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The Banking Union: a key building block of the EU project

Opening remarks at roundtable "Banking Union – Five years in the making"
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Dear chairs of the Single Supervisory Mechanism and the European Banking Authority, president of the European Banking Federation, ladies and gentlemen, good morning.

Let me start by welcoming you to Banco de España for this roundtable. Over the next couple of hours we intend to discuss both the achievements and pending elements of the Banking Union (BU) on its fifth anniversary. We are honoured to be accompanied by such distinguished panelists, so thank you for accepting our invitation and for being here today.

But before getting down to the discussion, I would like to share with you a few general thoughts on the European Union project and the role the Banking Union (BU) plays as part of this collective endeavour.

In my remarks today I will point out what the BU has meant in terms of greater integration for the euro area banking sector, and I will also refer briefly to those developments that, in my view, may still be missing if we are to achieve a truly integrated and cross-border banking sector.

The EU project has certainly improved the life of millions of people in Europe since its creation, not only in economic terms, but also regarding rights and living standards across the whole Union.

The success of the EU project cannot be assessed solely on the basis of its economic performance; we must also look at its other original objectives, namely, to increase the level of political and economic integration in the region.

Throughout its history, the EU integration process has not been linear, and not even gradual. Actually, over nearly seven decades, the European project has experienced long, quiet periods –where little or nothing remarkable happened– punctuated by, so to speak, 'transformative periods', that have contributed decisively to its development and to shaping its current form.

Normally, these deep transformations have been introduced in an orderly and negotiated fashion. For example, the launching of the Single Market in 1993 was the result of lengthy negotiations, which started when it was apparent that the European economy needed a qualitative boost to adapt to the new international landscape.

The Euro itself was also the result of lengthy debates, negotiations and preparatory phases, that were not always fully successful. Take, for instance, the crisis of the European Exchange Rate Mechanism in September 1992.

Yet, despite all the difficulties, the Euro was successfully launched in 1999 and, after the introduction of the Euro notes and coins 2002, has been a tangible reality for all citizens. Indeed, its popularity in the 19 Eurozone countries is higher than ever. All in all, the Euro represents the most ambitious economic integration process the world has witnessed since the end of the Second World War.

Of course, the Banking Union is now an integral part of the Euro project. In fact, like pillars in a building, the BU provides resilience and stability to the whole Euro project. As such, the BU is in its own right one of those transformative developments that have contributed to deepening our level of integration.

However, unlike the single market or the adoption of the euro, the BU was not the result of a joint vision by EU leaders on the need to enhance banking supervision and resolution across the Eurozone. Instead, it was the outcome of bold and swift defensive reactions to preserve the single currency in the wake of the European financial and sovereign debt crisis.

Indeed, it was the crisis that led to the conviction that a common and enhanced framework for banking supervision and resolution was needed to help break the link between banks and sovereigns. This conviction gave rise to the Single Supervisory and the Single Resolution Mechanisms, which, so far, are the key components of the BU.

Another important development related to the Single Resolution Mechanism came to fruition last December, when the European Stability Mechanism was recognised as a common backstop to the Single Resolution Fund for both solvency and liquidity support.

Today the rationale behind the creation of the SSM and the SRB seems obvious. But, to be fair, before the European sovereign crisis erupted, there had been only a few warnings against the risks that a fragmented banking supervision landscape within the Euro area involved.

Tommaso Padoa-Schioppa and Romano Prodi were among those who, in the early 2000s, highlighted the inefficiencies and potential issues that the introduction of a monetary union without common supervision could entail. Despite their prescient analysis, their original calls for greater coordination among national authorities fell short of the kind of arrangement that was needed to address this structural flaw.

As the crisis later demonstrated, the much greater degree of integration brought about by the BU proved to be the most effective response to the crisis, as well as to the preservation of the euro.

Ultimately, as many viewed it when it was launched 20 years ago, the Euro project has been the catalyst for further reform and integration. As far as the banking sector is concerned, the BU has contributed to loosening the bank-sovereign nexus and it should give rise to a more integrated banking system.

