



BRIEFING PAPER

Number 06462, 30 December 2015

European Banking Union

By Tim Edmonds

Inside:

1. European Banking Union
2. Crisis Management
3. Other proposals: banking structures
4. Further reading



Contents

Summary	3
1. European Banking Union	4
1.1 Single Supervisory Mechanism (SSM): introduction	4
1.2 Establishment of the SSM	5
Legislation	5
The institutions	6
1.3 Single Resolution Mechanism (SRM)	12
2. Crisis Management	14
3. Other proposals: banking structures	17
3.1 Single capital requirements rulebook	17
3.2 harmonised deposit protection schemes	17
3.3 The Liikanen Report and banking structural reforms	18
4. Further reading	21

:

Summary

This note brings together the main documents and developments regarding the European Community's attempts to create a more pan-Community supervisory and recovery mechanism for members' banking sectors. Significant new measures were approved of in December 2013.

The measures will not apply to the UK because it is outside of the euro area.

The proposals are collectively called the European Banking Union which is comprised of two main 'pillars':

- The Single Supervisory Mechanism

The Single Supervisory Mechanism is a new system of banking supervision for Europe. It comprises the ECB and the national supervisory authorities of the participating countries. It is based upon a single Rulebook which provides legal and administrative standards to regulate, supervise and govern the financial sector in all EU countries more efficiently. It includes rules on capital requirements, recovery and resolution processes and a system of harmonised national Deposit Guarantee Schemes.

- The Single Resolution Mechanism

The main purpose of the Single Resolution Mechanism is to ensure the efficient resolution of failing banks with minimal costs for taxpayers and to the real economy. A Single Resolution Board will ensure swift decision-making procedures, allowing a bank to be resolved over a weekend. As a supervisor, the ECB will have an important role in deciding whether a bank is failing or likely to fail.

A Single Resolution Fund, financed by contributions from banks, will be available to pay for resolution measures.

The institution at the heart of the system is the European Central Bank which works with national regulators and other pan-European banking groups such as the European Banking Authority which does include the UK within its remit.

With respect to the current crisis in Greece, the ECB has as its focus the position of Greek banks. Questions about the broader public finance problems of the Greek government and Greek people, are outside of its authority, but well within the sphere of impact of the decisions it must take.

1. European Banking Union

The European Banking Union is built on two pillars:

- The Single Supervisory Mechanism
- The Single Resolution Mechanism

1.1 Single Supervisory Mechanism (SSM): introduction

The proposals were originally set out in a Commission document in 2012: [Banking Union & a single supervisory mechanism](#). At its heart:

- the European Central Bank (ECB) would become responsible for the supervision of all banks in the euro area, with a mechanism for non-euro countries to join on a voluntary basis.
- Specifically the will become responsible for tasks such as authorizing credit institutions; compliance with capital, leverage and liquidity requirements; and conducting supervision of financial conglomerates. The ECB will be able to carry out early intervention measures when a bank breaches or risks breaching regulatory capital requirements by requiring banks to take remedial action.¹

The Commission proposed to have the SSM in place by 1 January 2013. To allow for a smooth transition to the new mechanism, the proposals were phased in.

- As of 1 January 2013, the ECB assumed full supervisory responsibility over any credit institution, particularly those which have received or requested public funding.
- As of 1 July 2013 all banks of major systemic importance came under the supervision of the ECB extending to all banks by 1 January 2014.

The key point to note is that UK banks will be outside of the jurisdiction and hence the direct control of the ECB. Other parts of the overall bank reform agenda which will apply to UK banks.

Neither the Treasury nor the Bank of England produced official responses to the Report. However, there is an excellent summary of many of the issues connected with the proposal in the House of Lords European Union Committee Report [European Banking: Key issues and challenges](#).

