



Completing the Banking Union and Implications for CMU

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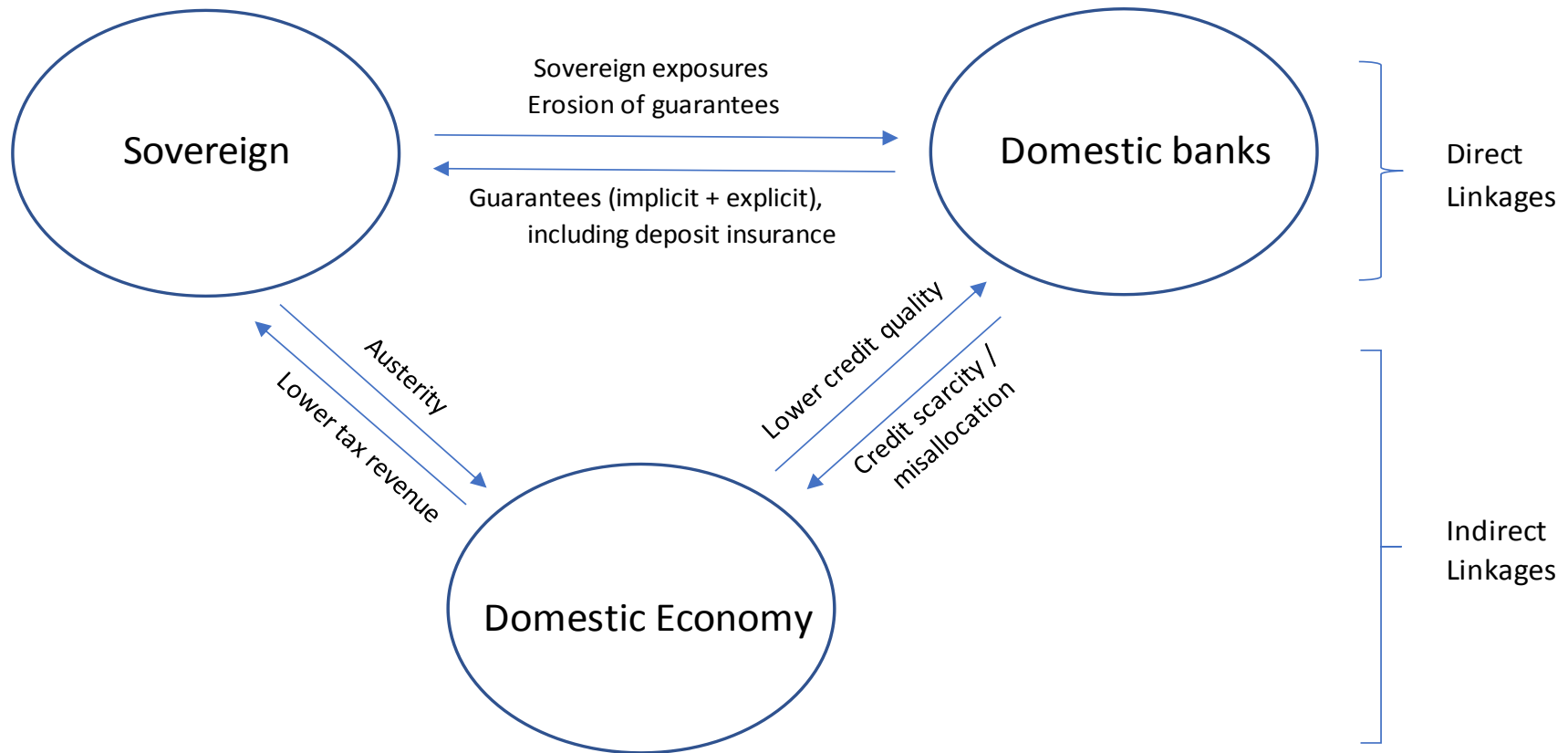
Banking Union Semantics

- An ongoing process started mid-2012
- A current set of institutions and policies
 - SSM + SRM = “Half-built banking union”
- Breaking the bank-sovereign vicious circle
 - HBBU + targeted policies to address bank-sov. linkages
 - “No-doom-loop banking union”
- A level playing field for banking business
 - NDLBU + lots of further harmonization
 - “Single-market banking union”, parallels CMU
- A geographical area

