(When) should a non-euro country join the banking union?[1]

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1 Introduction

The global financial crisis exposed numerous weaknesses in the European safety net arrangements. The fragmented European supervision was not adjusted to changes caused by growing internationalization and integration in the EU financial system and thus strengthened and unified financial supervision.

We analyze and assess both advantages and disadvantages of opting-in to the banking union[2] for non-euro EU Member States, focusing on the example of CEE countries. What would be the optimal choice: opting-in now or joining the banking union when entering the euro area? Answering this requires assessing the robustness of national safety net, structure and stability of the national banking system, as well as the construction of the banking union in its current shape.

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[1] Summary of the paper. The opinions expressed herein are those of the authors and do not reflect those of the associated istitutions.

[2] For the description of both supervisory and resolution pillars of the banking union and their general assessment see Smaga (2015).

The literature on evaluation of opting in to the banking union is still scarce. To our knowledge for the time being only Berglöf et al. (2012), Darvas and Wolff (2013), Kisgergely and Szombati (2014), NBP (2014) and IMF (2015) analyze opting-in from the perspective of CEE countries. We provide a comprehensive assessment of attractiveness of all aspects of banking union pillars from the perspective of a non-euro country and outline practical policy proposals to encourage opting-in. Moreover, we evaluate current willingness of each non-euro country to opt-in.

2 Potential benefits of opting-in

Potential benefits for the non-euro countries from opting-in include:

– Increased stability, confidence in the banking system and risk-sharing mechanisms (Belke and Gros 2015);
– Increase in quality of supervision and harmonization of supervisory practices that would counter any national bias/forbearance and provide a "quality stamp" (owing to the ECB's reputation and credibility);
– Improved home-host relations by streamlining communication and reducing/internalizing coordination problems;
– Access to parent bank supervisory data and a chance to participate in JSTs;
– Improved political position on the EU fora;
– For banks in opt-in countries – harmonized reporting and lower compliance costs;
– Addressing coordination and burden-sharing problems related to cross-border resolution.

However, for the time being, discussed benefits are mostly of theoretical and potential in nature because the Single Supervisory Mechanism (SSM)/Single Resolution Mechanism (SRM) have not yet fully proven their effectiveness and still no non-euro country has opted-in.

3 Potential risks of opting-in and possible remedies

At the same time, there are many immediate risks for a non-euro country that joins the banking union in its current shape. Those are mainly due to deficient structure of banking union pillars established within the unchanged treaty framework. Potential risks include:

– Limited influence of opt-ins over decision-making process within the SSM, as the Supervisory Board only drafts decisions ultimately taken by Governing Council in which opt-ins do not participate;
– Lack of access to liquidity facility at the ECB and to a fiscal backstop (European Stability Mechanism);

– Risk of insufficient “added value” of the SSM over national supervisory framework, as SSM creates another, centralized supervisory layer with increased administrative burden;
– Risk that banks in opt-ins will be “too small to matter” and home country interests will prevail over national financial stability concerns in opt-ins (e.g. related to centralized capital and liquidity management);
– Complicated and time-consuming decision-making process of the SRM that involves too many parties to ensure a timely “over-the-weekend” resolution;
– Single Resolution Fund (SRF) not having a sufficient size and not being mutualized from the start;
– Lack of single deposit guarantee scheme;
– Risks connected with opting-out (e.g. negative market reaction).

The cost/benefit analysis of opting-in is, for the time being, unfavorable for non-euro countries. Opt-ins transfer majority of their competences in banking supervision and resolution to a pan-European level, but the responsibility for financial stability still remains to a large extent on the national level (e.g. covering the costs of instability from national Deposit Guarentee Schemes’ funds).

Remedies to the identified drawbacks entail changes at least in the TFEU and the ESM treaty, ensuring equal rights and responsibilities of all SSM members (irrespective of their euro zone membership). This includes providing (for all SSM members) equal access to fiscal and liquidity backstops, full participation in SSM decision making processes, increased involvement of national supervisors and taking into account also risks systemic only in national dimension. A better capitalized Single Resolution Fund and completion of the banking union by establishing a pan European deposit insurance system (for a proposal see Schoenmaker and Gros, 2012) are additional prerequisites not only for encouraging opting-in, but also for a stable and efficient functioning of the banking union itself (building the so-called “steel-framed” banking union, see Véron 2013).

4 Conclusions

Opting-in to the banking union might therefore be a beneficial solution for a non-euro country that has: a high share of foreign ownership in the banking system, significant size of the banking system, highly concentrated banking sector with presence of SIFIs, low financial potential of national Deposit Guarentee Schemes and resolution funds and has an imminent perspective for euro adoption. Those features have different relative importances of among potential opt-ins in CEE countries. For the time being, only Romania, Bulgaria and Denmark have made a

positive assessment of the opt-in option, while others (Poland, Czech Republic and Hungary) adopted a "wait-and-see" approach[3].

Fortunately, euro area accession mitigates the majority of identified drawbacks. However, due to political constraints, implementing above mentioned remedies for opt-ins does not seem to be feasible in the short term. No "quick fix" remedies are present and changes in the treaties are required. Hence, it seems optimal for a non-euro country not to opt-in now but to join the banking union upon euro adoption (or just a few years prior to fixed euro adoption date). National political factors also play a significant role in deciding to opt-in and could sometimes overshadow the economic rationale. Moreover, the experiences of a "first mover" – a non-euro country that first decides to opt-in – can serve as a decisive factor to opt-in for others and increase the peer pressure.

Yet, it is too early to make a comprehensive and grounded assessment of the banking union. Therefore, the attractiveness of opting-in requires periodic reassessments.

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[3] Sweden and the UK are likely to remain outside the banking union.