Implementing the Banking Union

Patrick Bolton
Columbia University

Corporate Governance and Banking Union in a transatlantic perspective
ECGI Brussels 17 December 2012

Outline

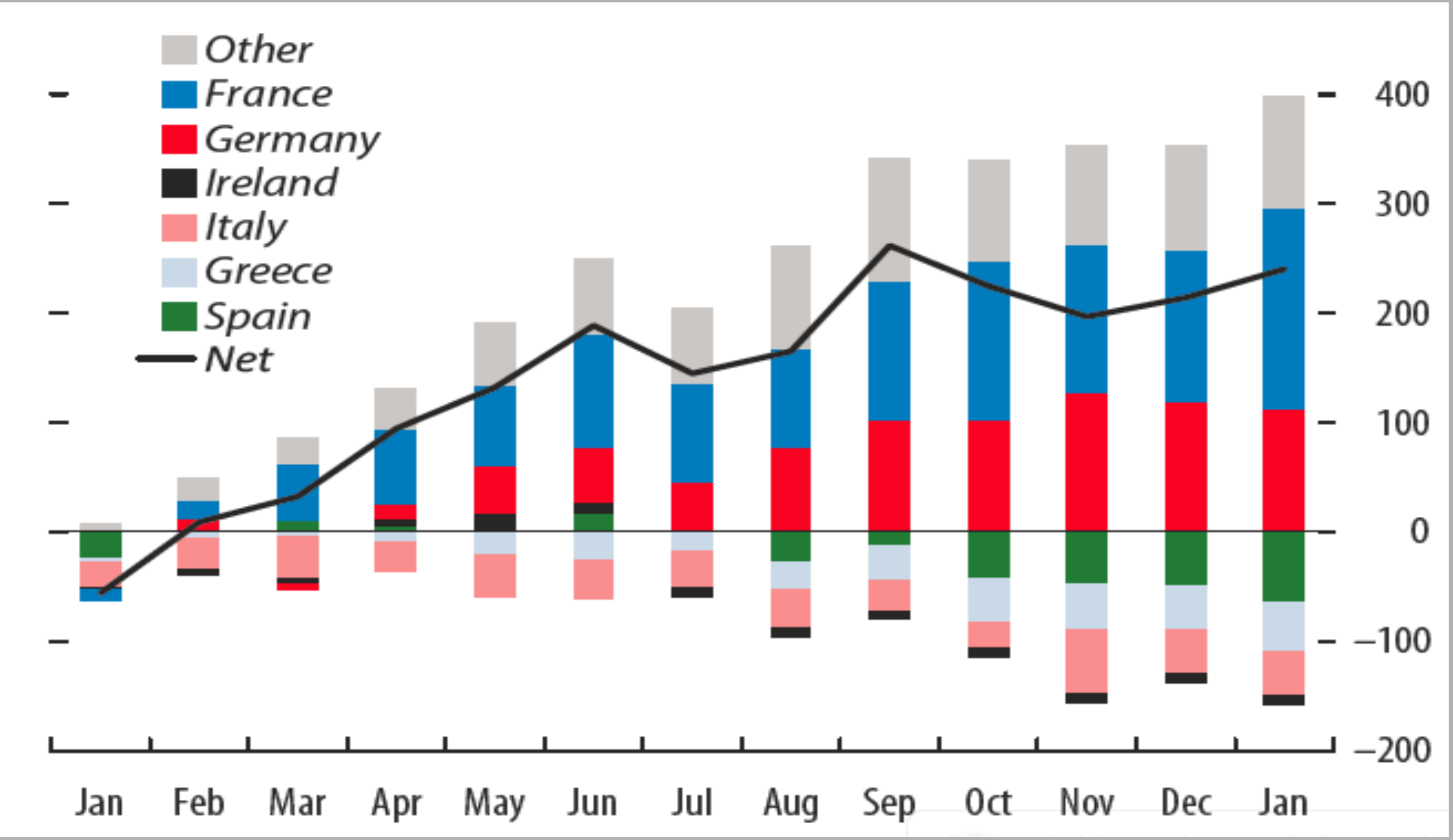
1) Single Supervisory System (SSM) is a **necessary condition** for an integrated banking system
2) It is a **key step** towards the **resolution** of the European Banking Crisis
3) A major political achievement involving a balanced governance structure
4) Open Questions about the functioning of the 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)



