# Jean Monnet Module

## "Economic Policy in the European Union"

Session 2.4. The Banking Union in the EU context

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With the support of the
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of the European Union

## Before the international financial crisis

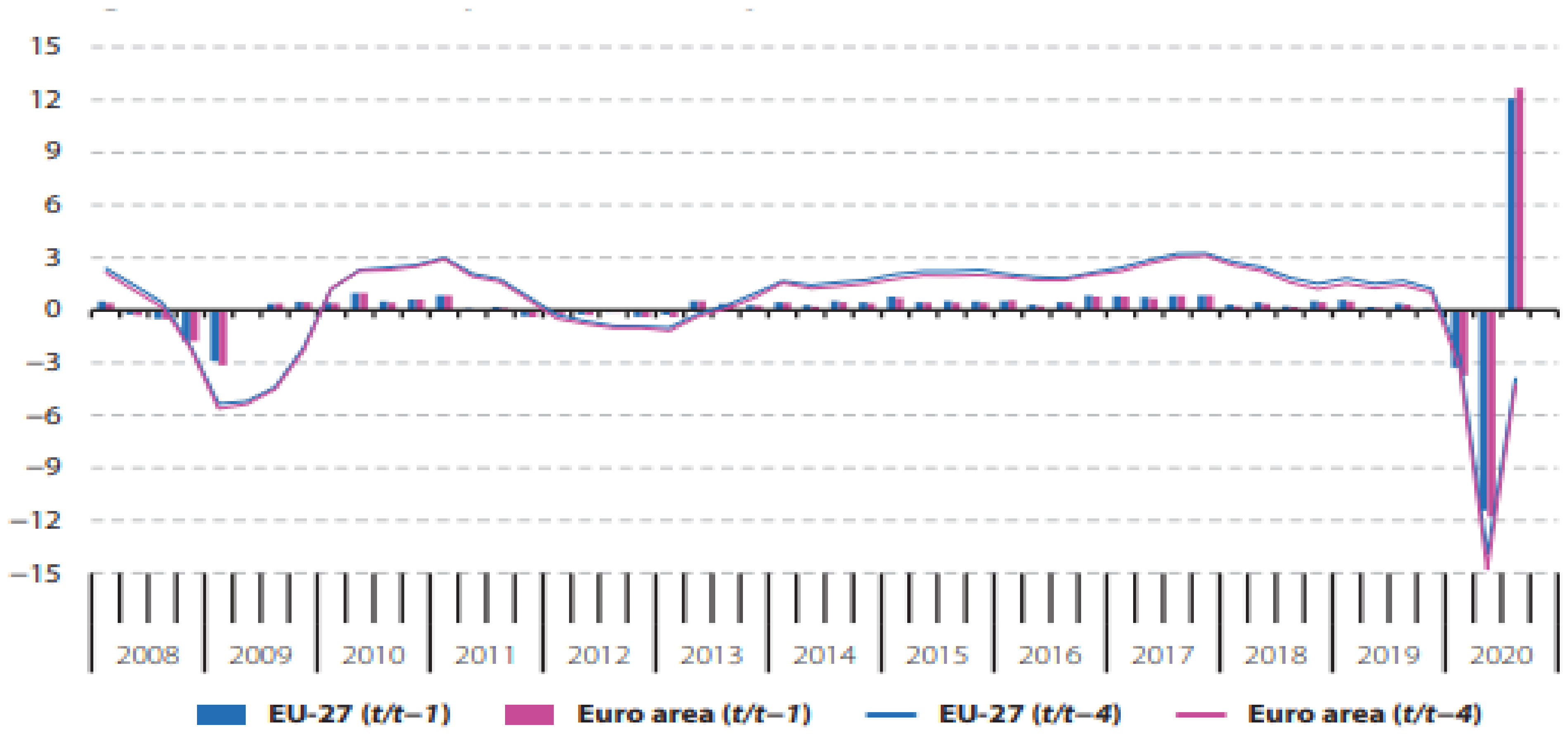
- Liquid interbank market
- Relative convergence in loan conditions to companies and families

## About the international financial crisis (2008-2013)

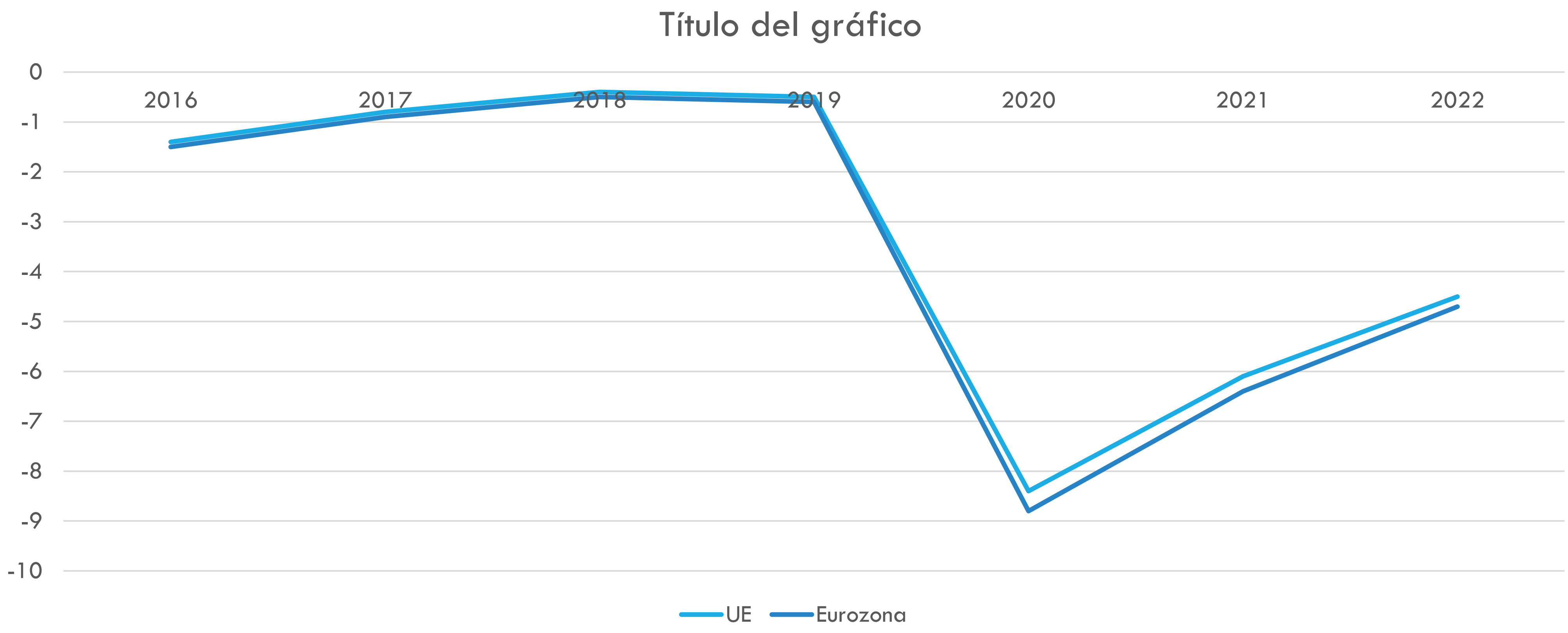
- Decrease in interbank loans
- Decrease in credits to the real economy. Hardening conditions
- Dependence on companies in the banking sector
- Automatic stabilizers:
  - National budgets
  - National social protection systems
- Stability and Growth Pact (SGP)

