Banking Union financial integration: time to consolidate trust - Eurofi Article by Elke König

Extensive literature exists on the benefits of financial integration and consolidation of banks. From the perspective of the Single Resolution Board, whose mandate focuses on achieving banks’ resolvability, having strong European banks is a natural aspiration. Where there is a solid business case, consolidation can bring economies of scale and increase profitability. It can improve diversification of risks within banking groups. It can also increase banks’ access to capital markets and decrease their funding cost, ultimately facilitating their build-up of loss absorption capacity to meet the so-called Minimum Requirement of Eligible Liabilities (MREL).

Moreover, like cross-border capital markets, **cross-border banks can play the important role of reducing risks through private risk sharing**within the Banking Union. Indeed, cross-border banks are better equipped to withstand and absorb idiosyncratic shocks that may affect one or another Member State. Beyond the perspective of banks and Member States, it is important to look at this topic from the perspective of the investor too. Financial integration could lead to more efficient markets and provide financial services users with better choices.

This being said, consolidation within the banking sector should not be seen as a panacea or a short cut to avoid necessary reforms. In this sense, it is crucial for a resolution authority that consolidation facilitates rather than hinders the resolvability of a bank, in line with the Single Resolution Board’s resolvability expectations.

Overall, the advantages of banks’ consolidation seem therefore evident. In addition, the establishment of the institutional infrastructure of the Banking Union can also be seen as a favourable element: although the third pillar, common deposit insurance, is yet to be built, a single supervisory mechanism and a single resolution mechanism are up and running.

In spite of all of this, financial integration within the Banking Union is still lagging behind. Several studies have found multiple causes behind this trend. Market factors surely play a prominent role. However, there are also challenges that could be addressed by policy-makers and regulators.

Among these, EU legislators and regulators should keep up the momentum on the clean-up of banks’ balance sheets. The harmonisation of relevant legislation, such as insolvency proceedings, could also contribute to remove barriers for the cross-border consolidation of banks.

Finally, yet importantly, rule-makers and regulators should resist the temptation of ring-fencing capital and liquidity resources, as this can lead to suboptimal location and rigidity in the deployment of such resources. Regrettably, the recently agreed banking package does not mark a step forward on this aspect. Rather, it runs the risks of, first, fragmenting decision-making within the Banking Union on external MREL, and second, ring-fencing of internal MREL. The Single Resolution Board already invests and will continue to invest significant resources to reach joint decisions with national authorities on resolution plans, calibration and location of MREL, and bail-in playbooks. Such day-to-day cooperation should increase mutual trust within the Banking Union, and ultimately be reflected in a future revised regulatory framework.

In a word, Rome was not built in a day. Just like in the United States, where financial integration took decades, it is not surprising that the road for Banking Union integration is still long and winding. However, the direction of travel should remain clear, and the need to consolidate trust along the way should be high on everybody’s agenda.