REFLECTIONS ON UNION EUROPEAN BANKING PROJECT

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Abstract: The international financial crisis has revealed malfunctioning of surveillance systems available until 2007-2008, as well as the relationship between banks and governments, which led to the idea of creating a European Banking Union, as a measure to prevent new negative phenomena. The project provides a centralized supervision of European banks, conducted by European Central Bank and the European Banking Authority, and common banking rules into European Union and the establishment of a common fund to guarantee bank deposits.

JEL classification: G01, G18

Key words: centralized supervision; common banking rules; banking union; resolution mechanism; banking crisis

1. INTRODUCTION

To have a financial supervision and create preconditions for strengthening the European banking sector under EU authority is necessary to have a Banking Union, which will be composed of two entities: the Unique Supervisory Mechanism of the Deposit Insurance and Resolution Mechanism for Credit Institutions. This Banking Union will try to break the link between banking crisis and sovereign debt crisis or, otherwise, between banks and national governments.

2. THE JUSTIFICATION TO CREATE EUROPEAN BANKING UNION

European Banking Union has three pillars (see figure no. 1): (1) The Unique Supervisory Mechanism; (2) The Unique Mechanism of Solving Situation for Banks in Trouble plus The Unique Resolution Fund and, also, (3) The Unique Deposit Guarantee Scheme. Each pillar has its pros and cons.

It will be a single manual of rules and it is important that it will have as less arbitrary factors of regulatory because, otherwise, the banks will go around the regulatory rules.

In essence, the Banking Union will have two tasks: supervision of banks and resolving banking crises. For that reason it was adopted the Regulation of Banking Supervision, and the Regulation of Bank Resolution (the resolution means an assisted by state restructuring for banks, to ensure the continue exercise of their functions in the economy).

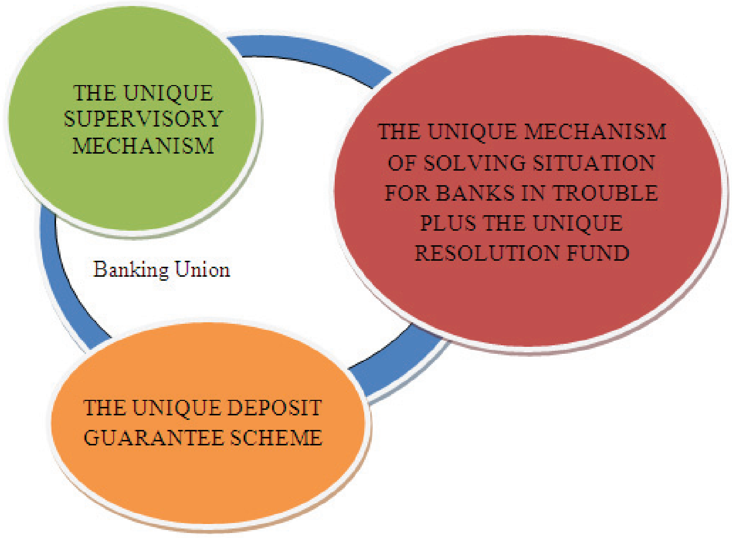


Figure no. 1

European Banking Union and Bank Resolution Mechanism are necessary steps for a Union Banking. The Unique Mechanism of Resolution (UMR) for Banking Union was proposed by the European Commission and will complete the Unique Supervisory Mechanism (USM). The Bank Resolution Mechanism will manage the problems of any bank in the euro area and of other member states of the Banking Union. The costs of resolution must, first, be borne by shareholders and creditors (bail-in method), but an appeal to availabilities of European Stability Mechanism is unable to be excluded in extreme cases.

Creating a single supervisory mechanism in the autumn of 2014 will be a milestone in order to create a banking union in Europe. This unique mechanism allows AML supervision, oversight entities belonging to credit institutions headquartered outside the EU.

Realities of recent years show that there have been major changes in the European banking system, which requires proper regulation.

Vice president of Romanian National Bank, Bogdan Olteanu, said at the conference "Key Legal Aspects of Bank Resolution": "In terms of bank resolution there are two important things. Changing of system in crisis, show us that negative externalities are so overwhelming that bank resolution should be managed differently. The second point is that we were very serious challenge to manage forming of new systems in our countries and for that, the authorities of our countries must work together to establish a new structure for bank resolution mechanism….. We face several levels of regulation. One is represented by national regulations. The second is the directive of banking resolution, and the third level is our participation in the process to designing an integrated mechanism."

