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Completion of the Banking Union calls for a comprehensive approach

Completing the banking union should remain a key priority on the European agenda. Reaching this goal would help mitigate the sovereign-bank loop, facilitate enhanced competition via expansion of cross-border banking and create additional channels for private risk sharing across the euro area. However, developing the banking union should not come at the expense of the financial stability of individual jurisdictions.

Efforts to finalise the banking union depend on solving a number of complex issues. These include creating a fully-fledged European Deposit Insurance Scheme (EDIS), dealing with some of the inherent inefficiencies in the current regulatory framework and enhancing the crisis management toolkit. In this respect, completion of the banking union should be pursued in a comprehensive manner and feature a package approach.

Some argue that in order to achieve a breakthrough in facilitating the expansion of banking activities across jurisdictions we need to introduce cross-border capital waivers. It is true that ring-fencing practices may to some extent be viewed as hindering the deepening of a single market for financial services. Yet, we also have to recognise that relaxing prudential regulation requirements in the current setting of an incomplete banking union causes financial stability concerns for host jurisdictions. With no EDIS in place, it remains primarily the responsibility of national deposit guarantee schemes to bear the financial burden if a subsidiary fails. Therefore, we need to ensure that facilitating the expansion of cross-border banking does not result in negative consequences for the financial stability of individual jurisdictions.

Against this background, any move towards establishing a mechanism for cross-border capital waivers should be accompanied by implementing adequate safeguards to credibly address the concerns of the host jurisdictions. A possible way forward could be to ensure that subsidiaries eligible for the waiver do not exceed a certain threshold, at the very least the threshold for significance set out in the Single Supervisory Mechanism Regulation. Additionally, the waiver should not be absolute and should have a built-in floor (e.g. 75%), which would in practice limit the reduction of capital held by the subsidiary.

Yet, even implementing the appropriate safeguards will not suffice to fully address the underlying financial stability concerns. This requires a return to the very fundamentals of the banking union's architecture - that is, finally putting in place its third pillar. A fully-fledged common deposit insurance scheme is essential to ensure that measures to enhance cross-border activities do not reduce the overall resilience of the euro area financial system. Ensuring that depositor protection is independent of a bank's establishment location would weaken the link between banks and national sovereigns, while at the same time providing a strong impetus for the expansion of pan-European banking.

Furthermore, in order to enhance the financial stability of the single currency area, the current crisis management framework needs to be reinforced. Agreement on creating a common backstop to the Single Resolution Fund represents an important step in the right direction. Nevertheless, it may still not fully address the liquidity needs of a large bank or in the event of a systemic crisis. Therefore, liquidity in resolution remains an important open issue in the current crisis management framework and deserves policymakers' robust attention.

On a broader note, the expansion of cross-border banking in the European Union largely depends on eliminating the existing non-prudential barriers. These include primarily divergent national insolvency and taxation regimes. Without a higher level of harmonisation in these domains, we will still fall short of reaching a truly integrated European banking market. ●