However, so far, the greater level of institutional integration of the BU has not been accompanied by greater cross-border activity in the banking sector. The absence of cross-border mergers is seen by many as evidence that we still have a long way to go in terms of market integration and diversification.

In my view, the lack of cross-border mergers can be partially explained by the over-capacity of the financial sector in Europe. Indeed, the benefits from synergies, potential cost-cutting and efficiency gains are mainly observed in mergers between same-country institutions, due to the greater redundancies in branches and central services. For most cross-border mergers, the business case is more difficult to anticipate in the current competitive landscape.

Admittedly, too, there are certain cultural, institutional and regulatory obstacles that hinder the emergence of a truly European banking market. The resistance to removing these obstacles largely imply preserving ring-fencing structures at national level, limiting or even impeding the free flow of capital or liquidity across borders.

In my view, after achieving a significant reduction of risks in the financial sector as well as a complete pan-European decision-making process, it would be time to call for an end to these national ring-fencing supervisory practices, which are detrimental to financial integration and, thus, limit the ambition of the BU as a single jurisdiction.

The implementation of the SSM and SRB may be seen as a remarkable achievement. But we must acknowledge that the BU still lacks one of its three main pillars, the European Deposit Insurance Scheme (EDIS). At a minimum, a building needs three pillars to ensure its structural soundness; likewise, I believe that the EDIS would contribute to making the BU more stable, particularly in times of stress, which is in fact when the resilience of structures are tested.

Certainly, a fully-fledged mutualised EDIS would have a strong impact on citizens' trust; but, in addition, a greater degree of risk-sharing within the euro area would also help align financial responsibility with the pan-European decision-making process, already in place in the areas of banking supervision and resolution.

Mervin King noted in the aftermath of the global financial crisis that international banks were global in life but national in death. I believe that, in a real EU banking union, financial institutions should be an EU matter, both in life and in death.

Apart from completing the BU, other elements are necessary to continue making progress towards a more complete financial union. From a regulatory perspective, the lack of a sufficiently homogeneous legal basis across the Eurozone is evident. While full harmonisation may not be possible in the foreseeable future, there are some critical areas, such as anti-money-laundering, fit and proper standards and insolvency rules at credit institutions, where a common set of rules across the Eurozone would foster the integration of the market, improving also the efficiency of supervision and resolution.

As regards the institutional side, and looking beyond the BU, I want to highlight a second priority which, in my view, is essential to enhance the capacity of the euro area to cushion macro-financial shocks. This capacity is linked to the development of deep and integrated capital markets.

The completion of the Capital Markets Union (CMU) would complement the BU and would foster a truly cross-border financial sector, allowing economic agents to smooth asymmetric, national shocks.

Last, but possibly not least, it may also be time to tackle the absence of a pan-European safe asset. While controversial, the implementation of a single EU risk-free asset would likely become a common benchmark, allowing the prices of equities and bonds across the euro area to reflect fundamental risk more clearly, enhancing the effectiveness of monetary policy and fostering the attractiveness of European capital markets.

A safe asset would also help mitigate the bank-sovereign nexus, reduce cross-border safe-haven flows in the event of crisis and, ultimately, improve financial integration. Of course, we should be cautious to design it in such a way as not to water down the incentives for sound national fiscal policies, which are the essence of achieving safety.

Let me conclude. Throughout its history, the EU has followed a path towards greater economic and political integration, which has brought clear benefits in terms of economic growth and citizens' rights.

The BU is an important step in this direction and has been key to addressing the euro crisis. Still, the implementation of certain regulatory and institutional elements are needed to reap the economic benefits of an increase in cross-border banking activities.

When assessing our capacity to deal with future financial crises, we should not forget that the institutional setting remains incomplete and policy space has been reduced. As memories of the crisis fade, we should strive to avoid complacency.

It is often said that in life you should expect the best but be prepared for the worst. Likewise, as supervisors we should strive to avoid financial crises, by applying supervisory tools to mitigate risk accumulations as well as reinforcing banks' management capabilities; but, at the same time, we should work with a longer-term perspective to complete the institutional framework, in case a crisis still occurs.

Thank you.