Banking Union for Europe: Burden or Benefit?

***eabh* lunch hour.** 17 Jan 2014. Frankfurt. Germany

The recent banking crisis highlighted the need for swift and decisive action by EU-level funding arrangements. The proposed European Banking Union is one of the most ambitious institutional responses, designed to buttress the monetary responsibilities of the European Central Bank by expanding its responsibility to creating a single European system of banking regulation, supervision and resolution. But, these ambitions pose challenges as well as opportunities and the devil is in the detail that underpins the broad claims of common interest in achieving greater European integration. After the controversy of the ECB's approach to the sovereign debt crises of the past few years, the Banking Union promises to deliver fresh impetus to the centralisation of policy-making. In October 2013 the first leg of the banking union was inaugurated as members of the Eurozone signed up to the Single Supervisory Authority.

However, achieving agreement to the Single Supervisory Authority has been a highly contested process and further progress on the other essential but challenging elements of the Banking Union may be prolonged. As the European Central Bank (ECB) takes over its role as Single Supervisory Authority in the Euro-zone, there is an opportunity to take stock of current developments in international financial regulation and supervision, and provide insights into possible future directions. The eabh lunch hour roundtable brought together a mixture of academics, bankers, lawyers and members of a range of relevant multilateral institutions to discuss the prospects for the future of the Banking Union and its contribution to resolving the fundamental weaknesses in the European banking system demonstrated in the global financial crisis. All participants spoke in their personal capacities.

Adalbert Winkler, Professor for International Development and Finance at the Frankfurt School of Finance and Management began with a historical perspective, looking to the banking union of the United States, which grew out of the financial crisis of 1907. During the great depression in the interwar period, the failure to create an effective resolution mechanism led to damaging bank failures on an unprecedented scale that deepened the depression in the USA. The response was the Federal Deposit Insurance Corporation, which began the process of cleaning up the banking sector by establishing a single resolution mechanism supported through contributions from member banks but with a fiscal back-stop. Common regulation and supervision helps to create a level playing field, but Winkler emphasized the importance of the Single Supervisory Mechanism (SSM) and fiscal back-stop for a properly functioning banking union. The USA may not, however, be a good model for Europe given the complexity of the domestic supervisory structure, with responsibility shared among many statutory institutions including the Office of the Controller of the Currency, Securities and Exchange Commission, the Federal Reserve Banks, state banking authorities as well as the FDIC (Federal Deposit Insurance Corporation).

The fiscal back-stop was a subject of considerable further discussion given the stage of the Banking Union. Agreeing to the key principals for supervision The prospect that member countries will agree to a mechanism to share risk in this way is very controversial. For Winkler, the fact that bad legacy assets were mainly in banks outside Germany and that a safety-net introduces the dangers of moral

hazard was the mainstream view. But others emphasized the opportunity for the ECB to have a fresh start, prevent zombie banks and facilitate European recovery, which would ultimately benefit Germany. The issue then is the balance of distribution of cost and benefit; the perennial problem of EU policy-making.

Kern Alexander Professor of Law and Finance at University of Zurich followed with observations from a legal perspective. The framework for the banking union was particularly challenging in the complex legal landscape of the EU. The introduction of a common resolution mechanism, with its implications for property rights across borders could in an extreme case lead to a referral to the European Convention on of Human Rights.

Karl Cordewener , Deputy Secretary-General, Basel Committee on Banking Supervision, Bank for International Settlements, described how multilateral discussions and consensus was built successfully through the Basel Committee. Successive rounds of guidance and best practice rules had culminated in the more comprehensive Basel III framework. This experience left him optimistic about the potential to overcome cross-border differences in the European context. Certainly, the thirty years of experience at the Basel Committee underpinned Europe's collaboration on identifying common supervisory principals. From its inception in 1975, France, Italy, Germany, Netherlands, Luxembourg and Belgium were all members of the Basel Committee. Along with representatives from the USA, UK, Switzerland, Sweden, Canada and Japan they began modestly by sharing best practice in banking supervision before developing more ambitious standards in Basel I in 1982. As successive crises rocked the international banking system over the following twenty years, these standards were developed and refined culminating in the Basel III framework that responded to the 2008 crisis.