There was a cautious response initially. The British Bankers Association issued a press release about the Commission's Report. It welcomed the establishment of a European wide format to tackle the 'euro crisis' but called for UK influence not to be sidelined. It said:

¹ EU Commission press release 12/9/12

"We welcome the European Commission's proposals to establish banking union to tackle the euro crisis, and its recognition that the UK's financial centre is good for Europe. It is essential to protect the single market, and the UK's role in setting financial services legislation. The single market is Europe's biggest asset and any splintering into a two-tier financial services market would threaten the ability of businesses across Europe to raise money for investment and would hamper economic recovery. The UK is host to the EU's main financial centre, and it is essential that it is not sidelined in the making of regulations that affect it more than other countries. We therefore welcome the Commission's statements regarding the importance of ensuring balanced and adequate representation of all member states in its decision making processes."²

One comment was that the proposal was illegal as it stood.³ Response to this has been that where there is a political will the legal obstacles can be overcome. At a technical level there is uncertainty as to how the ECB will separate its monetary policy duties from its micro-prudential duties. Much the same could be said of the Bank of England, however. According to an FT article, only the US Federal Reserve comes as close to uniting all the functions in the same authority.⁴ The article also raises the issue about which courts are to enforce supervisory decisions and which courts third parties could go to challenge a decision.

Then there is the relationship between the ECB and the other pan-European supervisors.

One effect of the increased powers given to the ECB, i.e. taking over as the competent supervisory national authority, is that the decision making processes within the European Banking Authority (EBA – which represents all 27 Member States) would be ECB-dominated. As the House of Lords Report notes:

The ECB needs to be fully accountable, both to the European Parliament and to national parliaments, in the exercise of its supervisory powers. There must be equality in the supervisory decision-making process within the ECB between euro area and non-euro area Member States who wish to participate. Equally, the role of the EBA in representing all 27 Member States must not be undermined and the Commission must defend the integrity of the single market as a whole.⁵

A much fuller account of the challenges to the voting 'modalities' can be found in an EU Commission document [here](#) or the European Scrutiny Committee whose relevant report can be found [here](#).

1.2 Establishment of the SSM

Legislation

² BBA press release 12/9/12

³ Financial Times, *ECB supervisory proposal illegal, says adviser*, 18 October 2012

⁴ FT, *Look before you leap into eurozone banking supervision*, 19 October 2012

⁵ House of Lords European Union Committee Report [European Banking: Key issues and challenges](#). 7th Report 2012/13; HL88

Two Regulations form the legislative basis of the SSM

- [Council Regulation \(EU\) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions](#) 
- [Regulation \(EU\) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation \(EU\) No 1093/2010 establishing a European Supervisory Authority \(European Banking Authority\) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation \(EU\) No 1024/2013](#) 

The ECB is the lynchpin of this system. The first Regulation (EU 1024/2013) requires it to cooperate with:

- the European Banking Authority (EBA);
- the European Securities and Markets Authority
- the European Insurance and Occupational Pensions Authority (EIOPA) – collectively known as the three European Supervisory Authorities (ESAs)
- plus the European Systemic Risk Board (ESRB).

The institutions

ECB role

Article 4 of the Regulation establishes the tasks conferred on the ECB:

- (a) to authorise credit institutions and to withdraw authorisations of credit institutions subject to Article 14;
- (b) for credit institutions established in a participating Member State, which wish to establish a branch or provide cross-border services in a non participating Member State, to carry out the tasks which the competent authority of the home Member State shall have under the relevant Union law;
- (c) to assess notifications of the acquisition and disposal of qualifying holdings in credit institutions, except in the case of a bank resolution, and subject to Article 15;
- (d) to ensure compliance with the acts referred to in the first subparagraph of Article 4(3), which impose prudential requirements on credit institutions in the areas of own funds requirements, securitisation, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on those matters;
- (e) to ensure compliance with the acts referred to in the first subparagraph of Article 4(3), which impose requirements on credit institutions to have in place robust governance arrangements, including the fit and proper requirements for the persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices and effective internal capital adequacy assessment processes, including Internal Ratings Based models;
- (f) to carry out supervisory reviews, including where appropriate in coordination with EBA, stress tests and their possible publication, in order to determine whether the arrangements, strategies,

processes and mechanisms put in place by credit institutions and the own funds held by these institutions ensure a sound management and coverage of their risks, and on the basis of that supervisory review to impose on credit institutions specific additional own funds requirements, specific publication requirements, specific liquidity requirements and other measures, where specifically made available to competent authorities by relevant Union law;

