

# European Financial System: Current Situation and Future Challenges



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# 1. Introduction and initial remarks

*“Intelligence is the ability to adapt to change”*  
(Stephen Hawking)

- Acknowledgments.
- Paradoxes: from the financial system itself to the use of English.
- First impressions on the preparation of this conference: feeling Europe; so many things in common.
- Let’s start...

# 2. The 2008 financial crisis (1)



- Ten years since Lehman Brothers collapse (2008-2018).
- A financial, economic and social crisis that reshaped the world.



# 2. The 2008 financial crisis (2)



## 2. The 2008 financial crisis (3)



- Lehman Brothers.
  - Investment banking vs. commercial banking.
- Subprime Mortgages + Derivatives.



- Acceleration of domestic problems.
- Confidence → Free fallen.
- A world wide crisis → A Western crisis?

The beginning

# 2. The 2008 financial crisis (4)



➤ New international players (and leaders?)



➤ The end of the post-Second World War order?



➤ Multilateralism-Bilateralism-Protectionism.

The consequences



# 3. The financial system (1)

- The financial system: why is it so important?
- From local financial system to global system: linkages.
- Recovering confidence.

## Financial system: Main functions

Provides **lending** to households and businesses

Allows individuals to **save and invest** for their future and channel savings to support the economy

Helps corporations and households to better manage and **insure against risks**

Facilitates **payment transactions**

Serves Central Banks for the **implementation of monetary policy**





## 3. The financial system (2)

A well-functioning financial system contributes to economic prosperity, stability, and growth.

Failure of the financial system may have profound negative consequences for the wider economy as the recent crisis demonstrated.



Impact on citizens: bail-out of banks in trouble with public money.

*(Between 2008 and 2012, a total of €1.5 trillion of state aid was used to prevent the collapse of the financial system) (Source: European Commission, "Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A reformed financial sector for Europe", 2014)*



### 3. The financial system (3)

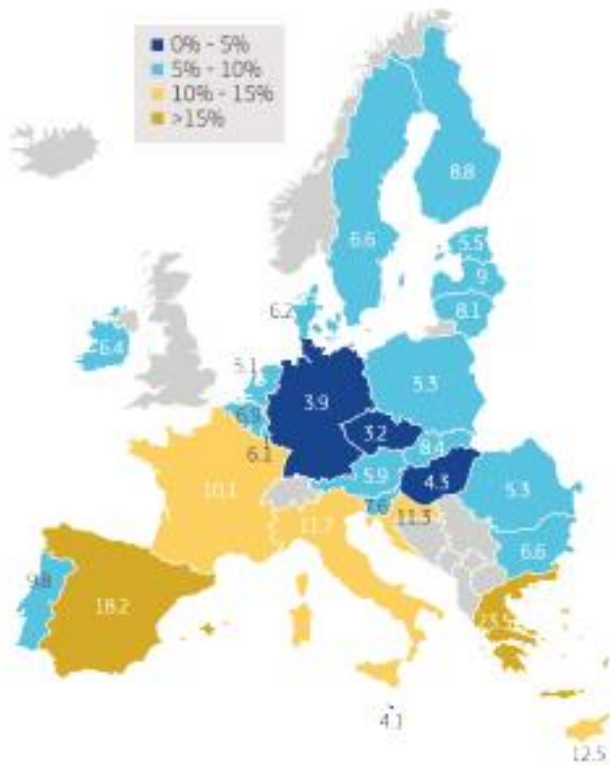
Other social and economic negative effects for households:

- High unemployment rates.
- Loss in income, wealth and opportunities.
- Substantial increase of public debt.



