LIGHTS AND SHADOWS IN THE EUROPEAN UNION

Who benefits from Banking Union?

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1. Although the subject of this panel is Banking Union, I feel that it is worth starting with a reference to Brexit. I would like to make three comments:

(a) Brexit is an example of dissatisfaction with the European project and, in a way, a judgement of the European Union;
(b) The consequences of Brexit will be more geopolitical than economic, though its economic effects will not be negligible, especially in the financial area;
(c) It is necessary to take advantage of Brexit to encourage deep political and economic reflection aimed at strengthening the euro area with effective systemic solutions.

The European Union and euro projects warrant reflection and more action to achieve their goals. It is necessary to step up integration if Europe wants to move forward lucidly and strategically to real political union. This requires greater balance (of missions, sharing and commitments) between richer, more developed surplus countries and countries with deficits and serious public finance problems. This will benefit everyone. For reasons of moral hazard, mutual trust and confidence in the European project, this must mean an opening-up of the richer nations in return for essential reforms and virtuous fiscal discipline (i.e. involving economic growth) on the part of the weaker countries.

2. Banking Union was and is a necessary project, due to its goals:

- To promote financial integration (reducing fragmentation);
- Separating the sovereign risk and banking risk;
- Furthering economic and monetary union.

Banking Union is based on three pillars. They are the Single Supervisory Mechanism, Single Resolution Mechanism and, still under discussion, a European Deposit Guaranteed System.

Banking Union has also brought a more demanding legal and regulatory framework in terms of supervision and resolution, based on a requirement to promote homogeneous rules (a level playing field) on fair competition at European level.

However, this requirement was seriously flawed right from the outset. The different banking systems in the European Union do not share the same starting positions. They have different degrees of ability to generate profits and, when all is said and done, to recapitalise, which is an absolutely critical factor in responding to new regulatory and supervisory requirements.
As a result, the principle of equal conditions in these circumstances raises the questions of proportionality, different transition periods, suitability to the system's needs and coherence with the goals of economic and financial stability of which the supervisors are the ultimate guarantee.

3. I would now like to talk about the situation in the Portuguese banking sector.

The sector's new regulatory and supervisory framework is much stricter in terms of capital, liquidity and risk reduction. It coincided with our financial and economic adjustment programme and the recession that we experienced (GDP fell 7.2% between 2010 and 2013) and placed our banks at a disadvantage in relation to their peers, which had survived the global financial crisis (many with clean balance sheets thanks to state and European aid) and were enjoying economic growth.

Due to a particularly demanding macroeconomic context, the Portuguese banks had to face (and in many ways are still facing) a very different starting point from that of their European counterparts, though they are subject to the same requirements and timeline for meeting them.

Additionally, Banking Union started up in 2014. This was precisely the year in which Portugal came out of the financial and economic adjustment programme with its economy and banking system still suffering the harmful consequences of the deep, long crisis that befell the country. It was also in 2014 that the first resolution of a financial institution took place. This landed the other banks in the system with the costs of the fall of one of largest institutions in the market. The legacy of this resolution plus that of another, less systemic bank the following year comes with the funding of the new resolution model to which the rest of the European banks will, here, also have to contribute.

If we do not consider the unsuitability of some requirements and the phasing-in of compliance with them to the particular economic, financial and structural context that the sector is facing, it may have undesirable effects on the system's stability. Where the resolution of BES was concerned, for example, the Portuguese banking system's main concerns were uncertainties as to accounting and prudential effects. The action taken by the government and Banco de Portugal with European instances seems to be on the right track. But there is still some uncertainty. In short, the Portuguese banks ended up having to make a much larger effort to comply with the new regulatory and supervisory framework. But they have been fulfilling their obligations doggedly in an adverse climate. The aim of Banking Union is to reduce financial fragmentation, though it must not be implemented blindly but in the context of a comprehensive assessment of the entire euro area. For example, the whole Banking Union architecture was designed on the assumption of economic recovery, which in Portugal is taking its time.

On the other hand, the time lag in relation to countries that reinforced their banking systems prior to the new regulatory framework and current rules on state aid has resulted in clear competitive disadvantages and has required longer balance-sheet repair programmes, with adverse effects on profits.

4. There are very few instruments for reinforcing the financial systems of the countries facing the greatest problems due to constraints caused by the legal framework in the European banking sector and the rules on state aid. The regulatory framework sets out stricter capital requirements while also discouraging private investment (bail-ins and burden sharing). The rules on state aid prevent the intervention of national authorities (resolution of banks precedes bailouts).