- (g) to carry out supervision on a consolidated basis over credit institutions' parents established in one of the participating Member States, including over financial holding companies and mixed financial holding companies, and to participate in supervision on a consolidated basis, including in colleges of supervisors without prejudice to the participation of observers, in relation to parents not established in one of the participating Member State;
- (h) to participate in supplementary supervision of a financial conglomerate in relation to the credit institutions included in it and to assume the tasks of a coordinator where the ECB is appointed as the coordinator for a financial conglomerate in accordance with the criteria set out in relevant Union law;
- (i) to carry out supervisory tasks in relation to recovery plans, and early intervention where a credit institution or group in relation to which the ECB is the consolidating supervisor, does not meet or is likely to breach the applicable prudential requirements, and, only in the cases explicitly stipulated by relevant Union law for competent authorities, structural changes required from credit institutions to prevent financial stress or failure, excluding any resolution powers.⁶

The ECB not only works with the three ESAs and ESRB but also with the 'national competent authorities' – central banks of the euro zone countries (Article 6).

Article 7 sets out requirements for the *"Close cooperation with the competent authorities of participating Member States whose currency is not the euro"*. The key part says:

Within the limits set out in this Article, the ECB shall carry out the tasks in the areas referred to in Articles 4(1), 4(2) and 5 in relation to credit institutions established in a Member State whose currency is not the euro, where close cooperation has been established between the ECB and the national competent authority of such Member State in accordance with this Article.

To that end, the ECB may address instructions to the national competent authority or to the national designated authority of the participating Member State whose currency is not the euro.

Close cooperation between the ECB and the national competent authority of a participating Member State whose currency is not the euro shall be established, by a decision adopted by the ECB, where the following conditions are met:

- (a) the Member State concerned notifies the other Member States, the Commission, the ECB and EBA the request to enter

⁶ [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions; Article 4, p74

into a close cooperation with the ECB in relation to the exercise of the tasks referred to in Articles 4 and 5 with regard to all credit institutions established in the Member State concerned, in accordance with Article 6;

(b) in the notification, the Member State concerned undertakes:

- to ensure that its national competent authority or national designated authority will abide by any guidelines or requests issued by the ECB, and
- to provide all information on the credit institutions established in that Member State that the ECB may require for the purpose of carrying out a comprehensive assessment of those credit institutions;

(c) the Member State concerned has adopted relevant national legislation to ensure that its national competent authority will be obliged to adopt any measure in relation to credit institutions requested⁷

Much of the rest of the Regulation sets out the specifics of the supervisory and investigative powers of the ECB. This includes the ECB's role in authorising new credit institutions (Article 14):

1. Any application for an authorisation to take up the business of a credit institution to be established in a participating Member State shall be submitted to the national competent authorities of the Member State where the credit institution is to be established in accordance with the requirements set out in relevant national law.
2. If the applicant complies with all conditions of authorisation set out in the relevant national law of that Member State, the national competent authority shall take, within the period provided for by relevant national law, a draft decision to propose to the ECB to grant the authorisation. The draft decision shall be notified to the ECB and the applicant for authorisation. In other cases, the national competent authority shall reject the application for authorisation.
3. The draft decision shall be deemed to be adopted by the ECB unless the ECB objects within a maximum period of ten working days, extendable once for the same period in duly justified cases. The ECB shall object to the draft decision only where the conditions for authorisation set out in relevant Union law are not met. It shall state the reasons for the rejection in writing.⁸

Chapter IV of the Regulation sets out the organisational principles of the ECB, the first of which (Article 19) is independence. Article 19(1) states:

When carrying out the tasks conferred on it by this Regulation, the ECB and the national competent authorities acting within the SSM shall act independently. The members of the Supervisory Board and the steering committee shall act independently and objectively in the interest of the Union as a whole and shall neither seek nor take instructions from the institutions or bodies

⁷ [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions; Article 7, p77

⁸ [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions; Article 14, p80

of the Union, from any government of a Member State or from any other public or private body.⁹

Article 26 establishes the office of the Supervisory Board which is responsible for the planning and execution of the tasks conferred on the ECB. The chair of the Supervisory Board of the Single Supervisory Mechanism was Mrs Daniele Nouy. Her term runs from 1 January 2014 for five years.¹⁰

The remaining institutions are the European Banking Authority and the European Systemic Risk Board.