# GDP GROWTH RATES (% VARIATION)

SOURCE: EUROSTAT

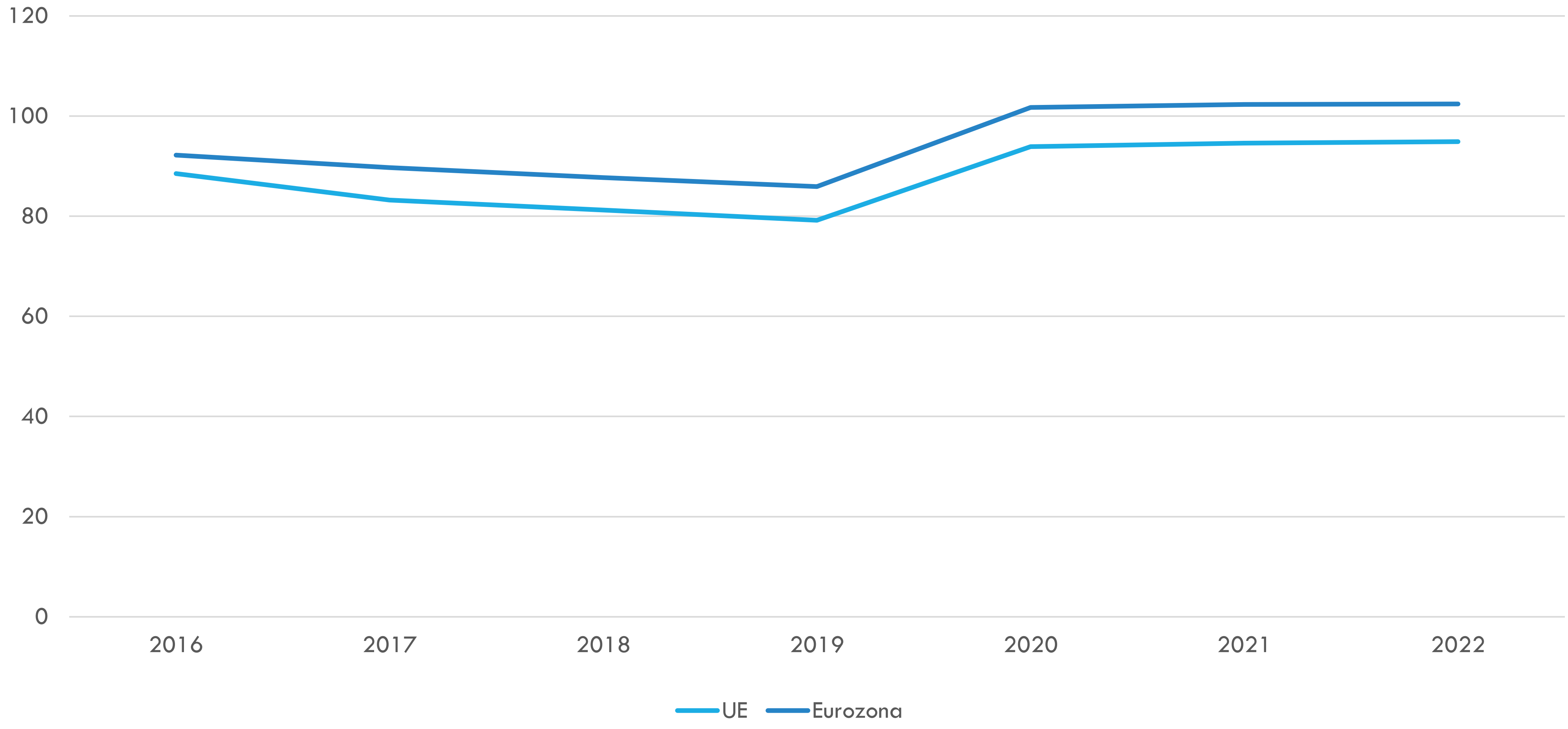


# PUBLIC DEFICIT (%GDP)
## SOURCE: EUROPEAN COMMISSION (2020)
## NOTE: 2021-2022 FORECASTS



# PUBLIC DEBT (% GDP)

## SOURCE: EUROPEAN COMMISSION (2020)
## NOTE: 2021-2022 FORECASTS



# THE CRISIS REVEALED

- Eurozone uncertainties materialize.
- Limited capacity of States, individually, to absorb shocks.
- Negative feedback between bank debt and sovereign debt in the eurozone.

**Banking Crisis – Sovereign Debt Crisis – Real Economic Crisis**

- Fragmentation of european financial markets.

Insufficiency of EMU → Improve eurozone economic governance

# ECONOMIC RESILIENCE IS APPEALED

**A country's ability to withstand a disturbance and quickly regain its potential after the recession.**

This capability determines:

- Vulnerability to shocks (how strongly it hits an economy)
- The absorption capacity of disturbances (minimizing the effect on production and employment). An impact can be absorbed through wages and prices, provision of credits and sharing financial risk.
- The ability to recover quickly after disturbances

**Resilient economic structures: capable of preventing shocks from having significant and persistent effects on the level of income and employment and, furthermore, capable of reducing economic fluctuations.**

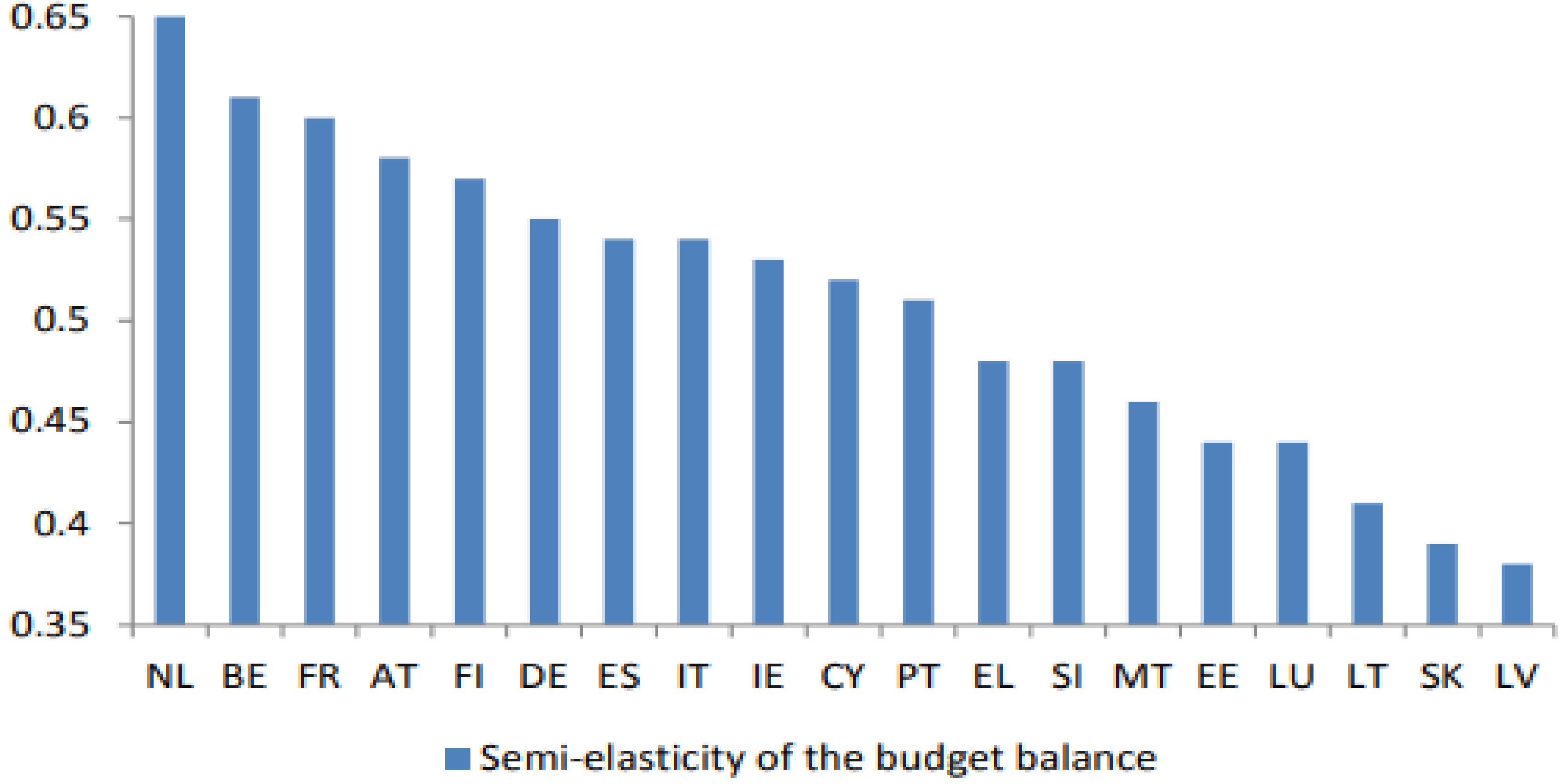
# THE CRISIS REVEALED

**Advancing financial sector integration: resisting a future crisis**

**Banking Union**

**Capital Markets Union**

# THE ELASTICITY OF EUROZONE NATIONAL BUDGETS, 2014
# SOURCE: MOURRE ET AL., 2014



# SOME MEASURES TO STRENGTHEN EMU

- **Fiscal Pact** and **Reform of the SGP**, 2011
- **Macroeconomic unbalance procedure**, 2011: early detection of macroeconomic vulnerabilities and tools to correct them
- **European Stability Mechanism** (EESM), 2012
- **Legislative Package on Budgetary Supervision**, 2013
- **Banking Union**, 2014
- Establish a **Convergence and Competitiveness Budgetary Instrument**
- Strengthening **EUROSTAT**

