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Fragmentation in banking markets: crisis legacy and the challenge of Brexit

*Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort*

Introduction

Dear Fernando, dear Bill, dear colleagues,

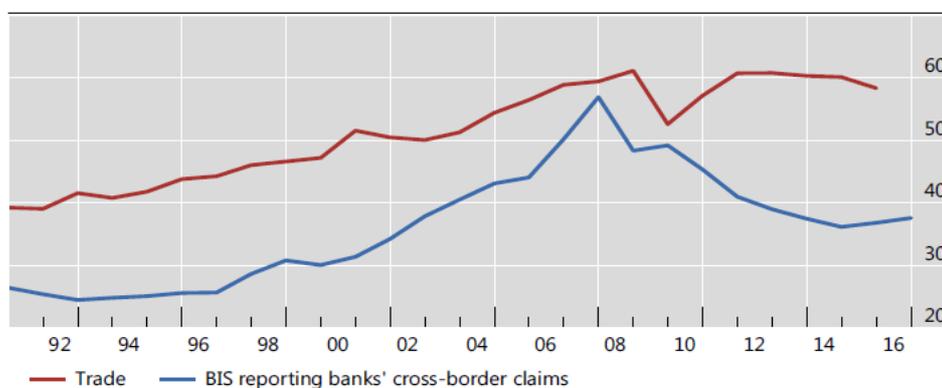
It is an honour and a great pleasure for me to address such a distinguished audience and open the discussions of this two-day high-level meeting for Europe on banking supervision. As we gather, today, ten years since the crisis struck, Europe goes through a long-awaited phase of economic recovery while facing important economic and geo-political challenges. With national economic policies in several regions of the world leaning towards an inward-looking strategy – if not mere protectionism – and facing the European-specific challenge of implementing the withdrawal of the UK from the European Union, the risk of sudden shocks and sudden reversals should not be underestimated. With very limited room for manoeuvre in monetary policy, the International Monetary Fund (IMF) (2018) calls European policy makers to adjust fiscal imbalances, promote structural reforms and further deepen the financial integration potential of the Economic and Monetary Union (EMU).

It is to this last aspect, financial integration at these challenging times, that I would like to draw your attention today. In response to the financial crisis, in the European Union, we have designed an overhaul of prudential standards, we have done tremendous progress in cleaning and strengthening the balance sheet of European banks and we have also laid the grounds – within the Euro Area - for integrated bank supervision and resolution. Still, while the health of our banking system has unambiguously improved, we struggle to restore financial integration. The European context is still fraught with distrust among jurisdictions and the temptation to give in to ring-fencing and protectionism is strong. I will elaborate today on the importance of financial integration and the policy challenge of restoring it, just as the UK withdrawal from the EU looms over European (and global) financial markets.

Stock take of financial integration and private risk sharing

The global financial crisis resulted in a deep contraction of cross-border banking activity. Commentators and academics came to speak about *financial de-globalisation*¹. Jaime Caruana (2017) labelled this strand of literature the theory of *peak finance*, in that it mimics the better-known peak trade hypothesis, whereby global trade no longer grows at a faster pace than global GDP. Indeed, based on Bank for International Settlements' (BIS) global statistics, McCauley et al. (2017) show that, following the 2007-09 financial crisis, the amount of cross-border claims of BIS reporting banks has fallen, as a % of global GDP, much more persistently than global trade volumes (see Figure 1). Global trade dynamics have somewhat recovered, whereas cross-border finance has not. Cross-border bank claims have gone from 60% of GDP, in 2007, to below than 40% in 2017.

Figure 1 Trade and bank cross-border claims as a % of GDP (IMF, World Bank, BIS calculations)

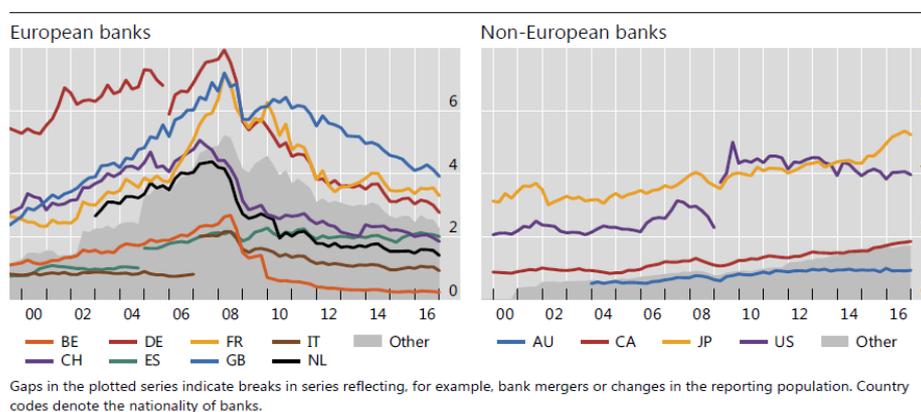


Sources: IMF; World Bank; BIS locational banking statistics; BIS calculations.

