BANKING UNION AFTER THE EUROGROUP JUNE DECISIONS

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Next steps in the development of the Banking Union

The way banks are supervised and managed in failure has improved considerably over the last decade. The Bank Recovery and Resolution Directive (BRRD), and the Deposit Guarantee Schemes Directive (DGSD) have established a powerful framework in the EU for dealing with failing or failed banks. A dedicated framework for bank resolution was established and all jurisdictions in the EU now have authorities dedicated to managing bank failures of any size. The authorities' actions, together with additional powers for supervisory authorities to intervene early in stressed banks, transform the landscape for handling idiosyncratic and systemic failures. The framework also includes the creation of the Banking Union, and completion of two of its envisaged three pillars – the Single Supervisory Mechanism and the Single Resolution Board.

However, it is also important to acknowledge that the process is not complete in particular with regards to ensuring full resolvability and achieving full MREL in particular for mid-sized banks.[1] The recent crisis events have represented an important testing moment and we must use this time to push for completion of those reforms.

Strengthening the crisis management and deposit insurance framework (CMDI) in alignment with the objectives of the European Commission review is, in my view, an important next step towards completing the Banking Union. It matters because improving the CMDI is a precondition for further integration of the banking market and for avoiding national ring-fencing when problems arise. More specifically, I would like to highlight four areas where changes are needed.

A stronger crisis management and deposit insurance framework is the next step for the Banking Union.

Firstly, in relation to the largest banks in the EU, there is a need to achieve high level of resolvability to ensure that when such banks encounter difficulties, it is possible to manage their failure effectively. To support this objective, the EBA has published guidelines on resolvability and transferability that should be complied with by all EU banks by 1 January 2024. EBA is also working on guidelines for testing resolvability that aim to frame how resolution authorities should gain assurance of institutions' capabilities to support the execution of the preferred resolution strategy. In this context, we also see a need to increase the overall transparency of the resolution framework to improve its credibility via greater predictability and a broader understanding by a wider audience.

Secondly, there is a need to harmonise insolvency regimes across the EU, starting with a clearer and uniform approach to the public interest assessment which determines whether a failing bank will be resolved, using the resolution tools, or liquidated. More harmonization here would introduce more predictability and ensure trust between home and host authorities. That is of particular relevance to mid-sized banks and banks with cross-border presence.

Thirdly, there is a need to introduce more flexibility to deploy resolution funds, and funds raised by deposit guarantee schemes more effectively. Currently, the hurdles to use such funds in resolution are so high that these funds are hardly ever used for this purpose. More flexibility in that respect would provide the authorities with the possibility to apply the most efficient tool and avoid value destruction in bank failures.

Finally, there is a need to further strengthen and harmonise deposit protection rules. While the agreement on the third pillar of the Banking Union – the European Deposit Insurance Scheme – remains elusive, we should continue strengthening the framework to ensure that where depositor payouts are needed, they are done as efficiently as possible. This matters because maintaining depositors' trust in the deposit guarantee is essential for financial stability. The EBA has supported the European Commission in the review of the current DGSD and made more than a hundred recommendations on how to improve the current framework, including clearer and better information for depositors, improved transparency concerning DGS funding, and clearer and more harmonised rules on complex or specific cases, such as failures where there are money-laundering concerns.

The Banking Union remains a work-in-progress. Enhancing its regulatory framework is a necessary step. At the same time, we should continue to foster effective integration of cross-border activities and the single market by enhancing supervisory cooperation and collaboration in properly assessing cross-border risks within the EU.

[1] *https://www.eba.europa.eu/eba-sees-progress-mrel-shortfall-reduction-largest-institutions-while-smaller-institutions-are*

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Completing the Banking Union: an even more urgent task in times of uncertainty

Banking Union is an essential element to safeguard financial stability and sustainable growth in the euro area. The euro area sovereign debt crisis of 2012 highlighted the extensive contagion channels between the financial system and sovereign issuers, their amplification effects and how easy it was for them to spill over national borders. The answer at that time was pivotal for the future of Economic and Monetary Union (EMU): a Banking Union was essential and, more recently, albeit still incomplete, it has been crucial to underpin the resilience of the euro area during the pandemic.