# AT INSTITUTIONAL LEVEL

- Euro Summit, Octubre 2014
  - Single monetary policy but national economic and fiscal policies
  - National economic and fiscal policies → issues of common interest
  - Concrete mechanisms for greater coordination. Working Group
- European Council Conclusions, Decembre 2014
  - Create a European Fund for Strategic Investments (EIB group)
  - Completing the Single Market: Removing Obstacles

# AT INSTITUTIONAL LEVEL

- European Council Conclusions, Octubre 2015
  - Banking Union (UB)
    - Working for deep and complete EMU
    - Achieve a unified and integrated financial system:
      - Correct transfer of monetary policy
      - Diversification of risk between countries
      - Trust in the banking system

# AT INSTITUCIONAL LEVEL

- Eurogroup, June 2019
  - Characteristics of the Budgetary Instrument for Competitiveness and Convergence (BICC)
  - ESM Reform Treaty:
    - Includes common support for bank resolution.
    - Greater role in future economic adjustment and crisis prevention programs
    - Promote debt sustainability
    - More effective precautionary credit lines

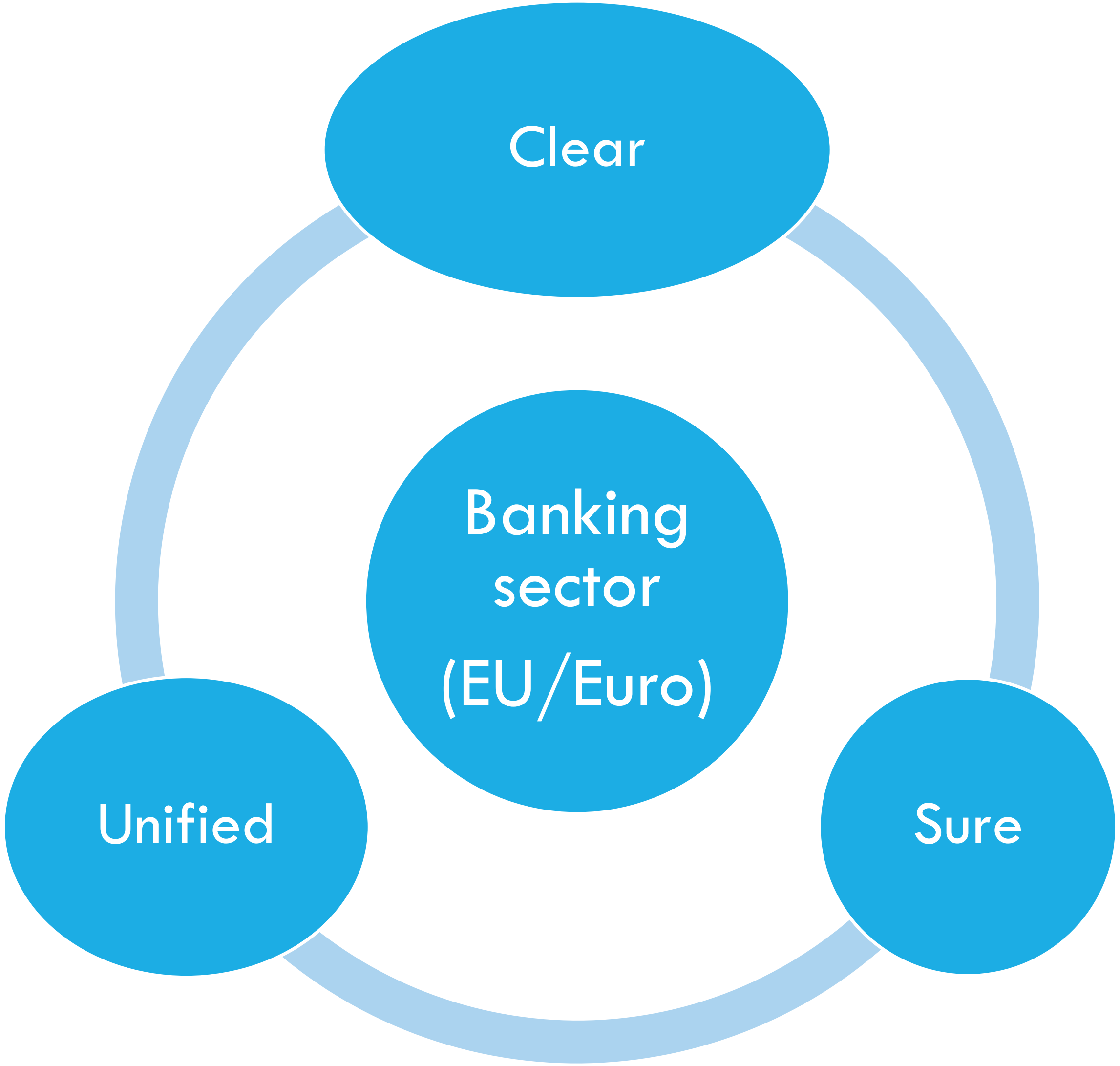
- Eurogroup, November 2020
  - Signature of reformed ESM in January 202. Ratification process.

# AT INSTITUTIONAL LEVEL

- Euro Summit, Dicember 2020
  - The Eurogroup is invited to draw up a work plan to complete the Banking Union.
  - Streamline work on the Capital Markets Union.
  - Ensuring EU leadership in green financing

# BANKING UNION

# BANKING UNION TARGET



# BANKING UNION

- In response to the 2008 financial crisis and the eurozone sovereign debt crisis.
- Supranational
- Single regulatory code in the banking sector: legislative texts applicable to financial institutions and guaranteeing equal opportunities throughout the EU

**Avoid distortions in the single Market**

**Ensuring financial stability in the EU**

# SINGLE REGULATORY CODE

# SINGLE REGULATORY CODE

Eliminate legislative differences between Member States and protect consumers: harmonization of national laws

