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The Single Market after the Banking Union

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Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

1. The state of the Single Market

I am here today, as I have been asked to address the effects of the Banking Union on the Single Market. The starting point of any assessment on this topic has to be the dismal state of the Single Market in the seventh year of the devastating banking crisis.

Following the introduction of the euro and the completion of the Financial Services Action Plan we have witnessed a significant increase in the integration of wholesale banking markets. According to a report published by the Commission in 2007, retail banking was significantly segmented along national lines, but a massive wave of cross border mergers had contributed to increase the number of banking groups serving retail customers in several Member States. These cross-border groups were indirectly promoting the integration of retail markets, through their consolidated balance sheet – or, more precisely, through their internal capital market.

The crisis has exercised a massive effect on this process. Cross-border groups have retrenched to national markets and stopped working as channels for the integration of retail markets: according to the BIS statistics, their claims on foreign affiliates have fallen by a cumulative half a trillion dollars since the start of 2008, and more than a trillion for euro area banking groups.

The mergers and acquisitions that have accompanied the restructuring of the EU banking sector have occurred exclusively on a national scale – as a matter of fact, in a number of bank restructuring, cross-border groups have been divided along national lines to make them amenable to restructuring with national tools. Cross border branching has fallen out of favour, with total assets of branches of EU credit institutions in other Member States falling by 18% since 2008.

These developments have several market drivers, but we have to recognise that public policies have played a major part. The decision, back in 2008, to rely exclusively on national backstops, within a loose coordination framework provided by the EU rules on State aid, has been the key driver of the process. National authorities have driven the restructuring process, following national priorities – i.e., home authorities encouraged a de-risking process centred on foreign jurisdictions and a refocusing on domestic markets, host authorities put pressure to maintain and even increase the capital and liquidity held in local markets. This often generated tensions between home and host authorities, which in some cases led to breakdowns in trust and cooperation. On the other hand, market participants have increasingly assessed the resilience of banks on the basis of the credit standing of the sovereign providing them with the safety net, and of the sovereign exposures in their balance sheets.

The EBA has done a lot, I believe, to contrast this course of events. We pushed for significant recapitalisation of EU banks, considering also the risks embodied in sovereign exposures. Strengthening capital has been, and still is, the most important precondition to re-establish the smooth functioning of the lending business in the Single Market. But we have also been very active in identifying and addressing conflicts between home and host authorities, via our presence in colleges of supervisors as well as through informal and formal mediation. These initiatives have been successful in a number of cases, leading to the removal of ring fencing measures or restoring joint decision processes that got blocked.

It is fair to say, though, that the Banking Union is the real game changer in this area. The origin of the problems lied in flaws in the institutional design of the Monetary Union, and it is the repair of the institutional set up that is going to address them.

Will this be enough? Will the Banking Union manage to restore the functioning of the Single Market?

2. The risk of a rift in the Single Market

I would argue that the Banking Union is a necessary condition to repair the Single Market, but not a sufficient one. At least for some time, the SSM and the Single Resolution Mechanism (SRM) will not encompass the whole European Union. Addressing the current segmentation of the Single Market will require more, a focused effort to restore the seamless operation of banks throughout the Single Market. In order to get an idea of the relevance of this task, let me remind you that out of the 43 large EU cross-border banking groups that are subject to the monitoring of the EBA, only 5 have business exclusively within the euro area. More than two thirds of the banking groups headquartered in the euro area have significant market shares in other Member States, and the same proportion of European groups headquartered in those Member States have significant business within the euro area.

We are still facing a risk that the repair of the Single Market will proceed with different speed and will be driven by different priorities within and outside the SSM jurisdiction. We cannot rule out the possibility that a rift opens up in the Single Market between Member States adhering to the SSM and SRM, and those that continue to rely on national tools for supervision and resolution. Only by maintaining an attentive focus on common rules (the Single Rulebook), common supervisory practices, strong mechanisms for supervisory cooperation and joint decisions, and especially, joined-up approaches to resolution, will we be able to contain the risk of a split two-tier system and restore the functioning of the Single Market as a whole.

3. The Single Rulebook

First, let me focus on the Single Rulebook. I have often referred to the concept of the Single Rulebook as the glue that should keep together the Single Market. If European legislation leaves too much room for national preferences in the legislation, this is often leading to national approaches that segment the functioning of the Single Market. Laxer domestic rules can be (and have been) used to favour the competitive position of national champions and attract business in national market places, but when the consequences of these approaches materialise, the adverse impact is rarely contained within national borders. At the other end of the spectrum, tougher national standards could be used to ring fence national establishments and constrain the movement of capital and liquidity across borders, thus maintaining segmentations within the Single Market.

