CONSIDERATIONS REGARDING THE CREATION OF A EUROPEAN BANKING UNION – A KEY ELEMENT IN REINFORCING THE BANKING SYSTEM

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Abstract

The idea of setting up a European Banking Union, an essential element in the reinforcement of the Economic and Monetary Union (EMU), has become a concrete project and it has been outlined as such after the financial crisis started in 2007.

The setting up of a Banking Union is a new project for the European Union and it comes as an answer to the financial crisis; this project has three major components: the Unique Mechanism of Surveillance (UMS), the Unique Mechanism of Resolution (UMR) and the European Deposit Guarantee Schemes.

At the basis of these infrastructure elements there laid: the Single Rulebook", the unique European regulation framework (made up of the capital requirements: "CDR/CRR IV – CRD IV Directive" and "Regulation regarding capital requirements" provided together with the standards and directions issued by the European Banking Authority "ABE") and a set of rules established for state subsidies.

The large flow of important information which exists in the matter makes it necessary for us to deal with this topic in a consistent and complex argumentation[7]*.*

Keywords: *Banking Union, Unique Mechanism of Surveillance (UMS), Unique Mechanism of Resolution (UMR), the European Deposit Guarantee Schemes, European Fund of Stability, European Mechanism of Stability, Single Rulebook – unique set of rules applicable in the financial-banking sector.*

1. Introduction

European economies depend up to 70-75% on the banking finances, while in Romania the domestic banking sector preponderantly supports economy from a financial point of view; in fact, the banking sector ensures about 92% of the finances granted by the Romanian financial system. 90% of the banking system assets are owned by foreign capital institutions. The risks involved in the process of devising, implementing and observing regulations imply: the possibility of reducing exposure and the withdrawal of foreign capital credit institution.

A report published by the European Commission on 22nd June 2012 provided the need to elaborate a long-term strategy for the creation of a future Economic and Monetary Union, which should contribute to the clarification of reforms and decisions both at EU level, and at the level of each member state.

Considering that the enlargement of European integration is a remedy for surpassing the financial and economic crisis, the European Commission members appreciated that the creation of a Banking Union could represent a new step in the European integration that could complete the Monetary Union.

The concept of Banking Union has been highlighted by the President of the European Commission at a formal reunion of the European Council on 23rd May 2012. This suggestion drew the attention of EU politicians to the need to create a Banking Union. Subsequent to this debate, when the European Council gathered on 28th-29th June 2012, the European Commission decided that it is necessary to elaborate a set of implementation measures. On 12th September 2012, the Commission came out with a set of laws comprising two regulations: the former one that granted the European Central Bank (CEB) surveillance powers and the latter one that modified the regulation for the settlement of the European Banking Authority (EBA) with the result that this Authority could bring into line the functioning statute with the new vision on the European surveillance architecture.

We would also like to underline that about 30 proposals for legislative enhancement have been adopted in the financial-banking system ever since the crisis started and up to the moment when the decision regarding the functioning of a Banking Union was made, so that economy could benefit from real advantages. The European Commission consolidated financial stability of the banking system through state subsidies and stability and adjustment programs.

2. Content

Literature Review

Of the measures adopted by the European Commission for increasing financial stability within EU, one should mention:

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I. Measures for improving integrated banking surveillance

The main measures adopted for a good functioning of the integrated EU banking surveillance system after 1st January 2011 are:

- setting up a European Banking Authority that deals with banking surveillance, including with banking re-capitalization;

- creating an Authority for European Titles and Markets that is meant to surveil capital markets;

- creating an Authority for Insurances and the European Pension System that could control the insurance sector.

Each of the 28 EU member states is represented in the three surveillance banking authorities; the role of the member states is to contribute to the development of an EU unique banking surveillance system and to the settlement of potential problems between member states, as well as to risk prevention and trust enhancement in the European banking system.

II. Measures for reinforcing the banking system

a) Increasing bank capitalization and solvability

Due to the financial-banking crisis, turbulent events which have occurred on the financial and bank markets have affected under-capitalized credit institutions (from a qualitative and quantitative point of view); as a consequence, these institutions started to need an unprecedented level of support from national authorities (i.e. from the state and the central bank). In order to tackle this issue, in July 2011 the European Commission suggested bank capitalization (CRD IV)[1] by implementing at EU level the global standards approved by G-20 and known as the Basel III Accord.

In this implementation project, EU plays a key role since it has applied these regulations on more than 8, 000 banks, that is on 53% of the global assets.

This is the reason why the European Commission devised a governing framework, which grants the involved national authorities new bank control powers, as well as sanctioning powers, which are applied whenever the bank risk is increased. For example, credit volume may be reduced if there is an artificial price increase, a fact which may lead to a crisis.

b) Banking restructuring facility.