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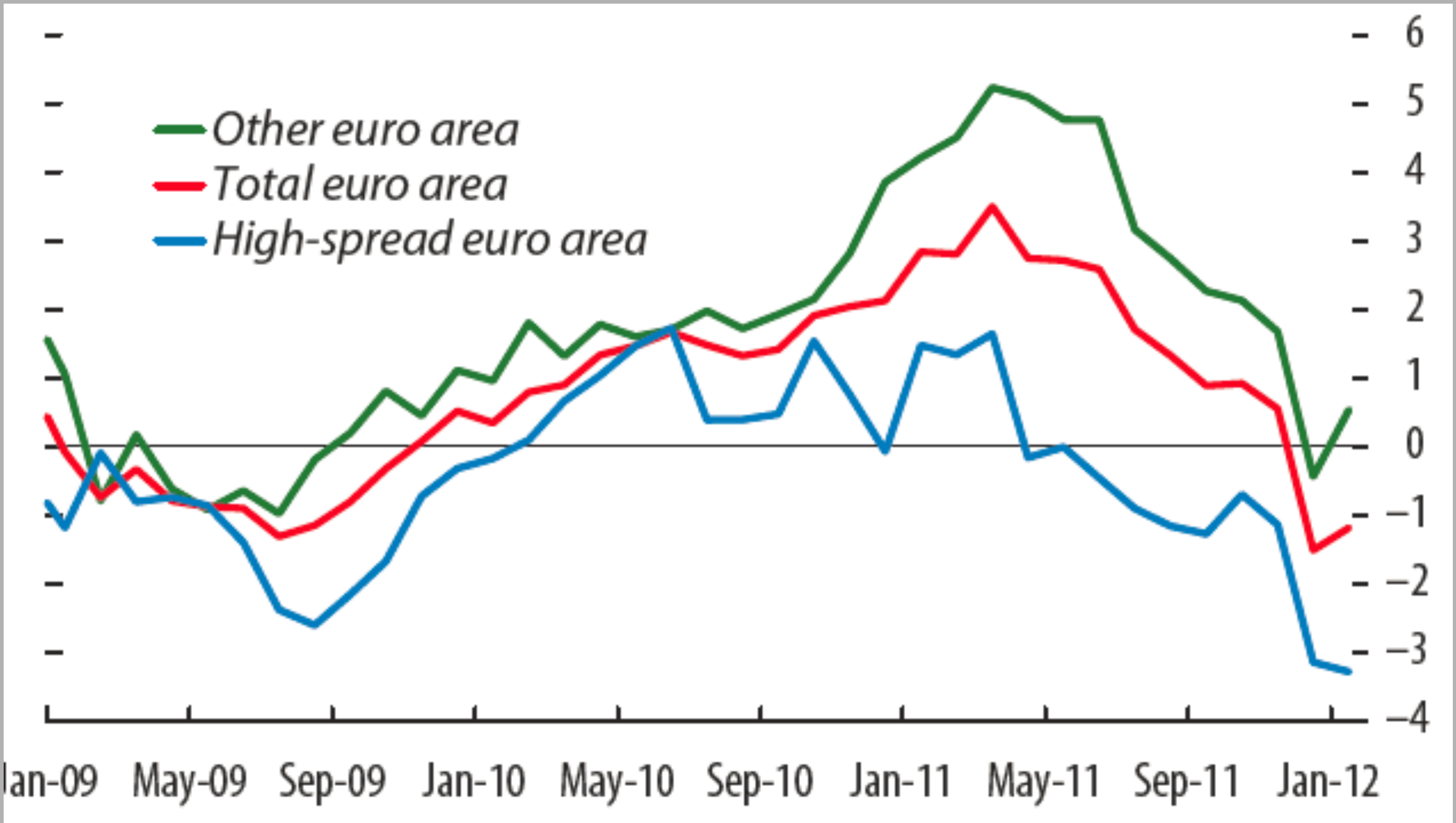
Source:
IMF Report 2012

Credit Growth to the Non-Financial Private Sector



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Bank Regulatory Nationalism

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.**

Single Supervisory System (SSM) How will it function?