# 3. The financial system (4)

Unemployment rates are falling but still differ substantially across Europe  
In %, March 2017



Source: European Commission

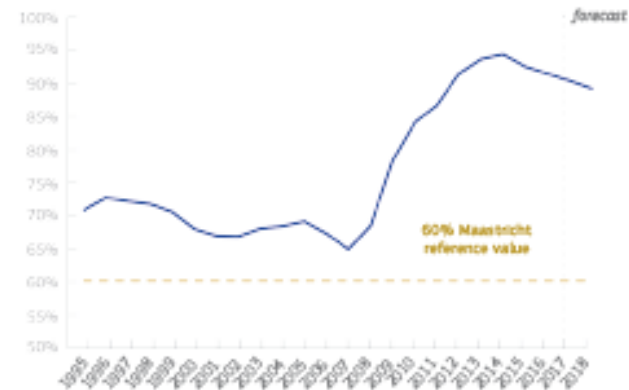


Unemployment in Europe

Public debt in the Euro Area



Public debt in the euro area increased sharply as a result of the crisis  
General government gross debt, as % of GDP



Source: European Commission



# 3. The financial system (5)

## Before 2008 crisis:

The largest financial institutions expanded significantly across borders and markets became increasingly **integrated internationally**, although **regulatory and supervisory frameworks remained largely nationally focused**.

## After 2008 crisis:

New international common principles for regulation and supervision → **Basel III**.



# 3. The financial system (6)

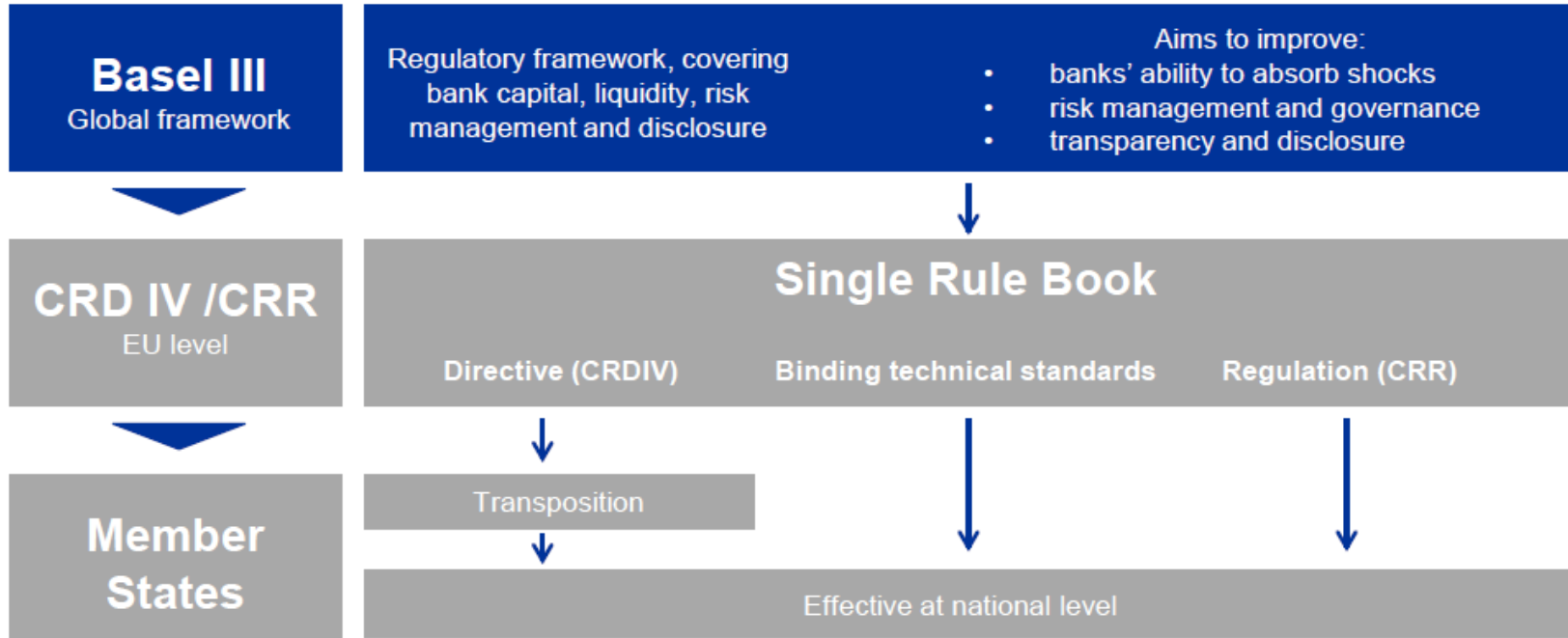
- **Political impulse:** G-20 (Financial Stability Board).
- **Basel III** → Internationally agreed set of measures developed by the **Basel Committee on Banking Supervision (Bank for International Settlements)** in response to the financial crisis.
- Where did banks went wrong?:
  - All sort of risks' management
  - Excessive risk-taking
  - Corporate governance
- What about the role of?:
  - Central Banks and other national authorities?
  - Citizens as customers → **The need of financial education.**

