Summary for non-specialists
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Post-Crisis Reversal in Banking and Insurance Integration: An Empirical Survey

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The on-going process of integration was abruptly reversed by the national approach to the resolution of financial firms during the 2007-2009 financial crisis. Being accountable to their parliament, national governments (as well as central banks and supervisors) only cared about the effects of ailing banks on the domestic financial system. The theoretical foundation for this behaviour is provided by the financial trilemma, which states that the three policy objectives, 1) maintaining global financial stability; 2) fostering cross-border financial integration; and 3) preserving national authority for financial policies; are not compatible. Any two of the three objectives can be combined but not all three; one has to give. Prior to the financial crisis, European governments pursued the second and third objective. European financial stability thus fell between the cracks.

The financial trilemma raises the following empirical issue: the extent of cross-border business affects the policy choice. If cross-border business is well advanced, authorities may be forced to give up national polices and pursue an international approach to financial policies (provided that authorities care about financial stability). If cross-border business is limited, authorities may still pursue national financial policies.

This empirical essay reviews post-crisis integration in banking and insurance. First, we look at aggregate data, which suggest that banking integration has reversed. More precisely, we find that cross-border banking flows into the Central, Eastern and South-Eastern European countries and peripheral counties (Portugal, Ireland and Greece) have been reversed. Next, we compile a new data set on cross-border activities of the top 30 banks and top 25 insurers in Europe. These data at the individual firm level indicate that cross-border activities remain persuasive within Europe. The top 30 banks pursue 23 percent of their business in the rest of Europe and 24 percent in the rest of the world. Insurance is even more international. The top 25 insurers conduct 31 percent of their business in the rest of Europe and 26 percent in the rest of the world.

This intensity of cross-border activities indicates that the potential for coordination failure among national authorities remains high in the aftermath of the financial crisis. Host country supervisors have so far responded by ring-fencing activities in subsidiaries, leading to further fragmentation. This essay argues that if we want to keep the benefits of both the single financial market (objective 2) and financial stability (objective 3), we need new supranational institutions that accommodate integration (through cross-border flows and branches). The advance to Banking Union with integrated supervision and resolution can provide the necessary policy push for an integrated approach.

But there is an uncomfortable corollary from supervision and resolution at the supranational level in the Banking Union. For countries that are part of the European Union, but not of the Banking Union, supervision and resolution will by definition be national. The logic of the financial trilemma suggests that countries outside the Banking Union only have one stable option of just subsidiaries and no branches within their borders. The natural, albeit painful, conclusion of this would be a two tier European banking system violating the single financial market.

Finally, this empirical survey reviews the impact of state aid on banks and insurers. Large banks and insurers that received state aid downsized their business at a strong pace (minus 18 percent for banks and minus 34 percent for insurers), while the total European banking and insurance sector grew after the crisis (plus 9 percent and plus 3 percent respectively). There is thus a significant impact, pushed by the European Commission's strong stance on restructuring as a condition for receiving state aid.