The ESM’s backstop to the Single Resolution Fund: financial safety net in times of crises - speech by Klaus Regling

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(*Please check against delivery*)

Good afternoon,

It has been a pleasure for me to see this high-level conference on “Bank Resolution and the Common Backstop for the Single Resolution Fund” unfolding during the last two days.

I followed the discussions with great interest and could see one common narrative emerge from this conference: we all want a stronger banking union, safer banks, and a solid framework that makes our Economic and Monetary Union (EMU) more resilient.

The treaty reform of the ESM with the introduction of the common backstop to the Single Resolution Fund (SRF) brings us closer to completing banking union, closer to a more resilient EMU. This backstop serves as a supplemental safety net, as it can lend funds to the SRF to finance a resolution in case the Fund's financial resources have been depleted.

But the backstop is not only a financial safety net; it is also a proof of the excellent inter-institutional cooperation between the ESM and the Single Resolution Board (SRB).

During the last years, my colleagues worked closely with their counterparts at the SRB. In fact, it took almost five years to move from the initial idea of a backstop to the SRF to the final step, the ESM's backstop; given the complex technical requirements, more than 20 legal documents had to be drafted. Sufficient progress in reducing risks in the banking sector will make it possible to introduce the backstop earlier than expected. And we, at the ESM, are ready.

We coordinated three "dry runs" this year. In these simulations we ran through every single step that would need to be done in case we have to activate the backstop in a crisis.

As we have learned during the last years, it's always good to be prepared for a next crisis. Especially in a monetary union with centralised monetary policy and decentralised fiscal policies.

To achieve a more resilient monetary union, we need more risk sharing and we need to consolidate risk reduction. I am happy to see that in the last few years, substantial progress has been made in this regard.

Notwithstanding the pandemic, we achieved a significant risk reduction in the banking sector. This was possible thanks to the implementation of the EU legislation aimed at reinforcing the resilience of banks and strengthening the framework for recovery and resolution.

Risk reduction was a precondition to take further steps to completing banking union. The early introduction of the common backstop became possible as we had achieved sufficient risk reduction in the euro area after the previous crisis.

However, risk reduction remains uneven across member states and uncertainty related to the current economic and financial outlook makes the overall picture difficult to read. In addition to that, the unsolved debate on the regulatory treatment of sovereign exposures (RTSE) makes it difficult to form a common view on the risk reduction objectives for further integration.

But uncertainty should not hamper further progress. Learning from the euro crisis, we adapted EMU and closed institutional gaps that had become visible: we set up several new institutions that have increased the effectiveness of crisis prevention and crisis management.

I am referring to the ESRB (European Systemic Risk Board), the three European supervisory authorities ESMA (European Securities and Markets Authority), EBA (European Banking Authority), EIOPA (European Insurance and Occupational Pensions Authority) and, of course, to the EFSF and the ESM. We also initiated banking union with the SSM (Single Supervisory Mechanism) and the SRB (Single Resolution Board).

All these institutions bolstered financial stability in Europe and helped to mitigate the effects of the pandemic crisis.

The first pillar of banking union, the single rule book and the SSM, have clearly passed the test of a major crisis. On average, banks entered the pandemic with much higher capital ratios. And they became part of the solution, rather than the problem, as it was the case during the previous crisis. A high degree of harmonisation in the supervision of banks also contributed to making the banking system stronger. However, looking at the first pillar of banking union, further harmonisation of national legislations and removal of barriers to cross-border integration would maximise the benefits of the Single Market both in terms of economic growth and financial stability.

The second pillar of banking union has assigned the orderly resolution of the systemically relevant banks and those with cross-border activities to the European level. The Single Resolution Mechanism (SRM) ensures that bank failures are managed efficiently, without burdening taxpayers and the real economy. The SRF, complemented by the common backstop, is expected to have sufficient resources to effectively resolve banks.

However, there is still a need for a solution on how to provide liquidity in resolution. This stems from the fact that the liquidity needs after the resolution of a bank or in a systemic crisis can be much higher than the solvency needs. Work is ongoing to find a solution and make sure that the system functions in an efficient and consistent manner. There is no easy solution as the models we see in other jurisdictions cannot be simply replicated in the EU institutional framework (e.g., no single treasury, no fiscal union).

Moving forward, a fully functional resolution framework and more harmonised liquidation rules for banks, predictability and consistency of the resolution action will further reinforce the EU banking sector and can pave the way for the introduction of a common deposit insurance scheme.

The third pillar of banking union, a common deposit insurance scheme at EU level, would complete banking union. Such a scheme would limit the risk of fragmentation in the euro area by reducing the vulnerability of national deposit guarantee schemes to large local shocks. It could ensure that the level of depositor confidence in a bank would not depend on the bank's location. This would reduce the probability of bank runs and therefore also the cost of banking crises. Moving to a European deposit insurance will require more steps to solve divergencies across countries on the regulatory treatment of sovereign exposures and define a common risk reduction objective.

The completion of banking union will have a profound effect on financial integration as well as financial stability. But we also need to consider the complex interactions and risks during a potential banking crisis. It is imperative to have an appropriate methodological framework in place that takes this complexity into account. Prior to a crisis, strong supervision ensures that the banking sector is resilient and capable of withstanding shocks. During and after a crisis, a robust safety net is needed to contain spillovers and contagion effects.

With the common backstop, we will make the safety net for bank resolution in the euro area much more robust. Even if a large shock in the banking sector occurs and the SRF's resources are not sufficient, the backstop will ensure that the necessary resolution measures can take place. This is a major step in creating a safer banking system and preserving financial stability.

Since the ESM was created in 2012, it has focused primarily on crisis resolution. With the revised Treaty, the ESM's new tasks, including the backstop to the SRF, will involve a stronger role in crisis management and crisis prevention. The ESM's broader mandate gives us the tools to prevent small fires turning into big fires. This will enable the ESM to be more effective in delivering on its mandate to strengthen financial stability in the euro area.

Thank you.

Author

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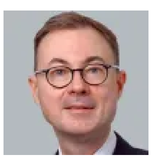

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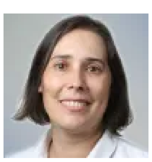

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