Consequently, completing Banking Union is an indispensable priority, particularly in the present context of high economic uncertainty that translates into heightened risks to financial stability. Furthermore, a complete Banking Union will allow us to fully reap the benefits of EMU membership, by guaranteeing the level playing field and a competitive and robust European banking system. The present status of the Banking Union is clearly not our desired destination. Rather, there is much work ahead. The costs of inaction damage the credibility of the project and should definitely be avoided. Certainty about the timeline is also key for decision-making by the different stakeholders.

Against this background, reaching an agreement on the way forward for Banking Union in June was very important. The Eurogroup (EG) has provided a welcome and practical response to this challenge by proposing to focus on an area where there are well-identified gaps to fill: strengthening the framework for the management of failing banks in the EU. Reducing the heterogeneity of liquidation procedures across Member States and broadening the uses of the different national deposit guarantee schemes for resolution and liquidation, as well as making them more consistent, are especially welcome adjustments to improve the resolution of medium-sized and small banks. We also need to facilitate the access to the Single Resolution Fund when it is needed without modifying the previous political agreements.

The costs of inaction damage the credibility of the project and should definitely be avoided.

Nonetheless, this way forward should not draw our attention away from a fully mutualised EDIS – the third pillar of the Banking Union as originally proposed – which should be the final goal. The EDIS is pivotal to ensuring a true Banking Union: first, it equalises the level of depositor confidence across the single market; second, it helps to delink depositor protection from depositor location, thus reducing the link between banks and sovereigns; third, it reinforces the level playing field for banks; and lastly, it strengthens depositor protection against local shocks. In the current situation, with both the SSM and the SRM already in operation, a common safety net for depositors at the European level is the logical complement to shared responsibility for banking supervision and resolution.

To further complete the Banking Union, we need to address banking market fragmentation. Market integration is key to reaping the full benefits of the single market for the banking sector and for the financing of the EU economy. Well-established common supervision and resolution frameworks are essential to build trust among the different stakeholders. Additionally, a mutualised EDIS will be the key element to overcome the current situation.

The issue of weakening the sovereign bank nexus and fostering the diversification of banks' sovereign bond holdings is a complex and particularly sensitive one. In my view, all the parties should make an effort to compromise on this matter. A fully mutualised EDIS, a Capital Markets Union and the inclusion of other missing elements in the EU financial architecture (such as a European safe asset) would enable the treatment of sovereign debt holdings under Pillar 1 to be addressed.

Nonetheless, in the present macroeconomic scenario, we need to be particularly careful to avoid episodes of financial instability. A message conveying progress towards a fully working Banking Union at the European level would help to mitigate the risks of instability.

In short, there are three key messages I would like to underline:

- Completing the Banking Union is essential. A fully mutualised EDIS is the main element outstanding to achieve this aim.
- Strengthening the resolution frameworks and further harmonising the use of national deposit guarantee schemes and bank insolvency procedures is a welcome and helpful immediate step forward.
- All sides should compromise on the missing elements of the Banking Union. This would ease the way for the diversification of banks' sovereign debt portfolios. Nonetheless, in light of the current macroeconomic uncertainties, we need to be careful to avoid introducing measures that could trigger financial instability in the euro area.

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Completing the Banking Union : an issue of equal progress and level of ambition

Remaining committed to completing the Banking Union and reaching an agreement on the third pillar, a European Deposit Insurance Scheme and its 4 building blocks (crisis management, depositor protection, single market for banking services and diversification of sovereign holdings) is important not only to make the European banking sector stronger, more competitive and more resilient but also for the further deepening of the Economic and Monetary Union and for the economic and financial situation of EU Member States as a whole. Furthermore, it will give more confidence to businesses and citizens in the European financial system.

We must not forget however, that the discussion on the third pillar and the development of a corresponding work plan with different workstreams has always been and remains very complicated as many areas are involved and Member States expressed many different views. The impact of Covid and the war in Ukraine on the current economic and financial situation of Member States, leading to more fragmentation throughout the EU also played a role.

Looking at the 4 building blocks, next to a discussion on the need to reduce fragmentation and the need to create a pan-European competitive banking sector, the discussion is also about risk sharing versus risk reduction, burden sharing, financial stability, consumer protection, harmonization of legislation, a level playing field for all types of banks... This shows clearly that the 4 building blocks are closely interlinked on top of the variety of areas covered and the different views.

