Banking sector

The banking system in the Euro area showed itself to be resilient throughout the many bouts of financial market volatility that occurred in 2016. Banks' capital and leverage ratios showed an improvement on 2015. In late July the European Banking Authority (EBA) published the results of the stress tests carried out on the European banking sector. For all the banks that were tested, the results showed an average CET1 (highest quality) capital ratio of 13.2%, well above the level demanded by regulators. In the worst of the scenarios for which the test was carried out, the average ratio would fall to 9.4% in 2018, with just one bank showing a negative CET1 ratio.

— European banks proved to be resilient in the face of repeated episodes of volatility in the financial markets. Bank profitability continues to face major challenges related to weak economic recovery, persistent low interest rates, asset quality issues and a heavy regulatory burden.

Regulatory environment

Banking Union

2016 was the first year in which the first two pillars of Banking Union were in full operation at the same time.

— The Single Supervisory Mechanism (which seeks to ensure uniform supervision across all Euro area banks;

— The Single Resolution Mechanism (which seeks the effective conduct of resolution processes for failing banks).

Full Banking Union is, however, not complete and a third pillar remains to be added: a European Deposit Insurance Scheme (EDIS).

In its 2015 proposal, the European Commission (EC) recommended that the new EDIS should be introduced gradually. This would begin in 2017 with a Europe-wide reinsurance system for national deposit guarantee schemes, followed by a gradually increasing mutualisation of deposit protection until full mutualisation was reached in 2024. There would in practice be no advance in the sharing of risks until 2020, when the co-insurance phase would begin. In April 2016 the ECB showed its support for the proposal. During the year, however, a number of EU member states expressed a reluctance to embark on any form of risk mutualisation under a deposit guarantee scheme unless the risks still present in domestic banking systems had first been reduced. In response to these reservations, in November the European Parliament's Economic and Monetary Affairs Committee published a draft report in which it modified the Commission's proposal and replaced it with a reinsurance system to be launched in 2019 with little or no mutualisation. The demands of certain key countries and the European political calendar make it unlikely that the European Deposit Insurance Scheme can be in full operation by the time or in the form proposed by the EC.

The Capital Markets Union - an action plan

In mid-September the EC put forward further measures to accelerate the completion of the Capital Markets Union (CMU). The aim of the CMU is to establish a genuine single capital market among EU member states, with a view to providing finance for companies, especially SMEs and start-ups, and thus boosting investment and job creation.

Among the most significant measures proposed by the EC was the early introduction of the package of rules on asset securitisation, which has the potential to rapidly increase the availability of funds in the real economy. In particular, the European Parliament and the Council have adopted a securitisation package that is simple, transparent and standardised (STS). STS securitisations should, it is hoped, free up capacity on bank balance sheets and provide investment opportunities, stimulate the economy and increase financial stability. An agreement has also been reached on modernising the rules governing prospectuses. This will ensure greater ease of access to capital markets, especially for smaller companies. The EC also called on the European Parliament and the Council to finalise a proposal to strengthen venture capital markets and social investments. This will boost investment in venture capital and social projects and make it easier for investors to fund small and medium-sized innovative companies. In addition, the Commission stated its intention to take forward a programme to support the development of national and regional capital markets in member states.

The Commission has also proposed a series of measures to take forward the next phase of CMU actions in the short term. These measures include support for the development of personal pensions; drawing up a comprehensive European strategy on sustainable finance; and a coordinated policy approach that supports the development of FinTech in an appropriate regulatory environment. Finally, the Commission promised to consider, in close consultation with the European Parliament and the Council, the further steps in relation to the supervisory framework that are necessary to reap the full potential of CMU.