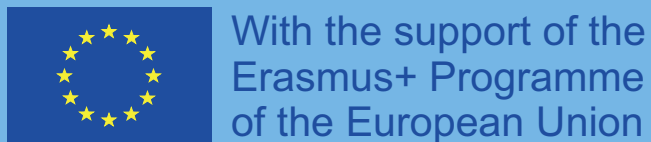


Jean Monnet Module

“Economic Policy in the European Union”

Session 2.4. The Banking Union in the EU context

Dr M^a Ángeles Rodríguez Santos



Before the international financial crisis

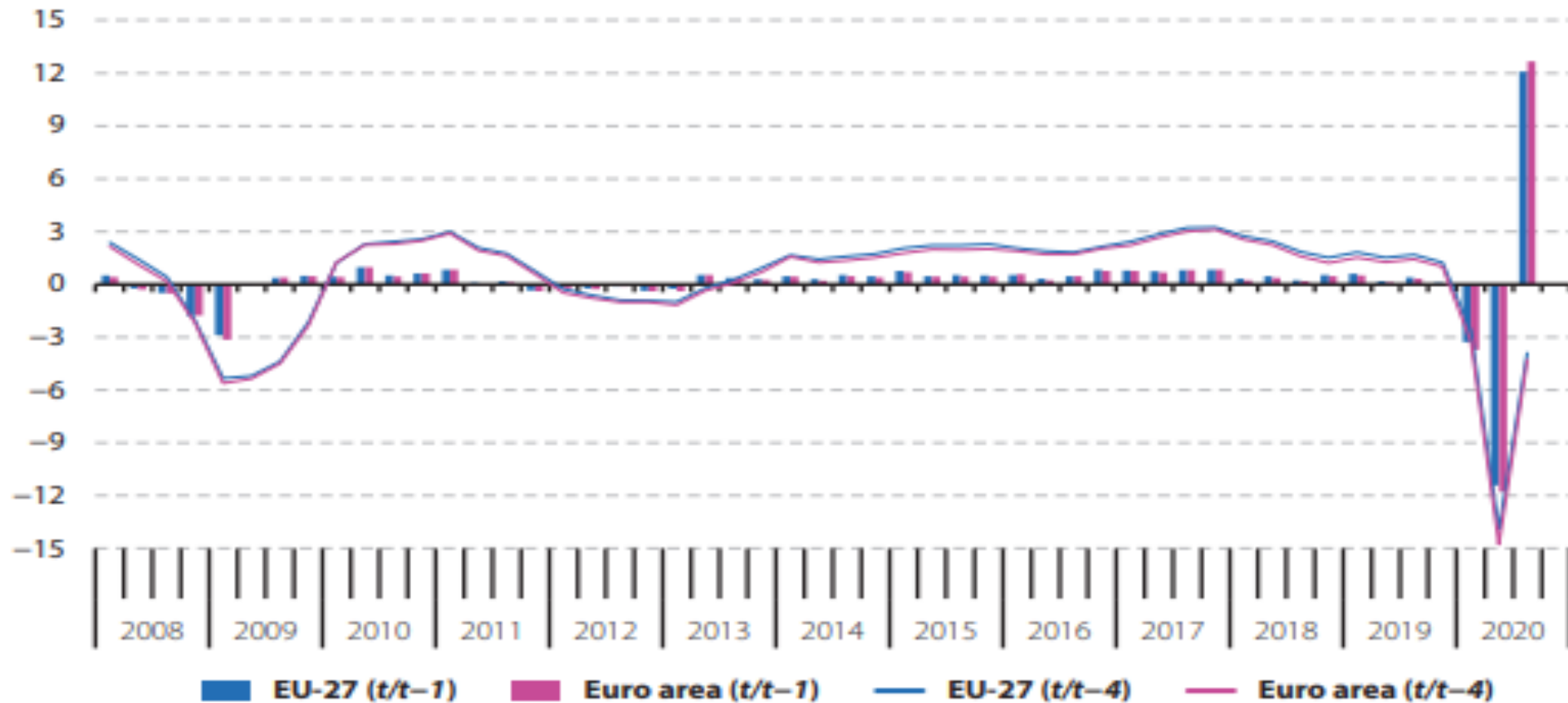
- Liquid interbank market
- Relative convergence in loan conditions to companies and families

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)

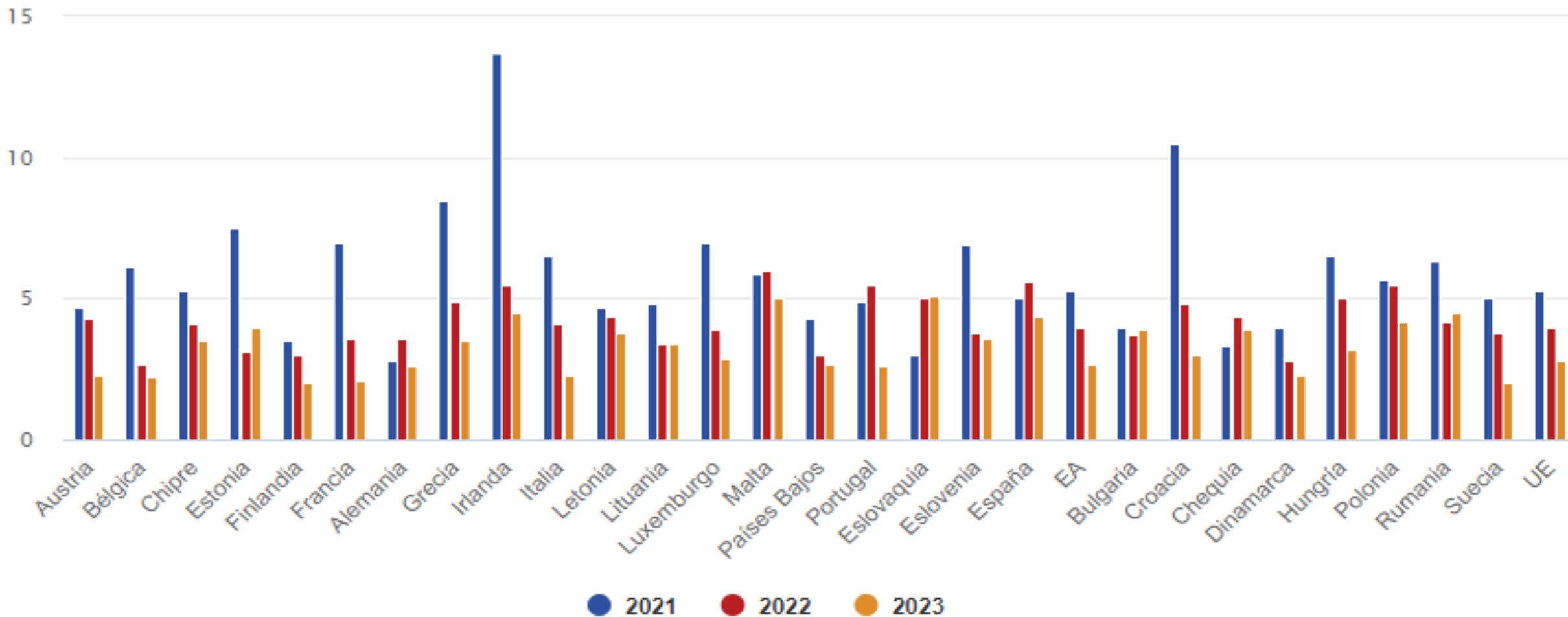
GDP GROWTH RATES (% VARIATION)