When it comes to the 'limited' results achieved at the June Eurogroup, the most important reason was undoubtedly the level of ambition between the different building blocks, this also includes speed and equal progress. Having the same level of ambition in all 4 building blocks is the precondition for making progress on the third pillar. From the beginning of the discussion on the work plan it was clear that getting to the same level of ambition in all 4 blocks would be very difficult, in particular because of the very strict and tough positions taken by Member States in areas like depositor protection and diversification of sovereign holdings . As a consequence showing high ambition in areas like the single market for banking services would have created unbalance as for many Member States a holistic approach, including the same level of ambition and same level of progress remains an important condition to reach an agreement.

Not a given that consolidation and waivers will lead to more competitive banks and investment.

Coming back to the issue of fragmentation and the importance of creating a competitive pan- European banking sector, it is important to note that the level of cross-border integration cannot solely be linked to the lack of consolidation or to prudential rules (e.g. liquidity and capital waivers). While there is no empirical evidence this would lead to fragmentation, it was stated many times during the discussion on the third pillar of the Banking Union that non-prudential factors, like taxation, company law, consumer protection, employment laws, do play an important role for cross-border integration and profitability and efficiency of cross-border banks. Another important factor is confidence and mutual trust in the system.

The memory of the 2008-2009 financial crisis is still too fresh and for this reason many Member States need a high degree of national supervision or the necessary safeguards, through legally binding acts, that the financial stability of subsidiaries of cross-border banking groups is guaranteed and in case of problems group support will be given. This is what the home-host discussion is really about. The issue of fragmentation is more complex than many people think and it is not a given that consolidation and waivers will lead to more competitive banks and investment into the real economy.

As already said, the discussion on the third pillar of the Banking Union is a complicated and complex discussion. For the moment, there is no other way forward than, as the Eurogroup stated last June, to start the discussion on the Commission's proposals concerning CMDI (Crisis Management Deposit Insurance). Let us hope that we can agree to the proposals on CMDI within the given timeframe.

Finding an agreement on the CMDI proposals will not be easy as discussions will concentrate on the enhanced use of the DGSs (alternative measures next to payout and resolution, possibly preventive measures), the inclusion of medium-sized and small banks in the resolution tools and MREL build-up, the role of IPS in the CMDI framework and harmonization of insolvency laws. This is only the first step in the process of agreeing on the third pillar.

By the time of agreeing of the CMDI proposals, Member States should have taken the necessary action to come to a more sustainable economic and financial position, with less divergences and fragmentation. This will be imperative to start discussions on the other 3 building blocks.

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Are we open to find different ways to improve efficiency in the banking sector?

There is widespread consensus, that improving the efficiency and therefore the competiveness of the European banking sector is crucial to manage the financial needs of the double transition, complementing thereby the benefits of CMU. Nevertheless, measures to improve the efficiency of cross border banking groups have remained rather limited so far. Obstacles are still in place that hinder the free float of capital and liquidity within cross border banking groups, preventing thereby their optimal allocation but also the economic benefits from economies of scales. It is to be expected that ring fencing measures to protect the host-country's stability will persist as long as suggested safeguards are not perceived as credible. The lack of credibility is costly, not only for the banking group itself but also for the authorities involved and indirectly for the real economy.

The inability of the Eurogroup in June to overcome discrepancies and find an agreement on the four workstreams for strengthening the Banking Union cannot be considered as helpful for building up trust, and we all agree that trust between public authorities is the crucial but missing element here in completing the Banking Union. Trust is needed to abolish ring fencing practises, trust is needed to overcome fears of moral hazard or free riding – but trust cannot be effectively prescribed, neither legally nor politically. Obviously, the time is not ripe for a further major step of integration. Maybe it was better to make a break right now than to create expectations and fail in operationalization, which might have damaging effects on the Banking Union as well.

Despite all, the agreement to move forward in CMDI is a step to be welcomed. But most likely it will not ease the problems of the European Banking sector in terms of low profitability and competiveness. After EDIS has been postponed for a longer period, there are no convincing ideas buzzing around that would offer sufficient reassurance to the Hosts, so ring fencing measures will remain in place.

Alternatives should be looked for to increase international competiveness of European banks.

