Banking Union in Three Steps

Karel Lannoo

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Eurozone authorities have no time to lose and need to move banking supervision rapidly to the European Central Bank, using an existing EU Treaty article as justification. This will give the ECB direct information about the soundness of individual banks for its liquidity-providing operations and restore market confidence. The current cooperative model is patently not working. In addition, the recent draft deposit guarantee Directive needs to be amended to create a single fund for the eurozone, which should also act as resolution authority.

Apart from a single regulatory framework, which is largely in place, a banking union requires a single supervisory authority, a common deposit protection and a harmonised bank resolution and liquidation system. These three elements already exist in some embryonic form, but they urgently need further elaboration.

A fast and secure way to implement the eurozone banking union is to apply Art. 127.6 of the EU Treaty (TFEU). This article, which is part of the Maastricht Treaty, allows the Council of Finance Ministers, acting unanimously, to confer specific tasks relating to the prudential supervision of banks to the ECB. Although this had been seen as a superfluous or remote possibility before the financial crisis, it is the quick fix we need today. It is also consistent with a trend observed since the financial crisis to move prudential supervision back to the central banks.

The main argument before the crisis not to involve the central bank in banking supervision was the possible conflict between monetary policy and financial supervisory functions. The crisis underscored the need for more information about the financial system at central bank level, even more in a eurozone context, where supervision remains decentralised, far away from the monetary policy function. The cooperative EBA model has already been discredited by the facts, most clearly in the Spanish bank bail-out case.

A second step is the creation of a single deposit protection fund. Such funds are fragmented in the EU today, functioning with different statutes and forms of financing. A timid 2010 EU proposal to bring more harmonisation to deposit protection systems and entailing a window for co-financing between funds is stuck before the European Parliament and Council. The European Commission should withdraw the proposal and propose an EU-wide pre-funded system. Such a fund could also be used to restructure banks, as is the case in the US with the Federal Deposit Insurance Corporation (FDIC). Taking a contribution of 1.25% of all eligible deposits in the EU, as proposed by the Commission, such a fund could dispose of €100 billion today.
A unified bank resolution and liquidation scheme is a third necessary step. The European Commission’s proposal of June 6th goes a long way towards an EU framework, with mandatory resolution plans, early intervention triggers and tools, asset claims and bail-ins. However, since the proposal is a directive and not a regulation, it leaves implementation in the hands of the many EU member state authorities, which would have to form complex resolution colleges for large cross-border banking groups, and eventually agree on keys for burden-sharing. In addition, the trigger for early intervention is the Tier 1 ratio of the CRD IV, the EU’s version of Basel III, which is relative and elastic because of the risk weighting of assets. A leverage ratio would have been far preferable.

Five years after the start of the financial crisis, the EU has lost precious time in responding. It has always been loathe to upset existing structures of the nation states, initially by giving more tasks to advisory-only committees, then by creating tiny subordinate authorities, and by agreeing with huge and costly banking bail-outs. The acceptance of a banking union must be taken to its full significance and be put in operation rapidly. The idea should not become one of the other acronyms of European integration, devoid of any real significance.