¹ The term 'financial de-globalisation' first appeared in Broda et (2009).

The piece of evidence that McCauley et al (2017) bring to our attention is that what we have so far considered as global fragmentation of finance may have been – almost exclusively – a European phenomenon. By disaggregating the BIS statistics by ownership of the bank assets, rather than by location of the bank, the authors show that whereas most EU banking systems (with the exception of Spain) underwent a deep contraction in cross-border activity, cross-border claims of banks of US, Japanese and Canadian ownership have only suffered short-lived contractions (see Figure 2). Potentially, non-EU banks have partly substituted for the retreat of EU banks.

Figure 2 Consolidated foreign claims, by banking system as a % of GDP (IMF, BIS, BIS calculations)

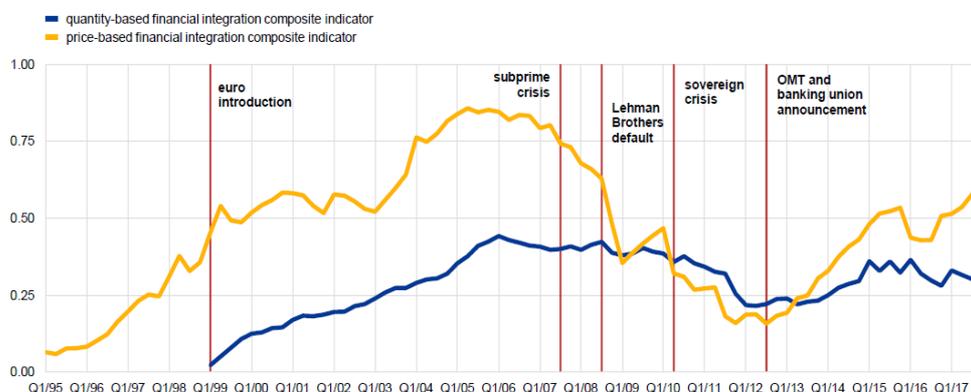


Ten years after the crash, we must ask ourselves what went wrong in the European response to the crisis and whether we have done enough to restore an integrated albeit more resilient banking system in the European Union.

Available evidence shows that, despite remarkable achievements in terms of balance sheets cleaning, regulatory harmonisation, and deepening institutional integration within the Banking Union, where the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) are up and running, financial integration is lagging behind. The Banking Union is failing to provide the degree of financial integration that we would have expected. According to 2018 European Central Bank (ECB) data on financial integration², quantity-based indicators of financial integration have been flattening out since 2015 (see Figure 3).

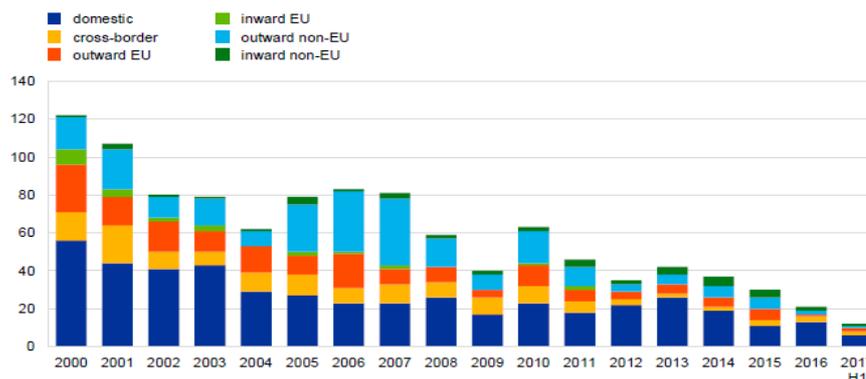
² 2018 ECB Report 'Financial Integration in Europe'.