Maybe at this point of time it could be helpful to start looking more intensively for other ways since the previous one was blocked. Maybe we even need to look from a different perspective. It's the banks that make the choices about their business structure, but are we ready to support them in their choice or do we put indirectly or implicitly stumbling blocks in the way? Despite all the difficulties and the time consuming and expensive process branchification might be an alternative, especially since the chances to achieve a free flow of capital and liquidity across the entire group in the nearer future have diminished drastically after the Eurogroup in June. Operating with branches rather than with subsidiaries might therefore become more attractive and more efficient, taking advantage from simplified governance structure as well as. Nordea and the UBS head office in Frankfurt are good examples.

So, how relevant are other factors that have prevented the conversion from subsidiaries into branches so far, such as legal issues and the soft pressure not to branchify? The most obvious consequences would be for deposit protection which would fall on the home country's national deposit guarantee schemes. But can a DGS in the current setting deal with large cross-border branches in a credible way? Who can provide support to the DGS in case of needs? Would we profit from EDIS here as well, especially when in times of rising spreads the issue of a credible (public) backstop might become more relevant again? What are the implications for the protection of deposits for stand-alone banks in the so called former host-country? In the end, might branchification be a new but different stimulus for EDIS?

Without any doubts large scale branchification leads to a lot more questions, also in other areas. Some answers and ideas are already in the air, such as amending DGSD to allow for larger transfer of contribution between DGSs to adjust the size of the funds to the higher target level without delay. Anti-money laundering is also often cited as an area where diverging national rules pose practical problems for cross border business, but here stronger harmonisation is envisaged by the current AML-package which might reduce the respective burden.

In any case it could be worth identifying the problems in relation to branchification in more details and trying to find answers and solutions to them. We might end up discarding the idea, but it might turn out to be a feasible approach as well. Whatever the case may be, it is most important to leave no stone unturned to raise efficiency in the banking sector and improve the financing of the real sector.

CHRISTIAN CASTRO

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EDIS and the 'sovereigns concentration conundrum'

The prelude to discussions in the June Eurogroup on the Banking Union and recent tensions in markets leading to swings in euro-area sovereign spreads, have reignited the debate on how to effectively complete the Banking Union and address market fragmentation in the EU.

Two focal points in such a debate were: first, how to advance towards a European Deposit Insurance Scheme (EDIS); and second: how to incentivise diversification of banks' sovereign debt holdings in the EU. As logically expected, the latter has contributed to revive some old debates on the prudential treatment of banks' sovereign holdings.

Unfortunately, results in the Eurogroup were rather limited. This, once again, suggests a need to explore new approaches and policy tools, taking advantage of evidence and experience accumulated during all these years of discussions.

In this regard, motivation and arguments supporting a fully-fledged EDIS are known. It involves institutional and economics reasons to complete the EU Banking Union. An EDIS can be seen as the missing third Pillar to sustain the Banking Union temple or – as recently suggested by Mr Enria – as the missing branch in a tree without which the EU Single Market and the Banking Union cannot be sufficiently "single" nor "unified" as they meant to be. The unity point is particularly relevant because the lack of an EDIS also works as a source of fragmentation for depositors, banks and, ultimately, for sovereign debt markets. To note, the price for an EDIS cannot be undue constraints to domestic sovereign debt holdings.

In fact, regarding the diversification of banks' sovereign debt holdings, it is useful to review five key empirical features of the observed domestic concentration.

First thing to have in mind is that banks' domestic sovereign debt holdings are a relatively small fraction of their balance sheets once liquidity needs considered. Just as an illustration: by end 2020, euro-area banks' domestic sovereign debt securities reached circa 4% of total assets. By the same date, the net outflows considered for the denominator of the Liquidity Coverage Ratio (LCR) were around 11% of total assets. That means that, if all these domestic sovereign securities were the only source of High-Quality-Liquid-Assets (the LCR numerator) available, they would be less than half of the HQLA needed to reach a 100% minimum level for an overall LCR. So, the alleged 'sovereigns concentration conundrum' is not that big, and diversification tools should not constrain liquidity management.

We need to explore new approaches and policy tools, drawing on evidence and accumulated experience.

Second, banks' sovereign holdings are not static. They tend to move countercyclically, playing a potential loss-absorbing role during stress periods. This cyclicality can be explained by shifts in risk-return opportunities in balance sheets along the financial cycle. So, diversification should not become a source of undue procyclicality.

