

# The Banking Union: Status and Outlook

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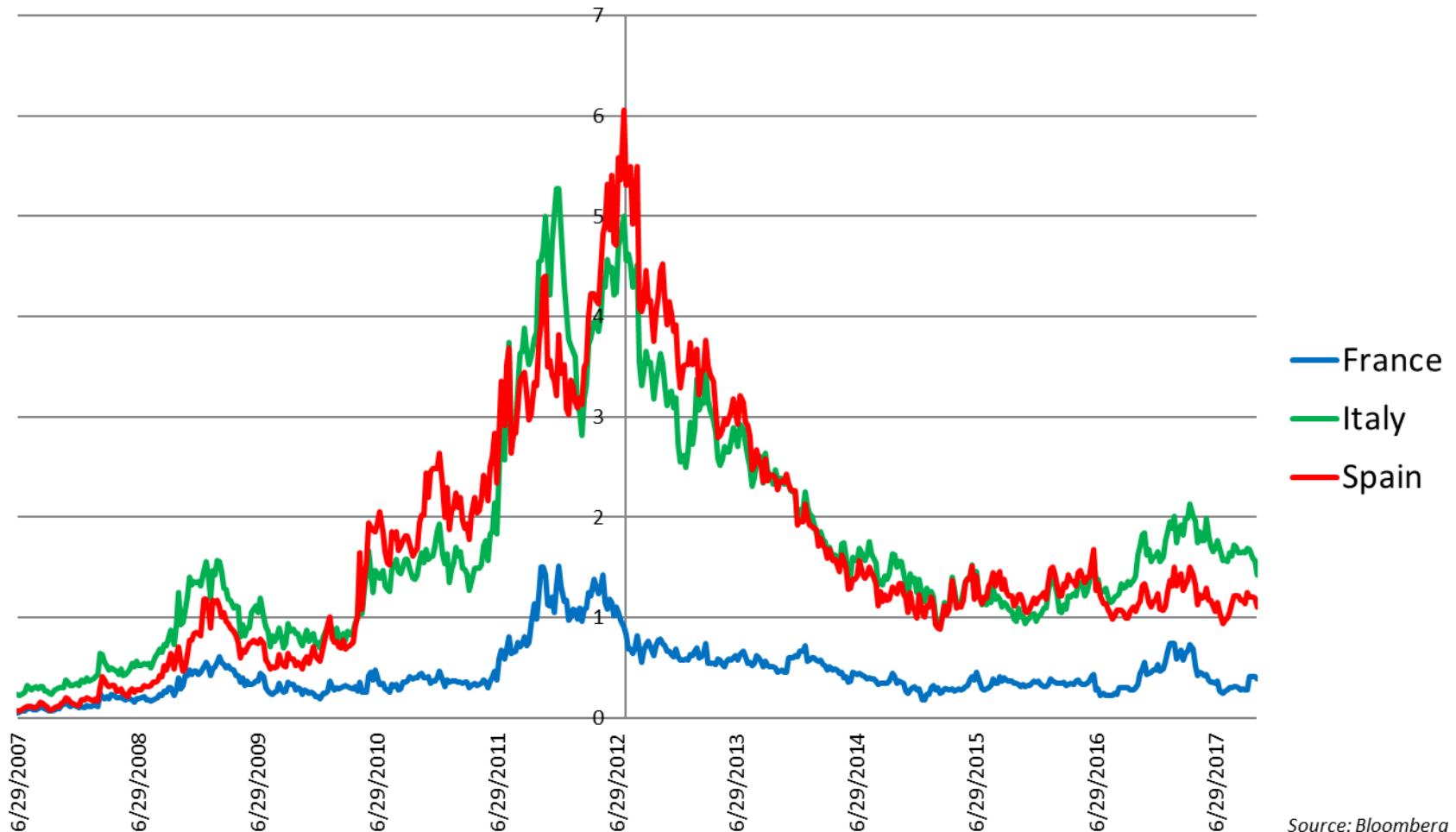
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# Today's Presentation

- What is Europe's banking union?
- Current status
- Policy agenda
- Questions for Sweden

# The Mid-2012 Moment

10Y Spreads vs Germany



# The Starting Point

**“We affirm that it is imperative to break the vicious circle between banks and sovereigns.** The Commission will present Proposals on the basis of Article 127(6) for a **single supervisory mechanism** shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. **When** an **effective** single supervisory mechanism is established, involving the ECB, for banks in the euro area **the ESM could**, following a regular decision, **have the possibility to recapitalize banks directly**. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution-specific, sector-specific or economy-wide and would be formalised in a **Memorandum of Understanding**. The Eurogroup will examine the situation of the **Irish** financial sector with the view of further improving the sustainability of the well-performing adjustment programme. **Similar cases** will be treated equally.”