Figure 3 Price-based and quantity-based composite indicators of financial integration (ECB 2018)



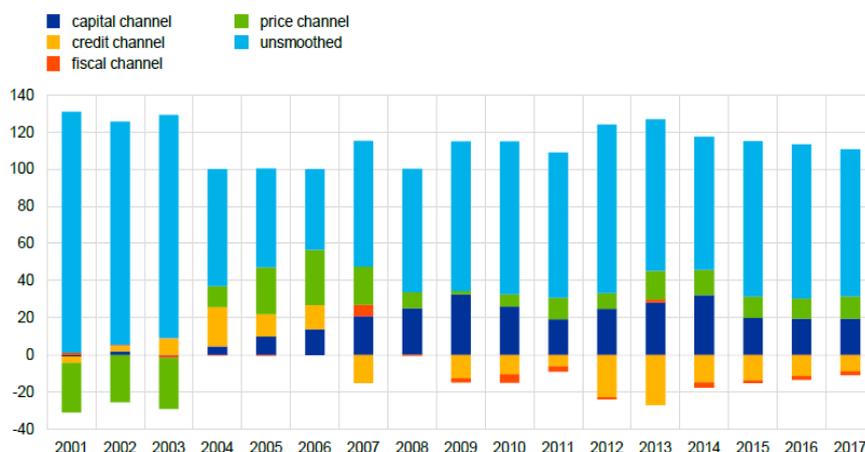
Bank Merger & Acquisition (M&A) transactions within the Euro Area have been on a steadily declining trend, both in terms of number and value, since the year 2000 (see Figure 4).

Figure 4 Bank M&As – number of transactions in the Euro Area (ECB 2017)



Whereas they used to be mostly cross-border in the pre-crisis period, they have increasingly become of a domestic type. Furthermore, as unveiled in research by Raposo and Wolff (2017), domestic M&A transactions have become increasingly of a ‘controlling participation’ type, whereas cross-border transactions have become increasingly of a ‘minority participation’ type. Certainly, all of this was, to some extent, driven by the post-crisis inward-looking bank restructuring strategies put in place by supervisors and Member States. Overall, since 2007, the credit channel (i.e. cross-border lending and borrowing) has been acting in the euro area as a shock amplifier rather than a shock absorber (see Figure 5).

Figure 5 Consumption risk sharing in the Euro Area and its channels: % of shock smoothing (ECB 2018)



Private risk sharing has been impaired in the euro area, and *a fortiori* in the EU. This should be a concern, as it is through risk-sharing channels that the overall system becomes, at the same time, more resilient and more productive.

One caveat seems necessary before moving on: being concerned about the current signs of fragmentation does not necessarily imply that we should aim for the pre-crisis financial integration levels. Those levels, especially as reflected in pricing, may not represent a fully healthy benchmark, in that risk complacency as well as the inability to price risk properly may have played a role. However, it is clear that the reaction to the crisis led us to excessively balkanised banking markets in the EU.

Ring-fencing, distrust and the challenge of restoring integration in the European Union

The inward-looking crisis management and restructuring strategies that supervisors and Member States adopted in response to financial distress lie behind the stylised facts I have just mentioned. First, in times of distress, foreign business proved to be the first to be curtailed, repatriated or suddenly required to operate on the basis of local funding. Home supervisors of cross-border groups realised that financial stress at subsidiaries could generate a potentially unsustainable burden for parent companies and that integrated funding could turn into a source of vulnerability. Second, host authorities took geographical ring-fencing decisions on affiliates of foreign banks operating in their territory, with the objective of protecting those banks' domestic assets, so that they could be seized and liquidated under local law in case of failure of the foreign parent company

or other group's affiliates. Measures included but were not limited to increased capital and liquidity requirements on foreign-owned subsidiaries, legal restrictions on intragroup cross-border asset transfers and limitations on the distribution of profits by foreign-owned subsidiaries, in some cases despite relatively positive economic fundamentals. In the host Member State perspective, this was done to better safeguard the interests of local stakeholders – shareholders, creditors and depositors, as well as deposit insurers and taxpayers – mitigate spillovers and cross-border contagion and support credit supply at the national level. In the absence of legal and institutional frameworks for burden sharing and in light of the uncertainty as to how the resolution of a cross-border group would unfold, supervisors and Member States took measures to defend the national interest. A notable exception, which offers a lesson on the way forward, was the European Bank Cooperation Initiative, also called Vienna initiative: within a cooperation framework involving relevant central banks and supervisory authorities, large banking groups with systemic presence in several Central, Eastern and South-Eastern European countries committed to maintaining cross-border activity and keeping their subsidiaries well capitalised, hence decreasing the need of ring-fencing responses from host authorities.

In the absence of burden sharing legislation, public support to failing institutions put several Member States' public finances under strain. A national bias also characterised banks' restructuring and consolidation, whereby available entities within national borders acquired failing institutions or their lines of business. Also as a result of this national bias, as I already mentioned, M&A transactions became predominantly of a domestic nature.