We are getting closer to the objective of a Single Rulebook in banking. For the first time, a large part of the prudential standards for banks is adopted through a Regulation (the Capital Requirement Regulation, CRR) and the EBA is entrusted with drafting a large number of technical standards: 35 Technical Standards will be completed in 2013, 67 in 2014. A significant number of Technical Standards is envisaged also in the draft Recovery and Resolution Directive and in other pieces of European legislation in the pipeline.

The EBA also plans to give physical visibility to the Single Rulebook, with a web-based solution that through hyperlinks will make accessible in a single point the primary legislation, all the related Technical Standards and Guidelines issued by the EBA, and all the questions and answers addressing practical application issues on the same subject.

The progress is undeniable, but have we done enough? The CRD4 and even the CRR still contain more than 140 provisions which include elements of flexibility for competent authorities. Of course, not all these discretions have a relevant impact; many are probably needed to reflect the diverse nature of the banking sector in the EU, including firms of different size, legal form and business model. However, there are areas in which the lack of fully harmonised rules might have an adverse impact on the functioning of the Single Market; and areas where some discretion granted to competent authorities would need to be constrained within a well structured European framework in order to avoid distortions and possible barriers to cross-border business.

For instance, we need to make sure that the definition of capital, which is the yardstick used in most prudential requirements, is absolutely the same across the Single Market. The CRR leaves some leeway to national authorities in assessing whether capital instruments satisfy the principles defined in the legislation. We have to be sure that this does not lead again to differentiated approaches. The EBA is given a role to monitor the process and we'll need to be extremely rigorous. A second example is the flexibility granted to deal with systemic risk and macroprudential concerns. This flexibility is absolutely warranted, as we need to be able to adjust prudential requirements to reflect the build-up of credit or real estate bubbles in local markets. But this needs to be constrained within a common European framework, to avoid a misuse of these tools to ring fence capital and liquidity in domestic jurisdictions. A third example is in the Recovery and Resolution Directive (RRD), which also leaves significant margins of national flexibility in the implementation of bail-in tools, which will determine the distribution of losses to the various categories of creditors in a failing bank. If not constrained within a European framework of cooperation and coordination among home and host authorities, such discretion carries the risk that choices will be a made on a case by case basis, and could embody a home bias – i.e., they could lead to a preference for bail-outs when the losses would be borne mainly by domestic players, and a strict application of bail-in when most creditors in a certain category are resident in foreign jurisdictions. Moreover, the discretion could provide national authorities with tools that can significantly affect the cost of funding, and therefore the competitive position, of national champions.

I realise that having a big bang to a Single Rulebook could be very challenging and rather unrealistic, having in mind the complex institutional set-up of the EU. But we need to gradually develop mechanisms that identify the areas where the differences in rules are hampering the functioning of the Single Market and escalate the issue to the attention of the law makers. I believe the EBA could usefully play this role in banking legislation, through a wider recourse to our advisory role. We have already sent to the European Commission, Council and Parliament some Opinions, for instance on the definition of capital. A formal recognition of this role of "guardian of the Single Rulebook" would be helpful. The forthcoming review of the European System of Financial Supervision could provide an opportunity to consider strengthening our advisory role.

4. Supervision and resolution of cross-border groups

Truly single rules are not sufficient to reverse the increasing compartmentalisation of the activities of cross-border groups in each Member State. Additional policy tools need to be activated to re-create an environment that supports the smooth conduct of cross-border business.

I would like to mention five areas in which we need to make progress going forward, if we are to truly re-establish a well-functioning Single Market: (i) convergence of supervisory practices; (ii) effective recovery and resolution plans; (iii) well functioning mediation; (iv) disclosure of truly comparable data; (v) good governance, i.e. ability to decide at the EU level when this is needed.

In all these areas important steps have already been taken, but I would point out that the institutional set up is still delivering half-baked solutions: we are moving in a European direction, but we are also maintaining so many safeguards for national authorities that the risk is that the effective functioning of the mechanisms developed for the Single Market will be impaired.

i. Convergence of supervisory practices: the Single Supervisory Handbook

Let me start with the most daunting challenge, convergence in supervisory practices. A lot of progress has been made by the EBA. The simple fact that we are now moving to a single framework for supervisory reporting is a major step forward. The EBA stress test and recapitalisation exercise back in 2011 and 2012 led to true coordination of supervisory assessments and policy responses in the middle of the crisis. We are also working hard to address the perceived lack of consistency of Risk Weighted Assets (RWAs) calculated by EU banks through their internal models. We aim at identifying material differences in RWA outcomes, understanding the sources of such differences and formulating policy solutions to enhance convergence between banks and to improve disclosure.

