EBCI Vienna Initiative

Vienna 2 Initiative

Working Group on the European Banking Union and Emerging Europe[1][2]

General considerations

- *The countries of Central, Eastern and South Eastern Europe (CESEE) have today very different starting points in relation to the banking union.* There are euro area members (Estonia, Slovakia and Slovenia), EU members outside the euro area (Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania) and non-EU members (Albania, Belarus, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Moldova, Montenegro, Russia, Serbia, Turkey and Ukraine).

- *In many CESEE countries banks headquartered in Western Europe play a central role.* Subsidiaries or branches of these banking groups are in many of the host countries considered to be systemic while still being small in relation to the balance sheet of the banking group. Subsidiaries and branches often rely on substantial parent bank funding, although efforts to create local funding markets are underway. In some of the countries outside the euro area domestic lending in euro has been extensive.

- *CESEE countries have a clear interest in a complete and successful European banking union.* The interdependence of the banking systems makes sound supervision and financial stability in the banking union critical to all CESEE countries. Maintaining financial stability in CESEE host countries is also of interest to the ECB and the SSM. Ensuring a proper role for countries that are not yet part of the banking union will contribute to the banking union's success, as further elaborated below.

- *All three elements of the full banking union - common supervision, resolution and safety net with backstops –are required for its effectiveness.* Although the political process may require sequencing, being well prepared for future crises and helping overcome the current euro area crisis necessitates all elements being in place. Establishing only common supervision would be a concern to all Vienna 2 members—supervisors, central bankers, IFIs and commercial bankers. Common resolution and its financing were seen as critical elements of a functioning banking union. It is fundamental to speed up the completion of the steps leading to a full banking union.

[1] These bullet points form the basis of a more extensive report for the attention of the relevant European authorities. They reflect the discussions of a working group meeting hosted by the EBRD in London on March 13.
[2]The European Commission and the European Investment Bank were observers in the Working Group on the Banking Union and may have different views on the issues addressed in this document.

- *Many members underscored that an effective banking union ultimately requires a common Deposit Guarantee System.* In the short run this may be hard to achieve since it requires fiscal agreements. Until an agreement on a common Deposit Guarantee is ready, credible and harmonized national deposit insurance systems are necessary. And this requires a strong and reliable commitment of all relevant European and national authorities.

- *Being prepared ex ante for what may be needed to agree upon ex post is generally recognized to be a good idea.* Principles and procedures for crisis management and resolution can and should be discussed in advance. As this inevitably involves questions of potential burden sharing, fiscal authorities need to be involved.

- *Banks generally support the banking union project and argue for it to be as comprehensive as possible.* But there is a worry that the supervisory structure may be unclear and complex during the transition to a full banking union. A lengthy transition process could create multilayer supervision/resolution system, under which there will be no clear decision making authority. Reporting requirements, stress testing, etc. should be more simplified and consolidated than they are today.

- *Information from national authorities, from the ECB and from other European authorities must be timely and consistent.* Given the uncertainty about the banking union project that will necessarily prevail for a long period, information to markets should be well prepared and coordinated.

Considerations for SSM countries

- *The SSM has a number of potentially very positive implications for participating CESEE countries.* Long-standing home-host coordination problems can be addressed in a credible manner by centralizing supervision at the ECB. Supervisory standards should be expected to improve in quality, independence of supervision should increase and implementation of regulation should become more harmonized and consistent. The fear of “home bias” should diminish and compliance cost for cross-border banks should eventually fall. In the short-run, the SSM should help mitigate fragmentation. Although these positive factors should dominate in the long run, some problems remain to solve in the short run.

- *As only common supervision is to be established in the first phase, a mismatch between decision-making power and responsibility for the consequences of supervisory decisions is created.* National authorities will not be responsible for supervision of domestic banks, but will still bear the fiscal or financial stability consequences that may arise from supervisory failures. This dilemma argues for giving high priority to the work on a proposal for a single resolution mechanism in order to minimize the period of mismatch. In the interim the ECB should work as closely as possible with national authorities to observe and handle situations where the mismatch may be of importance.

- *Agreeing on the interface between banks, the ECB and national supervisors is an important challenge for all participants in the SSM.* Parent banks usually find it efficient to have the ECB as a single contact point, while national authorities feel that contacts should be through them, at least as long as they remain partly responsible for domestic financial stability and any fiscal costs of bank resolution. A balance must be struck here between having one single authority in charge of significant banks and ensuring sufficient recourse to the local expertise and resources of national authorities in order to arrive at good decisions and facilitate consistency with the treatment of the other banks, which are not directly supervised by the ECB.

- *The modalities of cooperation between the ECB and the EBA are not yet entirely clear.* Both authorities will be extensively involved in setting supervisory principles, norms, and practices, although the draft amendment to the regulation of the EBA retains its role as the regulatory and supervisory standard setter in the EU. Consistency and avoiding double-layers of regulatory/supervisory activities require close cooperation and agreement on the division of labour.