Third, the so-called 'bank-sovereign' nexus is mainly explained by macroeconomic factors such as GDP growth, industrial production, unemployment rates or, simply, country of location. That helps to understand why correlation of CDS premia between sovereign and banks tend to be not that different of CDS correlations between sovereigns and non-financial corporates. So, the logic of the 'diabolic loop between sovereign and banks' does not seem an argument to motivate diversification.

Fourth, concentration in domestic sovereign debt holdings – 'home bias' – is also observed in banks holdings of corporate debt and equity. Such a home bias also seems to move cyclically. So, diversification should be mindful of underlying structural economic factors.

Five, scarcity of 'safe-assets' or 'high-quality' sovereign bonds makes sovereign debt portfolios to be intrinsically concentrated when compared with other types of assets such as those in corporates or retail portfolios. So, diversification of sovereigns has its own natural limitations.

But the question remains: what is truly new and what can be done?

What is not new is that, as a result of the characteristics of banks' sovereign holdings, including their low-frequency high-impact risk features, prudential policy tools are not the right ones to incentivise diversification. They are likely to do more harm than good. If nonetheless, for a given reason, they have to be used, it should be ensured that their design and calibration minimise negative consequences for banks and economies.

One new thing, and a major breakthrough, is the issuance of bonds by the EU. This is the right type of policy tool to address the root causes of the 'sovereigns concentration conundrum' while considering the distinctive features of sovereign debt. To develop new tools to face new kinds of shocks as the ones we are experiencing, is a step in the right direction.

Finally, it may be worth to continue exploring ways to integrate sovereign debt diversification into the design of an EDIS – for example, as an element to determine contributions to the fund.

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As Banking Union progress slows, the importance of Capital Markets Union grows

As we gather in the beautiful surroundings of Prague, there are worrying storm clouds on the economic horizon for the euro area. At the time of writing, Barclays expects a mild recession in Q4 22 and Q1 23 as inflation-induced real income losses more than offset the support provided from low unemployment and high household savings.

It is therefore crucial that we get the policy infrastructure right to help banks and other financial services institutions support European corporates, helping them mitigate the worst of any impacts and return us to economic growth. In our view, this means a renewed focus on two main focus areas for policymakers: Banking Union and Capital Markets Union. Whilst there has been commendable progress on both, we must be more honest about the remaining challenges.

We were encouraged by the Action Plan the Eurogroup were considering and given it was not agreed in full, we think the Commission should look holistically at what it can do to make progress when it brings proposals forward later this year. All solutions should be considered here, and a new approach to the asset side, i.e. the harmonisation of lending products, is to be encouraged, rather than a singular focus on the liability side (principally deposits). Areas we would highlight include:

- OSII buffer: we need to ensure less heterogeneity in macro-prudential tools such as the O-SII buffer and this should be addressed in the macro-prudential review.
- Cross-border lending: more progress needs to be made in this space. There is a Eurogroup goal of facilitating a more integrated single market for banking services which needs to be advanced.
- We should also focus on the need to remove certain local jurisdictional differences. The fact that the MREL calibration for small and medium banks is typically decided by national resolution authorities, and thereby subject to different approaches to bail-in, can give rise to further level playing field issues.
- As previously noted in this publication, European Banking Union suffers from the continuing absence of an EDIS solution, which clearly lacks a unity of purpose given the availability of alternatives to fix the issue. That being said, the asset-side challenges are multiple and would need to be programmatically addressed by a concerted European effort.

It is crucial we get the policy infrastructure right to support European corporates.

On CMU, stronger, deeper and more liquid capital markets are achievable if we have a more honest, conflict-resolving approach to unification and realise that the capital market needs the kind of political support that EMU and Schengen benefited from. The opportunity is too great to be ignore. A recent New Financial report* measured EU member states against each other and identified an ambitious but achievable growth opportunity: pools of long-term capital could more than double, injecting around €14 trillion into the EU economy. To realise this opportunity, we must accept the fact that on average, bank lending represents 75% of corporate borrowing in the EU compared to approximately 25% in the US. Capital markets must therefore be capable of financing a greater proportion of the European economy.

A clear lesson from the many years of attempting to create a genuine pan-European capital market is that there remains too much national self-interest. Perhaps we are deluding ourselves that the EU can follow the US, where different parts of the country specialise in different sectors (West Coast for venture capital, Chicago for derivatives and commodities and NY for equity/bond trading). We urgently need a unified ecosystem if we are to unleash the power of the European capital markets, otherwise the EU will be left behind the US, UK and Asia.

