European Stability Mechanism

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"We need to stay on course while minding the transition"

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The topic of this panel "Overcoming banking fragility in the euro area" can be discussed from different angles. Let me address it from an ESM perspective by outlining what has been achieved, where we see the main challenges and the need for further action. In a nutshell, we have made great progress with Banking Union, but the transition period until the banking system has fully adjusted to the new environment poses clear risks. Principally banks, but also national and European policymakers, are called upon to address fragilities emerging from low profitability and legacy assets.

We have come a long way since the financial and the sovereign debt crisis and have achieved a lot. Beyond managing the immediate aftermath of the crisis, Europe has created a new 'single' rulebook which helps level the playing field for all actors in the European banking market. We have created the new European Supervisory Agencies – EBA, ESMA, and EIOPA – for different market segments and have a new entity that monitors systemic risk – the ESRB. We have set up Banking Union supervision at the supra-national level with the SSM. We also created a new framework for bank resolution – something that did not exist before – and created a Single Resolution Mechanism, including a Single Resolution Fund. Europe-wide stress tests have brought enhanced transparency and greater understanding of the state of the European banking sector. Last but not least, I want to mention the ESM, where we have instruments to serve as a second or third line of defence when countries are faced with banking problems.

Our achievements are already bearing fruit but we need to stay on course to fully recover. Credibility has returned. The asset quality review, the stress testing exercises, and the transparency exercises have provided investors with greater transparency than they have ever had before. Massive recapitalisations of over half a trillion euros and sustained deleveraging have made European banks safer. Financial fragmentation is receding and the recovery is slowly taking hold. Nevertheless, we need to continue our work to build on investors' newly gained trust. The European Deposit Insurance

Scheme is still under construction. New standards like MREL and TLAC are being developed and will assure that the bail-in instrument functions better going forward. Existing legislation needs to be implemented. Also, importantly, we need to think about the link between sovereigns and their domestic banking sectors which magnified the recent crisis in several instances. All of these issues continue to require our attention.

At the same time, we cannot neglect transition issues which remain in many countries. The efforts European banks have made are enormous and costly – in particular as they are coming out of a crisis. Banks need to adjust to this new and still challenging environment. Many continue to face difficulties dealing with it in a profitable way. Banking in 2016 is a very different business from banking in 2008. Also, legacy problems are still haunting banks in some countries, including in Italy. High levels of NPLs are binding resources and need to be addressed. All of these issues need to be taken into account and accommodated while we implement the new banking union framework. This will contribute to the success of the Banking Union.

Going forward there are three main areas in which we need to work to be successful. The new banking union framework is a common project at the national and the European level. To ensure its success we need to continue our work at all levels.

- Banks have to find new business models and work towards sufficient profit margins. This will require further cost-cutting and adjustment to new technology and regulation. We have to make sure that, while banks have the necessary time to adjust, through transition arrangements, they do not relax their guard and instead continue their efforts.
- At the national level, Member States are called upon to continue implementing reforms and update legislation and regulation – in particular to deal with the NPL problem. For example the bankruptcy law should be modernised, and fiscal frameworks need to set the right incentives to promote a swift solution to the legacies of the crisis. Collateral enforcement needs to be adequate and the time periods given for adherence need to allow for reasonable delays.
- At the European level we still have open questions that require further work, importantly backstopping the Single Resolution Fund. Notably, there is a commitment to design a common backstop before the end of the ramp-up period. This should be considered soon; we should not lapse into post-crisis complacency.
- Lastly, all of us need to be ready to accept the new post-crisis environment. The new regulation we have created will require a new and different banking sector. This will cost jobs – at least initially, require more capital, and may prompt some branch closures. But

this is what we wanted and needed. Faced with the crisis, the resulting losses and bank failures, and the instances in which we had to resort to taxpayer money to avoid a collapse, we took steps to make banking safer. All of us in the policy world should be open about this and support the transition process to promote financial stability and improve financial intermediation in Europe.