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Much still needs be done!

At the time of writing, Europe is entering a Corona lockdown. The impact on our economies and the subsequent challenges for the banking system in the Eurozone are yet to emerge.

Gladly, important progress has been made since the last financial crisis. Banks, urged by the international regulators, have successfully built up absorbing capacity. A statutory resolution framework, run by dedicated authorities, is now firmly in place, and banks are progressing towards resolvability.

However, much still needs be done. Policy priorities in the Eurozone include liquidity in resolution, resolution decision-making, harmonization of insolvency regimes and a European Deposit Insurance Scheme.

Starting with liquidity in resolution: By 2023, the Single Resolution Fund is expected to have accumulated €60bn of contributions from the European banking system. This represents a big step forward but potentially will not be sufficient to fund multiple failures of significant banks. In addition the Eurogroup has designated the European Stability Mechanism, or ESM for short, as a backstop.

Until then and beyond the capacity of both schemes, temporary central bank funding remains paramount. The instrument currently in place is Emergency Liquidity Assistance, or ELA for short, where the main responsibility and risks continue to ly with the national central banks.

As a result, the ESM and the national central banks will need some involvement in resolution planning when it comes to projecting potential funding needs. A common standard on collateral eligibility for ELA would help ex-ante preparation by banks and could come with a requirement for a positive Governing Council approval of ELA instead of the current objection rule.

Now to decision-making for resolution. This is already a complex undertaking, involving the Council, the Commission, the Single Resolution Board, national resolution authorities as well as the European Central Bank - and it will become even more complex with the ESM Board of Directors and several national central banks. I find it worthwhile and quite important to reflect on this complexity and consider simplifications in the decision-making. In my opinion the provision of ELA needs to be with the ECB, and speedy decision making may well be a priority.

Failing banks not passing the „public interest test“ and that therefore are not resolved are to be wound down under insolvency rules. The fact that the applicable rules are national and not yet harmonized can create rather different outcomes for investors and are likely to create improper pressure on governments to bail-out debt holders. This is important as no creditor can be worse off in resolution than in insolvency. A European bank insolvency law would of course reduce the complexity of the resolution of banks and increase transparency for investors.

The final piece remains a European Deposit Insurance Scheme operating on a "least cost basis". This would allow for optimal use of resources when losses in insolvency would be higher than a solvent wind-down of the bank. These initiatives will require joint efforts by law-makers, regulators and industry experts, and some will take longer to reach political consensus.

Europe cannot afford to be complacent and needs to get all of the above done. I remain optimistic but joint efforts are of the essence. ●