

# Banking Union home-host dilemma



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### Banking Union beyond home and host

Almost six years after the establishment of European banking supervision, we still hear people talking about “home” and “host” jurisdictions and authorities within the banking union. This distinction certainly does not match the reality of shared decision-making and responsibilities within the Single Supervisory Mechanism. It does, however, reflect the continued existence of specific features in

national markets, and to some extent also the regulatory framework, which continues to allow for national ring-fencing policies.

The current situation is economically and politically sub-optimal. In economic terms, ring-fencing measures hinder the efficient allocation of capital and liquidity within banking groups. They prevent European banks from fully benefiting from economies of scale and the diversification of risks within the banking union. In political terms, ring-fencing measures reflect insufficient trust between Member States stemming from past experience. Thus, any serious attempt to break the current deadlock has to start by acknowledging the legitimate arguments and concerns on all sides. While closer cross-border banking integration could bring significant benefits, it should not come at the expense of local financial stability.

Achieving the right balance may require some targeted legislative amendments to provide sufficient safeguards that the parent will provide financial support in the event that the financial situation of a subsidiary deteriorates. This may take the form of enhancing the framework for intra-group financial support agreements. However, private sector actors should not wait for public authorities to act on this front, but should make use of all the opportunities available within the current regulatory framework and discuss with supervisors how best to enhance confidence in intra-group support.

Differences in national bank insolvency regimes across the EU represent another

potential obstacle to the smooth functioning of the banking union. While it seems unlikely that national insolvency frameworks will be fully harmonised in the medium term, certain targeted improvements may be feasible, for example as regards the treatment of creditors in the insolvency hierarchy. A key principle of the Bank Recovery and Resolution Directive (BRRD) is that no creditor should incur greater losses in resolution than it would have done under normal insolvency proceedings (known as the “no creditor worse off”, or NCWO, principle). However, in the absence of a harmonised regime for creditor hierarchies, the NCWO principle would result in different outcomes across the banking union in the event of a cross-border group being resolved.

Another source of uncertainty relates to the situation that arises when a bank is deemed failing or likely to fail but does not enter resolution. The laws determining what happens in such cases currently differ from country to country, and this divergence needs to be addressed. Concretely, the concept of “orderly winding-up”, cited in Article 32(b) of the revised BRRD, could be made more precise in order to ensure that national implementation results in a more harmonised treatment of failing banks across the banking union. There may also be a case for further clarification on the links between a failing or likely to fail decision (in the event of non-resolution), the reimbursement of deposits and the withdrawal of the banking licence. Progress on all of these fronts would allow us to move to a banking union in which a distinction no longer needs to be made between “home” and “host”. ●

## Martina Drvar

Vice Governor, Croatian National Bank

### Material matters: parent institutions and home supervisors attention needed

Local materiality (for example, the largest bank in Croatia presents only 2% of its parent’s balance sheet) requires parents to enforce (i) adequate compliance check of

the group governance and risk management policies through adequately scoped internal audit visits and home supervisors to support (ii) sufficiently granular recovery plans and (iii) frequent on-site inspections. Home supervisors need reassurance that highly centralized banking activities at the consolidated group level will ensure stress less provision of service for local economy.

Authorization of supervised activities rather than authorization of supervised legal entities could endorse branchification, lowering the regulatory burden for banks and contributing to more efficient ►



► financial servicing of European citizens. High-level standards for (i) intragroup transactions and (ii) key functions insourcing activities strengthen and secure the level of group integrations. Home supervisors should run regularly recovery plans' dry runs at the solo level of locally important banks, OSIs, to confirm credibility of recovery options, while their on-site inspections should be tailor-made to tackle also local material issues. This will increase oversight visibility of parent institution and home supervisors at the level of OSIs.

With the confidence in high-quality organization of banking activities established at the consolidated level and appropriate level of host supervisory attention, there would

be less need for ring fencing against potential liquidity and solvency problems of the European banking groups. In the banking union space, even if there will be consensus around EDIS in the near future, the other two pillars have to improve further with the help of regulatory initiatives. SSM's supervisory practice remains challenged by the absence of accounting powers and implementation of national options and discretions (NOD).

Accounting powers would provide SSM with ability to shorten the time lag in certain jurisdictions for recognition of adequate provisioning of NPLs and collateral evaluations, important for aligned resolution interventions, while NOD need to

be exercised at the level of the ECB as single rule maker (the most relevant example is limiting intragroup exposures at national level). SRM on the other hand, aiming to create effective resolution plans, could increase the level of parent institutions' ability to display their preparedness and contractual readiness to support their activity regardless of different European jurisdictions and distress conditions through the high-quality and highly operational recovery plans.

This better alignment of those attention levels directed and delivered from the both parent' and home supervisors' level would definitively improve the integration of banking in the EU. ●



## Maria Stolpe

Head of Group Public Affairs, Nordea

### Trust in the Single Market

Nordea is the leading bank in the 10th largest economy in the World - the Nordics. We are active in four small, liberal market economies, each with its different characteristics. Finland is in the Banking Union, Denmark and Sweden are in the EU but outside of the Banking Union, and Norway is outside of the EU but a part of the EU Single Market.

Since the beginning of the creation of Nordea twenty years ago, the vision was to create one Nordic bank, One Nordea. But despite the EU efforts to create a truly single market in Europe, operating as a cross border bank was difficult with the combination of an integrated cross-border

operating model and national legal entities. Nordea saw a need for structural changes to achieve One Nordea business and operating model, improve resolvability, simplify implementation of new EU regulation, and simplify governance.

Consequently, Nordea made two major changes to its legal structure: in 2017 the group merged its primary banking subsidiaries into one, creating significant branches in other Nordic countries and in 2018 the bank re-domiciled to Finland, moving into the Banking Union.

You could say that Nordea has done all in its power to structurally transform into the "perfect" cross-border EU bank. Has the regulatory side of the equation delivered at the operational level?

The simplified structure has indeed strengthened the drive for scale advantages and common processes and systems. The resolvability is improved; resolution entities now coincide with critical entities in the operating model - reducing authorities' execution risk. In principle, Nordea, including the branches in the Nordic home markets, is now subject to one set of regulation, incl. one ICAAP process, one SREP process, and the need for a unified legal structure continues to be relevant with additional regulation coming into force.

However, as the EU single rule book is still incomplete, the expected regulatory advantages has not come to fruition.

To function as a universal bank, Nordea must operate branches as well as

subsidiaries across the four Nordic countries. Therefore, the operating model is susceptible to divergence in regulatory definitions, and regulatory changes to accounting definitions. Examples incl. differences in definition of default, which has implications for credit risk modelling, and differences in IFRS9 implementation. Meanwhile, macroprudential requirements are still not harmonised, distorting the level playing field in capital and operations, and regulatory guidance on structure of branch supervision is vague. This reflects issues in prudential supervision, while the less harmonized legislation relating to conduct and compliance create even further issues.

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Experience shows that the many supervisory discretions distort the single market and prevents cross-border banks from being fully efficient, also in a branch structure. Even in the Nordics, where regulators have a history of mutual trust, cooperation and coordination, perhaps more so than in any other place in Europe, deviation in local practises and duplication of safeguards fundamentally hampers further integration.

This must be overcome to better enable cross-border banking in the EU. ●