Job Name: Video 1 – Audio 1
Transcribed by: Fidgety Digits
Researcher: Lyn Collie
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Welcome to video 1 on Banking Union in the EU. In this video we cover a general introduction to Banking Union followed by a discussion of the single rulebook in some detail. Before watching this you should make sure that you have done the prior reading in the textbook by Casu, Girardone and Molyneux on the subject.

So what is 'Banking Union'? And I put it in inverted commas because it is not some careful construct, it is a set of measures which have been introduced by the EU since the global financial crisis came to its full effect in 2009. And Banking Union in that framework has got three main parts. It has got the single rulebook which seeks to harmonise supervision and improve prudential standards, and that applies across the whole of the EU. The second side is to try and concentrate supervision in a single supervisor and a coherent system. And this has been labelled the Single Supervisory Mechanism, and this is now being run by the European Central Bank in Frankfurt.

The third side of it is a resolution mechanism, and resolution is how we get rid of the problems which have occurred. And so there is a Single Resolution Mechanism, SRM, which is being run by a Single Resolution Board, SRB in Brussels. And you will find there is a whole lot of these groups of letters, which will make life really hard for you, as they are all very, very similar. And the purpose of the whole of Banking Union is to try and make the chance of further banking crises like the one we have just had, much smaller. And to make the cost of resolving any new crisis, quite a lot smaller, and in particular that the cost to the taxpayer is as much closer to zero as it can be.

So let us turn to the single rulebook first of all. What has happened in the past in trying to set standards across the EU is that the EU has tried to go for minimum standards. What it is trying to do in this case is now get a single standard which runs right across the EU. The reason for only going for a minimum was that it is so difficult to get agreement among the countries We are now dealing with 28 countries. At the time that they decided to go for the minimum, they were still only dealing with 12 countries. And the idea is that if you try and get absolutely everything agreed … for example, take accounting, what is an accountant? For an acceptable definition of an accountant who could work in all countries across the EU, it took them 17 years to agree that. And what they did in 1985 was agree, under the single market programme, that they just go for the minimum. But the trouble with only having a minimum in the banking case is that of course people might try and go to an area where the standards are weakest. And if you do that, then it is undermining the way in which the system works.

So trying to set this single standard is going to be very much the responsibility of the European Banking Authority. And the European Banking Authority is in London and it is in fact the organisation which brings together all of the supervisors of banks in each of the countries. So there are one or two representatives on it from each of the countries and then a secretariat in London. And it has grown out of what used to be the Committee of European Banking Supervisors. So they have to agree what they want to do and come up with a single standard. The way in which this single standard is enacted is principally in this case through two regulations, in fact two rules.

The first one is called the Capital Adequacy Directive, and this is the fourth time they have done this, so this is known romantically as CAD4, and the capital requirements regulation. And there is a difference between Directives and Regulations. A Directive has to be transposed into domestic law in each of the countries, whereas a Regulation is EU law which applies direct to each of the countries, so they don't need to actually implement anything else themselves. But the problem that is required in this particular case is that you actually do need a rulebook, and if you look at these rulebooks they are enormous things.

If we take the case of New Zealand there's the Reserve Bank Act which sets out what banks are supposed to do, and that is quite a slim volume. But as soon as we get onto the banking handbook, or rulebook, then this is a ring binder -, not just one ring binder but several ring binders. If we look at some other countries, this extends to thousands of pages. So you can imagine that when you transpose the legislation from the directive into the handbooks, all of these handbooks in detail would be substantially different. And what they are trying to do is to get that difference to be as small as possible.

What they are doing in setting these standards in the rulebook is what is being done right across the world as a result of the global financial crisis. The regulatory standards for banks are organised and indeed recommended by the Basel committee, which as you can work out sits in Basel and is composed of the 20 largest countries, so it doesn't include New Zealand, but it does include Australia. And what they have agreed as a result of the crisis is to come up with a new level of regulation which is the third level and this is referred colloquially as Basel 3. But all that the EU legislation is doing is implementing Basel 3 in the EU.

Unfortunately of course this is an ongoing procedure and it is being updated at present with increasing the standards. And so Basel 4 is in, in progress and no doubt they have to increase the regulation. And these regulations relate primarily to the amount of capital that banks have to hold so that they will be safe if there is going to be a further shock. Obviously you can't be completely safe, but it is trying to make the cushion as large as it can be. And it also relates to the liquidity that the banks have to hold, because what happened in the case of the global financial crisis is that markets closed and banks were no longer able to raise finance in a hurry. And what they now have to do is to have enough liquidity, for example that they can run for a month even if markets are closed. By that time they can put into place alternative funding arrangements.

And as far as this side of Banking Union is concerned, it applies not just to the euro area, but to the whole of the EU, and indeed to the European Economic Area. In other words it includes Norway, Iceland and Liechtenstein as well. So that, if we consider this, all of the members of the EU are on the European Banking Authority. But the members of the European Economic Area don't have a seat at the table and they have to accept what their colleagues suggest.

So if we take all of this together what I am hoping you will reflect on is whether this sort of arrangement gives you the sorts of results which you will look for. Because, by having a single authority, and single standard, maybe you don't get the best standard. So the first question is, is competition among regulators good or bad for the prudential management of banks and for financial stability? Maybe that having some variety would give you a better choice for consumers.

The second issue which you might think about is: is enough effort being spent on this area of crisis avoidance, rather than what we are going to look at later on, which is making crisis management rather better? So we are just looking at these standards. Maybe more should be done than that. And then the last question which you might think about, as there has been a Financial System Inquiry in Australia recently - when the new government came in they wanted to see what changes they should make to the structure of financial regulation and they had an independent inquiry into it. What this Inquiry concluded was that Australia needed to be in the top 25 percent of advanced countries in terms of these capital standards.

In other words it needs to be above the EU given that the EU has got a large proportion of those countries in it. What you might ask yourself is well do countries like New Zealand actually need to be above that sort of average standard, do they really need to be in the top quartile? Are we more exposed, do we need to do rather better in terms of buffers than the EU does itself?

So what I hope you will do now is move on to consider these questions and then after that you can look at video 2, which is on the second aspect of the Banking Union, which is the Single Supervisory Mechanism.

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