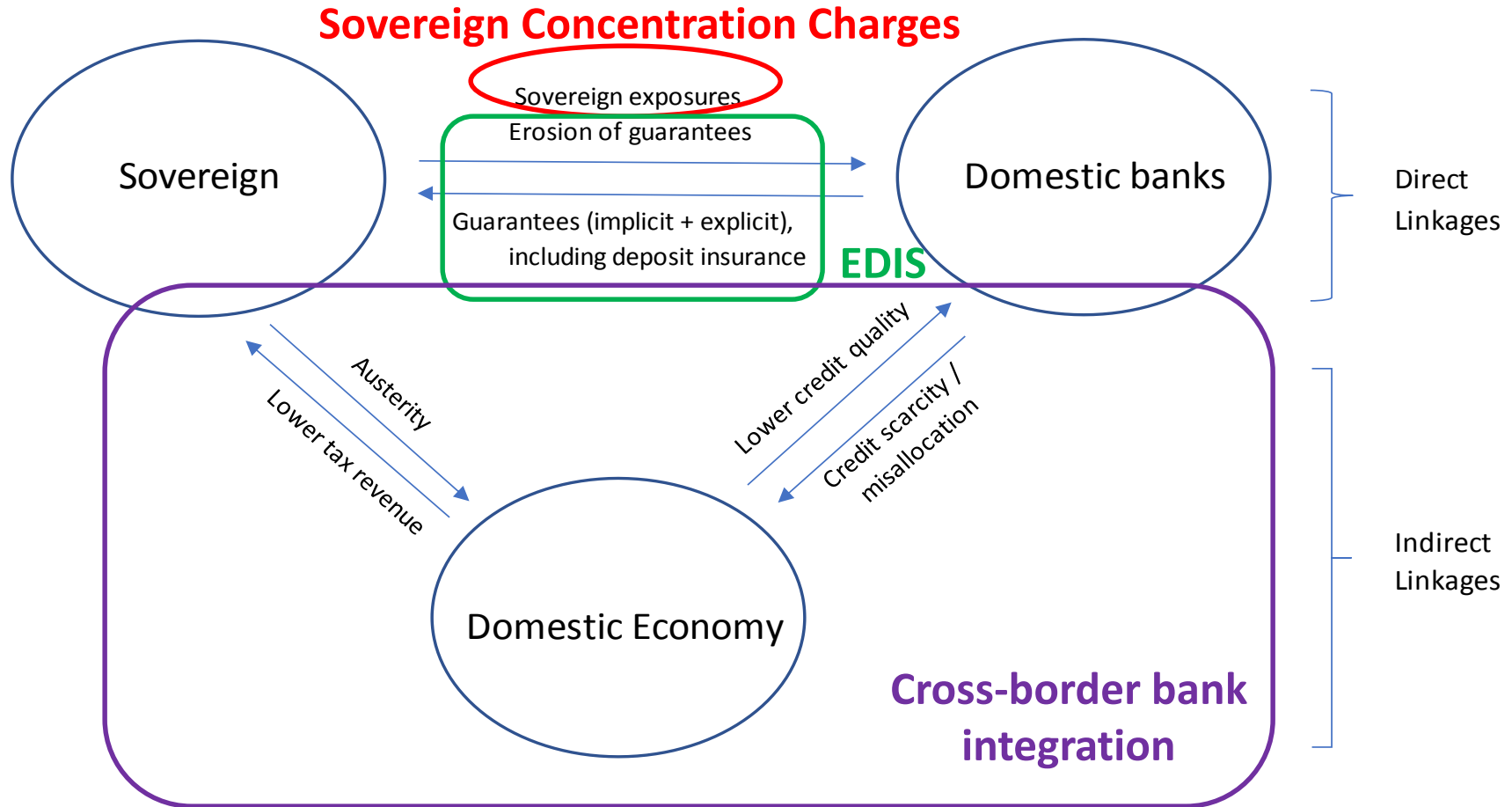
“Completing Banking Union”

- A minimal package of interdependent steps to break the “doom loop”:
 1. Sovereign Concentration Charges (SCCs)
 - Removing current high home bias in euro-area banks’ euro-area sovereign exposures
 2. European Deposit Insurance (EDIS)
 - European Commission proposal of November 2015
 - Possible refined design options
 3. Phase-out of geographical ring-fencing
 - End of penalization of cross-border expansion

Bank-Sovereign Linkages



Breaking the Vicious Circle



Sov. Concentration Charges

(Paper published by European Parliament, November 2017)

- Pillar-1 instrument
- Add to RWAs in capital ratio denominator
 - Only concentration, no credit risk assessment = acyclical
- SCC coefficient increases with concentration
 - Pain threshold in the 100-200% range
- Preparation long phase-in, grandfathering

Bucket	1	2	3	4	5	6	7
Sovereign exposure ratio	< 33%	33%- 50%	50%- 100%	100%- 200%	200%- 300%	300%- 500%	> 500%
Sovereign concentration charge	-	15%	30%	50%	100%	200%	500%