Imposing conditions on the financial banking sector is one of the political demands required by EU member states, which is financially assisted at international level.

The support of the Euro zone member states is made through the European Financial Stability Facility (EFSF), which offers borrowing facilities to countries so that they could obtain the recapitalization of financial institutions, under certain conditions, as well as through structural reforms that are applied in the internal financial sector. Macroeconomic adjustment programs have been supported through this facility and through the assistance offered for maintaining the payment balance in the following countries: Greece (50 billion Euros for bank recapitalization), Portugal (12 billion Euros for supporting bank solvency), Latvia (600 million Euros to contribute to the stability of the financial sector)[2].

c) Increased protection for bank deposits

At present, if a bank goes bankrupt, according to EU legislation, bank deposits in any member state are guaranteed up to Euro 100,000/person. Such a measure avoids harsh economic consequences like the collapse of the banking system in a member state and it prevents a panic situation followed by massive deposits withdrawal.

At the same time, national authorities have created a new structure outside banks and have transferred certain critical functions to this structure, i.e. deposit insurance as a safe measure. One can refer to the case of the Northern Rock Bank, which was split into a “good” part, comprising safe deposits and mortgages and a “bad” one, including non-performing credits[3].

d) Control of state subsidies granted to banks during the financial crisis period

One of the multiple measures taken for surpassing the banking system crisis is the one adopted by the European Commission – as a generally accepted and efficient solution, i.e. the coordination of activities at EU level in order to avoid massive capital and subsidies transfers from one country to another, which would lead to the collapse of the domestic market.

The threshold for granting state subsidies, which is meant to settle the problems that may seriously affect economic growth, is based on a guide elaborated in 2008[4] by the European Commission (in conformity with Art.107 (3) (b) of the TFEU, the Treaty on the Functioning of EU.

In 2009 the efficient restructuring of banks required that the European Commission should adopt a measure that would allow banks to have long-term profitability by analysing the proportion of costs in relation to the total incomes, and to avoid turbulence

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[1] European Commission IP/11/915; Memo/11/527 July 2011
[2] http//ec.europa.eu/economy finance/eu borrower/greek ban facility/index en.htm;
http//ec.europa.eu/economy finance/eu borrower/Portugal/index en.htm;
http//ec.europa.eu/economy finance/eu borrower/balance of payments/Latvia en.htm;
[3] European Commission IP/10/918;
[4] European Commission IP/10/918, January 2011;

caused by potential non-observance of competitiveness principles as a consequence of granting state subsidies[4]. Actually, starting with 1st January 2011, any bank that applies for state subsidies is obliged to elaborate and apply a restructuring plan.

The state subsidies control during a crisis period is meant to achieve two objectives: the surpassing of encountered difficulties by banks and their preparation for the post-crisis period. Ever since the end of 2011, the European Commission has intended to apply a post-crisis strategy; however, tensions recorded on the European markets revealed that the measures implemented during the crisis should be further applied. In consequence, it came as a conclusion that the special regulations adopted and applied by the European Commission at EU level for ensuring stability in the European financial-banking should be enforced as long as it is necessary and, when the market conditions allow, a permanent regime should be applied for state subsidies granted to support the financial sector.

e) Other measures

In order to enhance: bank surveillance, protection of bank depositors, capital requirements imposed on financial institutions and crisis management in the banking sector, the following aspects were considered: the analysis of the restructuring reform by Erkki Lükanen group experts; the elaboration of legislative measures for intermediary banks; credible credit ratings; increased surveillance for financial derivatives, hedge funds and uncovered securities; revision of current regulations for trading bank instruments; reduction of disloyal bank practices; reformation of the audit sector and of the accounting record.

The elaboration of a common legislative framework for the future financial crisis is one of the proposals made by the European Commission; this proposal aims at avoiding the mistakes made in 2008. This framework comes up with common financial instruments and legislative preventive measures, whose role is to reduce the budgetary burden that generates effects on the population of member states. The European Stability Mechanism (ESM) has been set up for this purpose; its capacity is to grant funds with a total value of 500 billion Euros for supporting banks in the Euro zone that face difficulties.

III. The components of the European Banking Union[5,6]

The reform in the regulation and control system devised for financial markets was based on complex analyses of the causes which triggered the financial crisis and of the solutions[7] suggested for settling its consequences.

The adopted decisions are part of a more complex concept which was developed by the European Council and which includes 4 pillars; the first pillar makes reference to the setting up of the Banking Union, with its three components: the Unique Mechanism of Surveillance, the Unique Resolution Mechanism, the European Deposit Guarantee Scheme. Pillar 2 comprises the integrated budgetary framework, pillar 3 creates the integrated framework for economic policies, whereas pillar 4 aims at creating a framework meant to ensure democratic responsibility enhancement.