Insufficient (i) capital and (ii) liquidity.





# 3. The financial system (7)



Source: Danièle Nouy, “The European banking sector: New Rules, new supervisors, new challenges”, Università La Sapienza, 21th November 2016.

# 4. The European Financial System (1)



## Before 2008 crisis:

- Insufficient European Union rules for banks
- Most of the regulation of national origin
- Banks supervised by national authorities

Trend to cross border activity.

## After 2008 crisis:

- Stronger rules for all the European Union Member States' banks (some of them of direct application –Regulations- without the need of transposition into national law).
- Banking Union for the Eurozone: centralized systems for supervision and resolution.

# 4. The European Financial System (2)



European Union reform measures:  
**Objectives**

Restoring and deepening the European Union **single market in financial services**.

Establishing a **Banking Union**.

Building a more **resilient and stable financial system**.

Enhancing transparency, responsibility and **consumer protection** to secure market integrity and restore **consumer confidence**.

Improving the **efficiency of the European Union financial system**.



# 4. The European Financial System (3)



- First steps, in 2011, for the whole European Union:
  - European System of Financial Supervisors (ESFS), for the consistent supervision and appropriate coordination among national supervisory authorities in the European Union:
    - European Banking Authority (EBA).
    - European Securities and Markets Authority (ESMA).
    - European Insurance and Occupational Pensions Authority (EIOPA).
  - European Systemic Risk Board (ESRB), which monitors macro-prudential risks across the European Union and issues warnings and recommendations to call for corrective action.

# 4. The European Financial System (4)



- **Banking Union**, the political decision: “Towards a Genuine Economic and Monetary Union” (Four Presidents’ Report) (2012).
- Main purpose: Breaking the doom loop between banks and sovereigns.
- Banking Union: Mandatory for Member States with the euro as their currency.
- In the future, all the European Union Member States should join the euro, and therefore the Banking Union, except Denmark (and United Kingdom...).
- For non-euro Member States it’s possible to join the Banking Union voluntarily.
- **“Whatever it takes” speech** (2012), by M. Draghi

The euro is the currency of 19 Member States

- EU Member States using the euro
- EU Member States not using the euro
- Non-EU Member States