Euro area summit statement, 29 June 2012

# Banking Union & OMT

“The June 2012 summit was perhaps the **most important European Council of my five years in office.** (...) I will never forget, a couple of hours later on that Friday, Mario Draghi walking into my office, right before the start of the summit’s last working session. A man under huge pressure, for the first time in the eight months during which I’d seen him at work, he now looked relieved. “*Herman,*” he said, “*Do you realise what you all did last night? **This is the game-changer we need.***” The commitment of political leaders to **European banking supervision** created the opening he needed for his own institution to step up its role in the crisis – with words, now famous words, and with action, the **OMT**, which both came that summer. **It was a turning point.**”

Herman Van Rompuy, Speech at the occasion of the Inauguration of the Single Supervisory Mechanism, Frankfurt, 20 November 2014

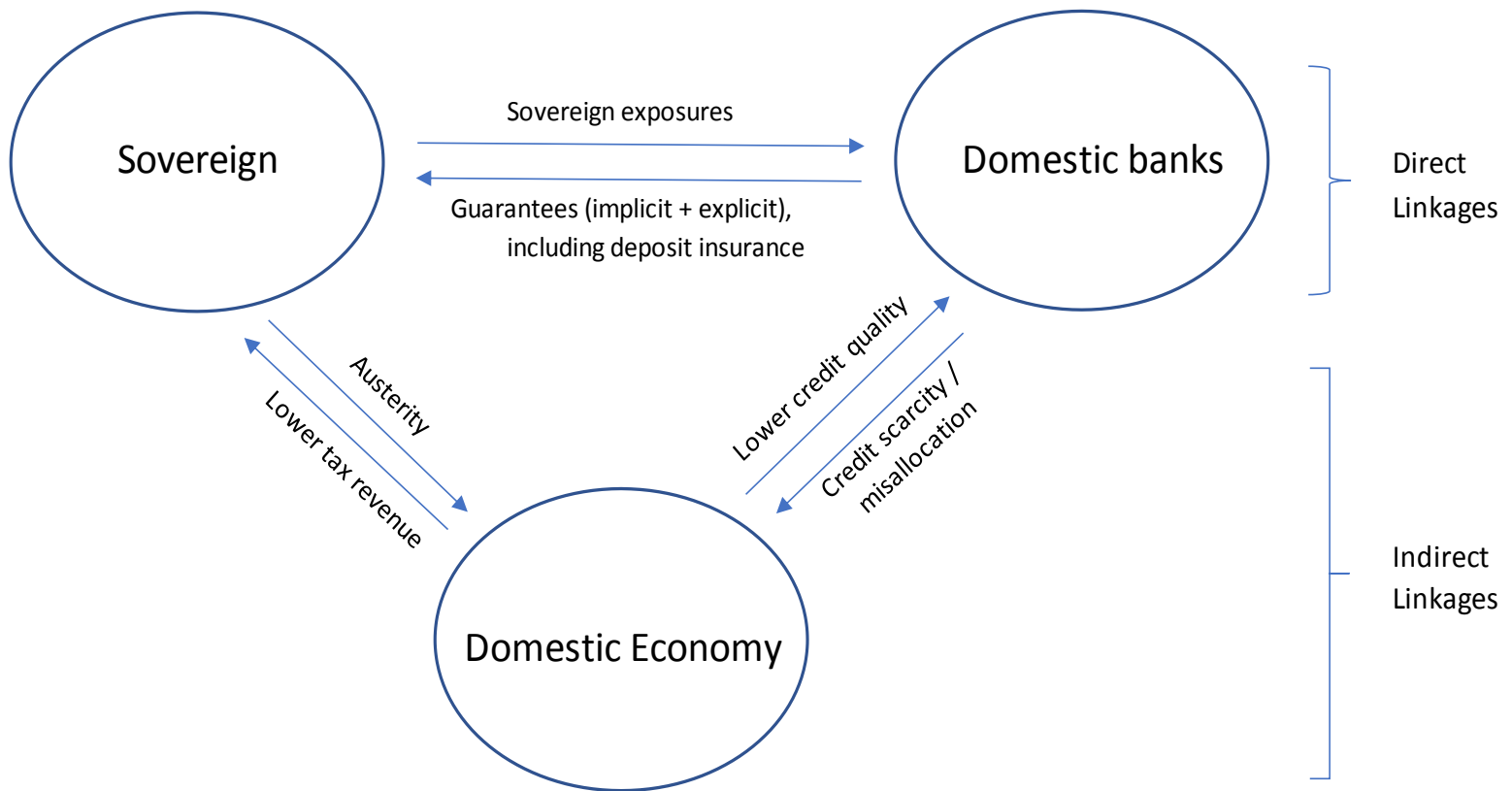
# Early Shift of Emphasis

- June 2012: ESM direct recapitalization, with retroactive effect where needed
  - i.e. ESM-funded “bail-out” to resolve legacy situations
  - BRRD bail-in (proposed early June) from Jan. 2018
- Immediate backlash in Germany (+FI, NL)
  - ESM direct recapitalization no longer for “legacy”
  - BRRD bail-in brought forward to Jan. 2016
- Dec. 2012: Single Resolution Mechanism

# “Three Pillars”

- Single Supervisory Mechanism: ECB
  - Started November 2014
- Single Resolution Mechanism: SRB
  - Full authority since January 2016
  - Single Resolution Fund: now ~€17bn, grows to ~€70bn by 2024
- European Deposit Insurance System (EDIS)
  - European Commission proposal November 2015

# Bank-Sovereign Linkages





# Recent Assessments

“Following the sovereign debt crisis, the euro area experienced first-hand the risks of a diverging supervisory and regulatory framework for cross-border finance – and faced a serious threat of financial market fragmentation when those flows reversed. Safety was restored by elevating supervision and resolution to the European level with the banking union. This was key to re-establishing trust in the banking system and reviving cross-border capital flows within Europe. These are only the first steps, but the direction of travel has been drawn.”

Mario Draghi, speech at Jackson Hole Conference, 25 August 2017

“We are still far from achieving one of the key goals set at the beginning of the SSM, namely to neutralise the transmission of risks between banks and public sector finances at the national level.”

Ignazio Angeloni, speech in Courmayeur, 22 September 2017

“We rather stand at the beginning than at the end of the banking union project.”

Thomas Wieser, remarks at FMA conference, 4 October 2017