European Banking Authority

The EBA was established in 2010 by the Regulation 1093/2010. Its primary function is to develop and then uphold a single European rulebook which covers the activities of the banking sector. The 2013 Regulation notes that:

The EBA [...] should therefore maintain its role and retain all its existing powers and tasks: it should continue to develop and to contribute to the consistent application of the single rulebook applicable to all Member States and to enhance convergence of supervisory practices across the Union as a whole.¹¹

It continues by outlining the main role of the EBA which is to “promote best supervisory practices in the internal market”; and that the “supervisory handbook should identify best practices across the Union as regards supervisory methodologies and processes to achieve adherence to core international and Union principles”. Matters which are within the remit of the EBA include:

On its website the EBA It describes its role thus:

The main task of the EBA is to contribute, through the adoption of binding Technical Standards (BTS) and Guidelines, to the creation of the European Single Rulebook in banking. The Single Rulebook aims at providing a single set of harmonised prudential rules for financial institutions throughout the EU, helping create a level playing field and providing high protection to depositors, investors and consumers.

The Authority also plays an important role in promoting convergence of supervisory practices to ensure a harmonised application of prudential rules. Finally, the EBA is mandated to assess risks and vulnerabilities in the EU banking sector through, in particular, regular risk assessment reports and pan-European stress tests.

Other tasks set out in the EBA's mandate include:

- **investigating alleged incorrect or insufficient application of EU law by national authorities**

⁹ [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions; Article 19, p83

¹⁰ See ECB [press release](#) 16 December 2013

¹¹ [Regulation \(EU\) No 1022/2013](#) of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, Para 6 p5

- taking decisions directed at individual competent authorities or financial institutions in emergency situations
- mediating to resolve disagreements between competent authorities in cross-border situations
- acting as an independent advisory body to the European Parliament, the Council or the Commission.
- taking a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market.
- To perform these tasks, the EBA can produce a number of regulatory and non regulatory documents including binding Technical Standards, Guidelines, Recommendations, Opinions and ad-hoc or regular reports.

The Binding Technical Standards are legal acts which specify particular aspects of an EU legislative text (Directive or Regulation) and aim at ensuring consistent harmonisation in specific areas. The EBA develops draft BTS which are finally endorsed and adopted by the European Commission. Contrary to other documents such as Guidelines or Recommendations, the BTS are legally binding and directly applicable in all Member States.¹²

The EBA's website, with more information about its role and organisation and work can be found [here](#). It has its headquarters in London.

European Systemic Risk Board

The ESRB was established in 2010 to provide macro-prudential supervision of the whole financial sector and economy. In the UK the Financial Policy Committee was set up for the same reason. It was set up by [EU Regulation 1092/2010](#). Article 3 of the Regulation sets out the tasks of the ESRB:

- (a) determining and/or collecting and analysing all the relevant and necessary information, for the purposes of achieving the objectives described in paragraph 1;
- (b) identifying and prioritising systemic risks;
- (c) issuing warnings where such systemic risks are deemed to be significant and, where appropriate, making those warnings public;
- (d) issuing recommendations for remedial action in response to the risks identified and, where appropriate, making those recommendations public;
- (e) when the ESRB determines that an emergency situation may arise pursuant to Article 18 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 issuing a confidential warning addressed to the Council and providing the Council with an assessment of the situation, in order to enable the Council to assess the need to adopt a decision addressed to the ESAs determining the existence of an emergency situation;

¹² European Banking Authority [website](#)

- (f) monitoring the follow-up to warnings and recommendations;
- (g) cooperating closely with all the other parties to the ESFS; where appropriate, providing the ESAs with the information on systemic risks required for the performance of their tasks; and, in particular, in collaboration with the ESAs, developing a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk;
- (h) participating, where appropriate, in the Joint Committee;
- (i) coordinating its actions with those of international financial organisations, particularly the IMF and the FSB as well as the relevant bodies in third countries on matters related to macro-prudential oversight;
- (j) carrying out other related tasks as specified in Union legislation.¹³

On its website the ESRB states its tasks as being:

- determining and/or collecting and analysing all the relevant and necessary information;
- identifying and prioritising systemic risks;
- issuing warnings where such systemic risks are deemed to be significant and, where appropriate, make those warnings public;
- issuing recommendations for remedial action in response to the risks identified and, where appropriate, making those recommendations public;
- when the ESRB determines that an emergency situation may arise issuing a confidential warning addressed to the Council and providing the Council with an assessment of the situation, in order to enable the Council to adopt a decision addressed to the European Supervisory Authorities (ESAs) determining the existence of an emergency situation;
- monitoring the follow-up to warnings and recommendations;
- cooperating closely with all the other parties to the European System of Financial Supervision (ESFS); where appropriate, providing the ESAs with the information on systemic risks required for the performance of their tasks; and, in particular, in collaboration with the ESAs, developing a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk;
- participating, where appropriate, in the Joint Committee of the ESAs;
- coordinating its actions with those of international financial organisations, particularly the International Monetary Fund (IMF) and the Financial Stability Board (FSB) as well as the relevant bodies in third countries on matters related to macro-prudential oversight;
- carrying out other related tasks as specified in Union legislation.¹⁴

¹³ [REGULATION \(EU\) No 1092/2010 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2010](#) on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, Article 3 p5

¹⁴ [ESRB website](#)

1.3 Single Resolution Mechanism (SRM)

To avoid the cycle of government debt bail-outs for banks leading to national debt problems the Commission proposed a common framework of rules and powers to help EU countries intervene to manage banks in difficulty. Such powers are likely to be considered in relation to the current Greek crisis.

The single resolution mechanism was agreed on 17 December 2013. The Lithuanian Presidency's press release can be found [here](#). The ECB assumed its full supervisory tasks on 4 November 2014, the full regulatory framework being completed in May and August 2014.

The Commission too produced a [press release](#) announcing the "momentous day for banking union" changes to Europe's financial sector" including the SRM and deposit guarantee scheme harmonisation:

It gives more detail on the SRM agreement:

The SRM Regulation builds on the Rulebook on bank resolution set out in the BRRD and establishes the following:

Scope: The SRM would apply to all banks supervised by the SSM. The Board would prepare resolution plans for all banks directly supervised by the ECB and for cross-border banks. National resolution authorities would assist the Board and prepare resolution plans for all other banks. At the time of resolution the Board would decide for all banks if resolution involved use of the fund.

Fund: A Single Resolution Fund pooled at European level from all the banks in the participating Member States. The Fund would be owned and administrated by the Board. The Single Fund would reach a target level of 1% of covered deposits over a 10 year period. During this transitional period, the Single Fund, established by the SRM Regulation, would consist of national compartments corresponding to each participating Member State. Those compartments would cease to exist at the end of the transitional period following their progressive mutualisation. The establishment of the Single Fund and its national compartments and the decision-making on its use would be regulated by the Regulation, while the transfer of national funds towards the Single Fund and the activation of the mutualisation of the national compartments would be provided for in an inter-governmental agreement to be established among the participating Member States in the SRM. Those Member States would endeavour in the inter-governmental agreement to finalise the negotiations by 1 March 2014.

Decision making: Centralised decision-making built around a strong Single Resolution Board (the 'Board') and involving the Commission, the Council, the ECB and the national resolution authorities. The ECB notifies that a bank is failing to the Board, the Commission, and the relevant national resolution authorities

and ministries. The Board assesses whether there is a systemic threat and any private sector solution. If not, it adopts a resolution scheme including the relevant resolution tools and the use of the Fund. The Council can object to the resolution scheme on a proposal from the Commission or can ask the board to amend it. The resolution scheme is then implemented by the national resolution authorities. If resolution entails State aid, the Commission has to approve the aid prior to the adoption by the Board of the resolution scheme.

Governance of the Board / voting modalities: In its plenary session, the Board would take all decisions of a general nature and the decisions which involve the use of the Single Resolution Fund above a certain threshold. In its executive session, the Board would take decisions in respect of individual entities or banking groups. The composition of the executive session of the Board includes the Executive Director, four other permanent members, while the Commission and the ECB would be permanent observers. In addition, to ensure that the interests of all Member States on which the resolution had an impact were considered, further members would be part of that session according to the institution that was being resolved. None of the participants in the deliberation would have a veto. However in view of the sovereignty of Member States to decide on the use of national budgets, the SRM could not require Member States to provide extraordinary public support to any entity under resolution.

Backstops: A statement on the backstops to the Single Resolution Fund and its national compartments accompanies the General Approach together with a Decision of the representatives of the euro area Member States committing to establish among themselves an inter-governmental agreement specifying the channelling of the funds (bank contributions raised at national level by each participating Member State) to the Single Resolution Fund and the activation of the progressive mutualisation of the use of such funds during the transitional period.