- **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…)

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?

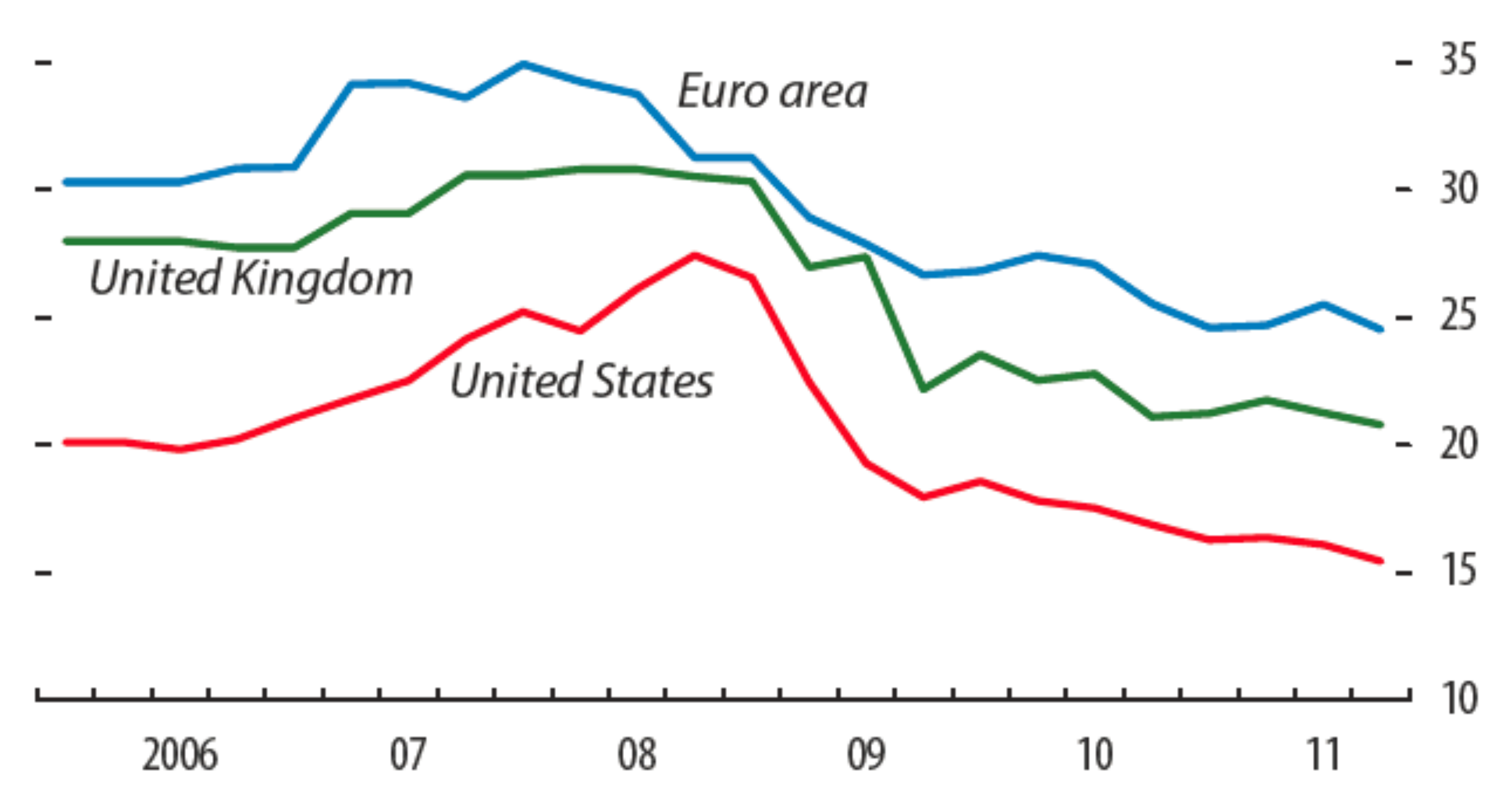
Single Resolution Mechanism

- 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)



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