This work is essential to restore the credibility and comparability of key regulatory benchmarks, such as risk-weighted capital requirements, which have been put into serious question during the crisis.

All these are areas where our work has changed the landscape. However, the manuals of national supervisors remain different, reflecting still distant approaches to day-to-day supervision, from the licensing of a bank, to the assessment of the risks via on-site and off-site instruments, to the framework for corrective action. The co-legislators, when establishing the SSM, considered it wise to give a mandate to the EBA to prepare a Single Supervisory Handbook. The idea was excellent: as the ECB will have to prepare a manual for its examiners, this would be a wonderful window of opportunity to have a single manual for the whole Single Market, at least in some key areas. The execution, however, was less impressive. A single handbook will be truly useful if, at least in some chapters, it will actually substitute the national manuals and design a truly uniform guidance for examiners. But the legislative mandate refers to the single handbook as a collection of good practices competent authorities can refer to. Hence, we will have the handbook, but also the SSM manual and national manuals in Member States not participating in the SSM. We are working hard to build the single handbook in a way that could be helpful, instead of just adding yet another layer of guidance. We started with a chapter on business model analysis, as this is a new area, in which all authorities need to develop new approaches. We plan to continue with chapters defining scoring methodologies in areas where competent authorities will have to achieve joint decisions (capital buffers under Pillar 2, liquidity buffers, recovery plans…). This is essential, as it is very difficult to effectively mediate between two parties when they come to different conclusions using completely different methodologies and metrics. Still, the lighter the convergence achieved with the single handbook, the more likely that different approaches between SSM and non-SSM countries will persist, with potentially adverse effects on the integrity of the Single Market.

ii. Recovery and resolution plans

Credible recovery and resolution plans, commonly agreed by home and host authorities are an essential pre-condition to overcome the tendency towards a renationalisation of banking business. If authorities are convinced that in case of crisis there would be again recourse to un-coordinated national responses, the rational policy would be to take pre-emptive action in good times and ring fence the local establishments. On the contrary, if there is a reliable commitment to cooperative solutions, greater degrees of freedom could be left in developing cross-border business and reshuffling capital and liquidity within cross-border groups, according to agreed criteria.

The EBA has already issued a Recommendation on the preparation and assessment of group recovery plans and launched three public consultations on draft technical standards on the content, scenarios and assessment of recovery plans. On such basis, we will be soon in a position to launch benchmarking exercises on recovery plans.

In order to build full trust between home and host authorities, comprehensive discussions and joint decisions on resolution plans and strategies are needed. The draft Recovery and Resolution Directive is making important progress in this area, but it also has some disappointing features. In particular, the draft Directive does not make it mandatory to reach a joint decision on the resolution plans for cross-border groups: resolution authorities can decide that they are following a non coordinated approach. Against the background of the Single Resolution Mechanism, this shortcoming becomes even more serious, as it might lead to unified approaches within the SSM and completely uncoordinated ones between the SSM and other jurisdictions in the Single Market.

Recovery and Resolution Plans will in any case remain “incomplete contracts”, to be adapted to the specific features of a banking crisis. Hence, mediation is not only indispensable in the phase of planning and prevention, but also when resolution occurs, to facilitate agreements on the best course of action between home and host authorities.

Also in this case, the willingness to protect national approaches to decision making in a crisis risk jeopardising the possibility of effectively deploying mechanisms for common decisions at the moment in which the likelihood of conflicts between home and host authorities is at the highest level.

iii. Binding mediation

The scope for joint decisions in colleges of supervisors has been significantly expanded in the European legislation that has implemented the G20 reforms. Joint decisions have often been introduced together with binding mediation attributed to the EBA. This is extremely important, as we need to have effective mechanisms for dispute resolutions between home and host authorities, so as to ensure that we indeed achieve a single decision for the group as a whole, parent and subsidiaries, instead of multiple decisions for each establishment in case of disagreement. As I mentioned already, the EBA tried to exploit to the maximum possible extent the potential for mediation, with a number of successful outcomes.