More details on the SRM can be found from the following Commission webpages [here](#) and the current 'final' text is [here](#).

2. Crisis Management

Theory

The ECB is the key body in any crisis management operation, with a range of tools and options open to it at any stage. There is a full explanation of how the interlocking pieces of the new system work on the [ECB website](#). This section summarises some of that information.

A crisis presumes that for whatever reason the supervisory work the work of maintaining capital and liquidity levels etc has failed. At this point the SRM procedures come into effect. The ECB note:

The interaction between the Single Supervisory Mechanism, the Single Resolution Board and national resolution authorities is structured around three main pillars:

complementarity of institutional roles

mutual cooperation

strong coordination

The ECB has a consultative role in resolution assessment and planning under the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR).

Resolution authorities will be responsible for deciding on the appropriate resolution action. The ECB will cooperate closely with the respective resolution authorities and notify them about the failure, or likely failure, of a bank.

Much of the work will be shared between Crisis Management Groups (CMGs) and [Cross Border Stability Groups](#) (CBSGs). These are composed of:

Who participates in CMGs?

CMGs bring together home and key host authorities of all Global Systemically Important Financial Institutions (G-SIFIs). These include:

supervisory authorities

central banks

resolution authorities

finance ministries

public authorities responsible for guarantee schemes

CMG members cooperate closely with authorities of other countries in which firms have a systemic presence.

And:

CBSGs foster cooperation among parties with common financial stability concerns related to financial cross-border groups. They enhance their readiness to react to a crisis and facilitate the management and/or resolution of an institution in the case of a cross-border financial crisis.¹⁵

At some stage in the future, it may be the case that bank crises are not inextricably linked with public finance crises. But that time is not now

¹⁵ [ECB Crisis Management Website](#)

and not in Greece. Thus the ECB is in the unenviable position of being responsible for part for the current Greek crisis but with the capability for making everything worse if it ceases to support Greek banks.

On 24th June 2015, the Dutch Central Bank head, Klaas Knot, is reported as saying "It's in the hands of the politicians now, we follow with great interest what is happening, We make sure that we keep the Greek banks functioning, which is our role".¹⁶

The Wall ST. Journal made much of the dilemma and 'headache' facing the ECB as whatever decision it takes about the banking sector inevitably 'spills over' into the broader crisis:

The ECB faces a choice between maintaining ample liquidity support for Greek banks and potentially undermining the ECB's credibility as a rules-based institution, or forcing the closure of Greek banks and enraging Greece's government and people.

Greek Prime Minister Alexis Tsipras's unexpected announcement in the early hours of Saturday that Greece will hold a referendum on July 5 on the bailout conditions creates a severe headache for ECB President [Mario Draghi](#) and the rest of the bank's 25-person governing council.

Whatever choice the ECB makes, one thing has become clear: It can't stay on the sidelines much longer.

"The ECB in particular is facing an immense dilemma," said Beat Siegenthaler, global macro adviser at UBS.¹⁷

The latest statement by the ECB, setting out its decision to maintain its emergency lending authority (ELA) to Greek banks is shown in full below:

- ECB takes note of decision on Greek referendum and the non-prolongation of the EU adjustment programme
- ECB will work closely with Bank of Greece to maintain financial stability
- Emergency liquidity assistance maintained at Friday's (26 June 2015) level
- Governing Council stands ready to review decision
- Governing Council closely monitoring situation and potential implications for monetary policy stance

The Governing Council of the European Central Bank today welcomed the commitment by ministers from euro area Member States to take all necessary measures to further improve the resilience of euro area economies and to stand ready to take decisive steps to strengthen Economic and Monetary Union.

Following the decision by the Greek authorities to hold a referendum and the non-prolongation of the EU adjustment programme for Greece, the Governing Council declared it will work closely with the Bank of Greece to maintain financial stability.

Given the current circumstances, the Governing Council decided to maintain the ceiling to the provision of emergency liquidity

¹⁶ [Reported Reuters 24 June 2015](#)

¹⁷ [Wall St. Journal 28 June 2015.](#)

assistance (ELA) to Greek banks at the level decided on Friday (26 June 2015).

The Governing Council stands ready to reconsider its decision.