Dirk Schumacher, Senior European Economist at Goldman Sachs International returned to the consequences of the banking crisis and the Banking Union's role. He emphasized the heterogeneity of the national banking systems in Europe in terms of size relative to GDP, with Ireland a particular outlier. Moreover the distribution of bank assets across the Eurozone, which would be covered by the ECB, is very uneven with Germany dominating. He showed that European banks' lending rates were falling, but lending standards to the private sector were nevertheless tightening. Italy was a particular area of vulnerability due to rapidly rising non-performing loans. A Banking Union was not a sufficient solution to these fundamental problems.

Chiara Zillioli, Deputy Chief Counsel of the ECB described in detail the framework for the Banking Union across three main pillars; supervision, deposit protection and resolution. She remained optimistic about the prospect for constructing the next two pillars while recognising that the Single Supervisory Authority was perhaps the low hanging fruit in the process. More difficult negotiations are yet to come to finalise the other elements that will lead to a more complete banking union. In December, the European Council agreed a general approach on a Single Resolution Mechanism; comprising a single resolution board and a single resolution fund. Negotiations with the European Parliament are set to be concluded by May 2014.

Emilios Avougleas, Professor of International Banking Law and Finance at Edinburgh University welcomed the European Banking Union (EBU) as competing the jigsaw of the institutions of the Union and explained that the purpose of the EBU is the convergence of the spread on the cost of borrowing of the different EMU member states by eliminating the contingent risk of a public bailout

in the event of bank failures. In his opinion the European Central Bank rightfully becomes the centrepiece of the EBU as it got all the critical calls right both in the context of bank financing in 2008 in order to avert a deadly liquidity crunch in the EMU banking sector and trough the EMT that is the main reason for today's lull in Eurozone sovereign bond markets. He concluded the panel discussion with a spirited critique of the likelihood of the banking union coming to fruition given the frictions among the constituent banking systems and the legal as well as administrative obstacles to the next two pillars.

The discussion from the floor and among the panellists focussed on he prospects for a fiscal back-stop that would elevate the Single Supervisory Mechanism to a more complete Banking Union. Without a credible Single Resolution Mechanism, the ECB supervision lack teeth. But sharing responsibility for resolving bank failures requires an ex ante commitment from participating governments to contribute to bail-outs or restructuring using national fiscal resources. This raises both the potential for moral hazard as well as political opposition if the benefits and burden of the safety-net are not distributed equitably among participants. The ability to negotiate a meaningful resolution mechanism in this way was considered remote by some participants in the panel and the audience. Further challenges included the limited range of the Banking Union both with respect to the nature of eligible institutions (only systemically important financial institutions) and the ability of a banking union based only in the Eurozone to be effective, while the City of London excluded.

For historians of European banking and finance, the financial crisis has opened up many new areas of enquiry and increased public interest in the development of banking systems in the longer term. As Emmanuel Mourlon-Druol made clear in his paper at that morning's academic conference, a Banking Union for Europe is not a new initiative (it was first mooted and abandoned in the 1980s) but the institutional context has changed with the monetary union and the creation of a European central bank. Whether the political, legal and institutional obstacles can be overcome this time will hold the attention of lawyers and economists over the decade to come.

Catherine Schenk. Panel Chair. University of Glasgow

*The first *eabh* lunch hour 2014 is part of the conference 'The challenges of International Banking Regulation and Supervision after 1945' jointly organised by EABH (The European Association for Banking and Financial History e.V.), the ESRC-founded project 'The Development of International Financial Regulation and Supervision (1961-1982)', University of Glasgow and the Frankfurt School of Finance & Management. Further information and conference papers are available when you click here.

Could you please add that for the sake of clarity before the concluding part. Otherwise my intervention is open to be unfairly misconstrued
and this passage seen outside the preceding context then

becomes grossly inaccurate.

Many thanks in advance

Emilios