPLs during the pandemic is a further risk faced by banks.

Mr Michaud then turned to the final part of his speech focusing on the way forward. A key step in the future is that banks need to undertake substantive work towards restructuring their activities, reducing operational costs, and reconsidering their business models. For the business strategy reform, consolidation could play a role in different ways, including M&As so that banks benefit from economies of scale or restructuring some of their activities. If such changes do not take place, the financial sector's stability runs into risks. In view of this, it is also important that policies for the exit of banks from the market are put in place. In addition, the Single Rulebook should continue to ensure that banks set aside adequate amounts of capital, whereas it is equally important to reform existing rules on provisioning and capital requirements. Mr Michaud further illustrated the importance of tackling anti-money laundering (AML), which we need to take seriously into consideration and build on the existing momentum for AML reforms. Not least, he mentioned that banks should also be aware of challenges emerging on account of climate change risks that they need to prepare for. Embracing the rules of the Taxonomy Regulation is vital for the transition to models, which take climate change into account. Nonetheless, such transition should be smooth and orderly, so banks do not face extra pressure.

A fruitful discussion followed Mr Michaud's presentation, which was jointly moderated by Prof. **Concetta Brescia Morra** and Prof. **Louis Morais**, both members of the EBI Academic Board. The questions focused on aspects of crisis management, DGS and banks' profitability. Mr Michaud's responses touched upon further nuances of the points he explored in his speech. He stressed – *inter alia* – the interlinkages between recovery and resolution stages, which need to be taken into account when marching towards the future. As regards the low profitability of banks, Mr Michaud acknowledged the difficulties of cross-border mergers. Yet, he emphasised that there are other ways that banks can increase their profitability, especially by reconsidering their business strategies. In his conclusion, Mr Michaud pointed out that the cornerstone for banks' profitability is from now on the banks' efforts. As he eloquently said, the public sector has done a lot so far and "it is [now] up to you market forces, move on".

D. Concluding Remarks

At the end of the Policy Conference, Mr **Nejc Smole**, Director of the Policy Center of the EBI, addressed to the audience some closing remarks. First, he expressed the wish of the EBI that the next-year Policy Conference will be organised with a physical presence. He then provided a concise synopsis of the main points and arguments raised and discussed during both days of the Policy Conference on the topic of Recovery and Growth in a Post-Pandemic EU. Finally, he warmly thanked on behalf of **Thomas Gstädtner**, **Christos Gortsos** and the entire EBI team all the speakers for their enriching presentations and participation.