The areas which should be given more focus include tax harmonisation; European bond issuance and the need for one area where this can be adjudicated; harmonised insolvency law; securitisation; reform of European primary markets; plus the various corporate governance issues and disparities across the Union. As progress on Banking Union falters, the importance of dialling up our ambition on these issues rises - we increase the efficiency of our cross-border banks and we diversify our economy's funding sources.

Recent geopolitical events tend to make us think initially about our domestic security – be that on energy, security or finance. In that context, no-one can disagree with the concept of strategic autonomy. However, it is crucial that we do not unintentionally limit access to finance for European corporates, as doing so will only restrict their ability to manage forthcoming headwinds. It is important that we widen and diversify the range of financing options available therefore strengthening the European economy, protecting jobs and facilitating growth.

Barclays Europe look forward to playing a constructive role in these challenges as we strive collectively to ensure a safe, strong and prosperous European economy.

A new vision for capital markets. New Financial February 2022.

CHRISTIAN EDELMANN

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Closing the value gap in European banking

The June Eurogroup gathering in Luxembourg promised to offer more clarity on integrating European banking and capital markets. Instead, it was widely seen as a disappointment.

While the work continues, the lack of progress shouldn't have come as a surprise. In times of geopolitical tensions, priorities change.

The war in Ukraine is feeding an already inflationary environment and an economy struggling to recover from Covid-related supply chain disruptions. As a result, concerns over fiscal stability in (Southern) Europe are growing, and the European Central Bank again is challenged to stretch its mandate to manage the widening of sovereign bond spreads.

How bad are things for banks in Europe? At first sight, the global financial services sector is in relatively good shape today and has been growing for the past several years. It has also shown remarkable resilience during the peak of the Covid crisis.

But growth and value creation have been skewed decidedly toward new players. In 2012, incumbent firms accounted for 90% of the total value of the financial services industry; today their share is just 65%, according to recent Oliver Wyman research (The Tectonic Shift Between Risk, Data, and Technology). Financial infrastructure and technology companies, or FITs, have begun to replace them, now accounting for 35% of the industry's value. While the top incumbent firms have increased their shareholder value by about $1.3 trillion over the past decade, according to Oliver Wyman research, the non-incumbents have increased their value by $3 trillion.

The vast majority of the FITs growth is taking place in the US and China, where the biggest technology firms there are piling into financial services. Europe lacks true "tech giants" and hence has seen more limited value creation thus far. As online wallets, digital tokens and the metaverse will eventually gain further ground, Europe is again at risk of standing on the sidelines.

The situation is especially bad for European incumbent banks. The market value of the top 20 banks in Europe at the end of 2007 was 58% greater than the top 20 US players; now it is 43% less. Annual profits of some of the largest US banks now exceed the market capitalization of a number of those banks in the top 20 back in 2007.

With the banking union not delivering the hoped-for panacea, what should European banks now do to address the value gap?

In the end, it will be up to European banks themselves to reverse the widening gap with US firms.

First, banks should not wait for the perfectly conducive environment for M&A, but rather should actively work with all involved regulators to achieve better synergies in cross-border M&A (Europe's banks can't ignore the M&A rush in fight with the US giants - Financial News (fnlondon.com)). They should challenge domestic ring-fencing practices in the Eurozone — in particular, by pushing for cross-border liquidity waivers, which national regulators can grant. Along those lines, banks should push domestic resolution authorities to not add MREL (minimum requirement for own funds and eligible liabilities) requirements to local subsidiaries of banking groups on top of the MREL requirements made by the Single Resolution Board.

Longer-term, European banks need to challenge their core business models. Yes, we have seen various rounds of restructuring and digitization at all European banks since the global financial crisis. But at their heart they are set up across traditional client-oriented silos (such as retail or wholesale banks or wealth management divisions), with the majority of their revenue streams reliant on risk intermediation. While rising rates now help these businesses, this is not enough to change the fortune of European banks.

These incremental revenues can create additional ammunition to finance a transition into the future — that is, to venture more deeply into technology, particularly data. Value technology services (such as payment, banking/insurance-as-a-service models or digital assets) are getting earnings multiples of 20 to 30, while connected data services (such as wallet services, connected ecosystem services for mobility, employment, education, commerce, or climate risk data) enjoy multiples of 30 to 40. Traditional risk intermediation businesses, by contrast, have multiples of just 10 to 20.

