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Is the European banking system safer ten years after the crisis?

EuroMemo GROUP
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10 years into the crisis – What prospects for a popular political economy
in Europe ?
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Regulatory Reforms after the Crisis

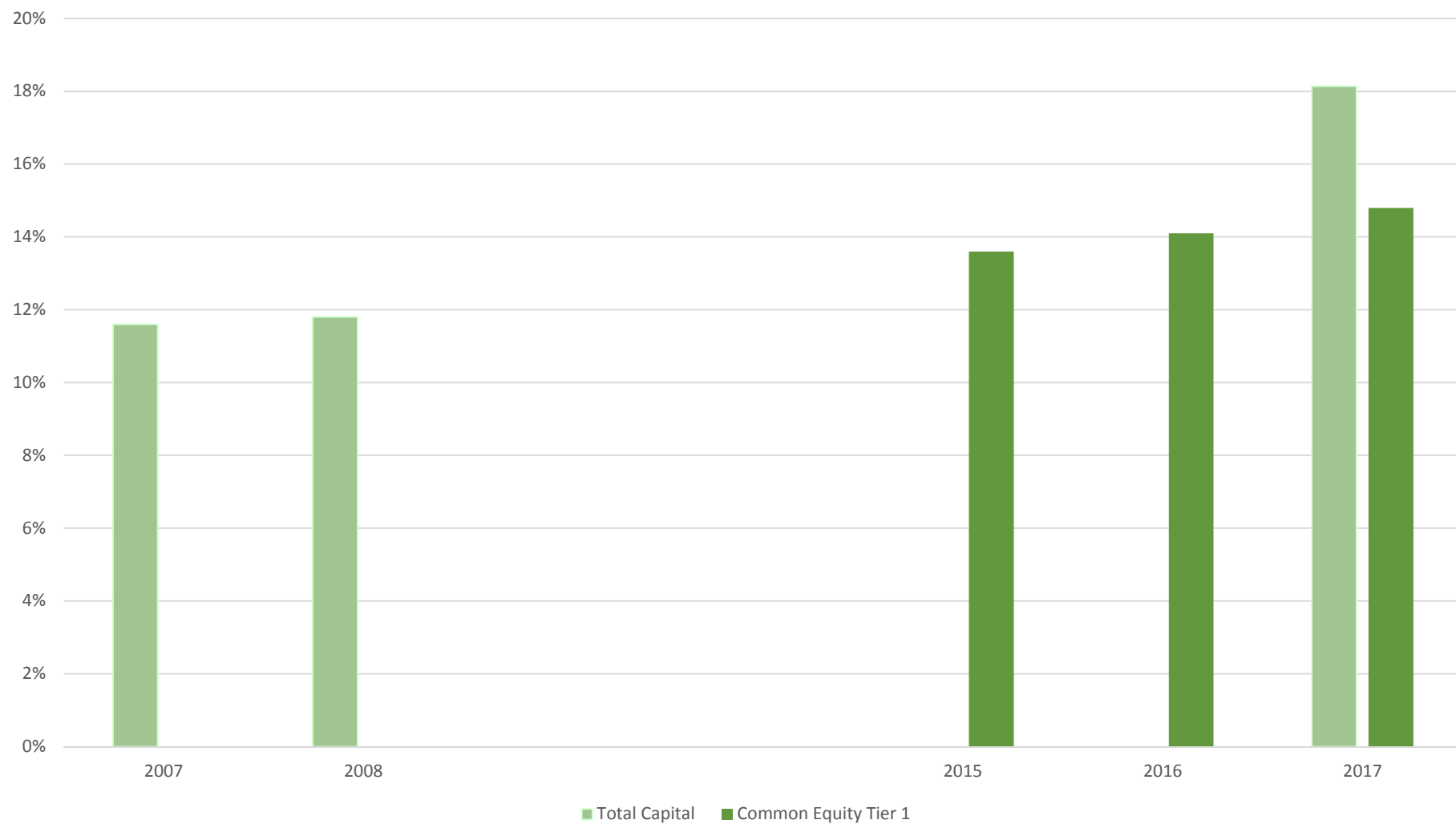
Basel III, III.5	Macroprudential Supervision	Recovery and Resolution regime
Capital Requirements Directive (CRD IV), Capital Requirements Regulation (CRR)	CRR, CRD IV	Banking Recovery and Resolution Directive (BRRD)
<p>Capital requirements: higher, better quality</p> <p>Liquidity requirements: Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR)</p> <p>Leverage ratio</p> <p>etc.</p>	<ul style="list-style-type: none"> ▪ Addressing systemic risks ▪ Addressing procyclicality of banking ▪ Addressing mortgage lending risks ▪ Instruments: systemic risk buffer, GSIIB buffer, counter cyclical capital buffer, Loan-to-value ratios, Debt-to-income ratios, ... 	<ul style="list-style-type: none"> ▪ Allowing banks to leave the market without state aid (insolvency regime for banks) ▪ Addressing Too-big-to-fail ▪ Bail-in, Minimum Requirement for own funds and Eligible Liabilities (MREL) ▪ Early intervention: regulatory paradigm shift*
<p>Not implemented: Structural reforms (Liikanen, Barnier, ..)</p>		

* Abandon business lines, sell participations, stop lending to certain customers, ...

