Interparliamentary Conference on Economic and Financial Governance of the European Union

Session III: "Banking Union and Financial Integration in the European Union"

17 October 2013, Vilnius

Honourable Members,
Ladies and Gentlemen,

Until recently, the scope of the EU financial sector reforms could have been hardly imagined, but the challenges that we face call for an ambitious policy response.

The EU urgently needs to strengthen the single market and overcome financial fragmentation. We also need to strengthen the systemic resilience of our economy and the financial system. Financial sector reforms, particularly work on the banking union, stand at the core of addressing these challenges.

In my presentation today I will focus on the state of play of the key elements of the banking union. I would like to begin with the Single Supervisory Mechanism (SSM). Then I will turn to the bank resolution and deposit guarantee frameworks. I will conclude by taking note of two additional reform areas besides the banking union: macro-prudential policy and structural reforms of the EU banking sector.

I. Banking Union

If it had not been clear before, it has become strikingly obvious now that a well-functioning single market requires an integrated framework of financial regulation and oversight. That is of essence in order to enforce the same high quality standards for banks across the EU, to safeguard taxpayers from bailing-out failing financial institutions, and to ensure timely intervention and the most effective crisis resolution once problems occur.

Measurable progress has been made on the Single Supervisory Mechanism so far. After the successful vote in the European Parliament in September, on Tuesday the Council endorsed the final agreement. The official completion of the legislative process will soon trigger a 12-month countdown for the ECB to assume its new supervisory powers.

It means that by November 2014 the ECB will become fully responsible for the functioning of new European supervisory system and direct supervision of around 130 largest European banks. The new capital, liquidity and other prudential requirements for banks (CRD IV/CRR) — or single banking rules — will provide a robust basis for this task.

After the final adoption, sound implementation of the SSM is the next key challenge for both the ECB and national supervisors. In particular, high expectations have been raised about the comprehensive assessment of the most significant European banks that the

ECB is preparing to supervise. It will cover around 85% of bank assets in the euro area alone and encompass risk assessment, balance sheet assessment, and forward-looking stress tests. The President of the ECB is expected to announce the start of this exercise in the second half of October.

The comprehensive assessment offers an opportunity to strengthen confidence in the European banking system. In this respect, it is important to be explicitly clear on how possible shortages, if and when identified, will be dealt with. The ministers exchanged their views on appropriate backstop arrangements during the recent ECOFIN. Work on specifying that is underway.

This situation provides a good illustration of why an effective SSM needs to be complemented by an integrated framework for dealing with undercapitalised banks. To this end, the Presidency of the Council advances two closely interrelated initiatives on bank recovery and resolution.

First, the Bank Recovery and Resolution Directive (BRRD) will introduce a sophisticated toolkit to better detect, prevent and manage individual banking crises. The main innovation — the bail-in tool — will limit the capacity of governments to intervene in failing banks and allow addressing bank problems without using public funds.

The Presidency has already started negotiations with the European Parliament. After finding compromise on such remaining issues as the flexibility of the bail-in, the extent of application of the Directive to smaller credit institutions or questions related to designation of the national resolution authority, we expect reaching the final agreement by the end of the year.

Second, the European Commission has recently drafted a legislative proposal on the Single Resolution Mechanism (SRM). While the BRRD aims at harmonising national recovery and resolution frameworks, the main objective of the SRM is to create a centralised decision making mechanism that would be more responsive to building up risks. It would also have adequate financing arrangements to facilitate resolution of failing cross-border banks.

The recent informal ECOFIN in Vilnius provided the first opportunity for ministers to exchange their views on the Commission's proposal. Since then, intense work has taken place at the working party level that was further discussed by the ministers in the beginning of this week. While there seems to be a broad consensus on the end objectives of the SRM and the overall need to prevent the misalignment between the levels on which financial institutions are supervised and resolved, the divergence of views makes reaching a compromise difficult. The most intense discussions primarily relate to the role of the Commission in the decision-making process, voting modalities in the proposed Single Resolution Board, safeguards to budgetary sovereignty in the context of the SRM, centralisation of decision-making powers and some other issues.

In accordance with the call from the European Council, the Presidency has set an ambitious target to reach a general approach in the Council by December, so that the agreement with the European Parliament could be reached before the end of the current parliamentary term. In this respect, the Presidency aims to finish negotiations at the working party level by the end of October. The limited scope of the remaining issues will then have to be addressed by the ministers themselves.

Allow me now to turn to the third element of the banking union – the single deposit guarantee framework.

In relation to work on single supervision and resolution, it is important to continue efforts on ensuring the robustness of national deposit insurance schemes in each member state, as proposed by the Deposit Guarantee Schemes Directive. The main aim of the Directive is to harmonise national deposit insurance frameworks. The Presidency has recently started negotiations with the Parliament and we expect to reach the final agreement by the end of 2013.

In the longer run we should, however, not avoid discussions on the best ways of concluding the banking union with a European deposit guarantee scheme. We cannot risk having a half-finished project – our main goal should be to have a complete one.

II. Other financial sector reforms

Besides the banking union, I would like to briefly touch upon two additional areas of on-going financial sector reforms that deserve special attention.

The first of them is related to macro-prudential regulation. The afore mentioned elements of the banking union – independent supervision, efficient resolution and a credible deposit insurance system – would ensure that the European financial sector could heal its wounds itself, but we also need sound macro-prudential regulation explicitly targeted at preventing the build-up of systemic risks.

Until the recent crisis, no authority had explicit responsibility for controlling system-wide risks. Noticeable progress has already been achieved in terms of establishing a pan-European macro-prudential framework. We have created the European Systemic Risk Board with the power of issuing warnings and recommendations and started assigning macro-prudential mandates to national institutions. Furthermore, the SSM Regulation will give the ECB binding macro-prudential powers towards the participating states of the SSM. It is important to ensure balanced attention to both health of individual financial institutions – that is addressed by the banking union – and resilience of the entire financial system.

Finally, my fellow colleague Mr Erkki Liikanen has also led an important work stream that aims to investigate the potential for further structural reforms in the EU banking sector. These reforms should address some of the core causes of the recent financial crisis, namely, the complexity of the financial sector, misaligned risk-taking incentives, and the *too big to fail* problem.

Given the fact that some member states are already in the process of implementing national bank structural reforms, an EU-wide approach is desirable to ensure a level playing field and effective functioning of the banking union. The European Commission intends to submit its legislative initiative on this issue next month. This will provide a basis for our further discussions.

Ladies and Gentlemen,

Our initial work on the banking union created high expectations. After reaching one of the fastest political agreements on the single supervisory framework, we must now prove the EU's ability to deliver further results. The on-going EU financial governance reforms provide a chance to build a stronger European banking sector and a more competitive single market than before. Using this opportunity should be seen as our collective effort.

Thank you for your attention.