

## Eurozone as Home Country of Banks

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Once again, the Eurozone Council has managed to surprise the markets. By moving banking supervision of the eurozone to the European Central Bank (ECB) in return for the direct recapitalisation of banks by the European Stability Mechanism (ESM), a huge step towards a more federal banking model has been taken. This move should allow a gradual de-nationalisation of banking and a more independent and streamlined supervision, which is what banking union is all about. But the decision will have to be taken to its full extent: it has far-reaching implications and raises many questions, essentially of an operational and legal nature and of scope. And it moves the EU-17 further ahead of the eurozone 'Outs'. These matters will have to be clarified in the coming weeks, implying an enormous workload for the European Commission, the Council and the ECB, and a roadmap to be adopted by the Ecofin Council on July 9<sup>th</sup>.

"We affirm that it is imperative to break the vicious circle between banks and sovereigns." The opening statement of the Eurozone Council conclusions sums it up. Banks should not necessarily be penalised for the fiscal position adopted by their home countries. Since the beginning of the financial crisis, the funding costs of banks have started to follow the funding costs of their sovereign, thus creating a very 'unlevel' playing field in the single market. Bank recapitalisation by the ESM, combined with Europe-wide supervision, should allow us to break the circle, although this will not happen automatically.

### **EBA back to core business**

Barely two years on from the start of European Banking Authority (EBA), and supervision will move to the ECB, based upon Article 127(6) of the Treaty. This decision should not be too difficult to implement, as banks in only four smaller countries in the eurozone (Estonia, Finland, Luxembourg and Malta) are not under the supervision of the central bank. It gives the ECB direct access to supervisory information of eurozone licensed banks, and allows it to do what the EBA did not manage to do sufficiently: instruct and supervise national supervisory authorities. But the decision has to be taken unanimously by the EU finance ministers, and although the UK Treasury has indicated that it is in favour of this move, other non-Eurozone countries could object.

Banking Union relegates the EBA to carrying out essentially its regulatory tasks for the EU-27, which is probably the way it should be. The EBA's supervisory tasks were in any case exceptional or difficult to implement, but can continue for the Outs. And clarifying this

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problem avoids the threat of the old Meroni<sup>1</sup> and related case law, which rules that the European Commission cannot delegate tasks it is not allowed to exercise itself.

### **Eurozone banking federation**

The June 29<sup>th</sup> decision brings about a sea change for cross-border banks and for supervisors in the eurozone. Rather than having to face multiple supervisory authorities, they will only have one licence and one central supervisor for the eurozone, doing away with the home country and the supervisory colleges, at least in the eurozone. In practice, a two-tier system with local supervision will continue for small banks, but the rules and supervision should be exactly the same, thus giving a significant new boost to cross-border mergers.

The Eurozone Council decision also means that a homogeneous deposit insurance system and a single resolution regime for the eurozone should emerge. Both elements were mentioned in the four presidents' paper, but not in the Eurozone Council conclusions. If the ESM will be used for recapitalisations, it also means that the same the same rules must be applied across the eurozone regarding bail-outs. The Commission proposal on the subject, published on June 7<sup>th</sup>, proposes harmonised rules, but leaves implementation to member state authorities. An earlier proposal on deposit guarantee schemes also left a large degree of discretion to the member states. Both will have to be changed now as a result of the Council decision. But the Eurozone Council will not be able to wait for the decision on the EU Crisis Management Directive, as the recapitalisation of Bankia is urgent, and should take place once the supervision has moved to the ECB, by the end of the year.

Another difficult issue is **sanctions**. Will the ECB obtain sanctioning powers as a result of an Art. 127.6 decision? In recent proposals the European Commission has given sanctioning powers to the European supervisory authorities. The same will have to be done for the ECB.

As with its counterpart in the US, the Fed, the ECB is thus becoming a broad central bank, which is, apart from the execution of monetary policy, also supervising the payment and settlement system, as well as the banks. It remains to be seen whether this move will re-establish confidence, bolster the euro interbank market and further financial integration.

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<sup>1</sup> The landmark Meroni case (9/56, 1957-1958) was one in which the European Court of Justice clarified the conditions under which a delegation of powers could be granted to a new entity.