SOURCE: EUROSTAT



GDP GROWTH RATES (% CHANGE) SOURCE: EUROSTAT

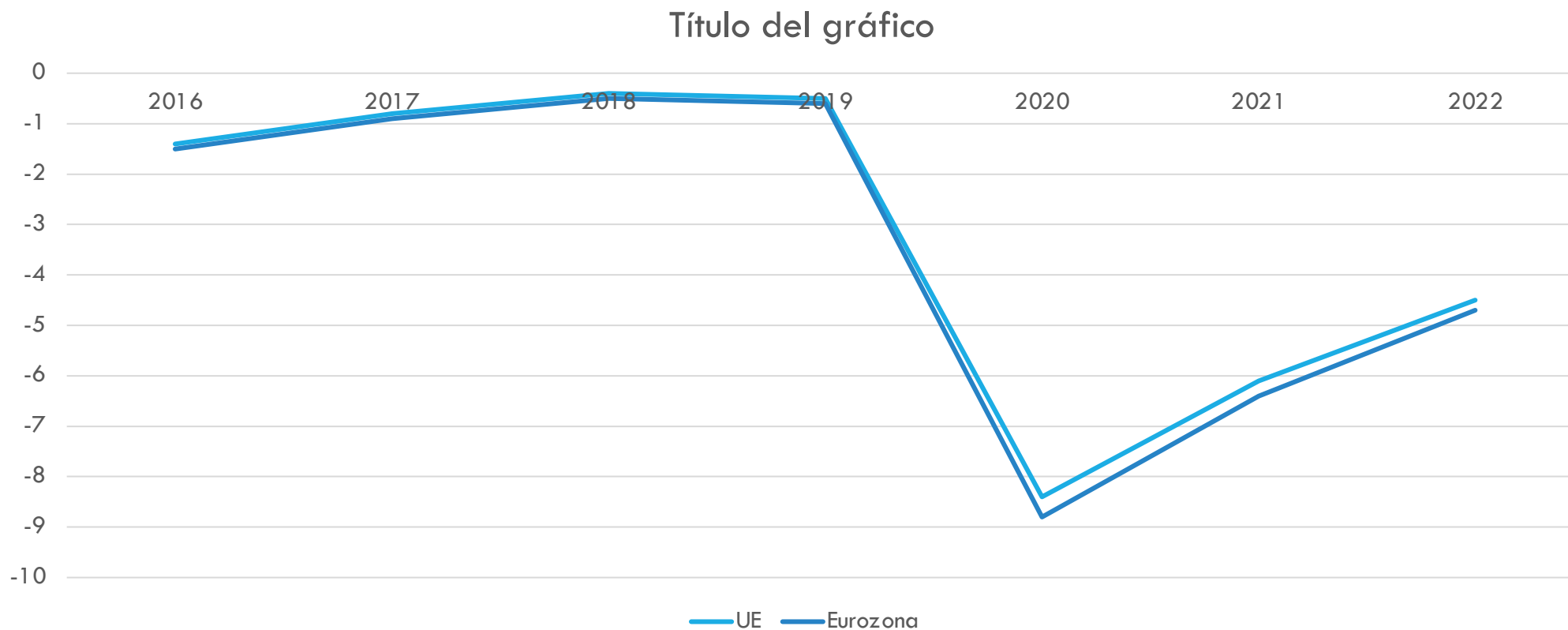
Pronóstico Económico – Invierno 2022



PUBLIC DEFICIT (%GDP)

SOURCE: EUROPEAN COMMISSION (2020)

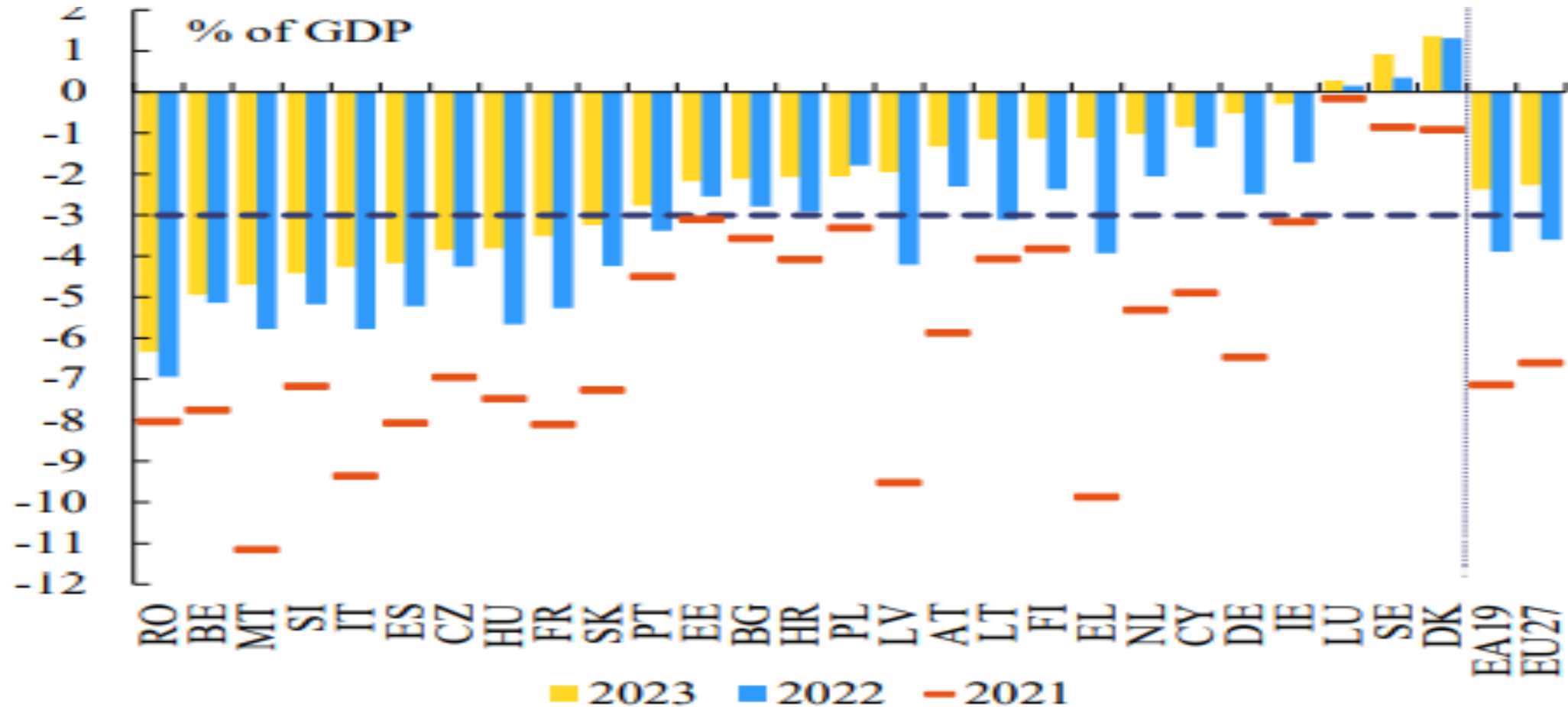
NOTE: 2021-2022 FORECASTS



PUBLIC DEFICIT (% GDP), 2021-2023

SOURCE: EUROSTAT (2022)