Ring-fencing and protectionism are not mere anecdotal evidence. Kleyменова and co-authors (2016) have a very interesting line of research where they investigate whether public intervention leads to protectionism in finance. Working on 1999-2011 UK data, they found that the nationalisation of foreign banks operating in the UK (and to a lesser extent, the injection of public capital in those banks) led to – other things being equal – a decrease by 15% in the ratio of UK exposures to domestic exposures. Essentially, they found statistical evidence of the fact that, following public intervention, external lending is cut back more than domestic lending. The same reshuffling, and of a similar magnitude, is found in relation to those banks' liabilities. The same research also finds that following nationalisation, banks tend to focus their foreign exposures towards a more restricted set of jurisdictions, potentially reflecting biased preferences by the public authorities managing those entities.

Whereas distrust, ring-fencing and protectionism could find some justification at the outbreak of the crisis and right in its aftermath, it should be concerning for all of us the fact that these attitudes still today loom worryingly over the political debate on the completion of the Banking Union, notwithstanding the progress made. It is from that concern that we should take action, making sure that we fully implement the safeguards of the institutional framework we have introduced so far but also, that we move on to the introduction of the missing arrangements.

Two current debates are illustrative of this heavy crisis legacy, namely the debate on the so-called SSM waivers (i.e. the waivers to the solo-level application of own funds and liquidity requirements within cross-border banking groups within the euro area, as included in the Commission's proposal to revise the Capital Requirements Regulation³), and the discussion on the launch of the European Deposit Insurance Scheme (EDIS).

The hostility that the proposal on the SSM waivers met in the Council's discussions on the CRR2-CRDV package signals the reluctance, particularly among smaller Member States hosting a significant amount of foreign subsidiaries, to remove regulatory obstacles to the free flow of liquidity and capital within groups. What is allowed within Member States would not be possible across borders, even within the Banking Union. As a result, banks are not in a position to consider the Banking Union as their domestic market. Notwithstanding all the efforts to set up an integrated institutional setting for supervision and resolution, host authorities still fear that capital or liquid assets might no longer be available to cover for local losses or outflows as they fall due, especially during a crisis. They often argue that their concerns will not be allayed until the European risk sharing architecture has been completed, and only once a waterproof cross-border resolution framework is in place.

At the same time, the discussion on the launch of EDIS is stalling, as opponents claim that common area-wide risk sharing arrangements would put participating jurisdictions on an unequal footing, unless further progress in the reduction of risks is first achieved in some Member States.

The risk reduction vs. risk sharing controversy led the debate into a gridlock. As we are here today, holding a high-level meeting amongst European supervisors, let me say that an excessively polarised debate does not serve the cause of the European project.

³ See European Commission (2016).

The two objectives are more interconnected than one may think, and polarising the discussion risks holding back progress on many fronts, preventing us from truly completing the repair of those mechanisms of the European architecture that, as the crisis showed, did not work.

Let me elaborate further on this aspect.

In the first place, it is a priority to correctly and fully implement the resolution framework in a cross-border setting. The Bank Recovery and Resolution Directive (BRRD) – and a fortiori its integrated application within the euro area - provide for those legal and institutional arrangements that were missing at the outbreak of the crisis. The framework foresees supervisory and resolution colleges, which are decision-making bodies in a cross-border banking setting and the place where cooperation among authorities should take place. The framework foresees Intragroup Financial Support Agreements (IGFSA), which can be included in the recovery plan and offer a recovery measure to up-stream, down-stream or side-stream losses, depending on which group's entity is under stress. The approval process of such agreements could be further streamlined, to provide sufficient comfort to all supervisors and shareholders involved that, in case the conditions for early intervention materialise, the transfer of resources is contractually regulated and predictable. Be it in the form of loans, guarantees or collateral, any intragroup financial support should be thoroughly assessed within Colleges, with a view to removing obstacles to the enforceability of the agreements. Potentially, further discussion could take place to enhance the cross-border recognition of commitments and the regulatory incentives to enter into such agreements. Certainly, an increased use of similar safeguards would reduce the rationale for ring-fencing and the regulatory pre-positioning of loss absorbing capacity.

The post-crisis cleaning of bank balance sheets is not yet complete, but has accelerated as a result of enhanced supervisory pressure and the implementation of the comprehensive roadmap agreed by the Council. The latest data available at the EBA show that during the period 2014Q4-2018Q2 NPL volumes decreased by more than EUR 400 billion, which is more than one third of the initial stock. Roughly 60% of this adjustment has taken place since the beginning of 2017, when the first policy components of the roadmap were activated. Substantial progress has been made, and efforts need to keep pace.