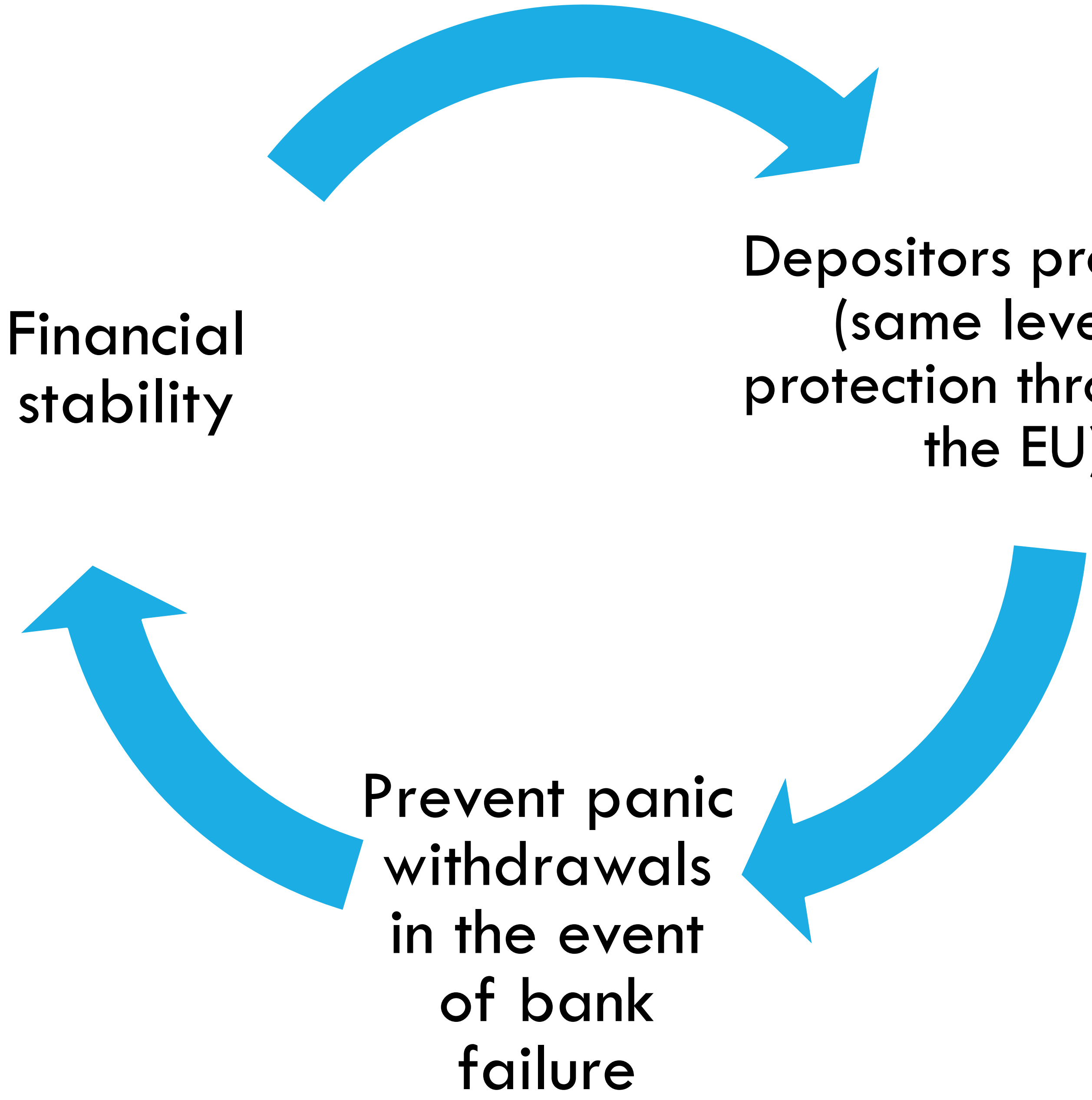
**Complete Single Market**

# PILLARS OF THE SINGLE REGULATORY CODE

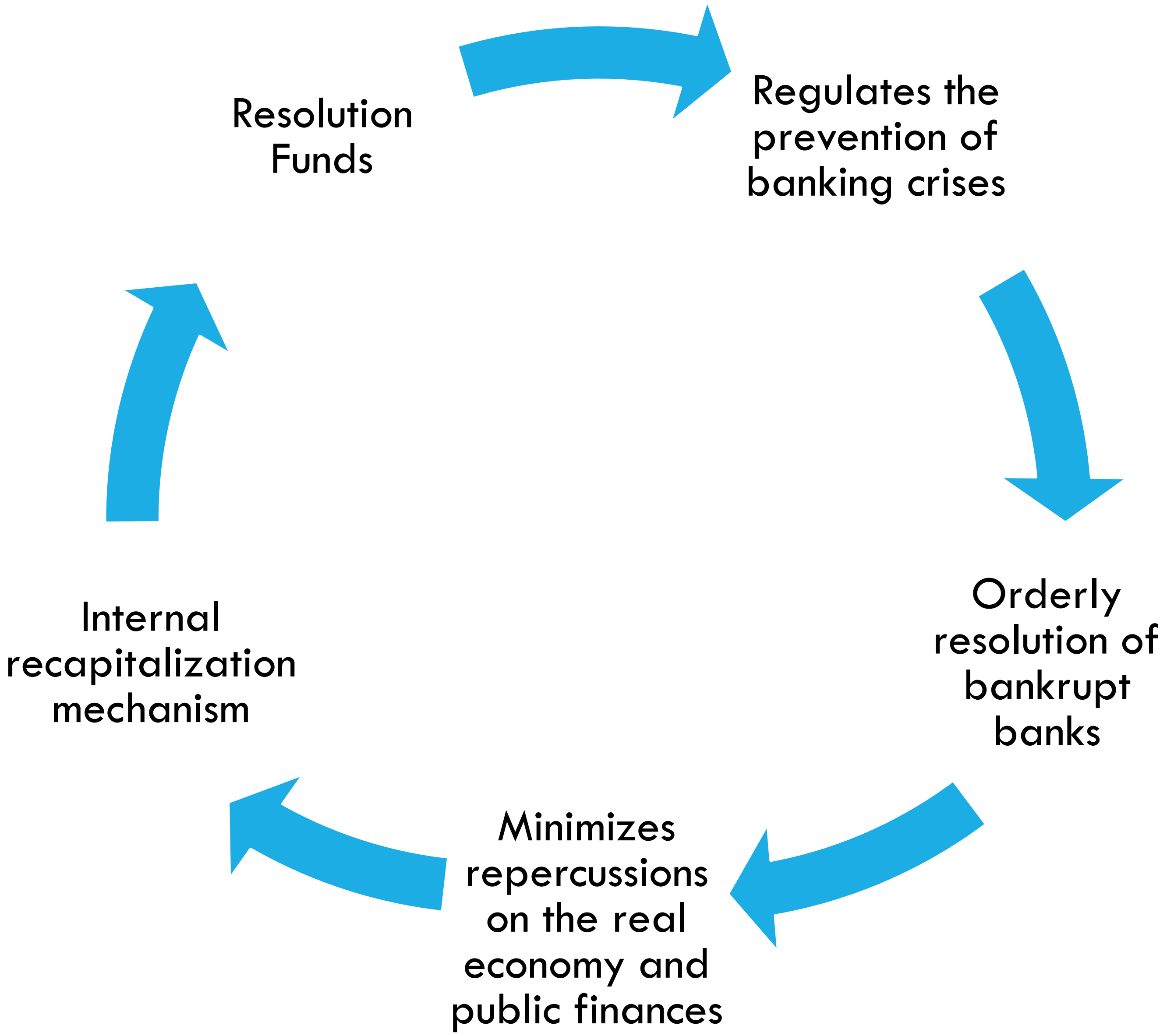
- IV Capital Requirements Directive (2013/36/CE) and Regulation of Capital Requirements (575/2013)
- Directive on Deposit Guarantee Schemes(2014/49/UE)
- Bank Restructuring and Resolution Directive (2014/59/UE)

# CAPITAL REQUIREMENTS (BASEL III ACCORDS)

# DEPOSIT GUARANTEE SYSTEM



# BANK RESTRUCTURING AND RESOLUTION



# WHO PARTICIPATES IN THE BANKING UNION?

- Eurozone countries

- EU countries that, without belonging to the eurozone, so wish.