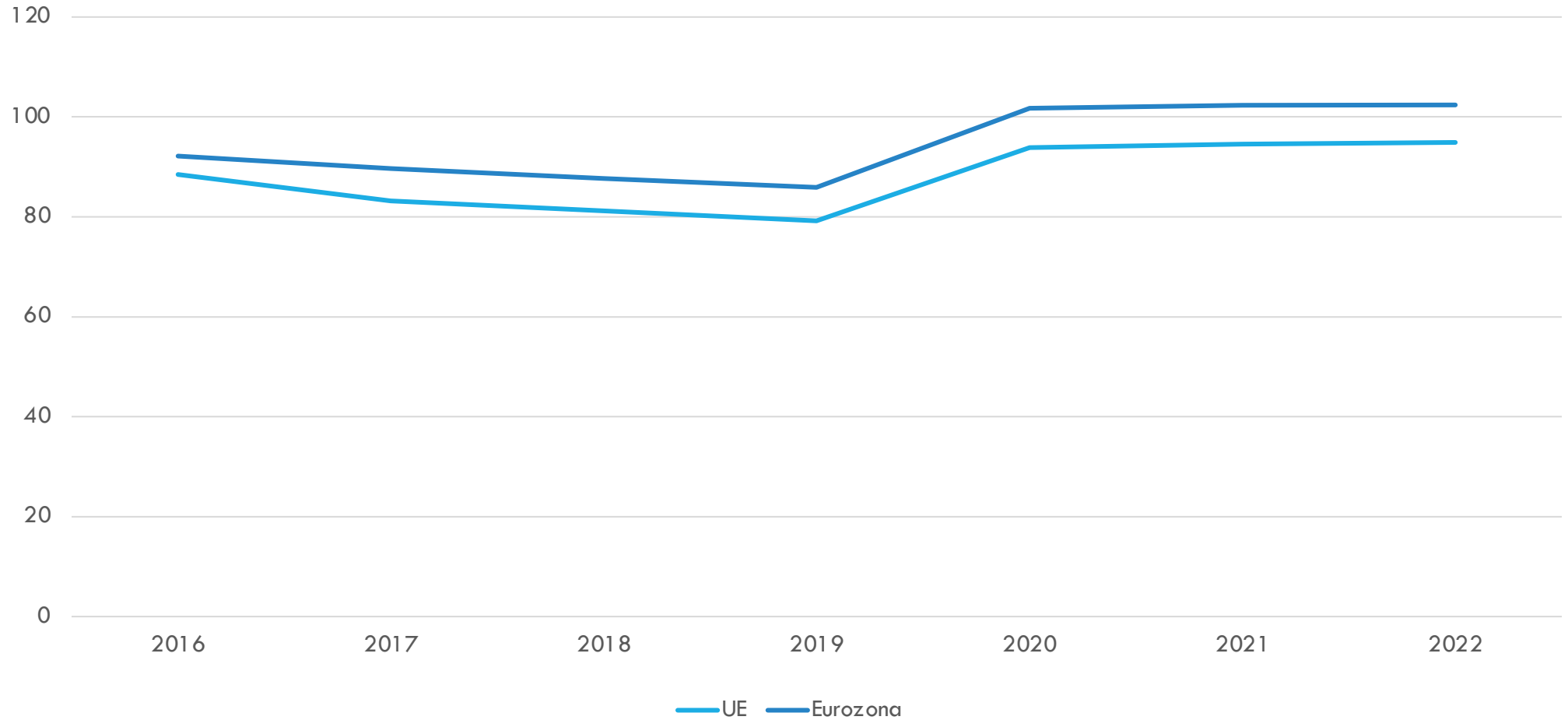
NOTE: 2022-2023 FORECASTS



PUBLIC DEBT (% GDP)

SOURCE: EUROPEAN COMMISSION (2020)

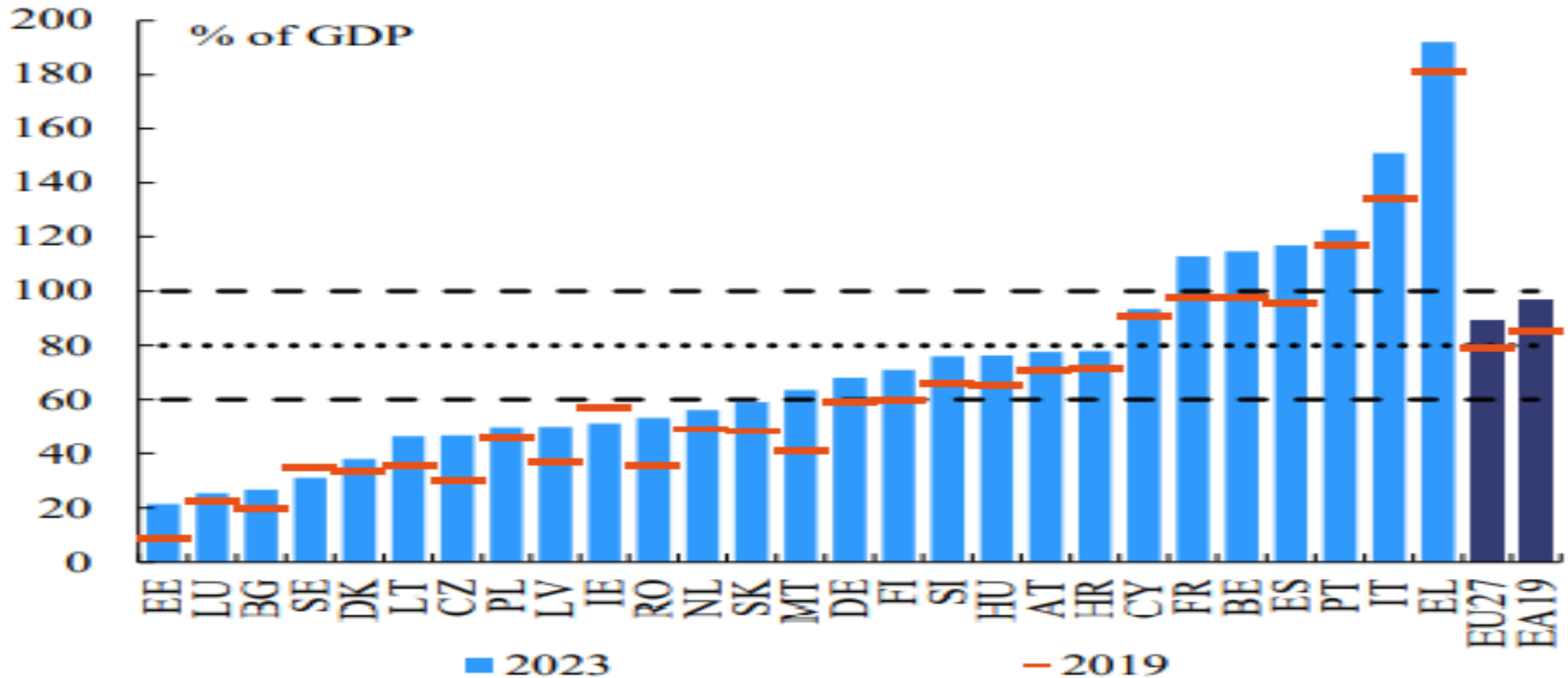
NOTE: 2021-2022 FORECASTS



PUBLIC DEBT (% GDP)

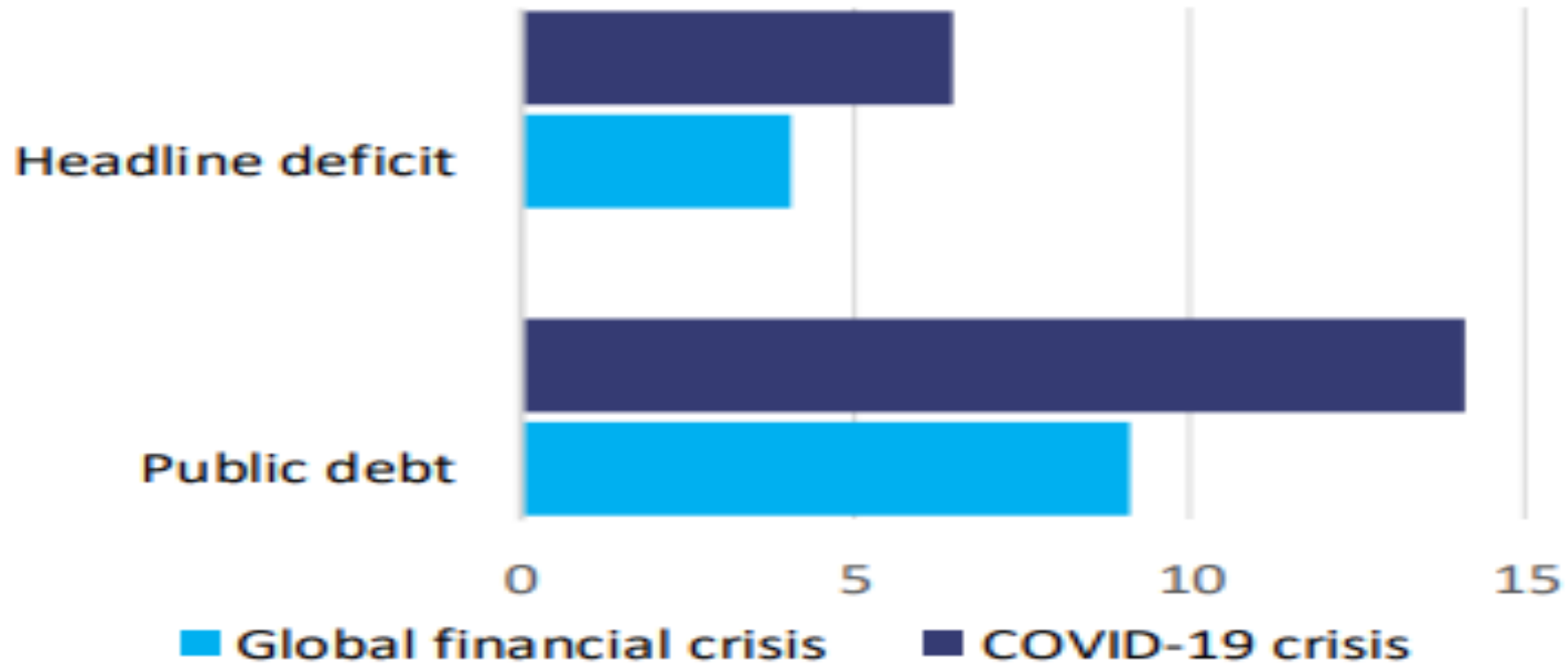
SOURCE: EUROSTAT (2022)

