AFME Members’ briefing call – Banking union
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Outline

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Opening remarks
Context for the banking union proposal
Why do we need banking union?

Based on a highly stylised account of the Eurozone crisis...

**Partial economic convergence**
- Low convergence in MS policy, performance, competitiveness
- Growing macro-prudential risks, especially in property markets

**High sovereign borrowing**
- Slow growth, high unemployment, low inflation all keep deficits high
- Some sovereigns also took on large liabilities from banking sector

**Highly geared financial sector before the crisis**
- Banks and consumers in the EU became heavily overstretched during a long period of expansion

**Financial sector stress**
- Recession erodes banks’ capital
- Banks shrinking and deleveraging
- Reg reforms are procyclical: more capital and liquidity: lower leverage

**Deflationary macro policy**
- Eurozone framework locks in low nominal GDP growth
- Adjustment by inflation or internal devaluation no longer an option

**Growth slow or sharply negative**
- Weak private demand and low confidence
- Austerity may deepen recession

**Sovereign / bank links:**
- Banks hold large amounts of (domestic) Eurozone paper
- Risk of further bank failures limits strength of sovereigns

*Investors have little appetite for bank equity...*

*And demand premium to buy sovereign paper...*

**Structural solution requires stronger common oversight and credible fiscal backstops**

Underlying causes  →  Proximate causes
Full banking union, in theory

Full federal approach would create common Eurozone institutions...

**Single Eurozone banking supervisor**
- Common Eurozone institution
- Covering all 6000 Eurozone banks
- And all supervisory functions

**Single Eurozone deposit guarantee scheme**
- One large fund (cf FDIC?) to backstop all Eurozone banks
- One funding model and level

**Single Eurozone resolution authority**
- Common Eurozone institution...
- Full responsibility for resolving all Eurozone credit institutions

**Single Eurozone resolution fund**
- Common fund to support recovery and resolution of all €-zone banks
- Resolution authority pulls trigger
The key constraints are law, politics and time...

Legal constraints
- Existing EU Treaties defines what is currently possible
- There is no legal basis for a common banking supervisory framework
- But Article 127(6) TFEU allows a bottom-up approach, centred on the ECB:

  “The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously... confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

Political constraints
- Treaty change is not politically possible in the near term
- With common supervisory power comes common fiscal responsibility...
- ... and a significant loss of sovereignty for states with vulnerable banks

Time constraints
- Design, agreement and implementation of the full framework will take many years
- Economic and financial crisis in Europe continues to intensify

Barroso and Von Rompuy are taking a pragmatic approach
Commission proposals and the Council roadmap
The Commission strategy

Incremental progress on building the pillars of banking union...

**Single Eurozone banking supervisor**
- Single supervisory mechanism
- ECB at the heart of a new network
- Many tasks delegated to states

**Single Eurozone deposit guarantee scheme**
- National systems already in place
- New directive proposed, July 2010
- Single Eurozone scheme proposed by Van Rompuy, but timing open

**Single Eurozone resolution authority**
- Recovery and resolution directive (RRD) published in June 2012
- Single resolution mechanism proposed once RRD is passed

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Single supervisory mechanism
SSM: Scope and powers conferred on ECB

Scope
• ECB to be responsible for supervising all banks in the euro area
• ECB has no binding powers outside the euro area
• However other EU countries can join SSM and abide by ECB acts

ECB tasks / powers
• Powers of the ECB to include the following:
  ➢ Authorisations and withdrawal of authorizations
  ➢ Assessment of acquisition and disposals of holdings in banks
  ➢ Ensuring compliance with prudential requirements
  ➢ Imposing higher prudential requirements
  ➢ Undertake supervisory tasks in relation to early intervention
  ➢ Coordinating with the Commission on assessments for possible public recapitalizations
Roles and responsibilities

- ECB to assume home and host country duties in the euro area
- National authorities to assist ECB with supervisory tasks
- National authorities responsible for tasks not conferred on ECB

