THE UNIVERSITY OF AUCKLAND
Te Whare Wānanga o Tāmaki Makaurau
NEW ZEALAND

BANKING UNION IN THE EU

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FINANCE 383
Wednesday, 16 September 2015

EUC Network
New Zealand European Union Centres Network

The Europe Institute
An Institute of The University of Auckland

What is it?

Questions for Discussion (1)

Is competition among regulators good or bad for prudential management of banks and for financial stability?

Competition can lead regulatory authorities to get a reputation for being easier on banks.

Competition can lead to pressure to set higher standards so their banks have a better reputation with their customers.

Is enough effort being spent on crisis avoidance rather than crisis management?

What are the relative merits of the higher capital requirements, the higher deposit insurance and the introduction of bailing in?

The costs of the GFC have been very large.

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According to the Financial System Inquiry Australia should aim to be in the top quartile of advanced countries capital standards – i.e. above the EU. Where should New Zealand aim to be?

If the external standard is set correctly there is an argument that New Zealand should exceed it because it is a small economy open to a wider range of shocks and with less opportunity to diversify.

Questions for Discussion (2)

Will omitting the UK from the SSM help the SSM succeed or lead to a greater split in Europe?

Having the UK outside the game must surely reduce the flow of relevant information available and make consolidated supervision more difficult.

Drawing a dividing line on the basis of membership of the euro area is clearly irrelevant and any divisions should be based on the structure of cross-border banks.

Is there a better system that could be envisaged?

All of the EU/EEA should be in the inside and the supervisory arrangements should include the whole of banking groups and not just the banking part if risks are to be managed and the advantages of diversification offset against the higher risks of some other activities.

Is it a mistake to have the ECB running banking supervision?

- Will it conflict with monetary policy?
- Could it damage the ECB's reputation?
- Will it politicise the ECB?

Having a dual mandate for financial and monetary stability always runs the risk of a conflict but the better information that the ECB gets from supervision may help in the running of monetary policy and hence act as an offset.

Banking problems can harm central banks reputations.

The ECB will have to make decisions which will have political consequences for member states and that will be a problem.

Questions for Discussion (3)

Does the BRRD give resolution authorities enough tools?

The BRRD seems to have provided almost all the powers one can think of.

There may be some conflict on the basis of human rights of shareholders when resolutions take place.

The only obvious item that is weak is the access to taxpayer backed support for the short-run costs of resolutions.

Can recovery plans be realistic?

- Can authorities intervene early enough?
- Will there be enough loss absorbing capacity?
- Will bail ins generate a collapse in confidence?

There is considerable scepticism about whether a recovery plan can ever offer a believable strategy in a crisis. It is even more unlikely that authorities will intervene early enough on the basis of past evidence.

Under Basel 3 large banks have to hold excess capital both for cyclical reasons and because of their importance.

The design of a bail in matters – whether it is a write-down or a debt for equity swap. The former is likely to cause much more instability.

Will resolution through the SRB work?

– Will national governments still bail out their main banks?

There is little evidence to go on. As an EU level institution it might be above all the political pressures that will exist at the level of the member state.

Bailing out is only possible if there is no element of state aid and in any case can only be performed by the member state that has low enough debt to do so.

Are the resolution funds large enough?