NOTE: 2023 FORECASTS



IMPACT ON PUBLIC FINANCES OF THE GLOBAL FINANCIAL CRISIS (2009) AND THE COVID-19 CRISIS (2020), YEAR-ON-YEAR CHANGE, % GDP

SOURCE: EUROPEAN COMMISSION SPRING 2021 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

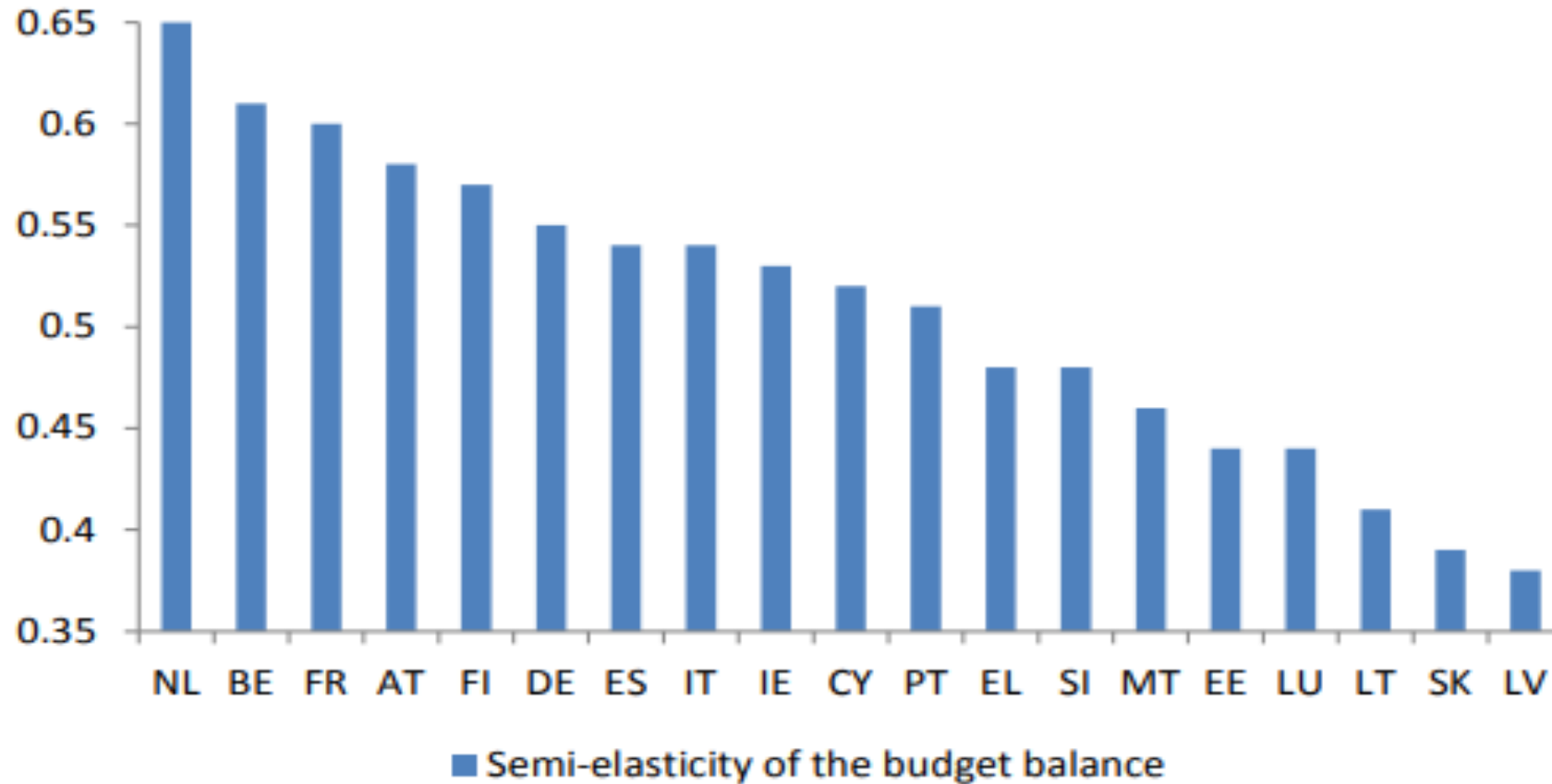
Advancing financial sector integration: resisting a future crisis

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 (ESM)**, 2012
- **Legislative Package on Budgetary Supervision**, 2013
- **Banking Union**, 2014
- Establish a **Convergence and Competitiveness Budgetary Instrument**
- Strengthening **EUROSTAT**

AT INSTITUTIONAL LEVEL

- Euro Summit, Octobre 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, Octobre 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.

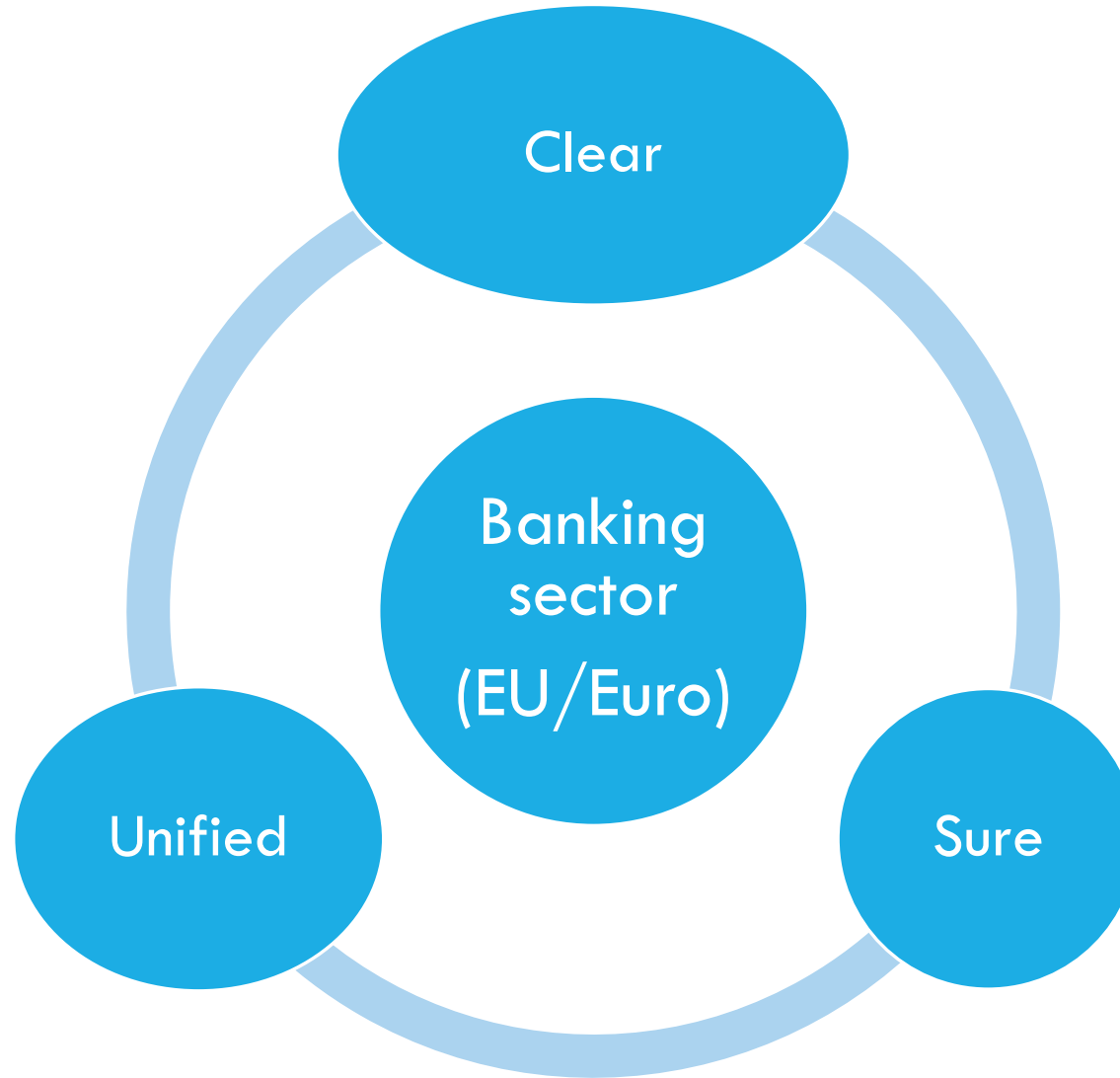
AT INSTITUTIONAL LEVEL

- Euro Summit, December 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)

