European Banking Union?

An EBRD view*

Jeromin Zettelmeyer

Deputy Chief Economist and Director of Research

*Not necessarily *the* EBRD view.

Presentation at the High Level Workshop of the Vienna Initiative

12 September 2012

The question

Proposals for a Eurozone-based Banking Union are a good idea to save the Eurozone.

But are they a good idea from the perspective of achieving better cross-border financial governance within financially integrated Europe?

- Within the Eurozone, the answer is clearly Yes.
- But financially integrated Europe includes many countries that are in the EU but not in the Eurozone; and some countries that are in neither.

The answer

European Bank
for Reconstruction and Development

The Banking Union is a good idea, provided that:

- Non-Eurozone EU members can “opt in”;
- There is a fair and incentive-compatible ex ante fiscal burden-sharing arrangement
- The transition problem is addressed (while a European Deposit Insurance Fund accumulates).
- A satisfactory arrangement is found for non-EU members of the Pan-European financial area.

Some clarification of terminology

European Bank
for Reconstruction and Development

- “Steady state” refers to the Commission’s vision for a full fledged Banking Union (B.U.)
  1. ECB single supervisor with wider-ranging powers, including early intervention.
  2. European Deposit Insurance Fund and Resolution Agency
  3. ESM as fiscal backstop.
- The “transition” refers to initial phase of the B.U., in which 1. and 3. are in place but not 2. (deposit insurance and resolution powers remain with national authorities).

Three issues for this presentation

1. Accommodating non-Eurozone EU members within the Banking Union in steady state
2. The transition problem for non-EZ countries that want to “opt in”.
3. An arrangement for financially integrated non-EU members

Membership of non-EU members

European Bank
for Reconstruction and Development

Two complications

1. Technical/legal problem:

   - Presumed supervisory body (ECB), fiscal backstop (ESM) are Eurozone institutions.
   - If it’s technical/legal there must be a solution (at least in steady state). E.g. allow non-EZ EU members to opt into ESM. The Commission has/will figure this one out.

2. Conceptual problem:

   - Countries outside the Euro have extra policy instruments to mess with their banking systems, even under a single supervisory mechanism and a single rulebook.