Banking Union – Institutional Setting

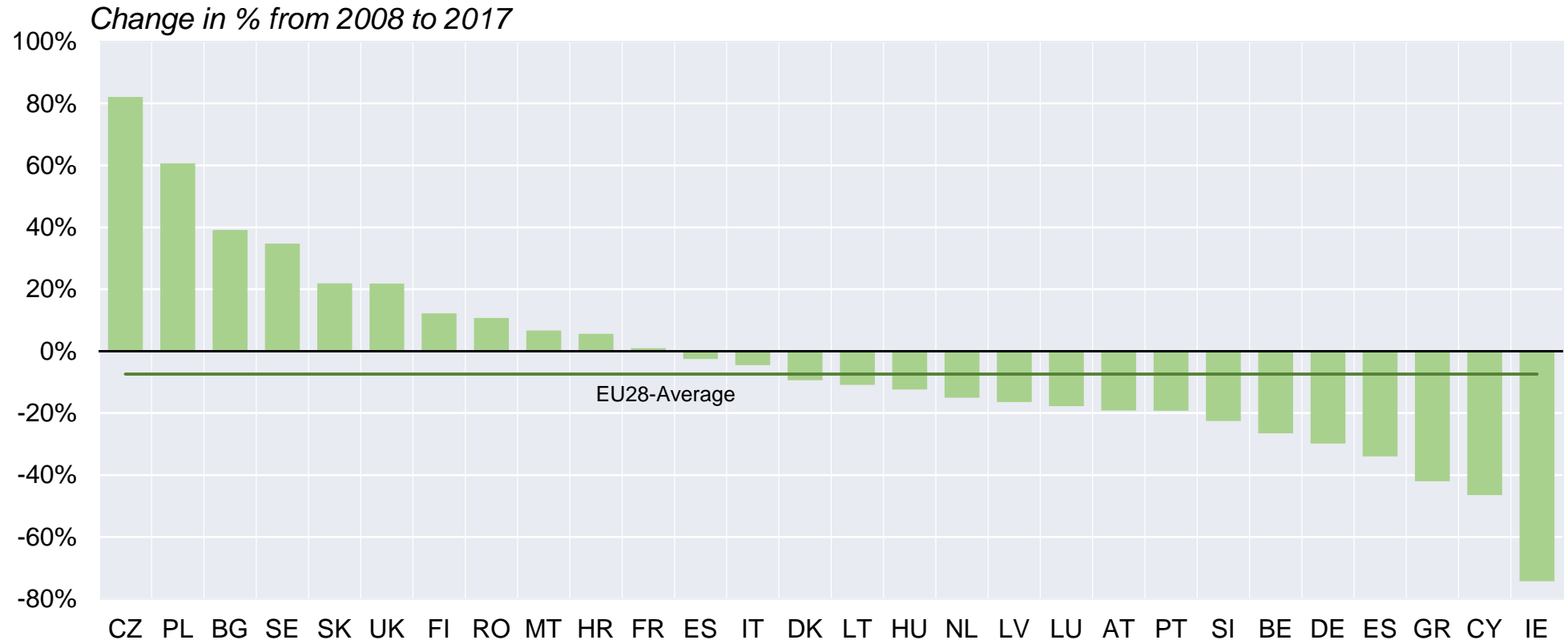
Single Supervisory Mechanism (SSM)	Single Resolution Mechanism (SRM)	European Deposit Insurance Scheme (EDIS)
<p>Aim: Harmonised Supervision of Significant Banks</p>	<p>Aim: Harmonised Rules for Recovery and Resolution of Banks</p>	<p>Aim: Common European wide deposit insurance</p>
<p>4.11.2014: ECB becomes supervisor for European banks (direct: SI, indirect: LSI) Supervisory Board (SB): consists of directors - national supervisors Undermine national lobbying</p>	<ul style="list-style-type: none"> ▪ 1.1.2016: Single Resolution Board (SRB) implements BRRD ▪ Single Resolution Fund (SRF) ▪ Backstop: European Stability Mechanism (ESM) 	<ul style="list-style-type: none"> ▪ Politically disputed ▪ Risk sharing vs. Risk reduction ▪ First step: harmonising national systems
	<p>Single Handbook, Single Rule Book</p>	

Capitalization of Euro area banks



Source: European Central Bank

Growth of total assets European banks



Source: European Central Bank

Bank profitability improved in 2017, mainly due to lower impairments

Decomposition of the change in euro area significant institutions' aggregate ROE from 2016 to 2017

(2016-17, percentage points)