Coordination

- ECB to co-operate with the EBA and express the common position of euro area members.
- Consistency in supervision across 27 member states to be strengthened by EBA development of a single supervisory handbook
- EBA to change some of its voting arrangements
- Co-ordination with non-euro area member states via the ECB’s participation in colleges of supervisors
Accountability and governance
• ECB to be accountable to the European Parliament (EP) and Council
• President, Vice President of Governing Council of the ECB appointed by Council after consultation with EP
• Monetary policy and supervisory tasks of the ECB to be separated
• Supervisory Board established to plan and execute ECB tasks

Resourcing
• ECB to levy fees to cover the cost of supervision. Fees to be proportionate to size and risk profile of credit institutions

Timeline
• Regulation to come into force on 1 January 2013:
  ➢ Largest institutions to be covered by 1 July 2013
  ➢ Institutions receiving or requesting public financial assistance can be covered before then
  ➢ All institutions to be covered by 1 January 2014
Wider implications of the banking union proposals
Implications for the Single Market

- Banking union impacts on the Single Market as a whole
- The geographical perimeter of banking union can change
- Non-eurozone member states can join in but on limited terms compared to eurozone countries
- ECB entrusted with prudential supervision will impact on EBA’s functioning and decision-making
- Proposed changes in EBA voting arrangements related to mediation but not to rule-making
- EBA to remain entrusted with the development of the Single Rulebook and to develop a Single Supervisory Handbook to ensure supervisory consistency and level-playing field
- Supervisory colleges to disappear within Banking Union and dynamics to change in EU colleges: impact on cross-border banking
- International supervisory colleges to also be affected
Linkages to other EU proposals

• The European Commission links the establishment of the SSM and EBA reform to the adoption, before the end of 2012, of three pieces of legislation currently being negotiated:
  ➢ Capital Requirements Directive 4 (CRD4)
  ➢ Deposit Guarantee Schemes (DGS)
  ➢ Recovery and Resolution Directive (RRD)

• In the framework of banking union, the Commission will propose at a later stage the creation of a single resolution mechanism

• A gap is envisaged between the set-up of the SSM and the implementation of a single resolution mechanism

• Strong political drive to complete the legislative procedure related to CRD4 by January 2013 – and to achieve progress on RRD and DGS

• Under proposed RRD and DGS legislation the resolution and deposit guarantees’ framework will remain essentially national
Potential impact of banking union on firms

**Short term**
- Limited change in day to day supervisory arrangements for Eurozone member banks (and of course non-Eurozone banks)
- *But* large Eurozone banks may be subject to multiple inspections
- Complexity for groups *partly* subject to ECB oversight (e.g. 3rd country firms and EU firms operating inside and outside the Eurozone)

** Longer term**
- Eurozone banks become subject to macro-prudential interventions by ECB (e.g. countercyclical capital buffers or other similar measures)
- Eurozone banks should expect more consistency in supervisory practices as a result of being responsible to a single regulator
- Potential cost savings as firms in the Eurozone will be dealing with one regulator rather than up to 17

**But much more detail is required to make a full assessment**
AFME position on banking union
Published our initial position today. We are strongly supportive.

Banking union is an essential step to resolve the euro crisis, support the euro and develop coherent architecture for EMU.

Proposed timetable and phasing-in are coherent with need to move rapidly with the SSM.

Resolution arrangements complementing the SSM to be put in place as quickly as possible – but without hindering progress on SSM.

Essential to achieve high quality and effective supervision through:
- effective supervisory arrangements: and
- solid supervisory principles

Need for ‘open architecture’ to allow non-Eurozone countries to join.

Our policy paper identifies three key challenges for policymakers:
- Quick and consistent implementation
- Clear and robust arrangements in the transition phase
- Strengthening the Single Market as a whole
Questions and answers
The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society.

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