Cooperation with the ECB

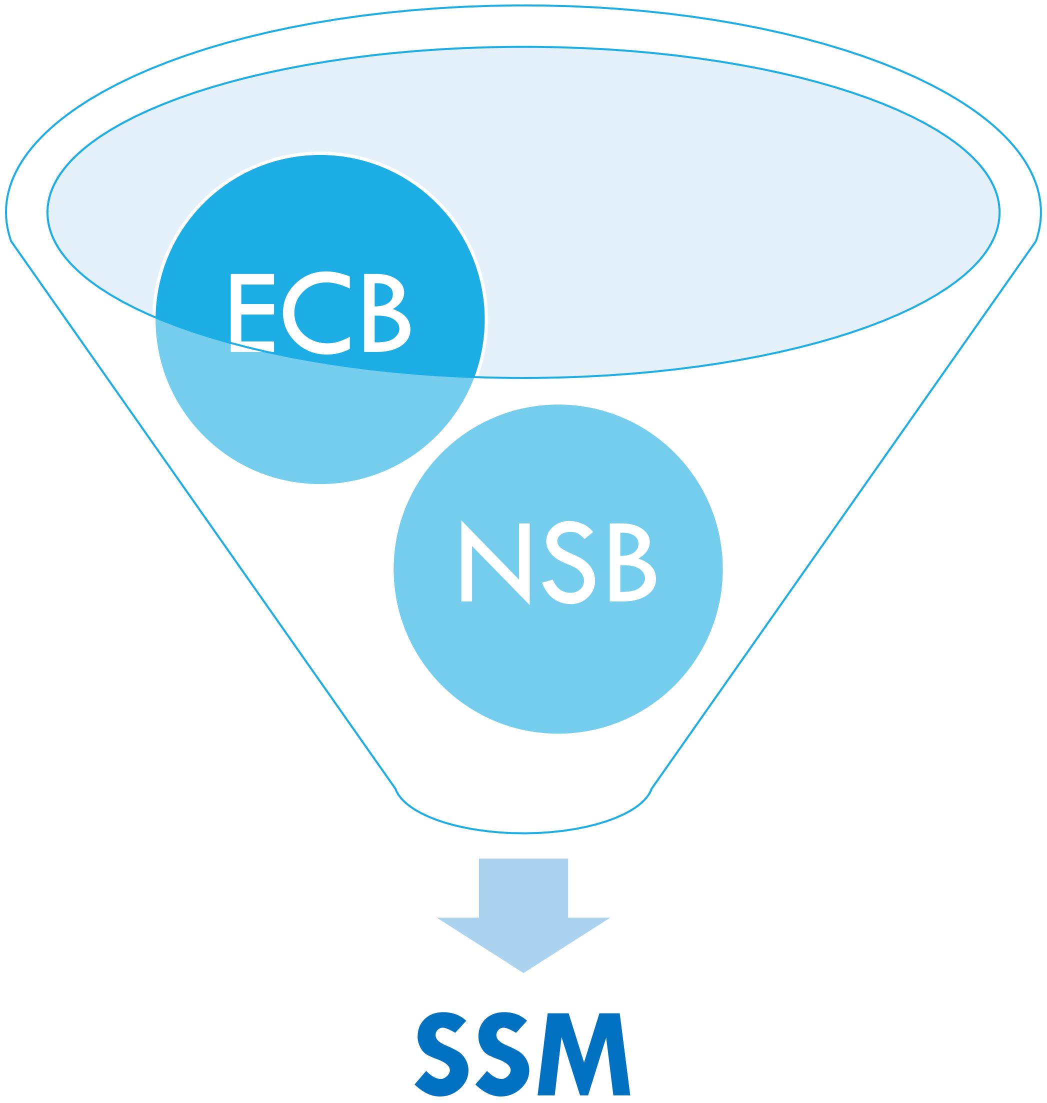
# Pillars of the Banking Union

- Single Supervisory Mechanism (SSM), 2014
- Single Resolution Mechanism (SRM), 2015
- European Deposit Guarantee System (EDGS), in progress

# PILIAR I. SINGLE SUPERVISORY MECHANISM

# PILLAR I. SINGLE SUPERVISORY MECHANISM

- Operational since 2014
- Supranational banking supervisory body.
- Independent character
- The ECB responsible for supervising the banks of the UB (single regulatory code)


ECB
NSB
SSM

# TARGETS OF SSM

Ensure the safety and soundness of the European banking system

Promote integration and financial stability in Europe

Ensure consistency of supervision

# FUNCTIONS OF THE ECB

- Responsible authority of the SSM.
- Authorizes, or not, credit institutions.
- Ensure compliance with prudential regulations.
- Adequacy of the entities' internal capital based on the entity's risk profile.
- Supervision of financial conglomerates.
- Early intervention measures when a bank fails to meet regulatory capital requirements.
- Accountable to the Council of the EU and the European Parliament.

# HOW IS MONITORING DONE?

- Supervises **significant** credit institutions .This significant character is established based on a series of criteria.

  - Each significant entity is assigned a JST (Joint Supervisory Team) made up of experts from the ECB and national supervisors.

  - The “less significant” institutions are also under the supervision of national authorities in collaboration with the ECB.

# WHEN IS A BANK CONSIDERED SIGNIFICANT?

## Size

- Assets ≥ 30,000 mill. € or representing 20% of the country of origin

## Economic importance

- For the specific country or the entire EU economy

## Cross-border activities

- Total asset value> 5,000 mill. € and the ratio of cross-border assets / liabilities in more than one Member State and their total assets / liabilities> 20%

## Direct public financial assistance

- The entity has applied for or received funding from the ESM or the European Financial Stability Mechanism

# CHANGE OF SUPERVISORY STATUS

**From least significant to significant**

- The national supervisor hands over responsibility to the ECB

**From significant to less significant**

- If it does not meet the requirements for three consecutive years, it is reclassified
- Supervision returns to the national authority

# List of supervised banks

# Evaluation of Banks by the ECB

# Example of supervisory sanctions

# Pillar II. Single Resolution Mechanism

# WHAT IS A BANK RESOLUTION?

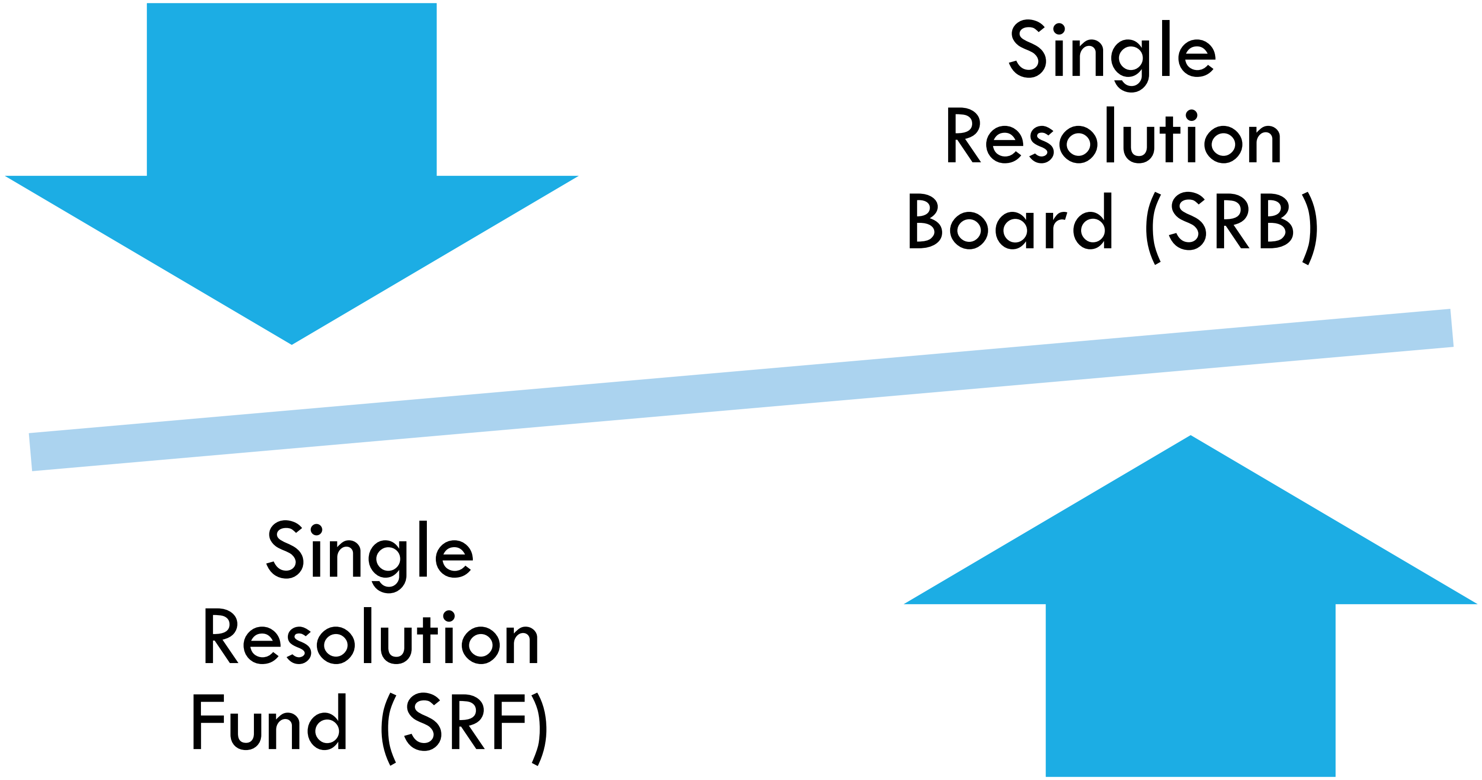
Restructuring of a bank, by a resolution authority, through the use of resolution tools to safeguard public interests, including the continuity of the bank's functions, financial stability and at the minimum cost to taxpayers.