Mario Draghi, ECB President, said: “We continue to work closely with the Bank of Greece and we strongly endorse the commitment of Member States in pledging to take action to address the fragilities of euro area economies.”

Yannis Stournaras, Governor of the Bank of Greece, said: “The Bank of Greece, as a member of the Eurosystem, will take all measures necessary to ensure financial stability for Greek citizens in these difficult circumstances.”

The Governing Council is closely monitoring the situation in financial markets and the potential implications for the monetary policy stance and for the balance of risks to price stability in the euro area. The Governing Council is determined to use all the instruments available within its mandate.¹⁸

¹⁸ [ECB Press release 28 June 2015](#)

3. Other proposals: banking structures

The proposals should be seen alongside the other three components of an integrated "banking union" –

- the single rulebook in the form of capital requirements;
- harmonized deposit protection schemes; and
- a single European recovery and resolution framework.

The following sections describe these, there is significantly more information on the Commission website.¹⁹ The section on Recovery is of particular relevance in the light of the Greek crisis.

3.1 Single capital requirements rulebook

The capital requirements for banks directive ([CRD IV](#)) which transposes via a Regulation and a Directive the new global standards on bank capital (commonly known as the Basel III agreement) into the EU legal framework, was published in the EU Official Journal on 27 June, 2013. It entered into force on 16 July 2013.

The new rules which will apply from 1 January 2014 tackle some of the vulnerabilities shown by the banking institutions during the crisis, namely the insufficient level of capital, both in quantity and in quality, resulting in the need for unprecedented support from national authorities. The timely implementation of the Basel III agreement features among the commitments taken by the EU in the G20.

The new framework sets stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. This new framework will make EU banks more solid and will strengthen their capacity to adequately manage the risks linked to their activities, and absorb any losses they may incur in doing business.

Furthermore, these new rules will strengthen the requirements with regard to corporate governance arrangements and processes of banks. For example, a number of requirements are introduced in relation to diversity within management, in particular as regards gender balance. In addition, in order to tackle excessive risk-taking, the framework imposes tough rules on bonuses.

3.2 Harmonised deposit protection schemes

A second strand of a more robust financial sector is ensuring bank deposits in all Member States are guaranteed up to €100 000 per depositor per bank if a bank fails and this prevents runs on banks with the attendant problems that causes.

In July 2010, the Commission proposed further [reforms](#) to ensure faster pay-outs (currently 20 working days, to be reduced to 7 working days). The proposal also includes strengthened financing, notably through a

¹⁹ See [Commission website](#) for more details

significant level of ex-ante funding. The exact numbers are still being discussed in negotiations but the Commission wants a minimum of 1% of covered deposits to be collected from banks over a 10-year period. In case of insufficient ex ante funds, the DGS will collect immediate ex post contributions from the banking sector, and, as a last resort, it will have access to alternative funding arrangements such as loans from public or private third parties. There will also be a voluntary mechanism of mutual borrowing between the DGSs from different EU countries.

The new Directive also improves depositor information. For example, when depositing money at a bank, depositors will countersign a standardised information sheet containing all relevant information about the coverage of the deposit by the responsible DGS. Banks will also inform their depositors about the protection of their deposits in their regular account statements. The European Parliament and EU Member States are in the final stages of negotiation on this text which should be formally approved in early 2014. Agreement with the European Parliament and the Presidency happened in December 2103. Only formal approval by the Commission and Parliament awaits. A Commission [press release](#) sets out the details.

3.3 The Liikanen Report and banking structural reforms

Subsequent to the proposals a high level EU expert group, led by Erkki Liikanen published a report on [reforming the structure of the EU banking sector](#). To give these various reports some sort of UK context, the EU Commission's proposals might be seen to reflect elements of the financial services legislation that has been passed, and is still being passed, whereas the Liikanen Report might be seen as the equivalent of the work done by our Independent Banking Commission – the Vickers Report. The main conclusions of the Liikanen Report were:

First, proprietary trading and other significant trading activities should be assigned to a separate legal entity if the activities to be separated amount to a significant share of a bank's business. This would ensure that trading activities beyond the threshold are carried out on a stand-alone basis and separate from the deposit bank. As a consequence, deposits, and the explicit and implicit guarantee they carry, would no longer directly support risky trading activities. The long-standing universal banking model in Europe would remain, however, untouched, since the separated activities would be carried out in the same banking group. Hence, banks' ability to provide a wide range of financial services to their customers would be maintained.