However, as we work on the priorities I have just mentioned, we should not underestimate the importance of private risk sharing and its interconnections with risk reduction. First, private risk sharing has potential for reducing the overall riskiness of the financial system. Second, private risk sharing cannot fully thrive on its own, ideally substituting for the missing institutional (i.e. public)

components of the EMU architecture. What we decide in terms of rules and institutional setting affects the private risk sharing potential and, in turn, the risk reduction potential. Let me elaborate on this aspect.

In the context of financial markets, private risk sharing essentially operates via cross-border capital markets and cross-border banking. As individuals and corporates invest in cross-border productive assets, they are better equipped to withstand idiosyncratic (i.e. national) income shocks. By the same token, as banks expand their presence and activity cross-border, they become better equipped to withstand shocks hitting any one jurisdiction among those in which they operate. Even more importantly, perhaps, in a system where banks' cross-border establishment is the norm, rather than the exception, cross-border consolidation becomes an effective adjustment mechanism in the aftermath of idiosyncratic shocks, mitigating the costs of post-crisis adjustments for national public and private budgets alike. We have seen this adjustment channels at work in truly 'single' jurisdictions for banking, such as the US but also, albeit to a lesser extent, in European regions such as the Nordic countries. Daniel Gros (2012, 2015) has shown how the combined action of cross-border banking business, cross-border consolidation and a centralised (i.e. federal) public management of the restructuring led to enhanced 'private' shock absorbing capacity in financial distress episodes of US States such as Nevada or Puerto Rico. Idiosyncratic shocks in comparable European realities, such as Ireland and Greece respectively, could not be equally absorbed by private means, due to the lack of a truly functioning cross-border banking network and a Union-wide coordination of the restructuring.

More generally, I believe that the purely domestic-oriented restructuring and consolidation strategies implemented by authorities and Member States in the aftermath of the last financial crisis in Europe, and the inability of the EU banking system to respond to the crisis as private risk sharing device, resulted in an insufficient adjustment process. These factors partly explain the weak profitability and over-capacity environment European banks were left with, which we still see at work today. Clearly linked to these dynamics was the slower pace of balance sheet cleaning that could be observed in the EU, relatively to other regions. A more open and competitive restructuring and consolidation process would have potentially led to higher exit from the market, more rapidly restoring efficiency, earnings capacity and, through that, a broader ability to get rid of legacy risk.

The polarised debate on the deepening of the EMU is holding back progress on these fronts.

First, the debate does not sufficiently acknowledge that institutional devices such as EDIS and the EU Common Backstop act as *ex-ante* confidence devices. As such, they contribute to unlocking

private risk sharing behaviours and outcomes that – in their absence – languish. We have already experienced the power of *ex-ante* confidence devices on financial markets, for instance in the case of the ECB's Outright Monetary Transactions (OMT). Furthermore, postponing the finalisation of a centralised safety net prevents the EU from developing truly 'federal' crisis management arrangements such as those that operated in the US through the FDIC.

Second, by leaving room to ring-fencing regulatory approaches – e.g., the requirement to maintain very high levels of capital and liquidity within each entity of a cross-border group (even within the euro area) – the current circumstances lean against the efficiency gains of cross-border banking. The resulting trapping of capital and liquidity at local level can be very material⁴. To the extent that this discourages cross-border banking by establishment, it prevents the European banking sector to build up the private risk sharing potential, with the undesirable implications on the overall riskiness and resilience of the system. Research by Wilson Ervin (2018) shows that the implications of ring-fencing on riskiness may be far reaching. Ring-fencing may, in fact, promote a 'prisoner dilemma' type of equilibrium, whereby all players end up being worse-off, in that all institutions become riskier than they would be in the presence of cooperation among national authorities.

It is necessary to overcome the polarised tone of the risk sharing vs. risk reduction debate, recognising that the two objectives are interconnected. Public decision and action are needed on both sides in order to achieve true progress. Instead of remaining trapped in never ending debates on what should happen first, on the right sequence of events, we should do what the EU is good at: agree on a clear roadmap in which progress is achieved, in parallel, on all fronts.

At the EBA we are beginning to devote concrete work to the topic of financial integration. We are currently preparing a bank survey through which we aim to identify if and which specific elements of the current regulatory framework may pose unintended obstacles to M&A activity and, more widely, the expansion of cross-border banking via establishment. We will look into well-known elements of heterogeneity of the regulatory framework, such as options and national discretions or the diverse macro-prudential toolkit, but also into issues related to Pillar 2 requirements and the institutional aspects of the Banking Union. This is in my view the necessary preparatory work for what could eventually become the development of a dedicated section of the Single Rulebook to Pan-European cross-border groups as specific regulatory entities, both as going concern entities and gone concern entities, as also advocated in Cahen and De Larosière (2018).