Sov. exposure ratio = sovereign exposure to a given member state / Tier-1 capital

SCCs: Expected Impact

Exposure ratio (%)	Marginal SCC	Average SCC	Capital impact (bp) (Tier-1 ratio = 10%)	Capital impact (bp) (Tier-1 ratio = 15%)
50%	15%	5%	-3	-6
100%	30%	18%	-17	-38
150%	50%	28%	-41	-90
200%	50%	34%	-63	-138
250%	100%	47%	-105	-225
300%	100%	56%	-144	-301
350%	200%	76%	-211	-430

- Diversification within euro area, not reduction of aggregate euro-area exposures
 - No international competitive distortion (if diversification)
 - Exact portfolio rebalancing patterns hard to predict
 - Not disruptive if well prepared (\neq credit risk weights)

SCCs: Potential Reallocation

Country	Number of banks in sample	Coverage of country's SIs (by assets)	Total domestic exposures of domestic banks in sample	Domestic exposures of domestic banks above 33% of Tier 1	Domestic exposures of domestic banks above 100% of Tier 1
France	6	93%	349,773	249,763	119,467
Germany	15	92%	301,538	242,432	155,080
Italy	6	78%	179,626	145,040	74,820
Spain	3	67%	135,978	92,143	23,634
Belgium	4	65%	51,844	43,675	27,091
Netherlands	4	95%	48,498	14,744	0
Portugal	4	85%	25,105	19,772	11,502
Austria	6	95%	22,511	13,243	2,596
Greece	4	100%	19,676	9,463	1,175
Ireland	3	89%	15,498	9,061	686
Cyprus	2	58%	2,779	291	0
Slovenia	2	80%	2,650	2,045	816
Finland	1	25%	1,755	0	0
Malta	2	65%	1,335	1,142	772
Luxembourg	1	23%	731	242	0
Total	63	83%	1,159,298	843,055	417,638

Refined EDIS Design

- Fully integrated institutional framework (SRB)
 - Mandatory national schemes phased out
- Compartments
 - National compartments sized by total covered deposits
 - Possibility of network-specific compartments (e.g. Sparkassen), with conditions to prevent abuse
 - Voluntary top-ups can remain unchanged
- National insurance fee add-ons
 - Based on quality of credit policies
- Waterfall structure is backstopped by ESM
- Comprehensive assessment of LSIs

Cross-Border Integration

- Phasing out of national ring-fencing of capital and liquidity
- Rewards for geographical risk diversification
 - Capital calculations (asset correlation parameter in IRB)
 - Stress test scenarios
 - Intra-euro-area linkages in G-SIB determination
 - Formula for deposit insurance fees?
- Too-Big-To-Fail safeguards
 - TLAC, higher leverage ratio (cf. Basel III finalization)

Other “No-Doom-Loop” Items

- All residual guarantees at European level
 - Enable ESM prec. recapitalization + guarantees
- Strengthening of SRM
 - Fuller SRB authority over resolution scheme execution
 - Harmonization of bank insolvency law
 - ESM backstop (ongoing) + liquidity in resolution
- Additional steps against needless bail-outs
 - Normalization of state aid control
 - Tightening of precautionary recap. process
- Elimination of structural distortions

Structural Distortions

	"Large Euro-SIs"				"Anglo-SIs"			
	# banks	GSIBs	% of aggregate assets		# banks	GSIBs	% of aggregate assets	
			All	Non-GSIBs			All	Non-GSIBs
Dispersed	15	6	44%	16%	43	9	87%	93%
Minority influence	18	-	13%	27%	5	2	6%	2%
Private control	11	-	3%	5%	-	-	-	-
Cooperative	13	2	24%	22%	4	-	2%	5%
Public sector	19	-	10%	19%	-	-	-	-
Nationalized	8	-	6%	11%	1	1	4%	-
Total	84	8	100%	100%	53	12	100%	100%

Euro-SIs are significant institutions (SIs) headquartered in the euro area with more than €30bn in total assets.

Anglo-SIs are equivalent institutions (groups > €30bn total assets) headquartered in Australia, Canada, UK & US.

GSIBs = Global Significantly Important Banks (FSB ranking of November 2016). Assets are measured as of end-2015.

Source: Nicolas Véron, "The Governance and Ownership of Significant Euro Area Banks", Bruegel & PIIE, May 2017

Implications for CMU

- Capital Markets Union is just another name of single market for financial services
- Banks will remain central to the euro area / EU / EEA financial system
- Completing the banking union is the real centerpiece of CMU
- Banking union also proof-of-concept for other Europe-wide financial supervision
 - Conduct of business (ESMA) and AML



Thank You For Your Attention

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