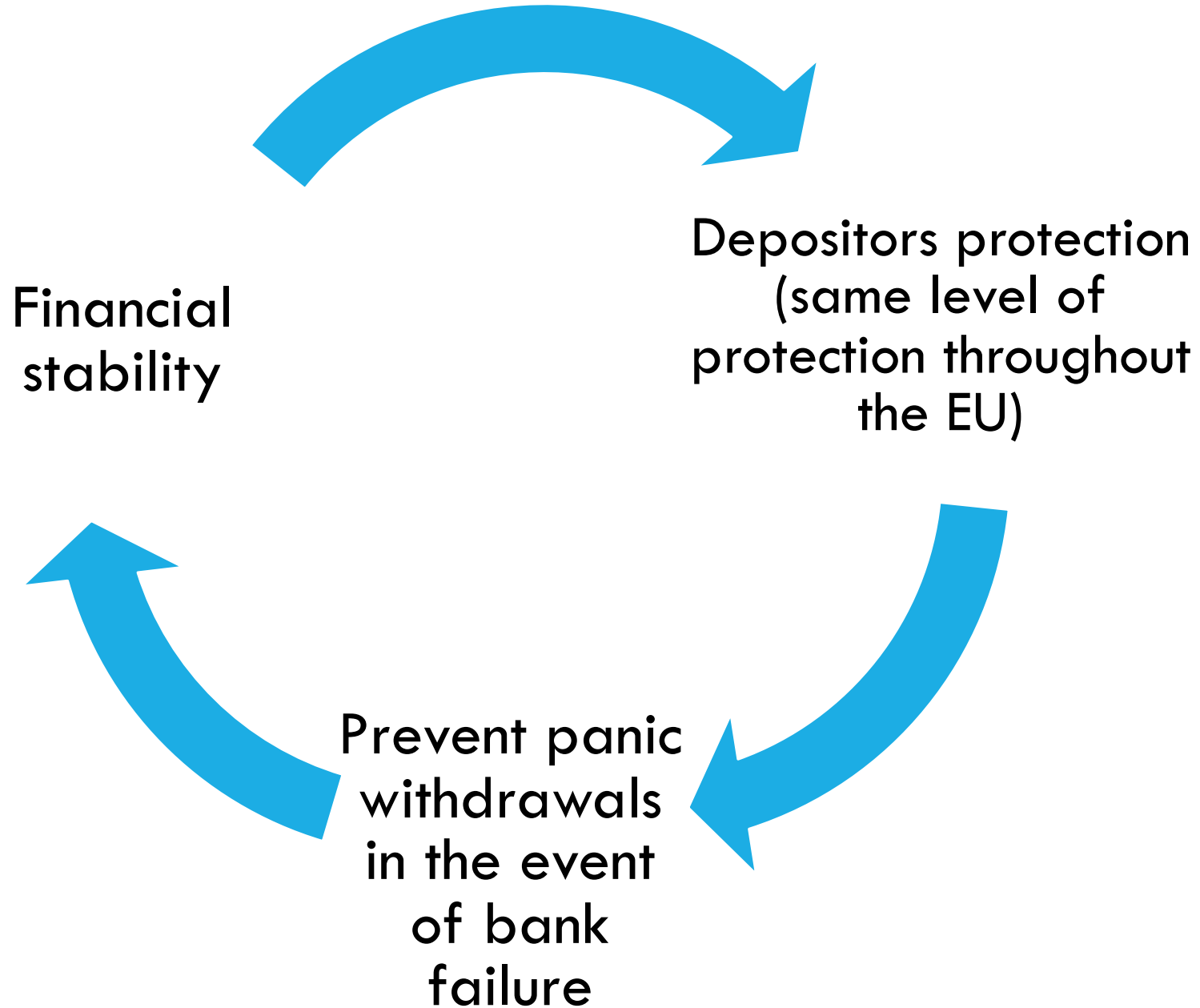
CAPITAL REQUIREMENTS (BASEL III ACCORDS)

Ensuring
loan activity
during
downturns

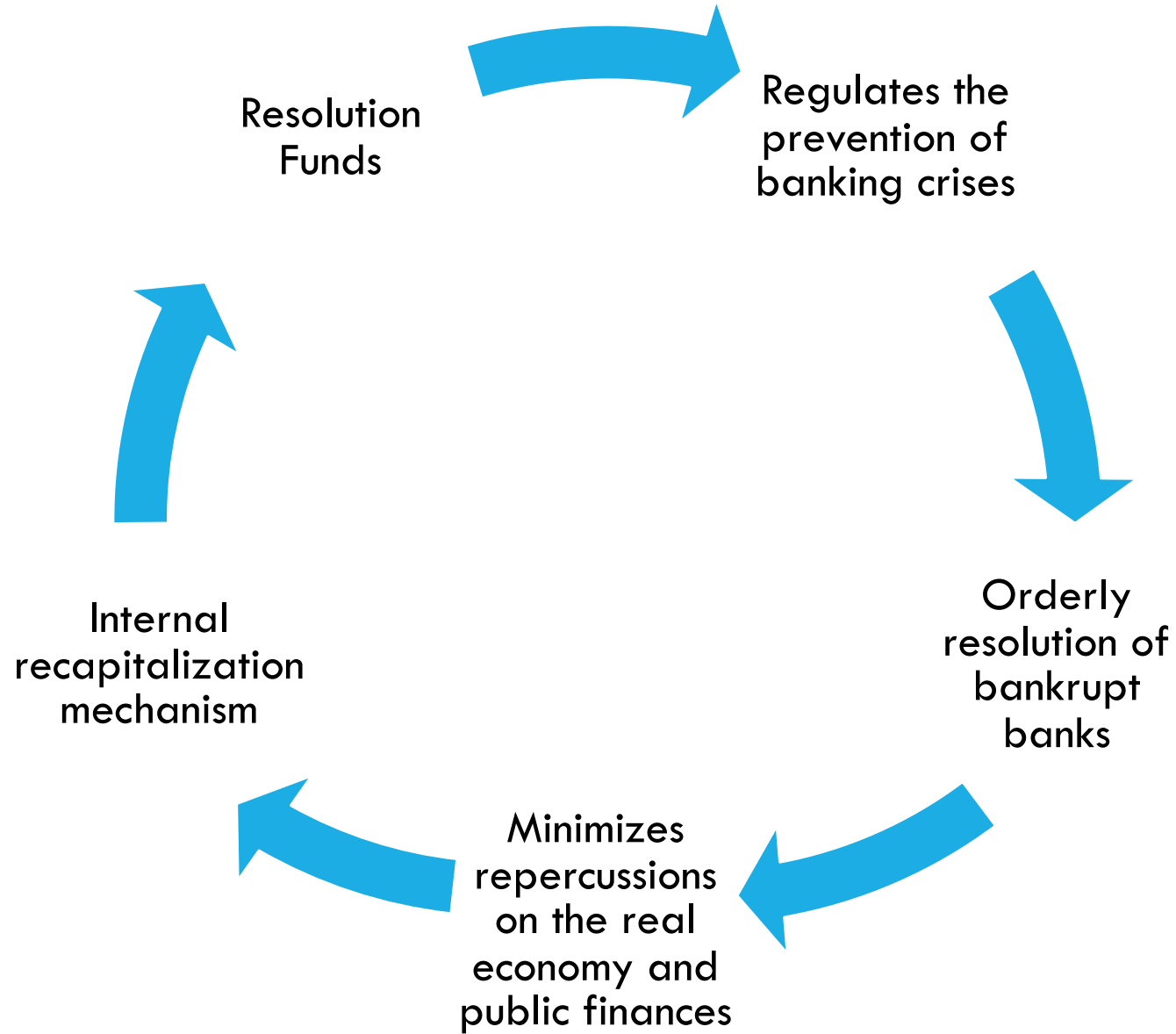
Ability of the
banking sector to
withstand adversity