Regarding the supervision of banks, we note the most radical change, because it moves the supervision of banks from national authorities to European Central Bank, whitch will supervise them directly. For start, is about 128 institutions - systemically relevant banks (major banks of Europe), with assets exceeding 30 billion euros or exceed 20% of the GDP of the state of residence. The 128 banks hold about 85% of banking assets in the eurozone. Until November 2014 the ECB will carry out a comprehensive evaluation of their assets, involving both other European institutions (European Banking Authority - EBA) and national institutions (banks supervisors in euro area and in other member states of the EU).

The evaluation incude three phases that take place almost simultaneously. First, it will take place a risk oversight and evaluation, which includes qualitative and quantitative analysis of the main risk factors: liquidity, debts and funding. In the second phase is to evaluate asset quality, being involved also EBA. The third phase aims to do stress testing, according to the results obtained in the previous phase.

The ECB will have the power to revoke banking licenses, to fine the lenders who don't follow the rules, to decide whether if a bank should be bail out, but also to decide directly to supervise any bank or group of banks considered to be a potential source of systemic risk. In time, the ECB will probably ask that all banks in the euro area (about 6000) must to join in the system.

This means a transfer of sovereignty, justified by the existence of a single monetary zone and through the bad experience of countries such as Greece, Ireland, Spain, which demonstrated a lack of regulation, large lack in decisions of national regulatory authorities.

The second task - solving of banking crisis by recapitalization or by ordered bankruptcy of an institution - is an approach known or recommended by the international financial crisis of 2007-2008. A new banking authority will take up the restructuring process and not ECB, which becoming the lender of last resort.

The banking sector in countries signatory to the agreement must contribute to a bailout fund of 500 million euro. As measures proposed by the representatives of euro zone, in addition to establishing the resolution fund (which should accumulate financial resources, in the next decade, of about 55 billion euros in contributions from banks, by a system similar to the deposit guarantee fund each country) included also the appointment of an EU Agency responsible with decision for bank bankrupt, and which can develope procedures for sharing the costs of resolving a banking crisis.

3. Sensitivities generated by the additional responsibilities of the ECB

Obviously, the creation of European Banking Union will generate some sensitive issues. If a bank in a country goes to bankrupt, the money will be received from Brussels by the depositor, which means breaking the link between banks and national governments (taxpayers' money won't be used to rescue banks). In this respect there is a risk of asymmetric treatment between euro area countries and those outside it, but members of the European Banking Union.

EU Member States agreed standards for deposit guarantee schemes, but failed to coordinate on a bill that would tighten regulations on financial derivatives market.

Also, the new tasks of the ECB could affect UK banks. British finance minister, which supports European Banking Union project, said that Britain will not participate in a banking union which require British taxpayers to pay for recapitalize European banks. Not being a part of the euro area and as opposed to project for financial transaction tax, Britain is not interested of European Banking Union project. Special privileges for requirements on London financial market, without incurring any cost, are unacceptable for the EU.

On the other hand, analysts draw attention to the fact that division of responsibility between national supervisory authorities (whose role will be limited to an advisory status and which have to cooperate with the ECB) and the ECB will lead to some additional problems because that kind of division and coordination for responsability can never work very well. The ECB and the national supervisory authorities will have to function as a system. The fundamental problem remains the Central Bank' independ.

A disagreement, for various reasons, came also from countries such as Hungary, Romania and the Czech Republic, which are members of the EU, but not of eurozone. They expressed concern about potential use on banks not covered by the new single supervisor, but aided by the European bailout fund. Then there are issues regarding a possible suing to ECB for a wrong use of supervisory mechanism, this initiative can create diplomatic tension, hence we need a mechanism to mediate potential conflicts.