# PILLAR II. SINGLE RESOLUTION MECHANISM

- Efficient resolution of banking entities with difficulties with a minimum cost for the real economy and for citizens.
- The ECB determines if an entity is in serious difficulty or is in danger of being (SSM).
- Operational since January 2015


Confidence in the banking sector
Targets of MUR
Eliminate fragmentation of the internal market for financial services
Avoid bank panic and contagion
Minimize the negative relationship between banks and sovereign issuers

# PILAR II. SINGLE RESOLUTION MECHANISM



# SINGLE RESOLUTION BOARD

SRB

- Independent EU agency
- Ensures the orderly resolution of bankrupt banks
- Manage the SRF

# DECISION-MAKING OF THE SRB

**Executive session**

- Resolution decisions

**Plenary session**

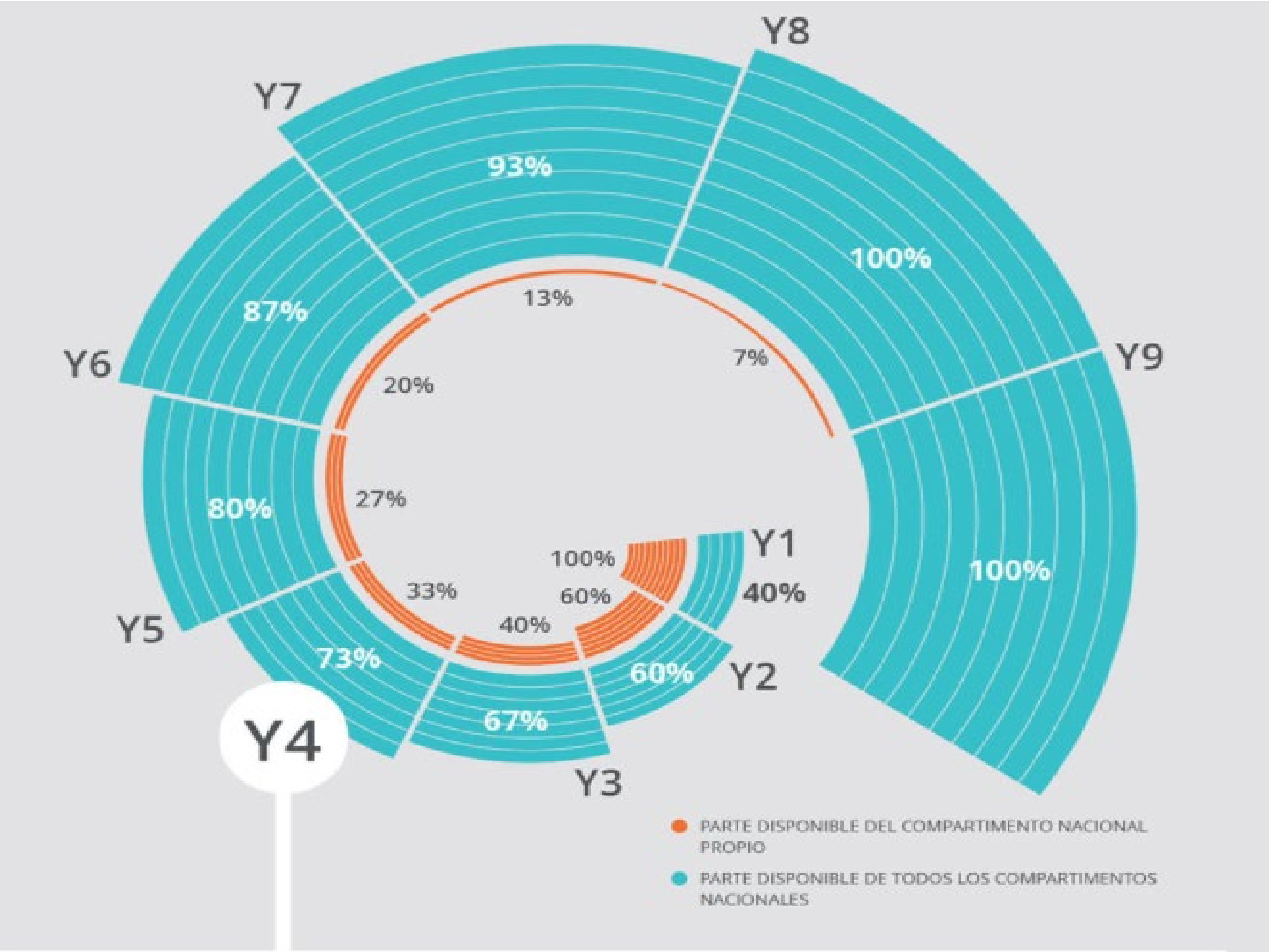
- Rules of procure
- SRB anual budget
- Investment and personnel issues

# SINGLE RESOLUTION FUND

- It is constituted for a period of eight years (2016-2024).
- It is used for bank resolution after having exhausted other options, such as internal recapitalization.
- It is financed through annual contributions from the banking sector.
- It must reach, at least, 1% of the amount of the guaranteed deposits of all the credit institutions of the UB before December 31, 2023

# SINGLE RESOLUTION FUND. NEW BACKSTOP TO THE SRF

- Reformed ESM provides that common backing.
- Line of credit available from January 2022.
- Aim to guarantee that the bankruptcy of a bank does not harm the economy or cause financial instability (avoid systemic crises).
- Reduce the link between the banking sector and sovereign debt.
- It will only be available when the FUR is exhausted, and its terms of use are met (for example: liquidation of several large banks).