Transitioning to the future will require more than an innovation lab — companies must undergo sweeping organizational change, turning these platforms into primary or at least equal reporting lines, with future leaders being groomed in these leadership positions.

In the end, it will be up to European banks themselves to reverse the widening gap with US firms. Those that show they can change are likely to find eager support among investors, regulators and prudential authorities across Europe.

PIER CARLO PADOAN
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Banking Union: the way forward?

There is no doubt the completion of the banking union depends on some complex and controversial issues. Even so, the failure of Member States to agree a way forward is disappointing. Not only was there no agreement on EDIS, there was no progress on the actions to achieve a true single market. This is a problem for cross border banks and the further integration of the EU banking sector.

A true Banking Union is key to ensure European banks can efficiently fund the European economy; continue their transition to green energy; embrace a digital future; develop private sector risk sharing; and reinforce financial stability in the Eurozone. It is equally important for the competitiveness of European banks, not only vis a vis foreign banks that have single, much deeper and more efficient domestic markets, but also with respect to new players.

Support of a more efficient flow of liquidity and capital between subsidiaries of the same banking group is critical. Cross-border groups should manage their liquidity and capital at a consolidated level, rather than for each individual subsidiary.

For the time being, one pragmatic solution lies in how supervisors of Europe-based banking groups apply pillar 2 requirements. They could take into consideration the risk profile of each subsidiary and its capital levels, rather than automatically mirroring requirements at a consolidated level. This approach would also not require legislative changes.

Another quick win would be a review of the policy governing the liquidity waivers. The SSM should amend the ECB policy which grants liquidity waivers for cross border groups to make it more flexible and easier to access for banks.

Finally, the revised methodology to calculate whether a bank is a GSII lacks rationale. If it rightly acknowledged that exposures within the euro zone should be treated as domestic exposures and therefore should not be a relevant indicator for the cross jurisdictional activity of a bank, it is not clear why a bank cannot be removed from the list of GSIIs by applying this methodology.

These changes would better reflect the reality of the Eurozone banking sector and remove an important obstacle to the free flow of capital and liquidity within cross border banking groups.

But to solve many of the current ring-fencing practices legislative changes are needed (either at EU or national level or at both). In the Union the vote of a majority of the Member States would be required.

It's critical to find pragmatic solutions to support a more efficient flow of liquidity and capital.

So far, every attempt to introduce cross border prudential requirements waivers or reduce discretions in terms of infra-group large exposures has failed. Countries whose banking sectors are dominated by the subsidiaries of foreign banks (host countries) fear that a crisis in the parent company could result in a liquidity drain and thus impact the host country's real economy.

The existing intra-group support actions within Group Recovery Plans of Single Entry Point resolution groups should provide sufficient reassurance that a parent company would support a subsidiary in case of crisis. The reputational cost of not doing so should alone give enough comfort to host countries.

However, this is not the case. We need solutions to reassure host countries that they would not be responsible for saving the subsidiaries located in their countries.

While the political debate has shifted away from arguing that the only possible solution would be the establishment of a fully-fledged European Deposit Guarantee Scheme (EDIS), there are several proposals which have been recently debated by regulators: i) a mandatory waterfall payment scheme; ii) the introduction of legally enforceable unconditional parent - subsidiary guarantees and iii) the transformation of legal entities into branches.

Branchification is the best solution, allowing capital and liquidity to be moved across borders without significant constraints. Legal obstacles to branchify subsidiaries dedicated to retail activities and the reticence of host jurisdictions could be overcome by moral suasion by the SSM.

Two years ago, the German Finance Minister proposed allowing capital and liquidity to freely flow intragroup in normal times while creating a waterfall payment scheme that clearly sets out in law how available funds should be distributed to the subsidiaries in host countries in times of crises. This should be revisited.

As for the bank crisis management and deposit insurance (CMDI) framework, there is a case for the harmonisation of the creditor hierarchyas well as the harmonization of the Least Cost Test. This last change would enhance the chances of using Deposit Guarantee Schemes (DGS) funds in early intervention and resolution to avoid atomistic liquidations of banks and reduce the costs for the national DGS itself.

To the same end, the State aid framework should clarify that private DGS' resources used in preventive and alternative interventions, when executed outside a public mandate, are not to be conceived as State aids.