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Never waste a good crisis - the Banking Union for a better recovery and lasting prosperity

The COVID-19 pandemic has affected all aspects of the European economy. Given sensible regulation, banks were better prepared with more capital and liquidity than in previous crises. Thanks to the single supervisory mechanisms, the ECB and national regulators were able to act swiftly and coordinate a response to free counter-cyclical buffers, introduce supervisory flexibility and providing operational relief. Sustained efforts to reduce risks have increased the resilience of the banking sector and freed capital previously tied up in non-performing loans. These measures enabled European banks to provide much needed liquidity to businesses hit by the crisis and to play a crucial role in mitigating the economic impact of the pandemic. All these examples are testament to the proper functioning of the regulatory and supervisory framework designed following the Global Financial Crisis in 2008.

However, the crisis has also highlighted that one must not become complacent. European financial markets are still fragmented and barriers to the free flow of capital and liquidity persist. Not leveraging the full potential of an integrated banking market may affect profitability, and thus, financial stability and the sovereignty of the common currency globally. The political impasse has also handicapped European banks competing with US and Chinese peers. Thus, important work remains to complete the Banking Union.

One of the priorities of Germany's presidency of the European Council is to improve the crisis management framework. The single resolution mechanism provides a reliable regime for dealing with systemically relevant banks in crisis. Two issues remain unresolved: First, frictions between the resolution framework and national insolvency procedures impair a smooth and effective crisis management. Second, there remain smaller banks below the threshold of public interest and unable to build-up sufficient MREL for bail-in in resolution. While market exit of non-viable banks must be ensured, we need to avoid that piecemeal liquidation negatively affects the efficient provision of banking services and depositors' confidence. Some of the tools proven useful in resolution could also minimise the disruption caused by the liquidation.

Cross-border consolidation in the European banking sector would help to reduce the fragmentation of European financial markets. This requires further efforts to eliminate barriers to doing banking business across borders. For instance, banking groups should be able to allocate capital and liquidity freely within the groups while maintaining comprehensive safeguards for host countries in times of crisis.

Of late banks have increased their holdings of sovereign debt. While this is necessary to fund governments' expenditure to support households and businesses in tumultuous economic conditions, we must not forget the viciousness of the sovereign-bank nexus. Gradually introducing capital requirements that reflect credit and concentration risks of sovereign holding in banks' balances could restore the incentives to hold a diversified portfolio. By contrast, failing to counter the sovereign-bank loop poses a threat to financial stability, discourages investors to hold Euro denominated debt and thereby weakens the sovereignty of the common currency.

The COVID-19 crisis proved once more that the banking union has been a game changer for the European banking sector and the economy at large. And while the COVID-19 response measures are currently on top of everyone's agenda, the long-term objectives of the Banking Union remain as relevant as ever: a strong banking sector, characterised by financial stability and the ability to provide reliable and low-cost funding, are vital for the European economy. The benefits of completing the banking union are clear – the way to achieve it is, too. ●