- *A strong and clear mechanism is needed to handle conflicts of interest between home and host countries given that the ECB will represent both.* The SSM would move the coordination between home and host countries participating in the banking union from colleges to the ECB and to the decision making body of the SSM. But this does not automatically eliminate potential conflicts of interest within the ECB's supervisory board. One area of possible conflict of interest is intra-bank-group support across borders in a crisis situation, when host countries representatives may feel that their national financial stability is threatened. Developing ex-ante guiding principles for the appropriate use of intra-bank-group support that duly take account of national financial stability concerns and financial stability concerns of the bank group may be helpful.

- *Clear decision making procedures for macroprudential policy must be established and implemented across jurisdictions and in the banking union.* Experience from the crisis suggests a bigger role for macroprudential instruments going forward and a need for appropriate central influence to take account of cross-border problems and to mitigate forbearance. On the other hand, factors affecting financial stability may be very different in different countries, indicating the need for appropriate national influence. With the CRD IV and the CRR giving direction, a careful balance between these considerations needs to be struck and adequate coordination and cooperation to safeguard the proper functioning of the EU common market need to be provided for. As a matter of principle, the ECB should take the lead in policies relevant for the whole banking union, while national authorities should remain in the driver's seat for policies catering to the idiosyncrasies of their own economies. In practice, a clear distinction between common and national interests may be difficult to find. The agreement reached recognizes the influence of both. Further work on how the agreement on macroprudential instruments shall be handled in practice (and conflicts solved) should be undertaken. Agreeing on guiding principles, also clarifying the role of the ESRB, would be an important step forward.

- *Careful implementation of the new structure is key to its success.* Consistent implementation of harmonized regulation greatly reduces costs both to banks and to society. National discretion in implementation should be minimized.

Considerations for opt-in EU countries

- *EU countries that opt into the SSM will essentially have the same benefits as euro-area members.* The SSM governance structure has provided for their influence to the extent possible within the confines of the current treaty. However, some important factors need to be considered.

- *Non-Euro countries lack the support of ECB liquidity in crisis times.* This is true for all non-euro-area countries, but it is particularly relevant for CESEE countries with extensive euro-denominated lending. Access to properly structured and conditioned swap arrangements with the ECB for opt-ins would greatly increase incentives for SSM participation. Given substantial euroization in many opt-in countries, national central banks and the ECB would need to cooperate closely on liquidity provision to safeguard financial stability in times of crises. Ex-ante agreements on the modalities for such cooperation would be helpful in bolstering confidence.

- *Opt-in countries should participate in the discussion of how to operationalize the new supervisory structure.* The ECB works closely with the euro-area supervisors in designing the practical modalities of the new supervisory system. To ensure that a variety of viewpoints is taken into account and to build confidence, this cooperation could be extended to potential opt-in countries.

- *Uncertainty about conditions for the next elements of the banking union should not prevent opt-ins from entry.* As long as the conditions for the common resolution framework and the common safety net and backstop are not agreed upon, it may be difficult for many countries to fully subscribe to the banking union. This argues for completing the banking union as swiftly as possible and involving potential opt-ins closely into the design of the outstanding elements.

- *In a future change of the treaty the rights of the opt-ins could be strengthen*. A treaty change could allow for an improved governing structure of the SSM and open up for involving the opt-in countries in the ESM and in other future additional backstops. This, of course, would require corresponding fiscal contributions from the opt-in countries.

Considerations for non-EU countries and for EU countries that do not opt in

- *Countries that cannot or will not become SSM members still benefit from the banking union.* They will benefit from simplified work in colleges and simplified communication networks, and indirectly from more stable financial systems in the SSM countries. But they may also risk an increasing isolation from major decisions made at the ECB or the EU that directly affect their banking sectors.

- *A good working relationship between the ECB and the competent authorities in non-SSM countries should be of interest to both in order to build confidence.* A permanent mechanism should be established among existing authorities to achieve this.

- *Appropriate influence of non-SSM countries in supervisory colleges should be ensured.* The EBA can help by exercising its role as a neutral mediator and guarantor of respect for the competences of all college participants. In addition, non-EU countries can be granted non-voting membership in relevant colleges. Supervisory colleges will be important for all non-SSM countries to coordinate and cooperate on supervisory issues. Stronger agreements other than the current rather general "3rd party" engagement between EBA and EU candidate or potential candidate countries should be considered.

- Macroprudential decisions taken by the ECB may also influence non-SSM countries and non-members. EU countries are represented in the ESRB but non-EU countries are not. Mechanisms for wider cooperation on macroprudential issues should usefully be put in place. It would be particularly helpful to create opportunities to exchange information ahead of time so that non-SSM countries and non-EU members can provide feedback and prepare for the impact on their economies.

- *In some non-EU countries the legal supervisory framework is considered to be weak, for instance in the area of confidentiality.* It should be in the interest of all participants to harmonize this legislation when considered a problem.