A European banking union

In recent months, the EU has discussed the need to move towards a so-called banking union, comprising common systems for banking supervision, deposit guarantees and crisis management. The European Commission recently proposed what is considered to be a first step towards such a banking union - a system of common banking supervision in the euro area.

The Commission's proposal is comprehensive and would constitute a substantial change of EU banking supervision.[1, 2] The proposal gives the ECB responsibility for supervising all banks in the euro area. The idea is to phase in the supervisory mandate. As of 1 July 2013, the ECB would take over supervision of systemically-important banks from the national supervisory authorities and, from 1 January 2014, exercise supervision over all banks in the euro area. However, from 1 January 2013, the ECB can choose to supervise specific banks. The proposal explicitly mentions banks that have received or applied for public support.

The proposal does not mean that national supervisory authorities would become superfluous. Under the proposal, they would continue to conduct supervisory tasks, but under the ECB's overall responsibility and decision-making powers. Within the ECB, the idea is for a special supervisory board to be created to plan and execute supervisory work. However, just as for monetary policy, the final responsibility would rest with the Governing Council of the ECB. Under the proposal, non-euro countries would be given the opportunity of joining the common supervision, but with very limited influence.

The European Commission's timetable is very ambitious and aims to reach a decision before the end of the year. One reason for the hurried timetable is that, in June, the euro area's heads of state and heads of government resolved that functioning joint banking supervision for the euro area's banks was a precondition for broadening the scope of the European Stability Mechanism (ESM) to include the direct capitalisation of banks. This would provide an alternative to granting loans to the relevant member states, which leads to a corresponding increase of public debt.

The idea of switching to joint supervision of Europe's banks is neither new nor unreasonable. As banking operations become more international, the weaknesses of purely national supervision are becoming more apparent. National authorities have neither enough incentive nor the possibility of considering the repercussions of the actions of a major multinational bank in other countries. The Riksbank thus noted as early as 2007[3] that it may be appropriate to subject systemically-important banks to joint supervision and presented its thoughts on how this could be achieved.

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[1] See also the article New measures to manage the crisis in the euro area, *Monetary Policy Report October 2012*, Sveriges Riksbank.
[2] Another initiative is the work of what is known as the Liikanen group, see *High-level Expert Group on reforming the structure of the EU banking sector*, October 2012. For the Riksbank's consultation response, see http://www.riksbank.se/en/Press-and-published/consultations/consultation-responses-by-the-Riksbank.
[3] BIS, Regulatory challenges of cross-border banking – possible ways forward. Speech by Stefan Ingves, 23 July 2007. http://www.bis.org/review/r070724a.pdf.

For smaller banks, the arguments for joint supervision are not as strong, as the cross-border effects of an individual bank's problems are normally minor. However, there are examples from Europe that have shown that an inability among national central banks to manage problems in small banks can lead to major problems in other countries. In a monetary union, incentives for national authorities to be clear on their own banks' problems can also be limited.

However, introducing a system of joint banking supervision is a highly complicated project, with the problems, both practical and political, being many. It is thus extremely important that the solution considers all aspects and is not rushed through.

One important factor to consider is that joint banking supervision will ultimately lead to questions with clear fiscal policy implications for the participating countries. These would include, for example, how deposit guarantees and costs for bank support and bank resolution should be funded and allocated between countries. A significant amount of ex ante funding of such resources, mainly by the banks themselves, would be an important precondition for support to be granted when necessary. One complicating circumstance is that the health of the European banks varies widely from country to country, meaning that expected assistance needs differ between countries. A long-term sustainable solution must consider this so that there is no systematic transfer of resources to weak banks from well-managed banks and taxpayers in countries with relatively strong public finances. Making joint banking supervision effective will require progress in parallel on these issues in the negotiations over a new deposit guarantee directive and the proposed directive on crisis management.

It is also of central importance that each country, under the framework of joint microsupervision, has sufficient scope to manage financial stability risks within its own borders. This is particularly important in a country like Sweden, which, due to its relatively large banking sector, risks being impacted by large economic costs in the event of a banking crisis. Consequently, it is very important that the Swedish authorities have the possibility of setting capital requirements for the Swedish banks above requirements for banks abroad. This is an important aspect of the assessment of several different parts of the European Commission's proposal, not least decision-making within the European Banking Authority (EBA), see below. It is also an important argument for placing responsibility for macroprudential policy instruments on a national level.

Effective joint banking supervision also requires all participating countries to be given the opportunity for sufficient influence over the decisions taken by the joint supervisory authority. The Commission's proposals are not balanced from this perspective. As far as possible, euro countries and participating non-euro countries should have the same degree of influence. This could involve, for example, voting rights for the participating non-euro countries in the special supervisory board that the Commission proposes should be set up within the ECB. However, it should be noted that this would not mean full co-determination, as the final responsibility lies with the ECB's Governing Council, in which non-euro countries are prevented from participating by the Treaty on the Functioning of the European Union (the EUF Treaty) and the ECB Statute.

The European Commission's proposal would also entail major changes for countries choosing not to participate in the joint supervision. An important starting point for the European Commission is that a joint supervisory authority makes greater demands of joint regulation than national supervision does. Within the EU a large share of the responsibility for producing joint regulations for banking supervision lies with the EBA. Regulations that are determined by the EBA apply for all EU countries, however, and are not limited to applying only to countries that choose to participate in the joint supervision. If, as the European Commission proposes, the ECB were to coordinate the euro countries' actions in the EBA, there would be a significant risk that the regulations on banking supervision within the EU would reflect the wishes of the countries participating in the joint supervision rather than the needs of all 27 EU countries.

Due to the EBA's mandate to settle disputes between different supervisory authorities in the form of what is known as binding mediation, far-reaching coordination of the euro countries' actions in the EBA could make it significantly more difficult for supervisory authorities from non-participating countries to carry out supervisory measures regarding cross-border banks with operations in one euro country. According to the ECB's proposal, if the ECB, as a counterparty in what is known as the college of supervisors, were to question a certain measure and refer the matter to the EBA for a decision, the coordinated actions of the euro countries would automatically settle the matter. How a reasonable degree of protection of minorities can be ensured under the framework of the EBA is therefore important.

Intensive negotiation is currently underway within the EU’s council structure with regard to the European Commission’s proposal. Considerable energy has been expended on the issue of whether non-euro countries will have sufficient incentive to join the joint supervision. This concerns in particular these countries' influence in the decision-making process within the ECB. Another important question has been how the EBA's decision-making rules can be modified to ensure a reasonable balance between the needs and wishes of participating and non-participating countries.

In summary, a great deal suggests that joint supervision of at least the major cross-border banks is justifiable. However, such a project would be very complicated and would require many major issues to be resolved for the results to be efficient and sustainable over the long term. A solution should not be pushed though in a short-term attempt to manage the current financial crisis in Europe.