Source: European Commission



# 4. The European Financial System (5)

From bail-out to bail-in

European Deposit Insurance Scheme (EDIS): Under negotiation

**100,000 eur/depositor and entity**

Single Resolution Mechanism (SRM): 2016

**Single Resolution Fund**  
Directive 2014/59/EU

Single Supervisory Mechanism (SSM): 2014

**Regulation (EU) 1024/2013**

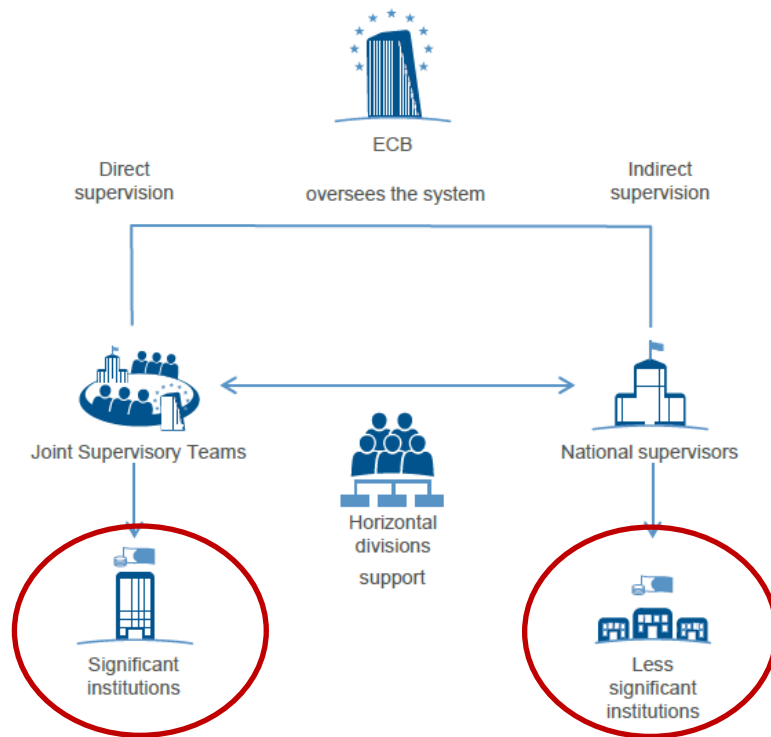
**BANKING UNION**

**Single Rulebook**  
Directive 2013/36/EU (CRD)  
Regulation (EU) 575/2013 (CRR)

# 4. The European Financial System (6)



## Distribution of tasks within the SSM



Source: Danièle Nouy, cited above.

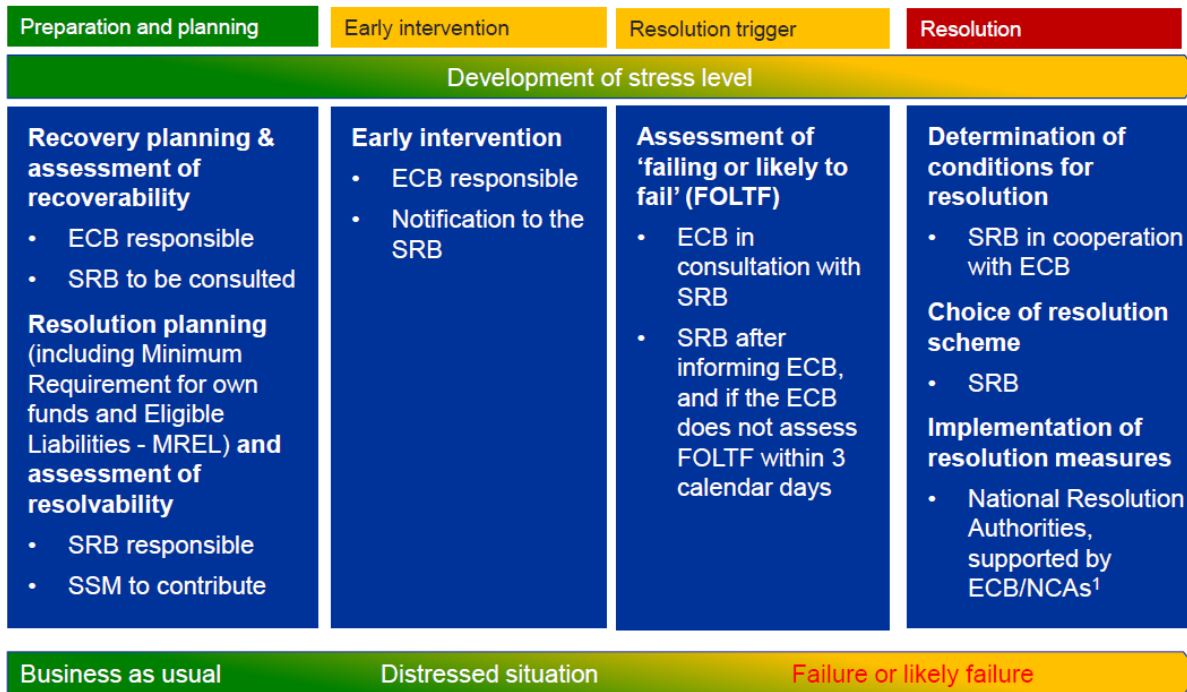
## Key SSM facts

1. The Single Supervisory Mechanism (SSM) is the **largest banking supervisory authority of the world.**
2. Currently **127 banking groups (~1,200 banks)** in 19 countries under direct ECB supervision. More than **80 %** of euro-area banking assets under direct ECB supervision.
3. Around **3,200 smaller institutions** are directly supervised by the national competent authorities (NCAs), with the ECB being responsible for the system at large.
4. Banking assets under direct and indirect ECB supervision amount to **more than 26 trillion Euros** → about **2.6 times euro-area GDP.**



# 4. The European Financial System (7)

## How do supervision (ECB) and resolution (Single Resolution Board, SRB) interact?



Source: Danièle Nouy, cited above.

