

Abstract

Towards the European Banking Union: tools, perspectives and critical elements

The outbreak of the subprime mortgage crisis in 2007 marked a turning point for the global financial sector. The new challenges posed by this situation of worldwide banking emergency had to be met by the economic and financial actors.

The European Union member States have felt the effects of the crisis exceptionally hard. This is due to the fact that there is a vast degree of economic interconnection between countries of the euro area but, at the same time, there is no unified supervisory and prevention system at European level. In addition, since the financial crisis started, several European countries had difficulty in financing their sovereign debts because of macro-economic imbalances. As a result, there was an increasing number of European banks with a dangerous sovereign debt exposure. Available risk management tools turned out to be strongly pro-cyclical and the combination between the effects of financial crisis and the Eurozone crisis' ones amplified the scope of difficulties. In order to face the systemic dimension taken by this event, a concerted action of European countries and institutions is required.

A long political process to put together sufficient firewalls at European level has been carried forward, combined with the attempts to restore market confidence.

On this basis, the aim of the present work is to outline a general framework of the project of Banking Union and to explain in which ways it could make a contribution to reach the targets that EU has set for the reform of the financial sector. To do this, an analysis of the set of tools developed by the legislation behind the European Banking Union project is useful. The attention is focused on the three pillars on which the architecture of Banking Union sits: the Single Supervisory Mechanism, the Single Resolution Mechanism and a Common deposit-insurance scheme. They are built on the basis of a new regulatory framework with common rules for banks in member States, set out in a single rulebook. Through the entry into force of this new dispositions, the robustness of the euro area banking system will be enhanced and standards and practices will be harmonized. Whereas it is an ongoing project, it is essential to have an idea of the progress done. With the prospect of the entry into

operation of the SSM in November 2014, the ECB is carrying out a comprehensive assessment of a group of European credit institutions categorized as “significant”. Further tools established by the project should be operational over the next years.

By contextualizing the project of Banking Union under the framework of reforms drawn up by EU in response to the crisis, it is possible to find common features with others initiatives and to define perspectives for a joint development. This is also helpful in properly identifying strategy of action and critical elements. In fact, the implementation of the project of Banking Union appears to be complex from a technical and political point of view. Firstly, all instruments prepared by EU institutions and member States will be able to work only if diversity in European banking sector is taken into account. In fact, the European banking sector is very diverse. As evidenced by the analysis of information on dimension of banks, business models adopted and assets held by financial institutions, there is a wide range of actors, different among them for services offered and type of clients. It is important to consider this element in shaping of policy and legislation because the measures taken could have a different impact on countries concerned. Therefore, diversity should strengths EU financial sector but, at the same time, unity in structures and standards is necessary to ensure stability and growth. Building on the lesson of the crisis, the main European reforms are intended to limit sources of systemic contagious and to restore confidence of citizens. This is the purpose of the structural reform of EU banking sector which has been elaborated in the wake of international proposals in this field, such as the Britain one or the American one. The guidelines that have inspired the regulatory proposals of European institutions are included in the “Liikanen Report” submitted by the High-level expert Group on structural bank reform in 2012. This document pays particular attention to the need of reducing the probability and the impact of failure with the aim to guarantee better protection to clients, especially retail ones. To this end, the most significant recommendation of the Group regards the need of requiring legal separation of certain particularly risky financial activities – first of all, proprietary trading ones – from deposit-taking banks within a banking group. The reactions at this proposal among European credit institutions has not been entirely positive. There are, instead, member States – such as France, Germany and Spain – in

which national governments have drafted legislative proposals providing for a banking activities separation.

An additional measure aiming to increase the financial solvability and the transparency of the European credit institutions is the proposal for a regulation on the shadow banking system. In fact, it is closely linked to the traditional banking system and it represents a dangerous transmission channel for the systemic risk.

The establishment of the Banking Union is also a political question. This is witnessed by the important role played by the elements of responsibility and democratic legitimacy into decision- making processes. A large number of agents needs to be involved in this project, leading to critical points. In fact, the last part of the present work deals with the most significant problematic issues arise from this ongoing process.

Firstly, the attention is focused on the difficulties in the field of representative financial services. As mentioned above, the European financial landscape is broadly diversified. It is characterized by the coexistence of different interests and positions which needs to be taken into account during the establishment process of Banking Union. In order to reach this goal, an effort for the democratic composition of these interests is required. The entities which provide representative services are organized according to peculiar models and they have a different representative intensity in the EU. A simplification of procedures and an effort for the unification of the representative section are necessary towards the achievement of the establishment of the Banking Union. At the same time, a strengthening of structures connoted by a lower representative intensity could be useful to give voice to all.

The second critical element mentioned is the problem of the mutualisation of the risk linked to the new banking resolution procedures within the regulation framework provided by the Single Resolution Mechanism. The most problematic aspects have to do with the transfer and the mutualisation of contributions to the Single Resolution Fund and to the creation of a common backstop. Member States have taken up contrasting positions on these points. In order to reach a decision which is broader legitimated, it is indispensable to operate major changes in national institutional framework and to allow necessary limitations of sovereignty.

Because of its big impact, the entire project of Banking Union needs to be supported by responsible and widely approved choices. The possibility of establishing efficient and solid structures will depend on this.