Box 2.3

SUPERVISORY POLICY IN MERGERS BETWEEN INSTITUTIONS

Declining profitability in recent years, together with the financial and economic situation triggered by the COVID-19 crisis, is prompting the consolidation of the financial system in several countries, among them Spain, where some institutions have decided to merge. These mergers aim to make the banks more resilient and boost their capacity to serve the economy in the context of the pandemic. Institutions need to strengthen their efficiency in light of narrowing margins and the write-downs that may be necessary.

These mergers will allow the resulting institutions to achieve economies of scale, make efficiency gains and improve their capacity to tackle new challenges – such as digitalisation – and, consequently, expand the supply of banking products through new channels.

In consolidation processes, supervisory authorities are tasked with making sure that the resulting business combination complies with prudential requirements and ensures effective and prudent risk management.

In the interest of transparency and clarity in its supervisory approach to merger and concentration processes, in January 2021 the ECB approved a guide that sets out the following supervisory expectations:

i) The sustainability of the resulting institution's business model. ECB Banking Supervision will analyse the business viability of the submitted merger plan, assessing the resulting institution's solvency and ability to generate profit going forward. Such ability must be based on efficiency gains, via a reduction in costs; geographic, product, and customer complementarity; and value generation at the resulting institution.

Further, merger projects must be based on a credible business plan, with reasonable and conservative assumptions.

ii) Robust governance and risk management requirements. The internal governance and organisational structure of the combined institution must satisfy the principles established in the EBA guidelines on internal governance (EBA/GL/2017/11). To this end, ECB Banking Supervision must check that governing bodies are adequately composed and function smoothly, that responsibilities are clearly allocated and that remuneration systems setting the right incentives are established.

Furthermore, the guide establishes that the supervisor will make use of its supervisory toolkit to smooth the completion of merger projects, through: i) non-penalisation of merger plans with higher capital requirements; ii) prudent recognition of badwill, which must help strengthen balance sheets at the time of integration; and iii) temporary acceptance of the use of internal capital requirement calculation models.

The principles set out in the above-mentioned guide on banking consolidation are being deployed in Spain, where there are two processes under way. First, the merger between CaixaBank and Bankia, which will be completed over the course of 2021 and will foreseeably result in the leading bank in terms of operations in Spain. Second, Liberbank and Unicaja are also negotiating their consolidation to create Spain's fifth-largest bank in terms of assets. It cannot be ruled out that other institutions attempt to merge in the future, with a view to gaining in profitability, size and competitiveness.