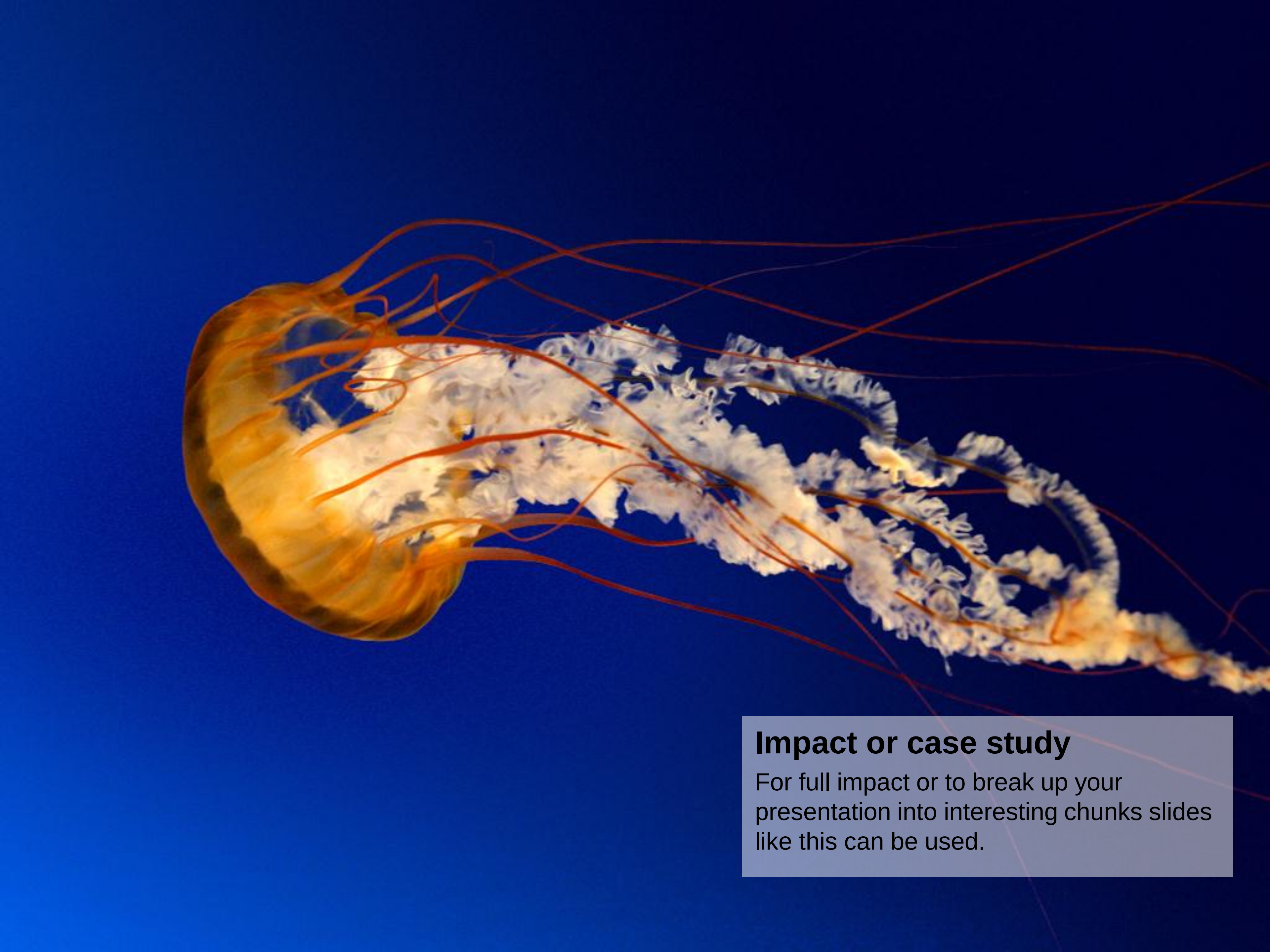
The conceptual problem is more general

- *All* B.U. members, even in the EZ and even in steady state, retain policy instruments that could undercut single supervision and rulebook
    1. Taxes and subsidies
    2. Housing policies (e.g. rental market, land use).
    3. … [other areas of national policy that can affect asset quality of banks]
- *Non-EZ* members retain one powerful extra instrument: monetary and exchange rate policy
- Hence, full mutualisation of fiscal backstop creates moral hazard

The solution: partial mutualisation

European Bank
for Reconstruction and Development

- Fiscal backstop always shared between European and national level
- Sharing rule should differ for EZ and non-EZ countries
  - E.g. EZ: two thirds mutualised; non-EZ countries one third.
  - Reflected in contributions to backstop fund (e.g. ESM); this would be half for non-EZ members.
  - Note that from the perspective of insurance against self-fulfilling runs on the sovereign, the banking system, or both, non-EZ members also *need* less insurance since they retain their central banks (assuming emergency access to ECB liquidity, e.g. via swap lines).



Impact or case study

For full impact or to break up your presentation into interesting chunks slides like this can be used.

The transition problem

There will be a period when:

- Banking Union insurance fund not yet operational
- ESM as backstop not yet available to non-EZ countries
- Single supervision/resolution already operating within EZ.

Joining in this period seems a bit unattractive.

- Lose your supervision power
- Do not yet benefit from insurance fund or fiscal backstop.

Problem: how to avoid a “home-host problem on steroids” during this period.