Y1
Y2
Y3
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Y7
Y8
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100%
40%
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60%
40%
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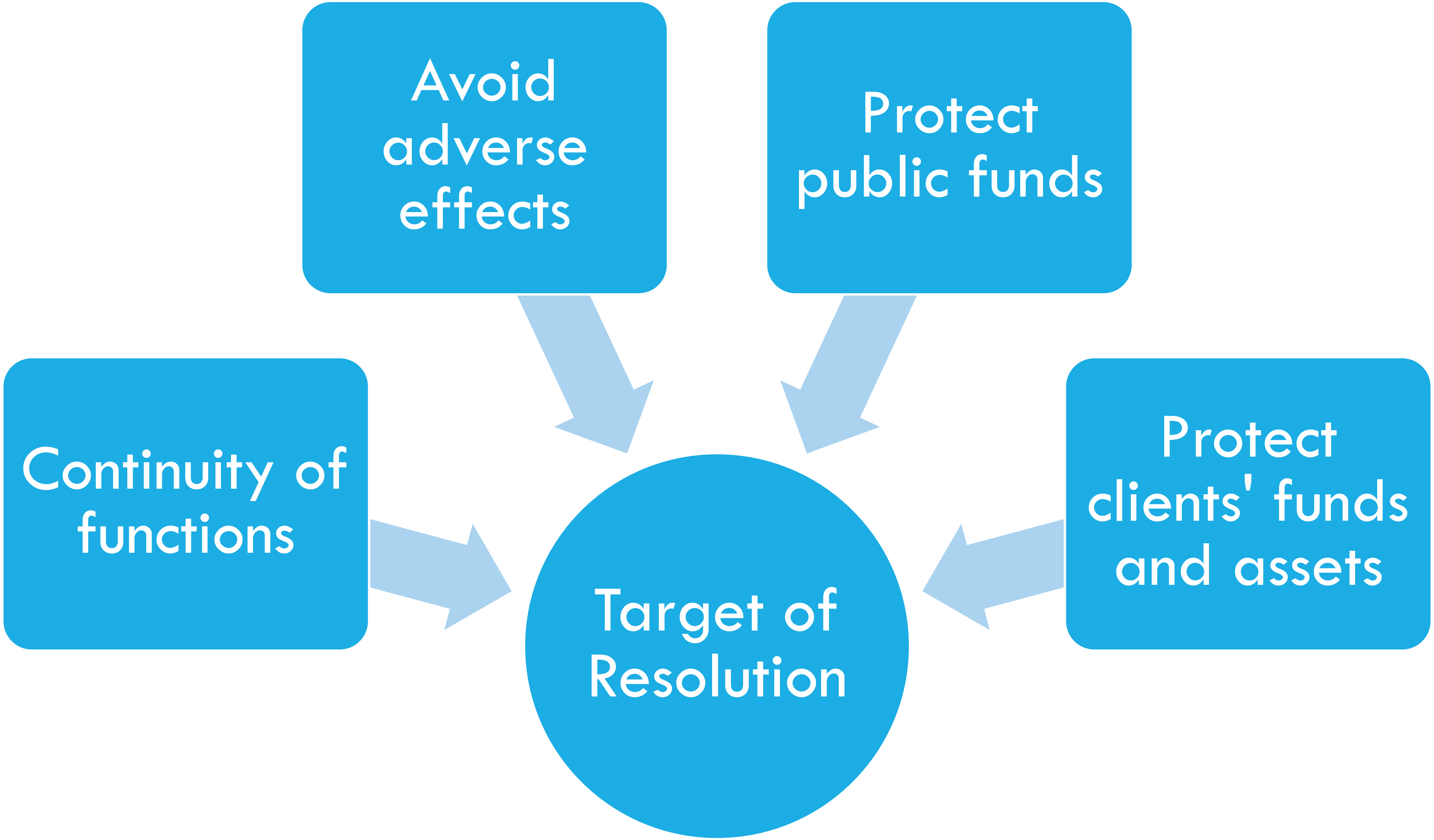
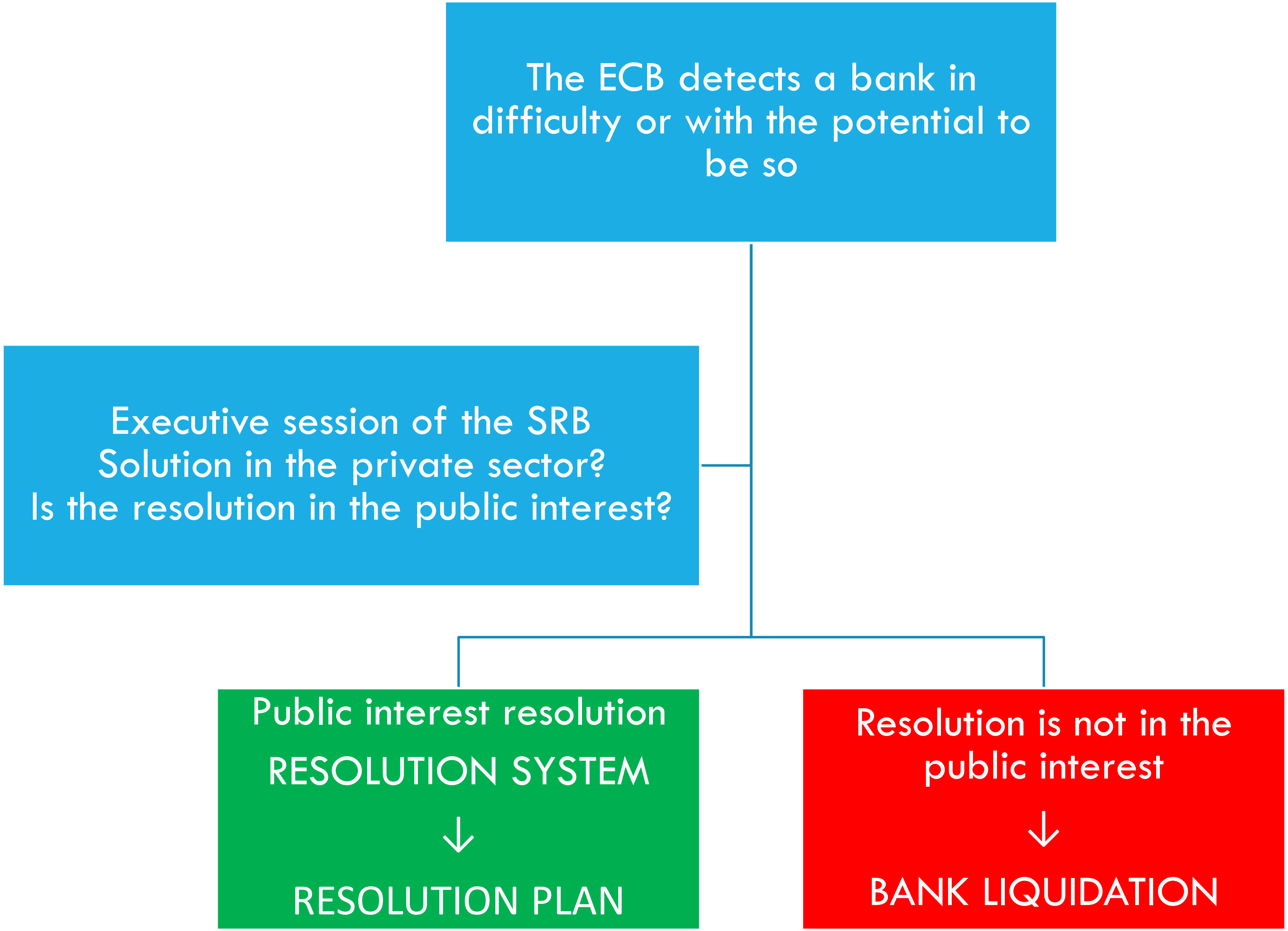
73%
27%
80%
20%
87%
13%
93%
7%
100%
100%
PARTE DISPONIBLE DEL COMPARTIMENTO NACIONAL PROPIO
PARTE DISPONIBLE DE TODOS LOS COMPARTIMENTOS NACIONALES


Avoid adverse effects
Protect public funds
Continuity of functions
Target of Resolution
Protect clients' funds and assets

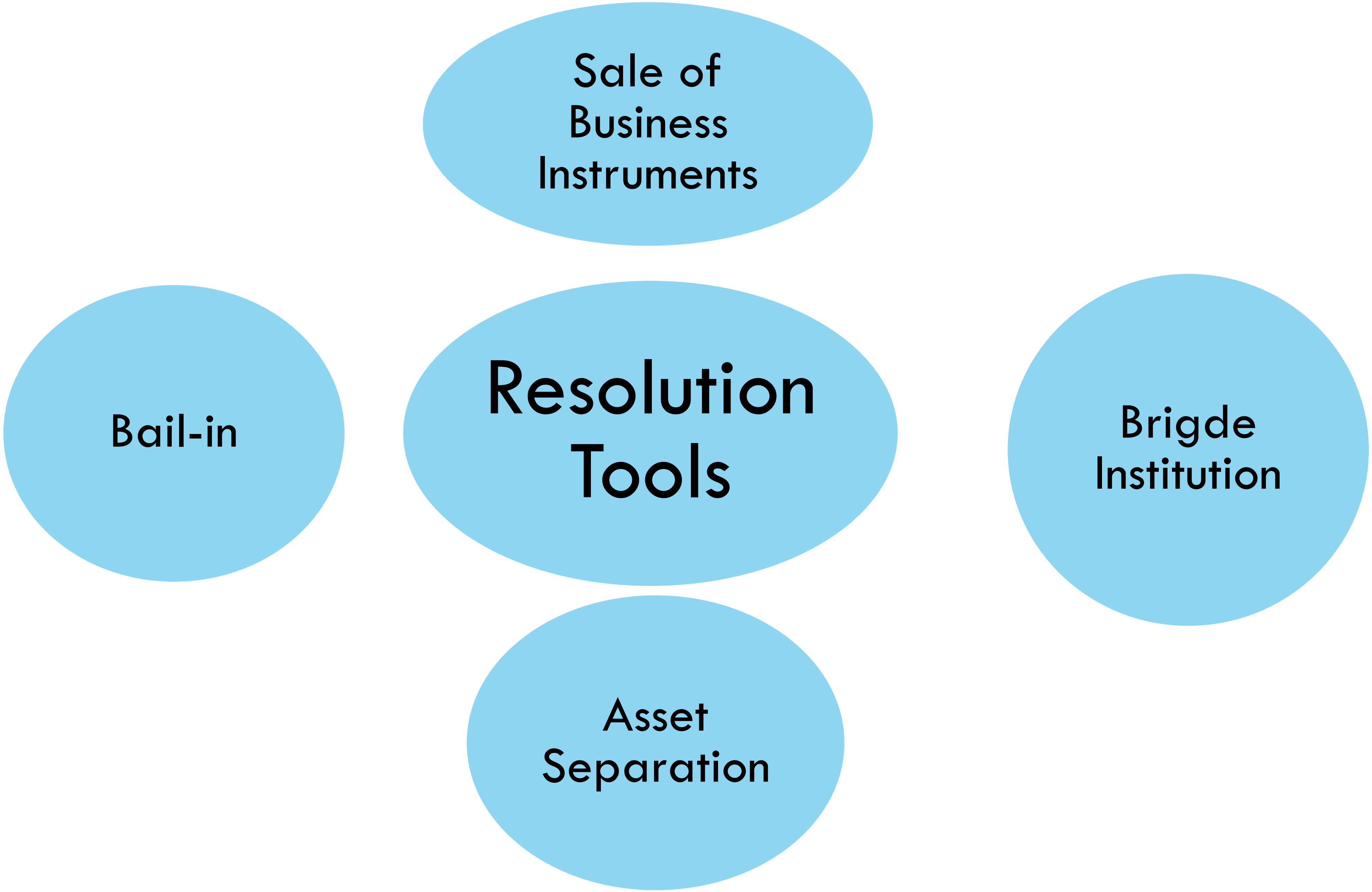

The ECB detects a bank in difficulty or with the potential to be so
Executive session of the SRB
Solution in the private sector?
Is the resolution in the public interest?
Public interest resolution
RESOLUTION SYSTEM
↓
RESOLUTION PLAN
Resolution is not in the public interest
↓
BANK LIQUIDATION