# 4. The European Financial System (8)



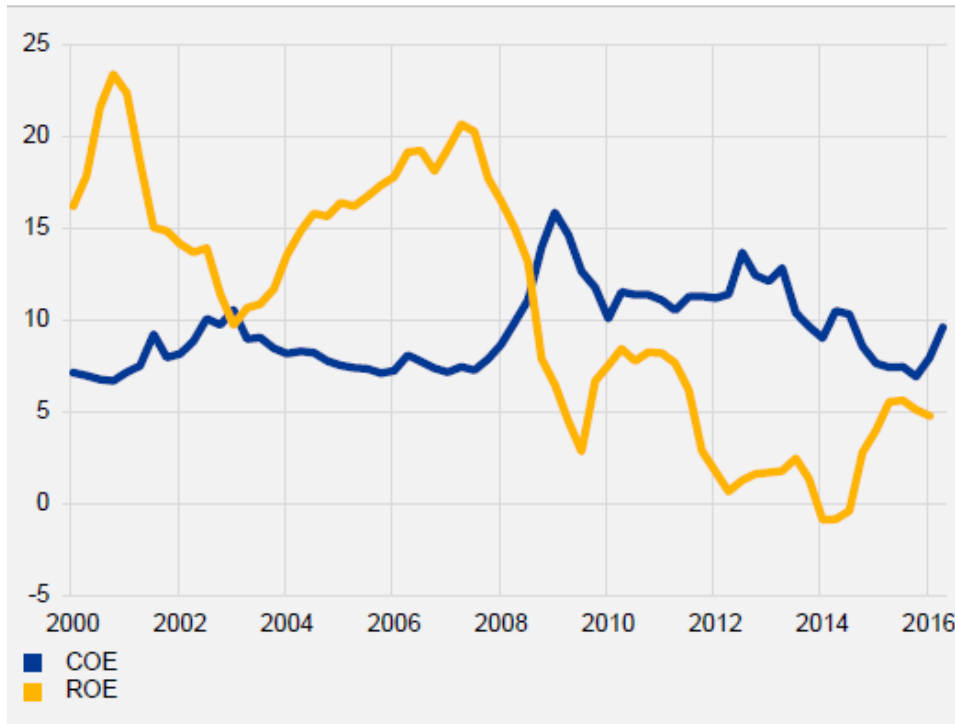
## ➤ Challenges for the European banks:

- Cooperation or competition?
  - Bigtech: Google, Amazon, Facebook, Apple
  - New business models: reducing costs and dependence on interest income.
  - Digitalisation of banking services.
  - Cyber-security / Cyber-risks.
  - Other non-financial competitors (shadow banking).
  - Banks are still, mainly, national.
  - Too big to fail banks / What to do in case of failure.
- } The “Fintech” revolution?

# 4. The European Financial System (9)



Return on equity and cost of equity and for listed euro area banks (Q1 2000 – Q2 2016; percentages)



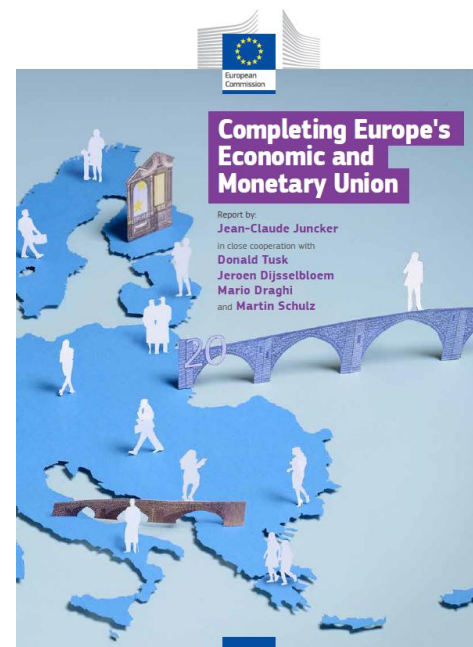
**Big trouble:** Banks must be profitable to develop their functions, especially to attract investors and supply credit to the economy.