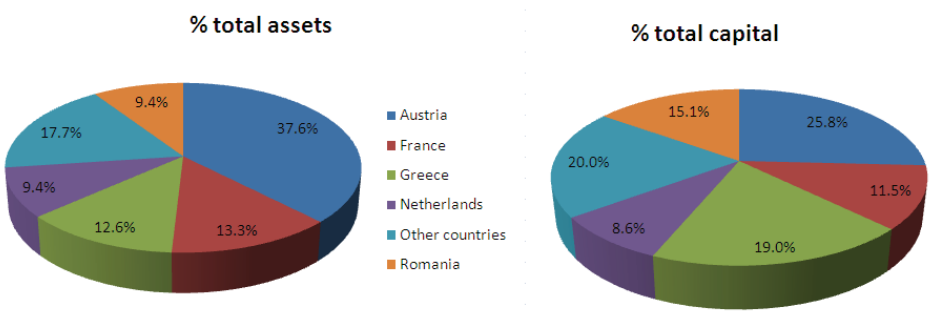
Critics believe that such a project would mean, actually, a common assumption for all member countries on the losses of some European banks. Also, the project would help the big banks from Central Europe, for reducing their exposures at their eastern subsidiaries.

4. WHY IS GOOD THAT ROMANIA TO BE A MEMBER OF THE BANKING UNION?

For states which join the euro area, including Romania, an accession to the Banking Union is a natural step, especially since in these countries work many European banking groups that are part of the Union.

Basically, 75% of total banking assets in Romania are of banks or financial entities mainly from euro area. These banks also own two thirds of the entire banking capital (see figure no. 2).

Romanian Banking System (March 2013)



Source: BNR, Isarescu, M – Banking Union: principles, challenges and perspectives, Sibiu, 17 May 2013

Figure no. 2

BNR governor showed, during the launch of the report "Romania 2020 new ambitions, ambitions retrieved. Dialogues on national interest", that, in the context of financial integration, which will become increasingly stronger in Europe," the preservation of all local supervision measures could lead to suboptimal results because of the limited information had by local supervision authority about the results and activities of the parent banks."

Not be ignored that there are some undesirable implications for Romania, such as restriction of presence for credit institutions with foreign capital and, also, restriction for foreign banking's capital, parent banks withdrawing already over 70% of short-term financing for local banks. Therefore, the imperative for Romania is considered the further restructuring and privatization of state companies, increasing labor market flexibility, the liberalization of administered prices so as to increase their competitiveness.

5. Conclusions

Banking Union was born as a result of the European Commission proposal that wanted an integrated financial supervision at European Union level. By creating Banking Union, economic convergence within the European Union will be built on three pillars: Monetary Union, Fiscal Union and Banking Union.

To prevent situations in which the state "collaborate" with the banks in good times and must save them from bankruptcy in adverse times, it requires a Banking Union in Europe.

We subscribe to the view of the Dutch Minister of Finance, according to which the creation of a banking union will make that banking sector become responsible for the risks they take and for the losses they will record.

In the absence of a banking union, banks are perceived that having as assets debts of the states, as appreciates Romanian central bank governor. Banking Union ensure placement on a more healthy basis and will restore confidence in euro.

In a Banking Union, capital requirements, liquidity, protection of customers are unique and in case of insolvency, banks will be recapitalized from a special fund. This is essential, because it breaks the vicious circle in which the state and the banking system affect each other: the state debt accumulates by pumping billions euro into the banking system and banks are exposed to sovereign risk by financing sovereign loans.

A banking union would avoid the current fragmentation in the euro area, which leads now to fragmentation of the single market.

The domestic bank capital movements hinder the free movement of capital and complicate monetary policy transmission mechanism in the euro area.

Banking Union could become the biggest financial reform since the creation of the euro, reform that would transfer control of banks from national level to European level, and demonstrate that financial stability and financial integration are not compatible with the preservation of national surveillance.

Last but not least, people who deposited money in banks in danger of bankruptcy will be better protected in case of existing banking union, and the models to address failing banks and to protect depositors will be more easy to apply.

Common supervisory measures would strengthen the confidence of depositors and markets and reduce the vulnerability of the European banking sector. It means, including more efficient management of banking crises, so that to minimize the negative consequences on the economy and recourse to public funds. We believe that decisions taken in the euro area will be political.\

In conclusion, Bauking Union means more capital, less debt and thus moderate risk. In this construction, the credibility of the European Central Bank is, in our opinion, the key of European Banking Union. For all these reasons, we believe that by creating of European Banking Union, European Union will demonstrate once again that it is a viable project and irreversible.

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