⁴ The ECB (2018) finds that up to EUR 130 billion of HQLA are held locally by subsidiaries of Euro Area's global systemically important banks, where these subsidiaries are located in a different Member State than their parent undertaking, to ensure compliance with the 100% Liquidity Coverage Requirement (LCR).

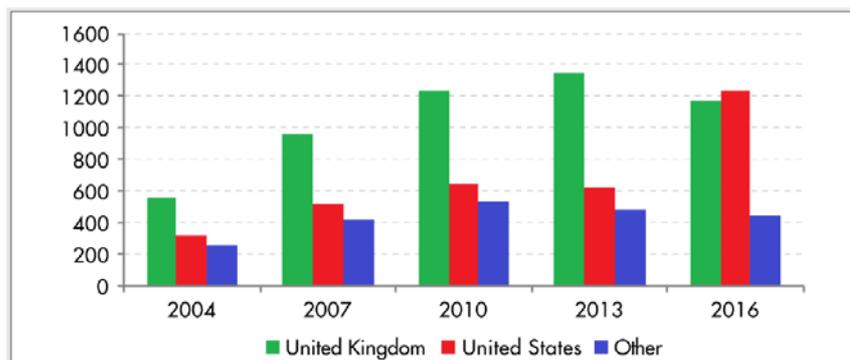
This discussion is made more urgent by the structural changes triggered by technological innovation. As new FinTech companies and global technology giants are entering the market for payments and other banking services, and banks are investing in new technologies in the pursuit of efficiency gains – often in partnership with specialised FinTech operators – it is essential that they view the Single Market as their domestic market. Segmented national regulatory approaches would prevent both incumbents and new entrants from reaping the full efficiency-enhancing potential of technological innovations. Final users and consumers would not fully benefit from heightened competition and technological improvements. In all likelihood, US and Chinese providers, which could rely on very large domestic markets to test and develop new products and business practices, would become leaders also in European markets. The EBA is working to support the scalability of technological and financial innovation through its roadmap on FinTech, with the objective of promoting fully harmonised and technologically neutral regulatory and supervisory approaches across the Single Market.

The UK withdrawal from the EU: a specific challenge within a wider supervisory trade-off

As we speak about the struggle of the Single Market to deliver the levels of financial integration that any supporter of the European project would have expected from it, one question comes up naturally and is unavoidable: is the UK withdrawal from the EU going to exacerbate all this?

The challenge of the UK withdrawal adds a good deal of uncertainty to the overall picture – also beyond the EU, given the role of London as a global financial hub, especially in the area of wholesale banking and as primary center for the clearing of derivatives. On the basis of 2016 BIS data, a study commissioned by the European Parliament (2017) shows that around 50% of all centrally-cleared interest rate swaps – and in particular 95% of the euro-denominated ones - are cleared in London. The UK, together with the US, has seen its leading role steadily increase during the period 2004-2013 (see Figure 6).

Figure 6 UK's OTC daily interest rate euro-denominated derivatives turnover, average, US Dollar bn (Xafa 2017 on BIS 2016 data)



The numbers relating to the interbank market confirm the major role of London for EU financial institutions. Around half of the bank assets of UK ownership, in the UK, are loans to non-financial corporations; the remaining share represents derivatives and other products, as UK institutions intermediate in London with EU counterparties on the markets of securities and funding. For foreign subsidiaries operating in the UK the share of total loans going to non-financial corporations is even lower, approximately 40%. Schoenmaker (2017) estimates that – on the basis of end 2014 data – 37% of the assets in the UK banking system is held by non-UK banks, with rest-of-the-world investment banks representing 22% and branches of European Economic Area banks covering 10%. As regards the role of London as entry point of non-EU banks in the EU, Schoenmaker shows that, as of end 2014, 92% of the European operations of the top 5 US investment banks, in terms of turnover, is located in the UK.

The content of any potential withdrawal agreement between the EU and the UK rests with the political authorities and the negotiating teams. It is not the role of bank supervisors to speculate on the outcome of the negotiations. Although it is everybody's wish that the parties will find a mutually satisfactory withdrawal agreement, as supervisors, we have to follow the most prudent approach and make sure that banks prepare for the worst case of a 'no-deal' scenario, a withdrawal of the UK from the EU without a ratified withdrawal agreement.

If that scenario materialises, for the purposes of EU law, the UK will become like any other third country. This has a number of repercussions. Where UK institutions wish to continue to access the EU's market, which is highly likely given the current cross-border nature of much of the financial services activities in the UK, they will have to find other ways to operate. In practice, this may mean

establishing a new presence in the EU, and relocating (parts of) existing business from the UK entity to this new establishment or to existing but expanded EU entities.