Source: Danièle Nouy, cited above.

# 4. The European Financial System (10)



- Next steps:
  - Building a Capital Markets Union (European Commission Green Paper -2015-).
  - “Completing Europe's Economic and Monetary Union” (Five Presidents’ Report), 2015:
    - Economic and Monetary Union “is not an end in itself. It is a means to create a better and fairer life for all citizens, to prepare the Union for future global challenges and to enable each of its members to prosper”.
    - Progress must happen in four fronts:
      - Genuine Economic Union (euro).
      - Financial Union (Banking Union-Capital Markets Union).
      - Fiscal Union (budget).
      - Political Union (democratic accountability).







# 4. The European Financial System (11)

“Reflection Paper on the Deepening of the Economic and Monetary Unión”, European Commission, 2017.



## Guiding principles for deepening the Economic and Monetary Union



Source: European Commission

# 4. The European Financial System (12)



“Reflection Paper on the Deepening of the Economic and Monetary Unión”, cited above.

## Elements to complete the Financial Union

Reducing risks and making banks more resilient	
<b>November 2016 Banking Package</b> Reinforcing the banking Single Rulebook with further risk-reducing measures	<ul style="list-style-type: none"> <li>✓ <i>in place</i></li> <li>▶ <i>under negotiation in the European Parliament/ Council</i></li> </ul>
Developing a <b>non-performing loans strategy</b> along four key policy areas: (i) Supervision, (ii) Secondary markets, (iii) Structural issues (including insolvency), (iv) Restructuring of the banking system	▶ <i>commitment to agree on a strategy at the ECOFIN Council of June 2017</i>
Completing the three pillars of the Banking Union	
<b>Single Supervisory Mechanism</b>	✓ <i>fully operational</i>
<b>Single Resolution Mechanism</b> Single Resolution Board + Single Resolution Fund to be fully mutualised in 2025	<ul style="list-style-type: none"> <li>✓ <i>Single Resolution Board up and running</i></li> <li>▶ <i>Fiscal backstop to the Single Resolution Fund to be put in place</i></li> </ul>
<b>European Deposit Insurance Scheme</b>	▶ <i>currently under negotiation in the European Parliament/Council</i>
Delivering on the Capital Markets Union	
Implementation and <b>mid-term review of Action Plan</b> to promote capital markets integration and establish a full Capital Markets Union by 2019	▶ <i>ongoing</i>
<b>Review of European Supervisory Authorities</b> – first steps towards a single European capital markets supervisor	▶ <i>ongoing</i>
Beyond Banking Union and Capital Markets Union	
Fostering diversification of bank balance sheets, for example through <b>sovereign bond-backed securities</b>	▶ <i>under assessment</i>

Source: European Commission

# 5. Final considerations and conclusions



- A globalized world, do we like it or not.
  - Opinion of the European Committee of Regions, “Strengthening European Identity through Education and Culture”, OJEU 5th October 2018:
    - “Education and culture are major factors in making Europe more resilient in the context of accelerating globalisation and current geopolitical trends”.
    - European identity: diversity of cultures.
- Financial system/Banking Union: supporting the European economy.
- Banking Union and Economic and Monetary Union, along with Fiscal Union: means to reach a Political Union.
- More Regulations instead of Directives: more competences developed by the European institutions → Need of more coordination with national authorities.
- Only a small part of loans and deposits are cross-border made.
- Lack of cross-border integrations of banks in Europe.
- Businesses, citizens and consumers must notice that this complex system works and is beneficial for all of them.

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