Improve risk
management

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

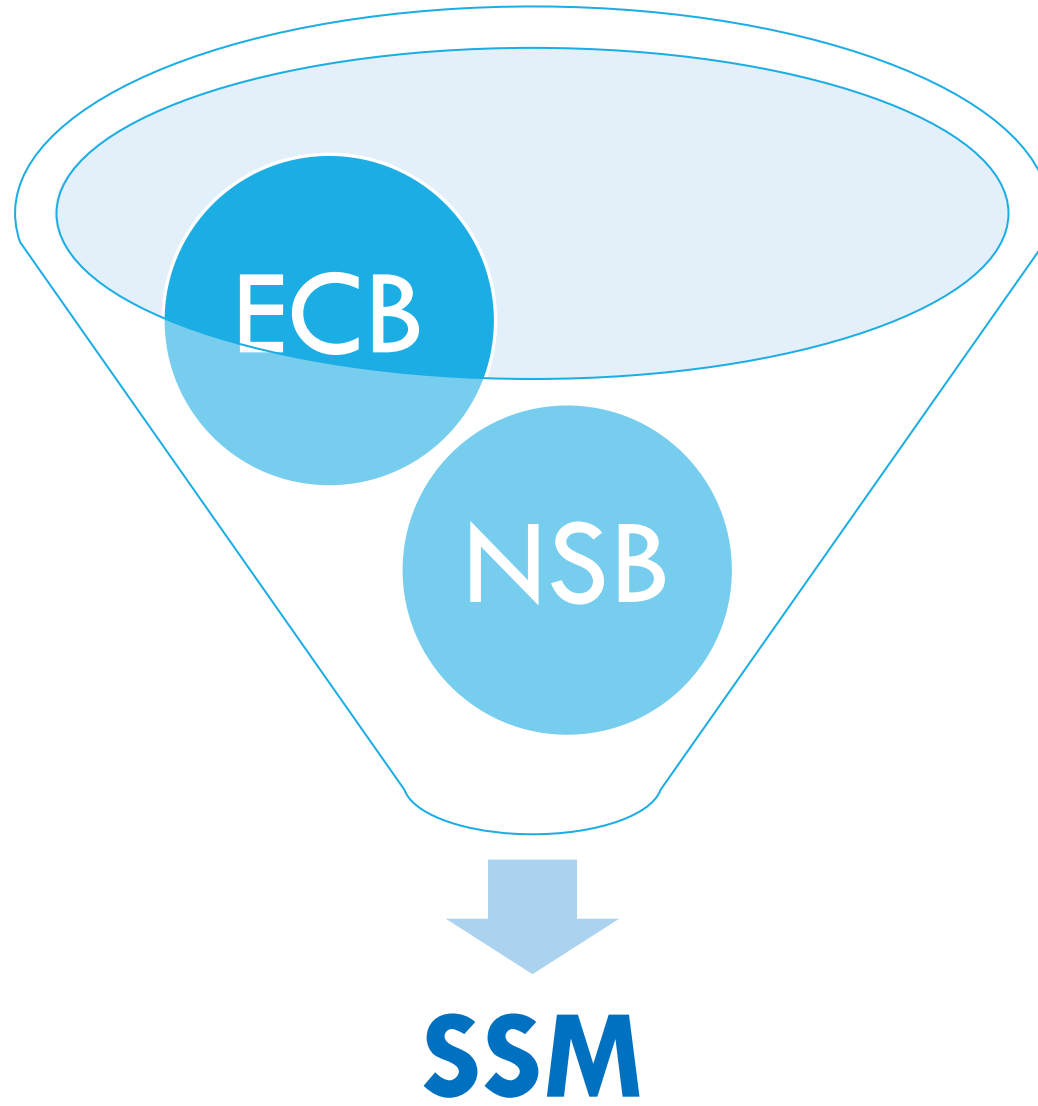
European Deposit Guarantee System
(EDGS), in progress



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)



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 \geq 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?

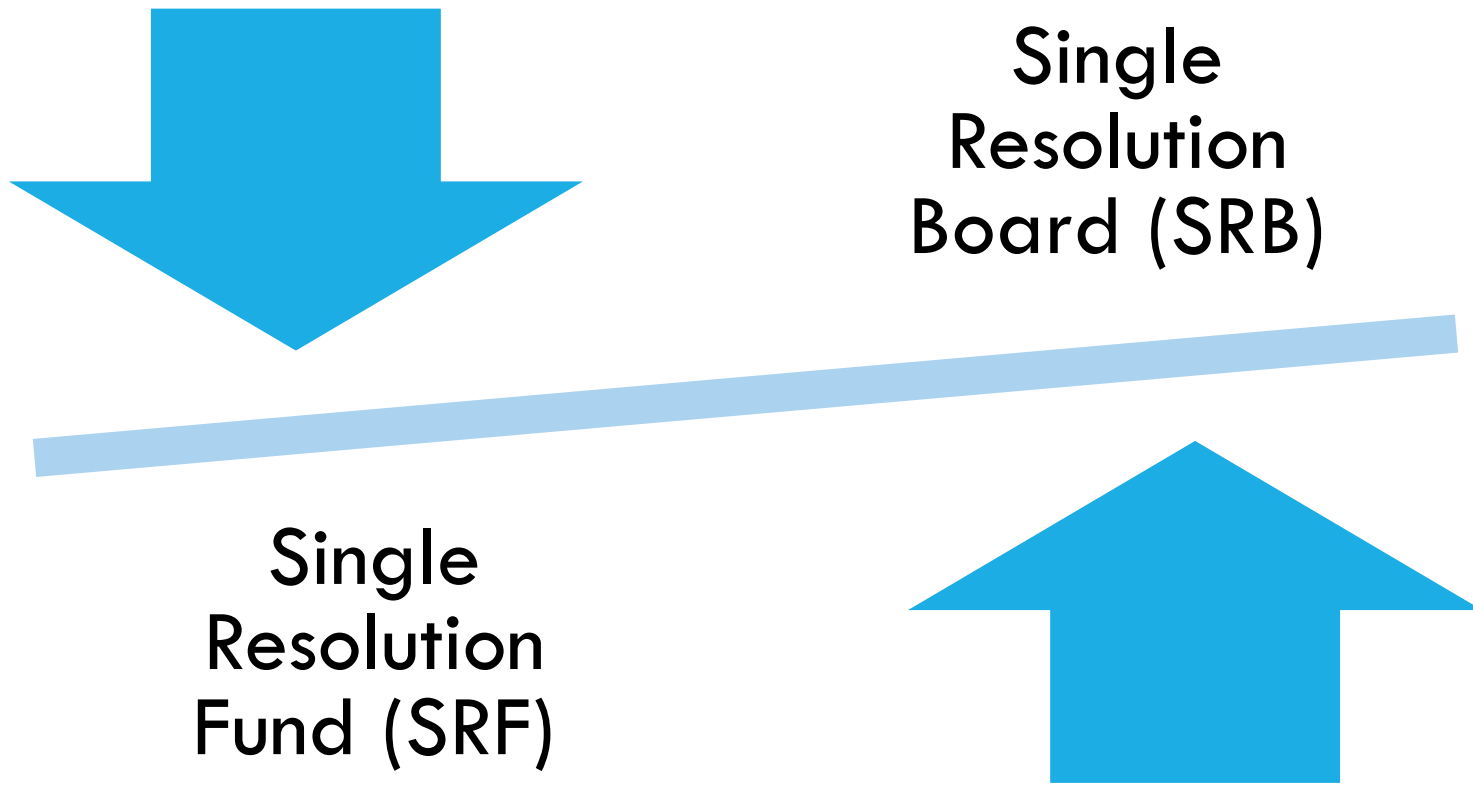
Restructuring of a bank, by a resolution authority, through the use of resolution tools to safeguard public interests, including the continuity of the bank's functions, financial stability and at the minimum cost to taxpayers.

