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Completing the Banking Union: an even more urgent task in times of uncertainty

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Banking Union is an essential element to safeguard financial stability and sustainable growth in the euro area. The euro area sovereign debt crisis of 2012 highlighted the extensive contagion channels between the financial system and sovereign issuers, their amplification effects and how easy it was for them to spill over national borders. The answer at that time was pivotal for the future of Economic and Monetary Union (EMU): a Banking Union was essential and, more recently, albeit still incomplete, it has been crucial to underpin the resilience of the euro area during the pandemic.

Consequently, completing Banking Union is an indispensable priority, particularly in the present context of high economic uncertainty that translates into heightened risks to financial stability. Furthermore, a complete Banking Union will allow us to fully reap the benefits of EMU membership, by guaranteeing the level playing field and a competitive and robust European banking system. The present status of the Banking Union is clearly not our desired destination.

Rather, there is much work ahead. The costs of inaction damage the credibility of the project and should definitely be avoided. Certainty about the timeline is also key for decision-making by the different stakeholders.

Against this background, reaching an agreement on the way forward for Banking Union in June was very important. The Eurogroup (EG) has provided a welcome and practical response to this challenge by proposing to focus on an area where there are well-identified gaps to fill: strengthening the framework for the management of failing banks in the EU. Reducing the heterogeneity of liquidation procedures across Member States and broadening the uses of the different national deposit guarantee schemes for resolution and liquidation, as well as making them more consistent, are especially welcome adjustments to improve the resolution of medium-sized and small banks. We also need to facilitate the access to the Single Resolution Fund when it is needed without modifying the previous political agreements.

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Nonetheless, this way forward should not draw our attention away from a fully mutualised EDIS – the third pillar of the Banking Union as originally proposed – which should be the final goal. The EDIS is pivotal to ensuring a true Banking Union: first, it equalises the level of depositor confidence across the single market; second, it helps to delink depositor protection from depositor location, thus reducing the link between banks and sovereigns; third, it reinforces the level playing field for banks; and lastly, it strengthens depositor protection against local shocks. In the current situation, with both the SSM and the SRM already in operation, a common safety net for depositors at the European level is the logical complement to shared responsibility for banking supervision and resolution.

To further complete the Banking Union, we need to address banking market fragmentation. Market integration is key to reaping the full benefits of the single market for the banking sector and for the financing of the EU economy. Well-established common supervision and resolution frameworks are essential to build trust among the different stakeholders. Additionally, a mutualised EDIS will be the key element to overcome the current situation.

The issue of weakening the sovereign bank nexus and fostering the diversification of banks' sovereign bond holdings is a complex and particularly sensitive one. In my view, all the parties should make an effort to compromise on this matter. A fully mutualised EDIS, a Capital Markets Union and the inclusion of other missing elements in the EU financial architecture (such as a European safe asset) would enable the treatment of sovereign debt holdings under Pillar 1 to be addressed.

Nonetheless, in the present macroeco-nomic scenario, we need to be particu-larly careful to avoid episodes of finan-cial instability. A message conveying progress towards a fully working Bank-ing Union at the European level would help to mitigate the risks of instability. In short, there are three key messages I would like to underline:

- Completing the Banking Union is essential. A fully mutualised EDIS is the main element outstanding to achieve this aim.
- Strengthening the resolution frameworks and further harmonising the use of national deposit guarantee schemes and bank insolvency procedures is a welcome and helpful immediate step forward.
- All sides should compromise on the missing elements of the Banking Union. This would ease the way for the diversification of banks' sovereign debt portfolios. Nonetheless, in light of the current macroeconomic uncertainties, we need to be careful to avoid introducing measures that could trigger financial instability in the euro area.