BANCO DE **ESPAÑA**
Eurosistema

Communication Department

29 July 2020

A fully-fledged banking union requires institutional change

Published in OMFIF (Official Monetary and Financial Institutions Forum) - Public Global Investor 2020

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The European banking union has succeeded in its first aim, of safeguarding the euro, yet more needs to be done to create a fully integrated European banking sector, writes Margarita Delgado, deputy governor, Banco de España.

Pull quote: It doesn´t make sense that national governments remain liable for the losses of a failing bank, while the responsibility for supervision falls on pan-European institutions.

The declaration by the French foreign minister, Robert Schuman, which kick-started the European project was commemorated on 9 May. Its 70th anniversary was celebrated in incongruous fashion, with people isolated in their homes because of Covid-19.

This health crisis has ravaged our economies and, above all, has had a dire human cost.

Institutions are depended on in this uncertain environment to bring stability and support. Governments, regulators and the European Union have responded to this call. The European Central Bank has taken decisive action to help companies and people. The EU recovery fund demonstrates the European commitment towards citizens and businesses.

Crises have helped shape the European project. The banking union, the latest addition to the project, was created to address flaws in the design of the euro, revealed by the sovereign debt crisis, which threatened to break the single currency. Five years after its creation, the banking union has successfully safeguarded the euro's integrity but it has not been able to produce a truly integrated banking sector. The crisis has highlighted the importance of this second objective, yet some things stand in its way.

A fully-fledged banking union requires institutional change. It still lacks one of its three fundamental pillars, the European deposit insurance scheme. This would contribute to increased stability in times of stress. The banking union will not be a single financial system until a euro deposited in any institution has the same backing, regardless of the home country of the bank. The EDIS is necessary for this.

There are other hurdles that need to be overcome to reap the economic benefits of increased cross-border banking activities. First, cultural, institutional and regulatory obstacles perpetuate the ring-fencing of national banks, restricting or preventing the free movement of capital and liquidity across the euro area. It doesn't make sense that national governments remain liable for the losses of a failing bank, while the responsibility for supervision falls on pan- European institutions.

Second, the lack of harmonised regulation perpetuates an unlevel playing field. Banking regulation is common across the EU, but there are other rules that are critical in establishing a sufficiently uniform legal basis, in particular those covering the prevention of money laundering, fit and proper supervision, and bank insolvency. Third, to ease integration of the sector, supervisory expectations, which are key in assessing the business case of a hypothetical merger, need to be communicated more clearly.

The completion of the banking union and the implementation of the related capital markets union would enhance private risk-sharing channels across Europe, helping European companies and citizens overcome current and future crises.

Confronted with previous upheaval, Europe has always delivered and it will do so again. Robert Schuman´s words 70 years ago remain as pertinent today:

'Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity.'