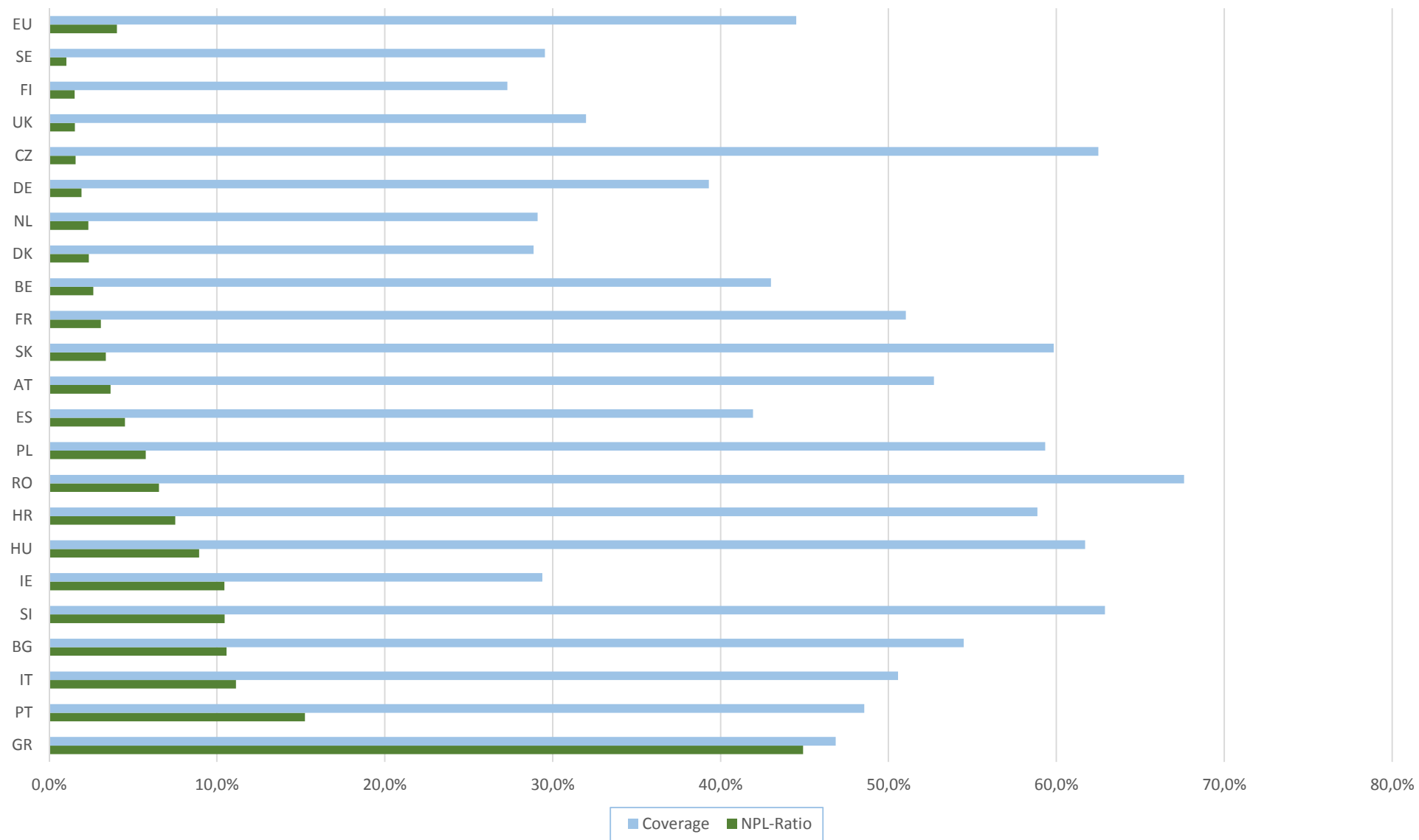


Sources: ECB and ECB calculations.

Notes: Based on a balanced sample of 112 significant institutions (adjusted for mergers and acquisitions). The green and red bars denote positive and negative contributions, respectively.

- Profitability not on a sustainable path, due to less provisioning
- High dividend payouts not justified

Credit quality of European banks



Source: EBA

Future challenges

Monte dei Paschi, Vicenza/Veneto vs. Banco Popular/ABLV

SRF: 55bn Euro until 2023

EDIS contested, national funds: 0,8% of covered deposits until 2014

Fiscal backstops increase

➔ **Problem of Too-big-to-fail not resolved yet, probability for state aid still high**

Growth of shadow banking: +30% since 2012

Approx. 272% of EU GDP, 40% of total assets fin sector

➔ **Regulation of shadow bank entities poses threat to financial stability**

➔ **Blind spot: structural weaknesses of European economy**

Policy proposals

Higher capital ratios for banks

End „Too-big-too-fail“ via effective resolution policies

Strengthen macroprudential policies in order to reduce systemic risks, mapru instruments beyond banking

Reduce complexity and concentration of bank groups

Stronger regulation of shadow banking and FINTECHs