# RESOLUTION PLAN

- Prepared by JUR + national supervisory bodies (NSB)
- Ensure that there are plans ready to go and that they can be put in place at any time.
- The plans are updated annually taking into account market and bank conditions.
- Document detailing:

✓ Bank characteristics
✓ Resolution strategy for that bank (tools)
✓ Evaluation of the bank's resolution capacity: the impediments to the bank's resolution are identified and its required minimum of enforceable liabilities is established (Minimun Requeried Eligible Liabilities, **MRE**L)

# EXAMPLE MREL-BBVA


Sale of Business Instruments
Bail-in
Resolution Tools
Brigde Institution
Asset Separation

# PRINCIPLES TO BE MET BY THE RESOLUTION

- The first to assume losses: SHAREHOLDERS Second: CREDITORS
- The management leadership of the entity is replaced
- Creditors of the same class are treated in the same way
- No creditor will incur greater losses than they would have incurred in normal insolvency proceedings
- The covered deposits are fully protected by the Deposit Guarantee Systems

# HOW THE MUR WORKS

The ECB notifies the SRB that a bank is bankrupt or in danger of bankruptcy

The JUR executive session decides if a private solution is possible or if the resolution is necessary in the public interest

resolution conditions:

they are not fulfilled: the bank is liquidated.

If they are met: the SRB adopts a resolution system.

The system determines the tolos for solving and usig the FUR

The plan goes into effect at 24 h. of its approval bay the SRB

# HOW THE MUR WORKS

Within 24 hours (from approval by the SRB) the Commission may:

- Adopt the system (national resolution authorities are launched) or
- Formulate objections to the resolution system
- Propose the Council to raise objections (the resolution is not necessary for the public interest). Simple majority
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If the Board objects to an entity undergoing the resolution process: it is wound up in accordance with national law

# EU- SRM INSTITUTIONS

## Council of the EU

| | | |
|---|---|---|
| Appoint SRB members | Raise objections to a resolution system | Betermine how the banking sector makes contributions to the SRF |

## European Commission

| | |
|---|---|
| Approves/formulates objections resolution system | Propose to the Council to raise objections |

## ECB

Notify the SRB if the bank is bankrupt or in danger of being bankrupt

## National resolutions bodies

| | | |
|---|---|---|
| Plan/adopt resolution plans for Banks that are not the responsability of SRB | SRB instructions apply | If they do not follow SRB instructions, the SRB issues executive orders to the troubled bank |

# Pillar III. European Deposit Guarantee System

# EUROPEAN DEPOSIT GUARANTEE SCHEME (EDIS)

- It would be guaranteed that € 1 deposited in a bank has the same value regardless of in which country of the eurozone it is located. This enables:
  - Competition on equal terms
  - Breaking the link between sovereign and banking risk
- Improve existing regulations on the protection of depositors in cases of bank failure.
- It is far from materializing. Until then:
  - Improve cross-border integration of the banking sector

# EDIS

Commission proposal, Nov. 2015, for bank deposits in the eurozone

Based on the SNGD system (Directive 2014/49/EU)

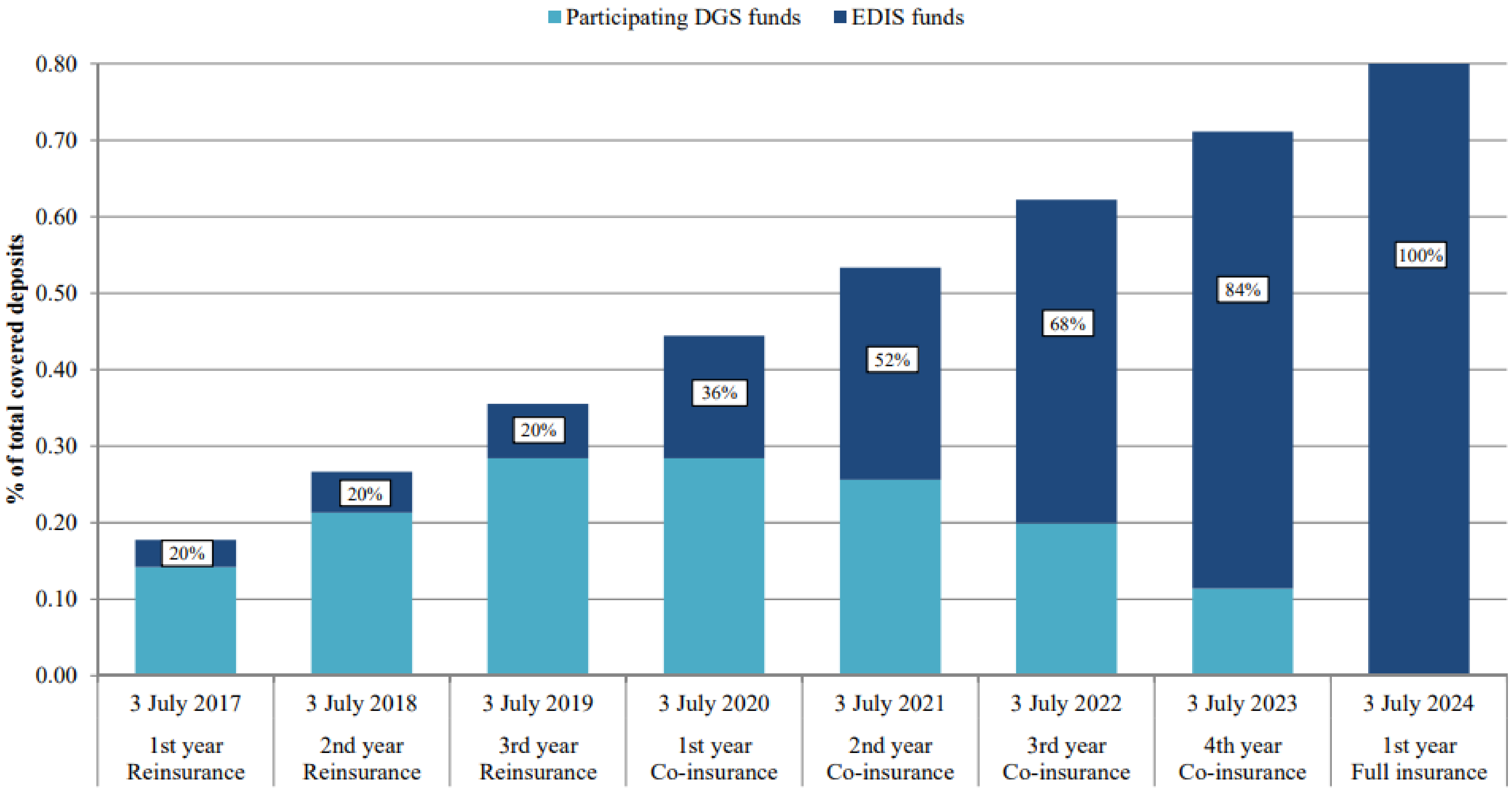
Uniform insurance coverage in the eurozone

Applicable to deposits of less than € 100 000 in all banks of the banking union

Contributions to this Fund would increase progressively over time

In the final stage, the protection of bank deposits would be financed, in its entirety, through EDIS, in collaboration with the national SGD

# EVOLUTION OF EDIS FUNDS COMPARED TO FUNDS OF NATIONAL GUARANTEE SYSTEMS, SOURCE: ECB



# DEPOSIT GUARANTEE SYSTEM

- If a bank fails and the deposits are not available, the SGD has to reimburse the depositors.
- All banks must become members of an SGD. It is built with contributions made by member banks based, among others, on their risk profile.
  - The fund is made up of low-risk assets that are available in the event of bankruptcy or the danger of bank failure.
  - Possibility for SGDs to grant loans to each other.
- Stress tests are carried out at least every three years to ensure that all DGSs in the Member States meet their obligations.
- DGSs can finance bank resolution, provided they meet strict conditions that prevent bank failure.

# EXPECTED RESULTS

- Solid banks capable of withstanding future crises:
  - banks' capital resources and liquidity ratios have increased
- Resolution of "non-viable" banks without affecting:
  - Taxpayers
  - The real economy
- Reduce market fragmentation: harmonization of standards in the financial sector.
- Diversified sources of financing for companies.
- Strengthen cross-border risk sharing.
- Strengthen the crisis management framework for retail banks.
- Work for the convergence of bank insolvency procedures.
- EDIS progress
- Single Capital Market

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