By definition, this will entail some degree of further fragmentation of financial markets. New or expanded establishments in the EU will need their own capital, liquidity and own risk management infrastructure, potentially leading to the duplication of certain functions and costs and the reduction of those economies of scale and scope that cross-border business has so far achieved.

Also, banks from the EU27 need to prepare for the potential loss of passport for their business in the UK, even though UK authorities publicly committed to provide for a temporary regime in case of no agreement. This could also mean repatriating activities (and resulting exposures) that they may have to carry out in the EU, once the UK withdrawal takes place. Part of this adjustment has already emerged in the form of a steady decline in the EU27 assets and liabilities towards UK counterparties (see Figure 7), which appears to be driven by a reduction of derivatives positions (see Figure 8), although a full appreciation of this development is hindered by exchange rate volatility.

Figure 7 EU27 banks' exposures to UK counterparties - assets and liabilities (EBA data)

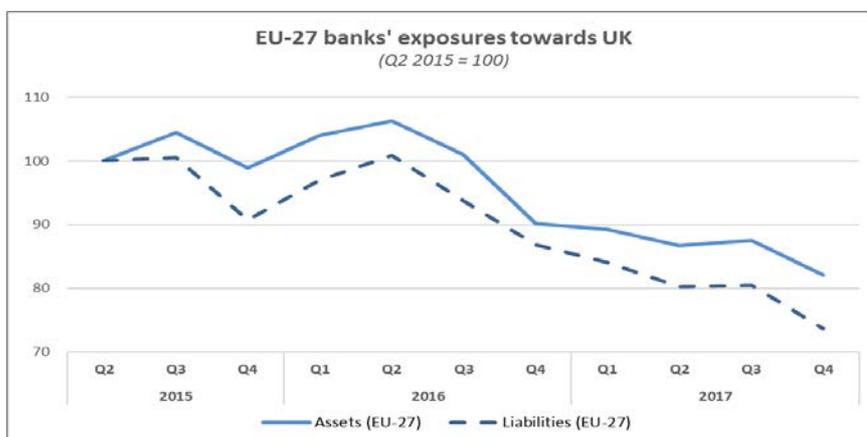
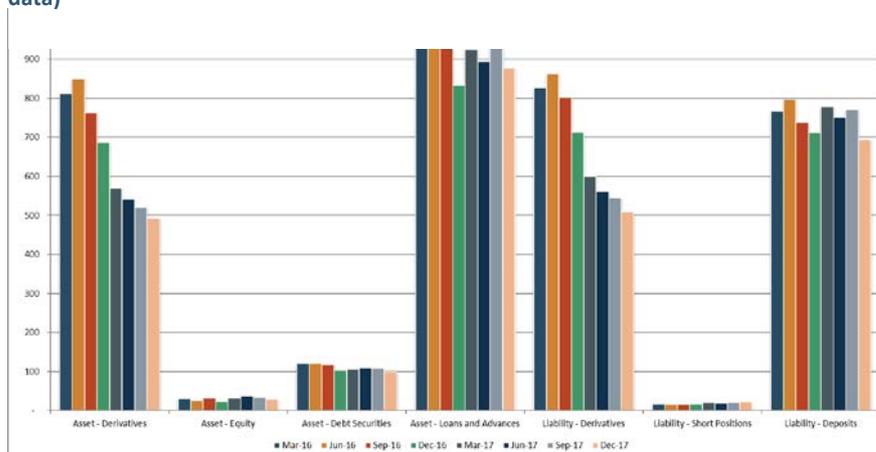


Figure 8 EU 27 assets and liabilities towards UK counterparties - by position type (EBA data)



In the current debate there are a plethora of studies attempting to estimate what could be the impact on costs resulting from fragmentation, with particular focus on the business of derivatives clearing. Financial institutions will try to limit the duplication of costs and functions as much as possible. Different methods are being explored to achieve this, and the EBA and other European Supervisory Authorities are monitoring this carefully.

With our two Opinions on the matter⁵ we have been clear that both UK and EU institutions need to prepare adequately and sufficiently ahead of the withdrawal date. We have also been clear that any new or expanded entities established in the EU must have real substance, and not operate as ‘empty shells’ or ‘letterboxes’ only. The EU passport exists because of the Single Rulebook and the trust that supervisors in the EU can have in each other because they are bound by a shared system of rules and oversight by common institutions. The UK becoming a third country would lead to the loss of the EU passport; as long as business is relocated to the EU27, local risk management capacity will have to be built up. The extent of the duplication required will be somewhat dependent on the future relationship between the EU and UK, and also on the cooperation between the EU and UK authorities. There is a high-level trade-off between cooperation and fragmentation that applies to the future EU-UK relationship as it more generally applies to any instance of cross-border regulation and supervision. The EBA is committed to contributing to an integrated and effective framework for cooperation with UK authorities.