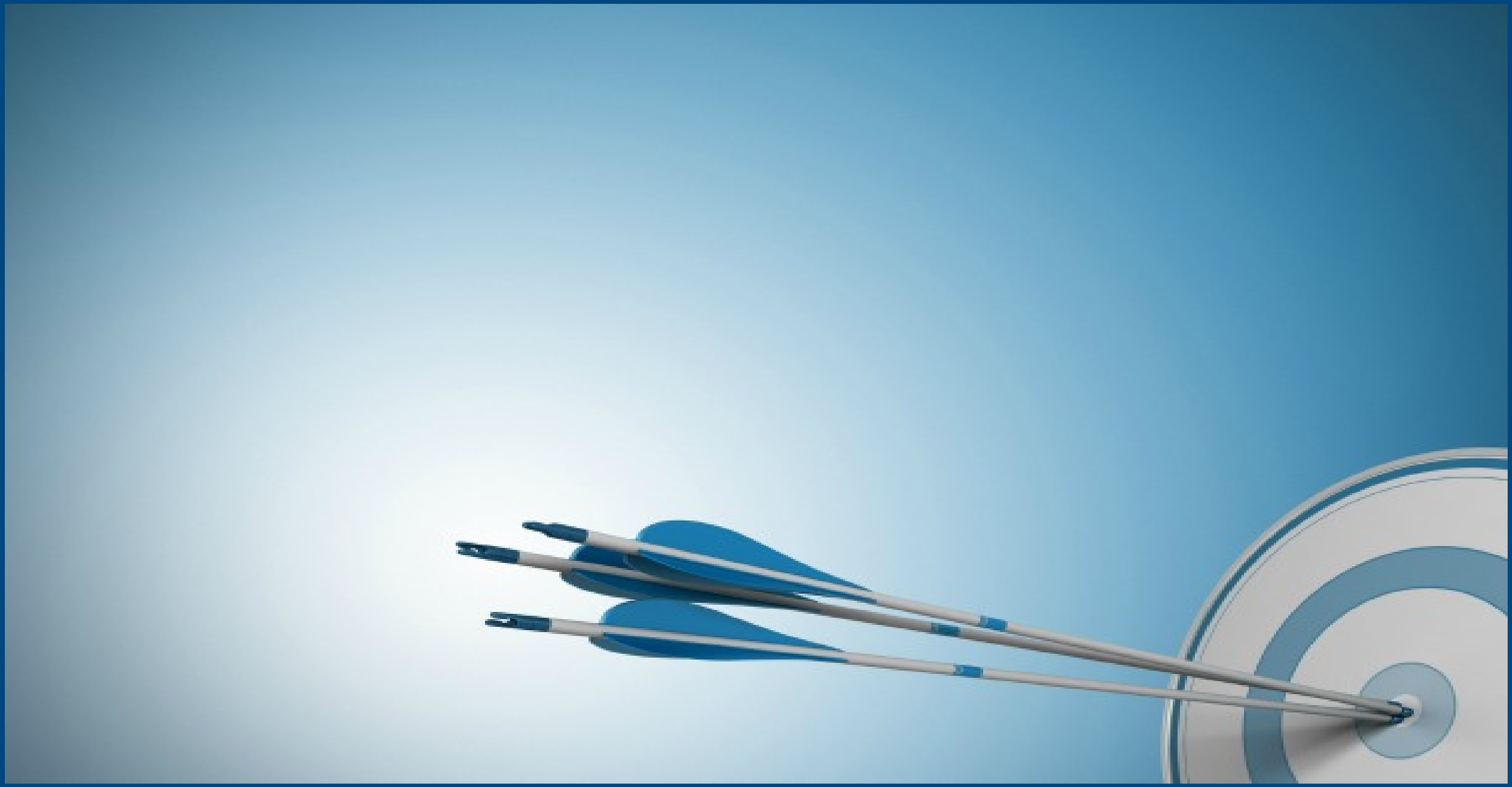
– Should the ESM be used?

A problem with a large bank is likely to be part of a more general crisis and hence there will be several failures occurring at the same time.

The circumstances where the ESM can be used are limited in the legislation. Someone has to be credibly able to pay it back.

Why is it needed?

Will it work?



Missing Parts

Non-euro countries

Financial conglomerates

Bank structure

Deposit insurance

SPOE vs MPOE

Major bail in

Resolution funds

What would a full banking union look like?

Important Parts

Full access for customers

Open competition for all providers

All main institutions operating simply and effectively

Efficiency

Questions for Discussion (4)

Should banking union be completed by harmonising deposit insurance and introducing a directive separating risky activities from retail banking?

Having unified deposit insurance will help so one country can draw on another if the failures are concentrated. Simply harmonisation will not be enough.

The question is whether the risky activities should simply be held in separate subsidiaries or whether they should be outside the banking group altogether.

Should the EU take the opportunity of the Treaty renegotiation required by the UK to complete banking union with a new independent supervisor who can cover the whole EU?

Placing the supervisory role in the ECB has two disadvantages, first, the possible conflict of interest and loss of reputation and second, the unwarranted confusion of membership of the euro area with membership of the SSM.

There will be too great sunk costs in setting up the ECB based system and too great conflict over where the new supervisor might be and how it would be structured.

Are bail ins realistic as a resolution tool?

– Will they avoid a systemic crisis?

They are an important tool in armoury and would avoid the use of taxpayer funds in many circumstances. The problem comes with large banks where the extent of the bail in is large. A bail in brings the realisation of the losses into the present and since the revived institution needs to breed confidence it has to be well capitalised meaning that the bail in will be larger than the losses.

A bail out on the other hand spreads the losses very widely not just over the whole of the taxpaying population but over the future.

Links to pictures and videos in the slides:

http://safe-frankfurt.de/focal-topics/banking-union.html

http://jasonrenshaw.typepad.com/jason_renshaws_web_log/2013/03/three-questions-for-educators.html

http://raikenprofit.com/passive-income/

http://www.hostgator.com/blog/2013/08/21/how-to-measure-website-success/

http://www.euinside.eu/en/analyses/bulgaria-banking-union-membership

https://www.youtube.com/watch?v=vo3SWSpHwzY

https://www.youtube.com/watch?v=sLFjz7u5e0o