European banking – there is strength in diversity - Eurofi article by Elke König

**If the European Union’s motto is ‘United in Diversity’, then perhaps the Banking Union’s motto should be something along the lines of ‘Strength in Diversity’.**

The Banking Union is a diverse mosaic of small and complex financial institutions. In some states, the banking market is dominated by foreign operators. In others it is small banks that have the lion’s share of the market. And in others still, the market is largely made up of just a few large banks. The structure of individual markets within the Banking Union varies hugely reflecting not least different traditional development. This diversity in structures is not necessarily a bad thing. For example, a large bank poses a serious risk to financial stability if it cannot be made resolvable; smaller banks may not have the economies of scale to be viable in the long-term. There are pros and cons to each model – the important thing from a financial stability point of view is that small banks and big banks have sustainable business models. Regulation and supervision have to cope with the variety of business models. Just to name two points: Regulation has to be proportionate, there is no “one size fits all” and in a single market the diversity in national rules has to be overcome to facilitate mergers and acquisitions.

A good regulatory framework can facilitate this, but of course, the role of the regulator is not to ensure every bank can make a profit. Every bank, big and small, must be in a position to comply with regulatory standards and bear the cost that is inherent in the safety net that regulation provides to society. That said, the regulatory landscape should facilitate as much as possible the natural behavior of a free market in the European banking sector. The challenge for regulation has always been to recognize that one size does not fit all, while also balancing the need for a level-playing field.

However, it is not just about regulation for the financial industry. A fully functioning Capital Markets Union, which allowed for investment to flow easily across the euro area, is much needed and would do much to ensure that banks have an enlarged “home market for capitalization and investment”. A proper, fully functioning capital markets union in Europe would allow for greater integration of investment, allowing for the possibility of more consolidation, creating banks ready to operate right across the 19 Eurozone countries. This would introduce competition for the consumer, but it would also diversify the banking market within many member states, which would be a good thing. Unlike the Banking Union however, the Capital Markets Union is more of a concept, and idea or a notion, rather than a concrete legislative framework.

There is also work to be done in harmonising insolvency procedures. In the Banking Union itself we have 19 different insolvency procedures, so banks and their investors will have to contend with and learn about many different legal systems just to invest in a market that is outside their home member state. The single market has still a way to go.

It is also true that completing the Banking Union and having all European deposits protected at EU level, in a harmonized way, would promote stability and confidence if and when the next crisis strikes.

There probably is a need for consolidation in the European banking market in order to remove overcapacity and ensure greater profitability overall. Some banks will simply have to exit the market; mergers and acquisitions can play a significant role in consolidation. In any case, a completed Banking Union and a full Capital Markets Union would be a solid framework so that the markets can be left to play their part, strengthening the sector going forward and thus helping to promote financial stability.

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