A. The Unique Mechanism of Surveillance (MUS)

The measure taken for adopting this component, which is an essential and advanced component, reconfigures, at pan-European level, the surveillance architecture of banks; its assets value - related to the whole EU banking system - amounts at 42.9 billion of Euro, i.e. 350% of the EU GDP[8].

This component states the responsibilities of the European Central Bank (CEB) as regards direct surveillance of important banks from the member states starting with the 4th November 2014, on the basis of two regulations: one regarding the prerogatives of the CEB in the area of surveillance and another one regarding the harmonization of the functioning of the European Banking Authority with the new vision regarding EU surveillance.

CEB banking surveillance objectives only concern the banks that are qualified as significant within the Euro zone. There are some limitations imposed on non-Euro states, such as the fact that they cannot fully benefit from the mechanisms which EU member states are entitled to. As an alternative to these limitations, it has been established that states from outside the Euro zone can join this mechanism under certain conditions, i.e. through a cooperation system with the CEB.

130 banking groups, which represent about 85% of all banking assets within the Euro zone, have been identified for the CEB to supervise significant banks. Several subsidiaries of credit institutions from outside the Euro zone are also included in the category of banks surveilled by the CEB, i.e. important banks from Romania, which expressed their commitment to be part of the Banking Union.

Apart from the CEB, national surveillance authorities within the Euro zone are going to directly surveil the other banks qualified as significant. However, CEB is the institution responsible for the efficient functioning of banks within the Unique

[5] "Piata financiara" no.4 (221), April 2014, pag.26;
[6] "Piata financiara" no.5 (222), May 2014, pag.18;
[7] The Report of De Larosier Group, February 2009;
[8] Doc/Com (43) of 29th January 2014;

Mechanism of Surveillance, hence its power to decide to directly surveil small banks, too.

Some of the criteria established for a bank to be qualified as significant are: the size of the bank, its importance for economy, trans-border activity, its application for and receiving public financial assistance at EU level through the European Stability Fund or through the European Stability Mechanism, the question whether that bank is one the three most significant banks in the country. The CEB makes the selection of significant banks by assessing banking assets (AQR) through an inventory and an audit that allow them to see the quality of assets and their level of capitalization.

The tests which the banks within the Euro zone must pass may include capital increase; these tests could, why not, finally lead to a re-directing of the financing towards areas that ensure high financial profitability. Each national competent authority will have to make tests that are similar with the ones imposed by the CEB so that they could identify risky portfolios which are potentially over assessed or which are not sufficiently provisioned. A complete assessment should conclude with an aggregated presentation of results, at country level, together with any recommendations for surveillance measures as imposed by the CEB.

For the efficient functioning of the Unique Mechanism for Surveillance, one should also add the three regulation levels: the ECB regulation, implementation norms regarding surveillance taxes, the working procedure of the Surveillance Council, which are completed with internal norms regarding professional secret and information exchange.

For example, apart from the surveillance tax which European banks should pay to the CEB, there are other important costs imposed on banks, which are linked to the setting up of the Banking Union; thus, all these must be induced through a contribution to the Unique Resolution Fund and to the national deposit guarantee schemes in order to ensure the necessary fund required as a guarantee.

B. The Unique Mechanism of Resolution (UMR)

The regulation of this mechanism forms, together with the Directive that provides the setting up of a resolution framework that includes credit institutions and investment companies (the BRR Directive), the new institutional vision in the banking resolution areas, which is based on a unique regulation framework (known as the Single Rulebook).

The directive offers national authorities common instruments and prerogatives for expressing their opinion *ex-ante* and for settling banking crises issues in an organized manner, including by eliminating from the market non-profitable banks. The set of instruments may be structured on three levels: training and prevention, preliminary intervention and resolution.

There is a general rule which obliges member states to make financial arrangements for financing the resolution, such as:

1. Selling the credit institution *in default*;
2. Setting up a “bridge bank”;
3. Separating assets;
4. Internal recapitalization.

The resolution is made when preventive and preliminary intervention measures did not manage to redress the financial situation of the bank and did not avoid major difficulties from occurring. If, at this level, the permanent authority considers that it cannot prevent a crisis situation for the bank, and that this situation generates consequences for key functions and the content of these functions, as well as for the financial stability or for the integrity of public resources, the permanent authority must take control over the credit institution and adopt decisive resolution measures at once.

Another important objective is to provide national requirements for making resolution financial arrangements on the basis of contributions paid by banks and in proportion to their risk profile, as well as to the volume of debts; these will ensure supplementary financing for avoiding the financing of state-resolution decisions.