Managing the transition

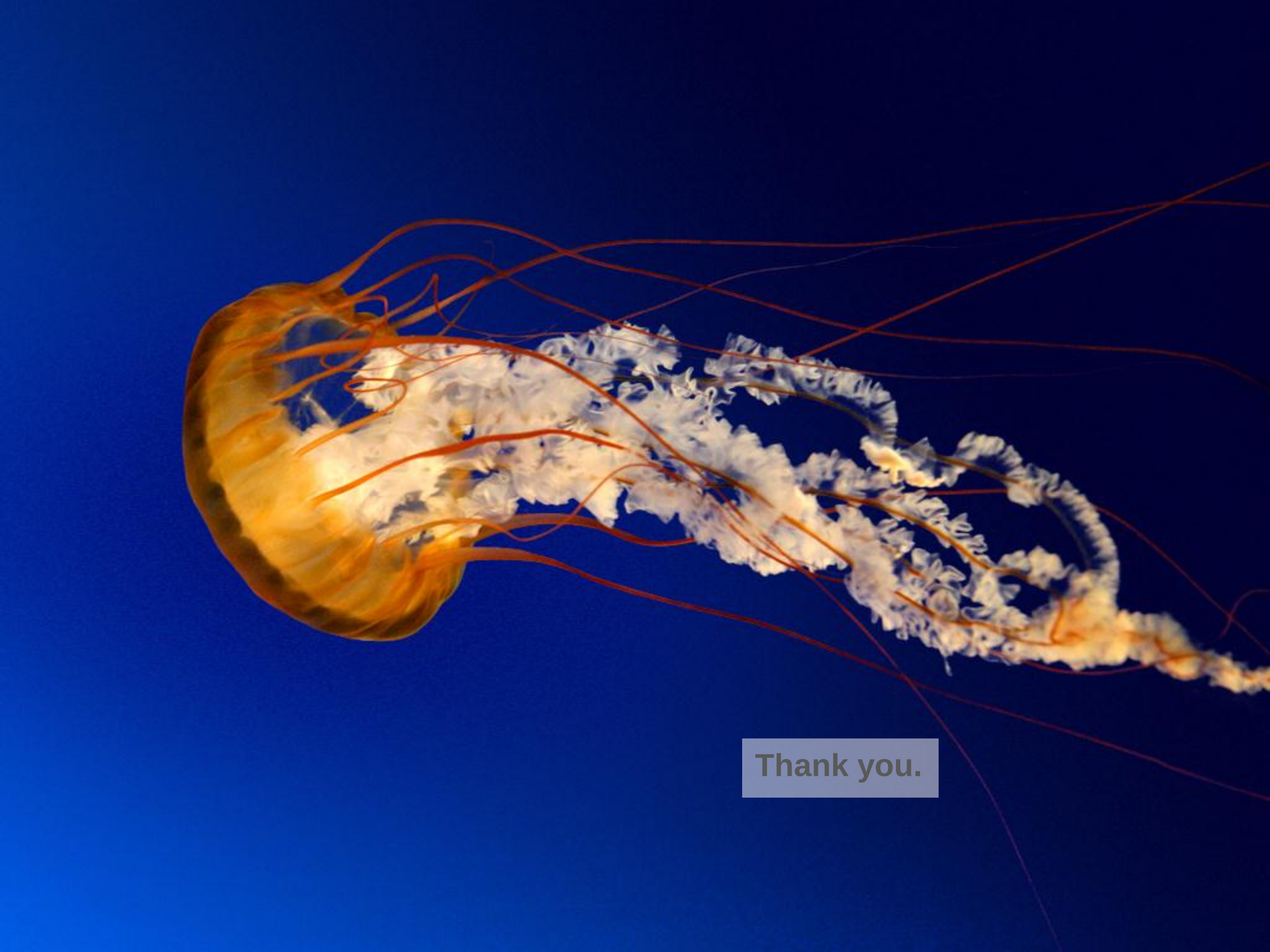
1. Extend ECB supervision to Eurozone bank groups *including subsidiaries outside EZ*
2. Ex ante sharing rule for fiscal backstop
   - So B.U. supervision internalises problems in the sub.
   - This should work technically/legally because the ESM would backstop national support mechanisms for parents, who in turn can support subs. Analogous to use of official support during 2009-10.
3. Local supervision over subsidiaries also remains in place.

The “outs” might be offered similar deal

1. Non-B.U. subs of parents located in B.U. supervised by both ECB and local supervisor
2. Ex ante fiscal burden-sharing agreement

But practical/legal problem might be bigger:

- Should subs be covered by local or Banking Union deposit insurance?
- Can resolution authority for subs be shared with or delegated to a foreign institution?


Thank you.