Once again, though, we have introduced the possibility for EU decisions with so many safeguards for national authorities that the instrument risks not being as useful as it could be – as a matter of fact, so far binding mediation has never been triggered by national authorities, which are the only ones empowered to activate the process. In fact, the legal basis for binding mediation in the EBA founding regulation has been formulated in such a way that some have argued we can actually perform this task only in cases in which one authority is in breach of European law. Instead, mediation is a useful tool in cases in which the authorities differ in their supervisory judgment, without any of them actually being breaching the law – regulators are in general rather reluctant to breach rules. We have written to the European Commission suggesting that it clarifies the legal text to remove any arguments for such a restrictive approach within the framework of the review of the European System of Financial Supervision, which is currently under way.

iv. Disclosure

Let me now move to my fourth point, the need to strengthen the framework for truly consistent disclosure of data by EU banks. This also is an important feature for the proper functioning of the Single Market.

Market discipline has not worked as expected in the run-up to the crisis, while it has even exacerbated the sovereigns-banks loop during the crisis. The lack of reliable and comparable information for banks across the EU has surely played a role and we need to act in this area. The EBA has already realised important improvements in harmonising definitions of key aggregates – most recently, with our standards on the definition of non-performing loans, forbearance and asset encumbrance. In presenting the final results of the 2011 stress test we published more than 3000 data points for each bank, and we plan to have another, similar disclosure exercise in a few weeks. Still, we need to make enhanced disclosure of comparable information a key feature of the new set up.

Once the new system of fully harmonised regulatory reporting is in place, it would make sense to develop guidelines to ensure that a minimum set of key information, prepared according to common definitions, is regularly disclosed to market participants, so as to put them in a better position to understand the risk calculations performed by banks and the differences in results. Ideally, the information should be made available on a common platform, as it already happens in the US. This progress should be accompanied by greater harmonisation of Pillar 3 disclosures, as recommended also by the Enhanced Disclosure Task Force (EDTF) established under the aegis of the Financial Stability Board (FSB). Also in this area, a stronger legal basis for the EBA would help, as now we cannot publish information without the specific consent of the banks.

v. Governance

Finally, let me touch a delicate and politically sensitive point: the governance for taking decisions at the EU level. I believe majority decision making has been a substantial improvement in the work of the EBA, as compared to the previous arrangements.

I surely understand the rationale for modifying the rules for our governance following the introduction of the SSM: national authorities from Member States that will not immediately adhere to the SSM do not want to run the risk that decisions taken at the ECB table in Frankfurt are rolled out to their respective jurisdiction, without any possibility to have a say. In order to avoid a built in majority for supervisors from countries participating in the SSM, the EBA founding regulation has been changed, introducing the concept of double majority and requesting that the EBA Board strives to achieve consensus. Similarly, the governance for mediation has been changed, extending the number of national representatives in the mediation panel and ensuring a balanced representation of “ins” and “outs”.

These changes, although well justified, will increase the complexity of an already burdensome decision making process. In order to protect national interests, we risk not being able to decide at the European level when this is most needed. There is a genuine danger that in order to achieve consensus the wording of our products is watered down and leaves space for different approaches, thus leading us further from the objective of genuinely European approaches.

I know we will have to live with this set up, and I must pay tribute to our Board members, as so far these new complexities have not affected the good spirit at the table and the willingness to decide by majority, with a view to preserving the quality of our products and their ability to deliver true convergence. But in the longer term, I believe that we will have to consider moving to a setting in which European decisions are taken with truly European mechanisms and the governance of agencies like ours is simplified.

5. Conclusion

In conclusion, the institutional set up for banking regulation, supervision and resolution is becoming increasingly European, but not necessarily less complex. The establishment of the SSM (and soon of the SRM) will go a long way in addressing the bugs that have impaired the functioning of the Single Market, but surely not all the way. As a matter of fact, we also face a risk of a split between “ins” and “outs”. To hedge against this risk, we have to build on the work already accomplished so far, possibly tightening some nuts of the institutional setting for the whole Single Market.

I tried to spell out where, in my view, the challenges lie: truly single rules, unified supervisory methodologies in some key areas, really joint decisions on and enforcement of recovery and resolution plans for cross-border groups, sound legal basis for mediation, governance mechanisms that allow taking European decisions. In a very compressed time frame the glass has become half full in all these areas. We should be proud of what we have achieved, but also mindful that there is another half to fill, if we are to restore and maintain a unified Single Market for all the 28 Member States of the Union.