As I have extensively discussed today, financial integration is facilitated by trust and cooperation between authorities. The more global the financial flows, the less direct the control national authorities have over the activities in their jurisdiction. The only way they can be comfortable that

⁵ EBA Opinion on Brexit issues (October 2017) and EBA Opinion on Brexit preparations (June 2018).

their system is not exposed to undue risks to financial stability is to gain information and oversight about the activities in the other jurisdictions to which their firms are exposed. This is a general principle. Such comfort is particularly important in the context of gone concern and resolution scenarios, where there are real losses to be borne by creditors (and possibly taxpayers) in different jurisdictions.

The legitimate supervisory concerns about local financial stability and prudential soundness can be addressed in two ways. One is to undertake ring-fencing and fragmentation measures that inhibit cross-border financial flows, while allowing very direct control over the national financial system. Another preferable approach is to put in place strong levels of cooperation and transparency between the authorities in supervisory and resolution colleges, and to fully exploit the contractual, legal and institutional cross-border arrangements that the resolution framework envisages, such as those I have mentioned earlier. To reverse the decline in cross-border financial integration, as well as to manage the UK withdrawal from the EU with the least possible disruption, high levels of cooperation and planning will be crucial.

The trade-off between cooperation and planning, on the one hand, and ring-fencing on the other, goes beyond the UK withdrawal process and we have seen it at work. Where mutual trust is not strong enough, policy measures may be taken that result in fragmentation of global banking groups. The requirement to establish intermediate holdings companies (in the US) or intermediate parent undertakings (in the EU) are examples of the remaining lack of confidence in the functioning of global arrangements for bank recovery and resolution. Internal Total Loss Absorbing Capacity (TLAC for Global Systemically Important Banks) is a tool for creating some level of trust through the pre-positioning of certain loss absorbing resources at subsidiary level.

In the context of the UK withdrawal from the EU, I am convinced of the fact that the more cooperation there will be between the EU and UK authorities, the more comfortable the EU authorities will be with certain activities continuing to take place in the UK, the lower will be the fragmentation linked to duplicating costs and activities. In this regard, the Commission's proposal on EMIR 2 is an interesting experiment, as it makes the relocation of clearing activities a last resort possibility, to apply only should the EU and the UK authorities fail to come to an agreement on 'enhanced supervision' of the London-based CCPs, leaving ring-fencing as a last resort. More generally, the more cooperation, oversight, and information sharing there is across borders, the more comfortable authorities could be with relying on controls exercised by fellow supervisors in other jurisdictions, and the more integrated wholesale banking and capital market activities can be.

Conclusions

“Trust leaves on horseback but returns on foot”: this Dutch saying rings true also with reference to trust between authorities, which has been severely damaged by the crisis.

The global framework to restore trust and support well-functioning, integrated cross-border banking business has been laid down here in Basel: strong international standards, close monitoring of compliance with those standards and, above all, a framework for crisis preparedness, management and resolution that should allow choosing cooperative approaches rather than ring-fencing policies. In the EU we went even further, hardwiring these principles in our legal framework, with joint decisions in supervisory and resolution colleges, new European authorities mediating between conflicting national interests and, in the euro area, a centralisation of supervisory and resolution functions at the European level. We now have to complete the construction and deliver concrete results. We need to apply the same determination we deployed to restore the stability of our banking sector to overcome fragmentation.

Progress is slow and time is running short. We have an internal challenge, which I consider existential for the Single Market and, especially, the Banking Union: the next financial crisis should not catch us still dealing with the legacy of the previous one and lacking effective mechanisms for – both private and public – risk sharing. We also have an international challenge, as Brexit will soon test the ability to smoothly oversee significant cross-border business with a third country, if, as expected, this will be the status of the UK as it withdraws from the EU.

In order to succeed we have to go beyond the polarised debates of these days, acknowledge that risk reduction and risk sharing are interlinked and put the objective of a truly integrated European banking sector that can act as a shock-absorbing device, at the forefront of our policy agenda. A renewed focus on the openness of our Single Market and intense cooperation with authorities from third countries should also gain prominence in a post-Brexit environment.

Randy Quarles, the Vice Chairman for Supervision at the Federal Reserve Board, recently intervened in the debate on cross-border resolution using a motto from the ranches in the American West: “trust everybody, but brand your cattle”. I believe it is time for us to decide whether we want to use a European brand for our cattle, or a collection of national ones.

Thank you very much for your attention.

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