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



PILAR II. SINGLE RESOLUTION MECHANISM

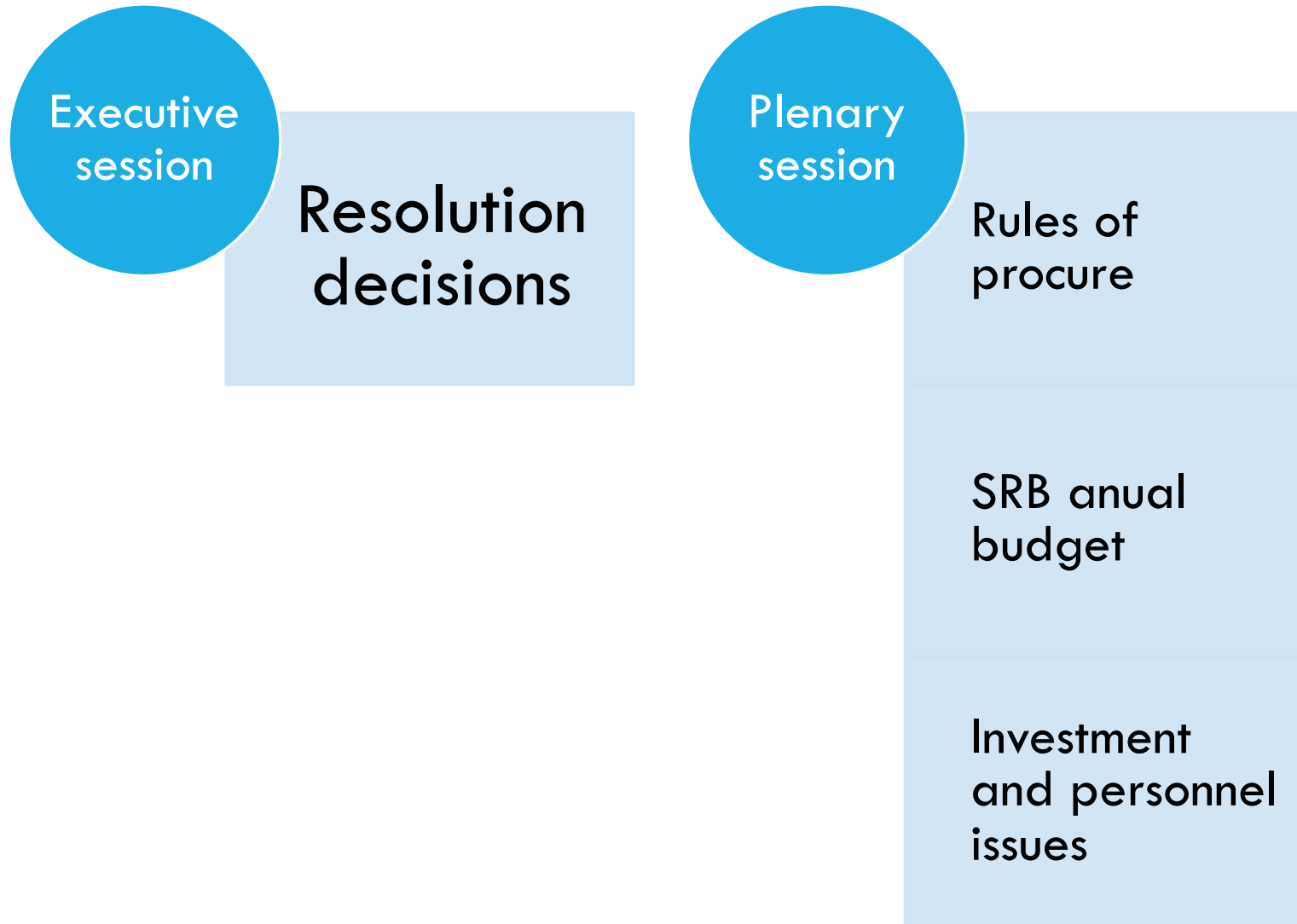


SINGLE RESOLUTION BOARD

SRB

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

DECISION-MAKING OF THE SRB

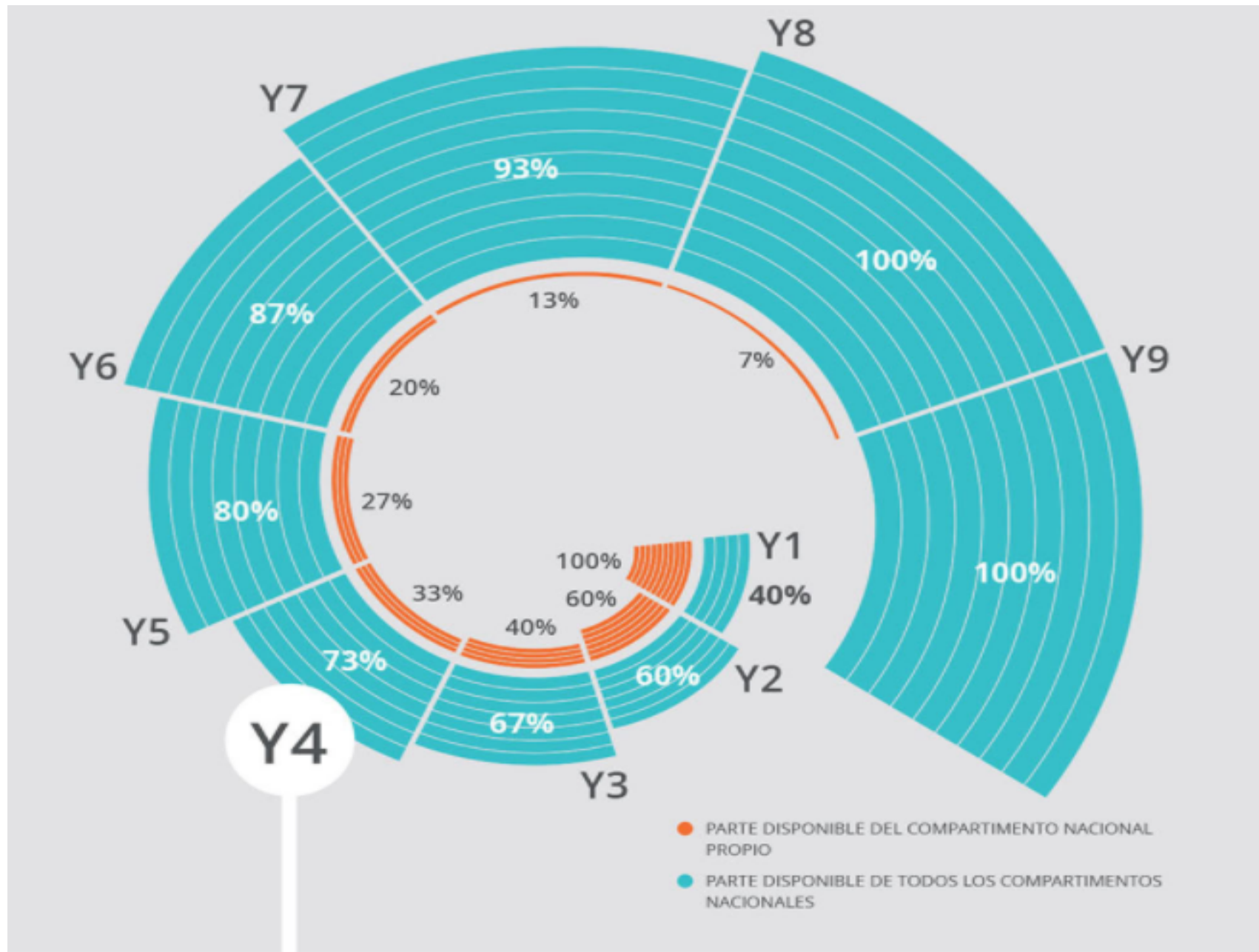


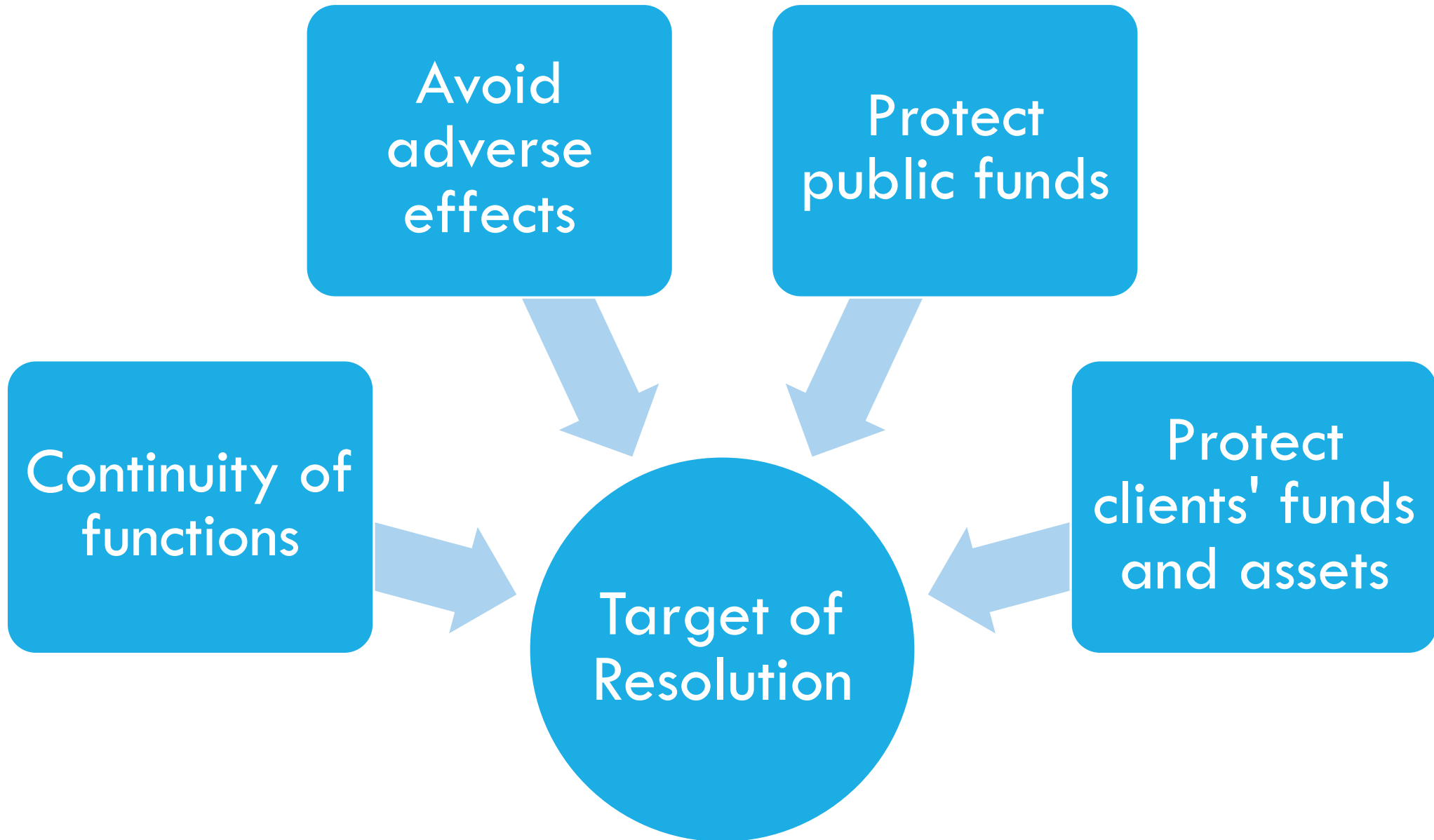
SINGLE RESOLUTION FUND

- 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).





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 (Minimum Required Eligible Liabilities, **MREL**)

EXAMPLE MREL-BBVA

Sale of
Business
Instruments

Bail-in

Resolution
Tools

Bridge
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 tools for solving and uses the FUR
The plan goes into effect at 24 h. of its approval by 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
- Propose the Council to raise objections (the resolution is not necessary for the public interest). Simple majority.

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

Determine 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 responsibility 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)

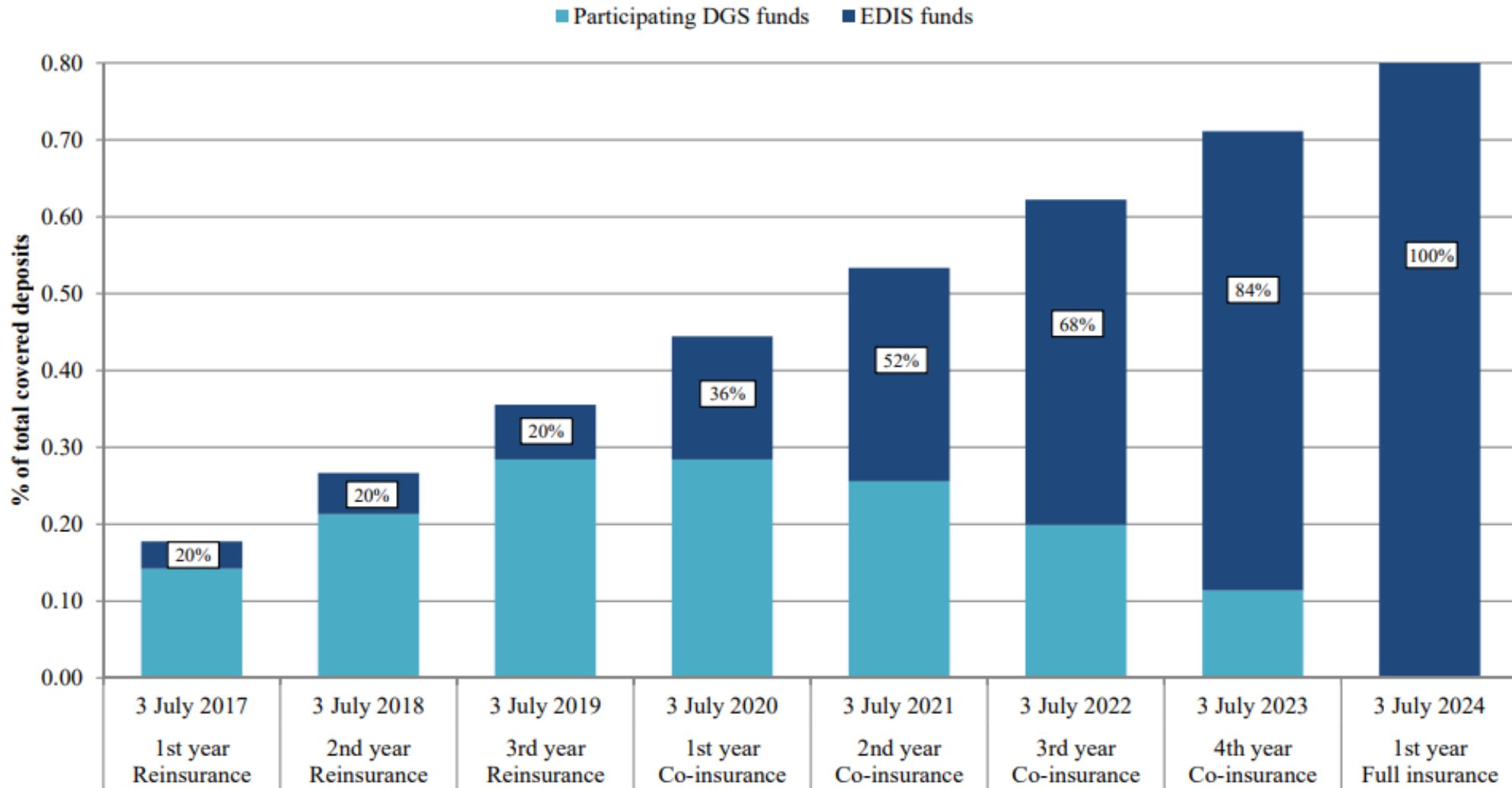
Uniform insurance coverage in the eurozone

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.

EUROPEAN DEPOSIT GUARANTEE SCHEME

- Need to advance in four areas of work:
 - The System itself.
 - Regulatory treatment of sovereign debt exposures.
 - Crisis management.
 - Improved border integration.

According to the European Commission: the probability of a liquidity deficit (guaranteed deposits, of up to 100,000 euros, not protected against a banking crisis) would be 87% in a crisis similar to that of 2008.

The probability is reduced to 46% in the case of SEGD working.
In the case of hybrid models, the probability is established between 47-56%.

EUROPEAN DEPOSIT GUARANTEE SCHEME

- German opposition:
 - unless other issues are addressed (lower bank exposure to sovereign debt).
 - Opposes the mutualization of deposits.
 - Reducing bad loans is not enough.
- The greater probability of a total protection of deposits would reduce the volume of national systems, in relation to guaranteed deposits, reducing costs for the banking sector.

SEGD HYBRID FORMULA

- Coexistence of a central fund and national guarantee systems. Diffuse



The central fund: provides liquidity to national systems when they run out of money

If the central fund runs out, the SRB could borrow from national systems (compulsory loan mechanism)

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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