Banking union – risk reduction comes to the fore

Summary

The European banking system has become more stable and crisis-resistant since the financial crisis. Establishing a banking union, i.e. establishing the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), as well as developing an additional capital buffer by the banks have contributed significantly to this. Despite this progress, there are still considerable risks within the European banking system. EUR 786 billion of non-performing loans continue to place a strain on the balance sheets of European banks.[1] These problem loans are distributed extremely unevenly. Weak euro countries such as Italy and Greece are much more strongly affected than sound economies. Banks and governments also continue to be closely interwoven, jeopardising the stability of the financial system in the event of a crisis.

Against this backdrop, the eurozone finance ministers acknowledged once again in June 2019 that excessive risks must be reduced as a matter of priority before bank risks can be communitised in the form of a centralised European deposit insurance scheme (EDIS). The finance ministers are expected to consider the EDIS proposal that has been discussed since 2016 once again in December 2019. Until then, the Eurogroup wants to develop a schedule for opening political negotiations about a European deposit insurance scheme.

The fpmi is calling for a consistent and sustainable reduction in risk. On the other hand, it rejects the communitisation of deposit protection in Europe. Given the uneven distribution of bad debt, EDIS would amount to a transfer system that passes on the costs of misguided economic and financial policy in individual member states to the European Community as a whole. This is not only true for the full insurance proposed, but also for the reinsurance model discussed. The Deposit Guarantee Schemes Directive (DGSD) adopted in 2014 already guarantees a high level of protection for savers across Europe while at the same time taking account of the proven performance of national protection schemes. No further measures for regulating deposit guarantees are required. Instead of considering sharing liability risks in Europe, the focus must be on reducing excessive risks and preventing these risks from building up again.

The following aspects must be taken into account in this debate:

- **Address problems at national level:** As the excessive risks were largely created by political misjudgements and mistakes by individual national banks at an individual member state level, risks must also be reduced at a national level.
- **Reduce bad debt:** The EU should set ambitious and specific goals to reduce the high volume of non-performing loans across the EU to a level comparable with other economic areas.

[1] European Commission, Fourth Progress Report on the reduction of non-performing loans and further risk reduction in the Banking Union, 12 June 2019, Brussels [in German]: https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:52019DC0278&from=EN.

- **Use banking supervision instruments decisively and purposefully:** Banking supervision must promote the reduction of non-performing loans wherever excessive risks exist.
- **Increase creditor liability:** Bank creditors must be consistently involved in financing restructuring and winding-up processes in order to prevent government bailouts or the communitisation of winding-up charges.
- **Improve insolvency law:** Insolvency law in the eurozone countries must be harmonised without compromising on creditor protection. The efficiency of the judiciary must also be enhanced.
- **Stimulate growth:** Eurozone countries must implement structural reforms in order to boost growth and prevent credit default risks.
- **Regulate public financing appropriately:** Every penny of loans granted to European countries to date without underlying equity backing must now be hedged by equity capital depending on the level of risk.

This is a summary of the key statements.
The full position paper can be downloaded from www.fpmi.de.