# Policy Objectives

- A large-scale banking crisis should not automatically trigger sovereign debt distress
- A sovereign debt restructuring should not trigger a bank run

# Policy Achievements

- Institutional build-up and “risk reduction”
- Comprehensive assessment (2014)
  - No “fresh start”, but credible stock-taking
- Greek crisis (2015)
  - ECB’s solvency claim (until mid-June) vindicated
- Portugal, Italy (2016-17)
  - Takeovers (BPI, Novo Banco), private-sector recap. (UniCredit, BCP, Banco BPM), public-sector recap. (CGD, MPS), closures (Veneto & Vicenza)
- Banco Popular Español (June 2017)
  - First & successful case of large-scale bank resolution

# Operational Challenges

- Institutional maturity
  - Governance: e.g. ECB Supervisory Board
  - Supervisory transparency
  - Institutional culture / national perspectives
- Supervisory arrangements
  - SIs: Joint Supervisory Teams, broadly functional
  - LSIs: supervisory model still largely untested
- Resolution arrangements
  - Insufficient central control over “execution” of resolution schemes?

# Moral Hazard?

- Contrast with early days of crisis 2007-08
  - Shareholders wiped out; junior debt bailed in
- Senior debt bail-in: not yet standard practice
- Lingering national risk-sharing schemes
- Pervasive politicization of bank governance
  - Listed banks with dispersed ownership still a minority
  - Contrast to “Anglo-Saxon” countries

# Bank-Sovereign Linkages

- Direct: banks to sovereigns
  - Deposit insurance (e.g. Cyprus), lingering guarantees
  - Publicly-owned banks (but very heterogeneous)
- Direct: sovereigns to banks
  - Sovereign exposures / home bias
- Indirect: macroeconomic linkages
  - Most banks still have domestic profile
- Vicious circle still default assumption
  - Further policy steps needed to alter expectations

# Policy Agenda

- Risk-sharing
  - Core issue: EDIS
  - Also: ESM intervention
  - Cross-border integration
- Market discipline
  - Core issue: sovereign exposures
  - Further harmonization: bank insolvency law, prudential, accounting...
  - Tightening of state aid guidelines

# Sovereign Exposures

- Proposal: Sovereign Concentration Charges
  - Only on euro-area exposures of euro-area banks
  - Focused on concentration risk, not credit risk
  - No charges if exposures diversified inside euro area
  - Calibration, transitional arrangements → no disruption

[http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602111/IPOL\\_STU\(2017\)602111\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602111/IPOL_STU(2017)602111_EN.pdf)

- Together with EDIS
  - For reasons of policy + politics



# Changing Geography?

- Brexit impact
- Close cooperations
- International governance

# Thank You For Your Attention

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