As to the Unique Resolution Mechanism (URM), it is applied to credit institutions from the member states which are subject to this mechanism. The regulation framework established by the BRR Directive is applied to all EU member states.

The main purpose when setting up URM was to oblige banks with financial difficulties to be recapitalized by their shareholders and creditors without resorting to public resources.

The aim of launching the resolution procedure for a bank depends on three conditions:

a) The bank finds itself or is supposed to find itself in a major difficulty;

b) When such a major difficulty situation cannot be avoided through any mechanism of the private sector;

c) When the resolution is publicly intended because the bank is systemic and it may affect financial stability.

The institutions involved in the decision-making process are: the European Central Bank, the Unique Resolution Committee - a newly set up structure, the European Commission, the EU Council and national resolution authorities. The Unique Resolution Committee functions together with the Unique Resolution Fund, which will be created through the contribution of the member states depending on the risk profile of every credit institution and amounting at an estimated level of 55 billion Euros. The Fund will be set up on the basis of an Inter-governmental Accord as regards the transfer and mutual nature of contributions, which will have to be ratified by member states.

This fund is going to have national compartments within each member state, which will collect contributions and transfer them gradually during the transition period; during the first year, there will be a 40% transfer of the fund target level, continuing with other 20% during the second year and maintaining a progressive and equal increase for the next years.

C. The European Deposit Guarantee Scheme

One has to explain that, so far, no supranational deposit guarantee scheme - whereby protection of depositors could be ensured in case a bank goes bankrupt - has been devised. The goal is to create a network of national guarantee schemes, within which member states could benefit from a guarantee fund for deposits, which would be properly financed *ex-ante*.

For concluding the regulation of this scheme, by reconfiguring the existing ones[9], it is necessary to introduce novel elements, like: reducing the period within which depositors are paid from 20 days at present to 7 weekdays; simplifying and harmonizing payment commitments; introducing *ex-ante* financial agreements, which would include a minimum target level that in general amounts at 0.8% of the guaranteed deposits that must be set up within 10 years, i.e. in 2024; simplified access to the information regarding national deposit guarantee schemes; offering loans on a voluntary basis from the national deposit guarantee schemes.

Another novelty is the access granted to these schemes, thanks to the new reconfiguration, to contribute to financing credit institution resolution. The newly regulated reconfiguration was approved by the European Parliament (EP) on 15th April 2014, so that member states are to include its provisions in domestic legislation within a year after its publication.

One should mention that from the point of view of the funds liquidity, the Fund for Deposit Guarantee in Romania (FGDR) currently has resources for paying 27% of the deposits that are covered by the deposit guarantee scheme (in comparison with 0.8% that is required by the new Directive); this means that our country is in a good situation if we consider the European requirement. Similarly, the Fund for Deposit Guarantee in Romania may currently cover 99.9% of natural persons' deposits of Euro 100,000. The Fund for Deposit Guarantee in Romania and the banking system are facing an infrastructure issue, which has to do with the IT area and which should correspond to the European requirements.

We appreciate the pragmatic level of regulation for the protection of bank deposits, which is going to increase the degree of trust invested in the banking system, as well as the clients' loyalty to the system.

3. Conclusions

The creation of the European Banking Union, together with the other measures adopted by the European Council, is a straightforward and long-term project for the Economic and Monetary Union. The European Banking Union is not a new legal instrument but it rather represents a political vision which is meant to ensure a deeper European integration through the recently adopted measures which are supposed to consolidate the banking sector regulation, as well as through other measures that are going to be adopted in the future.

This new project is expected to prevent the appearance of causes as the ones which led to the present financial crisis. This is the reason why banking surveillance should be reconfigured at European level. In fact, this project cannot achieve its goals and accomplish its purpose unless it is correlated with the creation of a European centralized model which could support banks that are no longer financially competitive by applying a unitary approach to the process of an organized withdrawal from the market.

Similarly, one should avoid obliging stakeholders to support the costs of implementing this process; in the future it will be necessary to set up a supranational institution that guarantees deposits. Such a guarantee project will be a very complex, bold and unprecedented process; it will be by far the most important project ever run at EU level ever since the EU was created.

Avoiding the appearance of a rupture between sovereign states and banks may be regarded as an alternative to the direct recapitalization of banks; this regulation is not provided in the present Treaty on the Functioning of the EU (TFEU). In the future, this subject will have to be analysed because it will help specialists identify the best solutions for avoiding the causes which led to the present crisis of sovereign debts that threatens the economic stability of certain states.

At European level, bank credited economies will remain the main development engine. In consequence, the banking systems will play a key role. After applying the new regulation model, some question will remain unanswered: finance promotion and re-crediting, as well as the evolution of capital allotments and bank exposures because the new regulations require a riskless crediting process; in a contrary case, these should be covered *a priori* with capital.

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