Implementing the Banking Union

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Outline

1) Single Supervisory System (SSM) is a necessary condition for an integrated banking system

2) It is a key step towards the resolution of the European Banking Crisis

3) A major political achievement involving a balanced governance structure

4) Open Questions about the functioning of the SSM

5) The SSM and Single Resolution Mechanism are far from sufficient to solve the European Debt Crisis

– Major Question: how will the Eurozone delever?
A Necessary Step to Preserve the Union

The financial crisis of 2007-09 has brought to light important centrifugal forces in the Eurozone that undermine the integrity of the banking system:

– link between banks and sovereigns
– flight to quality of deposits (etc.)
– credit crunch and breakdown of bank lending channel
– host country regulatory steps to impede cross-country flow of funds
Cumulative Euro-Area Deposit Flows, 2011–12 (billions of Euros)

Source:
IMF Report 2012
Credit Growth to the Non-Financial Private Sector

Source: IMF Report 2012
EXAMPLES:

• Icelandic banking crisis

• Conversion of local subsidiaries into branches of parent bank (Deutsche Bank in Portugal and Hungary)

• BaFin & Unicredit’s German subs.

• FSA & U.K. subs. of Santander

• Etc.
ECB oversees largest banks and cross-border banks (around 100 banks?)

- A separate Supervisory board composed of representatives of all Eurozone member states
- Decisions made via majority voting (simple majority + qualified majority...)

Corporate Governance and Banking Union in a transatlantic perspective
ECGI Brussels 17 December 2012
SSM: How will it function?

- Non-euro area Member States can join SSM
  - they then become *voting members* of the supervisory board...
  - but not of the ECB Governing Council (*steering committee*)...
  - Mediation panel
  - Sweden, Czech Republic and UK won’t join...
SSM: How will it function?

• Cooperation between EBA and ECB:
  – **Majority voting** by EBA members outside the SSM
  – what are the incentives to join the SSM?
  – what are the implications for cross-border banking between SSM-members and non-members?
  – can the SSM override FSA capital and liquidity requirements imposed on Eurozone banks?
Single Resolution Mechanism

- **An essential step** to delink banks and sovereigns
- **Goal** is: early intervention + bailing-in + bridge banks
- “a pecking order of bailing-in shareholders and some creditors, and relying on the banking industry ”…
- “..should include an appropriate and effective common backstop (an ESM credit line)”
- direct bank recapitalizations by the ESM but not before March 2014!
How will the Eurozone Delever?

• The pernicious effects of debt overhang are best cured through ‘debt restructuring’…

• But no major bank debt restructurings in the cards before 2014?

• Will there be any?

• No more sovereign debt restructurings in the cards?

• So how will the Eurozone delever?
Bank Leverage
(Adjusted tangible assets to Tier 1 common capital)

Source: IMF Report 2012