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Banking Union: Many Questions, Few Answers

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The proposed creation of an integrated financial framework, the so called banking union, leaves many questions unanswered, for example, concerning which institutions are to be supervised, the role of national supervisory authorities, the impact on the financial sector of countries outside the euro area and the consequences for the internal market. The establishment and effective functioning of the new system is in the interest of the whole EU. This is why it is important to conduct a constructive dialogue on this issue, with respect to the interests of all the parties, including the non-euro states.

Path to the Banking Union. The global financial crisis that escalated with the collapse of Lehman Brothers in September 2008 laid bare the improper supervision of the banking sector in both the U.S. and the EU. In addition to persistent macroeconomic imbalances among the euro-area countries, the eurozone's problems are derived from a vicious circle between public finances and the banking sector, which is particularly the case for Ireland, Greece, Cyprus and Spain. Weak banks have put a strain on public finances, which are used for recapitalisation, while the financial institutions own a disproportionately large part of government debt, which in turn affects their condition. To address these issues, in January 2011 the EU launched a new financial supervision system. The key element in relation to the banking sector was a new supervisory agency, the European Banking Authority (EBA), which cooperates with national supervisors. Over time, however, it became clear that the new system was flawed. The coordinating and regulatory powers of the EBA were weak and the stress tests it conducted were mild and in large part could not have estimated the scale of the problems, for example, in Spain. Meanwhile, national supervisory authorities had a tendency to underestimate the problems of their country's banks.

The report "Towards a Genuine Economic and Monetary Union" presented by Herman Van Rompuy before the European Council Summit of 28–29 June 2012, identified three key integrated frameworks to secure the future of the Economic and Monetary Union (EMU): financial, budgetary and economic policy. The integrated framework for the financial sector, the "banking union," is in turn designed to contain three key components—a single supervisory authority, common deposit insurance scheme and a common crisis management framework. On 12 September, the European Commission presented its first element, the Single Supervisory Mechanism (SSM), whose function under Article 127 (6) TFEU would be exercised by the European Central Bank in cooperation with the national supervisory authorities. The European Council in October failed to move the discussion substantially forward but indicated that the legal framework concerning SSM should be agreed by the end of this year. Not only had the pressure from the financial markets decreased significantly but also Germany wanted to obtain concessions from other Member States when it came to other elements of the future EMU, such as increased control by the Commission over the national budgets of euro area member states. France objected. More detailed proposals of the EMU reforms, including the banking union, are now being developed by Van Rompuy in collaboration with the presidents of the European Commission, the Eurogroup and the ECB, and will be presented in December.

Questions. There still are numerous points to clarify about the shape and mechanism of the future banking union. The criteria for the selection of banks that will fall under ECB oversight is unclear. The European Commission suggests supervision for all financial institutions in the eurozone, while Germany claims that it would not be technically feasible and suggests that only

200 systemically important institutions fall under its purview. Its concern stems not only from a desire to make the new system effective but also to protect from supervision German regional banks whose board members and managers are frequently linked with political forces. In any case, it seems that German claims about the excessive scope of supervision are reasonable and in the new system national supervisors must maintain their significance. Recent informal proposals suggest leaving the ECB to supervise only a limited number of large banks and those receiving European Stability Mechanism (ESM) aid in the future. Another point of concern is the need for an effective separation of the monetary policy and supervisory powers of the ECB as well as the division of the supervisory tasks between the ECB and national authorities.

To date, proposals for only one of the three elements of the banking union—the SSM—have been put forward. As for the other elements—the bank resolution scheme and common deposit guarantee system—no proposals have been put forward. Yet, the effective operation of the new supervisory system requires the simultaneous introduction of all three elements, otherwise there would be different levels of governance for supervision and for rescuing failing institutions, which may cause disagreement about who would bear the costs of the operation. The pressure to develop the SSM, probably stems from the desire to unlock the capability of the direct financial aid of the ESM for the banking sector and thus to strengthen the eurozone's short-term credibility. Direct aid from the ESM for the banking sector would only be possible after the effective creation of the SSM.

Non-eurozone Members' View. All the governments are aware that only by creating effective supervision on the EU level can proper oversight of the banking sector be achieved. This could stabilise the financial sector and alleviate the crisis. So, it is in the common interest of all the EU27 to do so. Several non-eurozone members, particularly the UK and those in the CEE, have nevertheless voiced criticism concerning the Commission's proposal on the SSM. Whilst the aim of the British government is to safeguard The City's interests, the CEE's problem is different. Their banking sectors are dependent on large eurozone banking groups, raising some important question marks. Risk assessment from the point of view of a banking group based in one of the EU17 may differ from that of one of its subsidiaries based in one of the EU10. The home supervisor may, after all, give greater weight to the interests of the multinational group than to its subsidiary in another EU country. This could have possible negative consequences for the latter, and thus for its taxpayers. Direct access to the ESM might also increase the credibility of banks in the euro area at the expense of those in the EU10, which could adversely affect the integrity of the internal market.

For these reasons, it seems necessary to create mechanisms for protecting EU member states that are not third stage EMU participants from being outvoted within the EBA by the EU17, coordinated by the ECB. Another solution would be to include dispute resolution through an independent panel of experts within the framework of the EBA. An increase in access by non-eurozone national supervisory authorities to information about the financial situations of large banking groups in the euro area should also be considered. Joining the new supervisory system would not actually give non-euro countries the possibility to formally influence ECB decisions, meaning that an opt-in is not an attractive option. In this context, the European Council's conclusions of 18 October calling for transparency and openness to countries outside the euro area provide a basis for CEE governments to make their case. Moreover, since the decision to grant the ECB new supervisory tasks will be conferred by a regulation requiring unanimity in the Council, non-eurozone members will gain leverage to make sure their interests are respected.

Except for some problems, such as those arising from long-term lending dependency on short-term loans, Poland's banking sector is in good shape. It has an effective system of supervision as well as a deposit-guarantee scheme which provides much better protection than some of the euro area countries (e.g. in France). The market valuation of some Polish banks is sometimes higher than their parent entities. Therefore, apart from the need to safeguard its interests, which is also the case of other non-eurozone members, Poland can have a more positive influence by providing useful input on the discussion about the final shape of the banking union.