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The coronavirus pandemic and banking integration

The spread of the novel Coronavirus disease (COVID-19) has once again shown how interconnected the world is. Within three months, a virus had spread from a province in Central China to six continents and, in particular, to every single Member State of the European Union (EU). A common challenge deserves a common response, with work underway not only to contain the spread of the virus but also to mitigate the socio-economic impact of COVID-19 and to support the recovery in the EU. Today, I wish to reflect on its impact on another area of the European integration project, born out of the insight that our economies and banking systems are deeply interdependent: namely the European banking union.

Thanks to the banking union, banks have entered this crisis in a much better shape than in previous crises: they have stronger capital levels, better liquidity positions and more stable funding structures. The results of our vulnerability analysis[1] show how this more robust position is allowing banks to withstand the current economic shock. Even before the COVID-19 outbreak, the European banking system suffered from a number of known structural weaknesses, such as low profitability, as reflected in high cost-income ratios implying little capacity to invest in new technologies.

This persistently low level of profitability is linked to an overcapacity in the European banking sector. Further integration and consolidation of the banking sector may therefore help in terms of economies of scale and scope, but also by contributing to better revenue and risk diversification, in particular in a cross-border context.

In response to the crisis, significant decisions have been taken to allow banks to continue lending to the real economy while preventing the risk of abrupt deleveraging processes. Some of these decisions were taken at the European level. Others were adopted by national governments, reflecting the allocation of competences in the EU. While national responses were deemed necessary for a fast response in some areas, the inherent risk of fragmentation needs to be carefully managed. Thus, it is of the utmost importance to ensure that existing European structures and fora are used for coordination. In our role as Supervisor we will ensure a consistent approach in the treatment of such national support measures.

Targeted further harmonisation of the prudential framework may also be needed to allow banks to exit the market in an orderly fashion without hampering the economic function of funding the real economy. The support given to the economy will be best used by allowing banks to address their structural problems rather than perpetuating overcapacity.

For this purpose, it is very important to ensure that, once the European Central Bank has declared a bank as failing or likely to fail (FOLTF) and the Single Resolution Board (SRB) has determined that there is no public interest for resolution, the bank exits the banking sector in a relatively short timeframe, even in cases where the FOLTF decision is based on likely insolvency, likely illiquidity or likely infringement of prudential requirements.

This could be ensured by the transposition of Article 32b of the Bank Recovery and Resolution Directive. However, with the same goal in mind, it is also important to further align the grounds for FOLTF and withdrawal of licence. As regards a wider revision of the resolution/liquidation toolkit, it should be ensured that at least the failure of all significant institutions/groups and other cross-border groups under the SRB's remit can be dealt with via EU-managed tools and processes across the banking union.

This would not only enhance predictability and the level playing field among failing banks but would also enable the banking union to turn banking crises into an opportunity to achieve a less fragmented banking sector.

Last, we may also need to improve the framework for intra-group support agreements to provide sufficient assurances that entities within a group support each other in times of stress. Having in place such safeguards necessary for local financial stability issues would help to dismantle the impediments to the free flow of resources within cross-border banking groups in normal times. ●

1. https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200728~7df9502348.en.html