This creates potential risks to the Member State's financial stability, which is something that must still be taken into account under the aegis of Banking Union. The absence of preventive mechanisms and the inflexibility of the new resolution framework will further delay more necessary intervention, thereby exacerbating structural weaknesses.

The Governor of Banco de Portugal has upheld the need for EU authorities to review some aspects of the existing rules. Following Brussels' assessment of the impacts of the new regulatory framework with the idea of possibly recalibrating requirements, it makes sense to propose revisions that have a good chance of winning due to their rationality and defence of competition.

It is important to ensure that the legislative and regulatory framework does not exacerbate the effects of the European rules, which are already very strict. We have to do our homework if we are to overcome the internal obstacles, which must be resolved quickly, as they depend only on us. The truth is that there are legal, judicial and tax-related inefficiencies that are standing in the way of the desired level playing field in the European Union. For example, it is important to remove barriers to speedier recovery of bad debts, which include slow judicial decisions in recovery processes and company insolvencies. Greater standardisation of Member States' practices is therefore essential.

5. The first message that I would like to convey today is that different starting points should mean difference rates of convergence on the final common goal, plus intensive, committed efforts to resolve delays and shortcomings in the Member States that are at a disadvantage.

Secondly, it is important to stabilise the current prudential framework and ensure that the incorporation of the Basel rules into European law (complete implementation of the Basel III package and adoption of the Basel IV rules) does not involve substantial additional capital requirements that compromise the European financial system's ability to finance the economy. Execution and transition periods must be adapted to the circumstances.

On the other hand, Banking Union will only be complete after the third pillar, a European Deposit Guarantee System, has been implemented. It is important to ensure that risk reduction, a necessary condition for greater sharing of risks, does not place the European banks at a competitive disadvantage in relation to their peers in other jurisdictions. In particular, prudential treatment of exposure to sovereign debts in Europe must only be revised after the review by the Basel Committee.

Thirdly, I would like to stress the importance of also ensuring a level playing field between the banking sector and new players in payment services and so-called shadow banking. I repeat what has already been said by many: "The same business, the same risk, the same rules".

The banking system complements other sources of funding of the economy, which benefit from its contribution, by improving companies' balance sheets and improving their access to loans. The digitisation of financial services can create virtuous partnerships, but unfair competition is unacceptable.

Fourthly, in spite of very important developments in terms of supervision, "single supervision" is in fact "multiple supervision" (micro prudential, macro prudential, behavioural and resolution). This means that the banks are facing a plethora of equally important demands with significant consequences in the form of further capital requirements and the allocation of human and financial resources.

It is therefore absolutely critical for Banking Union to achieve:

- Greater coordination between the different entities regarding needs for information and time limits for providing it;
- Greater coordination between micro and macro prudential decisions and greater coherence of macro prudential decisions at European level;

- Compatibility of the goals and actions of behavioural supervision and consumer protection with those of prudential supervision and financial stability;
- A better balance between measures aimed at improving banks' resolution capacity and the need to preserve the banks' financial standing and business models;
- A more harmonised approach between monetary and prudential policy to mitigate contradictory guidelines (e.g. use of TLTRO and consequent penalisation of the SREP).

It is also important to ensure that regulation and supervision are on the same page by enforcing the rules of competition.

6. In conclusion, let us look at each of the three Banking Union pillars:

- As far as the supervision pillar is concerned, we feel that the road we have travelled has generally been highly positive. It is very clearly aimed at strengthening institutions and their governance, even though we must agree that starting conditions were not always taken into account and there is room for improvement in terms of the different institutions' actions;

- Regarding the resolution pillar, as I said, Portugal was a pioneer in the use of resolution measures and all that they involved in terms of a new approach to dealing with institutions in serious difficulties. There is a burdensome legacy of long-term costs plus all the uncertainty of contingencies that may be allocated to the Resolution Fund;

- Finally, talking about the third pillar, it is more than ever vital for it to become a reality so that depositors' trust is not shaken in the new resolution framework. As it had the opportunity to inform the European authorities, the Portuguese banking sector upholds the creation of a European Deposit Guarantee System in line with the European Commission's proposal at the end of last year.

The great and worthy purpose of Banking Union was to defend the stability of the European financial system by increasing banks' soundness, preventing future crises and basically protecting taxpayers' money. Implementation of this framework should not therefore compromise or lose sight of its central purpose.

In Portugal's case, at a time of urgent revitalisation of economic growth, the existence of a stable, sound financial system is essential in ensuring that it can fulfil its mission of financing the economy and providing secure, effective payment services.

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