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Safeguarding financial stability at local level within the Banking Union

Whilst we must not underestimate the remarkable progress achieved in recent years, we should acknowledge that Europe's financial architecture still needs to be completed and strengthened. Without a pan-European banking system, EDIS, and adequate resolution and liquidation mechanisms, financial crises tend to be local. The responsibility of ensuring financial stability and depositors' confidence lies with individual sovereigns, which have limited instruments and room for intervention. As we stand, effective risk-sharing mechanisms have not been put in place. The sovereign-bank doom loop – the trigger for creating the Banking Union – persists. Indeed, supervisory and resolution decisions are mostly European, whereas the ultimate guarantor of financial stability remains national: banks are European in life but remain national in death, creating a mismatch between control and liability.

As it is clear now, not all countries were ready to implement the Bank Recovery and Resolution Directive (BRRD) as scheduled. This implied that over recent years, some countries have had to resort to alternative instruments to safeguard financial stability – these decisions were met with outcry and criticism as they were perceived as attempts to circumvent the existing rules. It could be argued that the current setup made bank liquidations an easy way out for European authorities as the ensuing financial and political costs lie with national authorities. It should not be forgotten that few things can be more destructive to public trust in European institutions than threats to financial stability. In this regard, the conclusions reached by Denmark and Sweden on the (public) analysis of their possible participation in the Banking Union deserve careful consideration by having clearly identified the risk of conflict arising between the local objectives of financial stability and in the Banking Union as a whole.

Against this background, the harmonisation of EU banks' liquidation regimes has been heralded as one way forward. However, in the absence of an appropriate legal framework, liquidation might imply the immediate interruption of lending support, as well as the suspension of payments; it may have disruptive effects for creditors, depositors and other stakeholders, ultimately reinforcing the sovereign-bank doom loop.

Instead of moving immediately towards such harmonisation, efforts must be made to establish an enabling framework for the orderly management of failing banks of locally systemic importance, combining elements of the resolution and liquidation frameworks, with a view to minimising losses and protecting depositors and non-financial borrowers. Such an enabling framework should include the definition of high-level principles to be agreed by all Member States for application at national level. For those banks assessed as not having (European) public interest, room for manoeuvre should be available in view of national preferences.

Recourse to alternative measures as foreseen in the Directive on Deposit Guarantee Schemes or to public funds, as an ultimate backstop, should be considered in this regard. It also goes without saying that further stabilisation mechanisms – a fully-fledged EDIS, the provision of liquidity in resolution, a common euro area safe asset – and addressing home-host tensions are also needed and urgent. This is even more so, as pressure for consolidation to increase profitability and efficiency of the European banking sector is increasing, and raises the question of how to reconcile further integration with safeguarding financial stability at local level in the current incomplete and imperfect set up.

On the one hand, supervisors and regulators should provide a stable view of the supervisory and regulatory frameworks allowing market participants to make informed decisions. On the other hand, without risk sharing and pan-European banks, sovereigns need to find the means to protect competition in their local markets and to safeguard the flow of funding to the economy when branches and subsidiaries of foreign banks exit during a downturn (as observed during the previous crisis).Summing up, decisive political will to move forward with the completion of the Banking Union is required. As the impacts of the coronavirus reverberate, this must now also be a priority for policy-makers and relevant institutions. Failure to do so can call the future of the European project into question. ●