Second, the Group emphasises the need for banks to draw up and maintain effective and realistic recovery and resolution plans, as proposed in the Commission's Bank Recovery and Resolution Directive (BRR). The resolution authority should request wider separation than considered mandatory above if this is deemed necessary to ensure resolvability and operational continuity of critical functions.

Third, the Group strongly supports the use of designated bail-in instruments. Banks should build up a sufficiently large layer of bail-inable debt that should be clearly defined, so that its position

within the hierarchy of debt commitments in a bank's balance sheet is clear and investors understand the eventual treatment in case of resolution. Such debt should be held outside the banking system. The debt (or an equivalent amount of equity) would increase overall loss absorptive capacity, decrease risk-taking incentives, and improve transparency and pricing of risk.

Fourth, the Group proposes to apply more robust risk weights in the determination of minimum capital standards and more consistent treatment of risk in internal models. Following the conclusion of the Basel Committee's review of the trading book, the Commission should review whether the results would be sufficient to cover the risks of all types of European banks. Also, the treatment of real estate lending within the capital requirements framework should be reconsidered, and maximum loan-to-value (and/or loan-to-income) ratios included in the instruments available for micro- and macro-prudential supervision.

Finally, the Group considers that it is necessary to augment existing corporate governance reforms by specific measures to 1) strengthen boards and management; 2) promote the risk management function; 3) rein in compensation for bank management and staff; 4) improve risk disclosure and 5) strengthen sanctioning powers.²⁰

The EU announced [its plans](#) based in part on the Liikanen report, for structural reform of the banking sector on 29 January 2014. The proposals are summarised below:

The proposal on structural reform of EU banks will apply only to the largest and most complex EU banks with significant trading activities. It will:

1. Ban proprietary trading in financial instruments and commodities, i.e. trading on own account for the sole purpose of making profit for the bank. This activity entails many risks but no tangible benefits for the bank's clients or the wider economy.
2. Grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading entities within the group ("subsidiarisation"). This aims to avoid the risk that banks would get around the ban on the prohibition of certain trading activities by engaging in hidden proprietary trading activities which become too significant or highly leveraged and potentially put the whole bank and wider financial system at risk. Banks will have the possibility of not separating activities if they can show to the satisfaction of their supervisor that the risks generated are mitigated by other means.
3. Provide rules on the economic, legal, governance, and operational links between the separated trading entity and the rest of the banking group.

To prevent banks from attempting to circumvent these rules by shifting parts of their activities to the less-regulated shadow banking sector, structural separation measures must be accompanied by provisions improving the transparency of shadow banking. The accompanying transparency proposal will therefore provide a set of measures aiming to enhance regulators' and investors' understanding of securities financing transactions (STFs).

²⁰ [High-Level Expert Group on reforming the structure of the EU banking sector](#), p111

These transactions have been a source of contagion, leverage and procyclicality during the financial crisis. A better monitoring of these transactions is necessary to prevent the systemic risk inherent to their use.²¹

Links to the full proposal and summaries can be found [here](#).

²¹ [EU Commission press release](#) 29 January 2014

4. Further reading

The debate on the Commission's proposals in the Commons was held on 6 November 2012. It can be seen [here](#).

House of Lords European Union Committee Report European Banking: Key issues and challenges; HL 88 2012/13

For 'academic' responses, the following 'Vox EU' entries are helpful:

[The commission's proposal on bank supervisory powers for the ECB](#)

[Banking union: A federal model for the European Union with prompt corrective action](#)

[The first step in Europe's banking union is achievable, but it won't be easy](#)

There is a general guide to Banking Union on the [ECB website](#).

About the Library

The House of Commons Library research service provides MPs and their staff with the impartial briefing and evidence base they need to do their work in scrutinising Government, proposing legislation, and supporting constituents.

As well as providing MPs with a confidential service we publish open briefing papers, which are available on the Parliament website.

Every effort is made to ensure that the information contained in these publically available research briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

If you have any comments on our briefings please email papers@parliament.uk. Authors are available to discuss the content of this briefing only with Members and their staff.

If you have any general questions about the work of the House of Commons you can email hcinfo@parliament.uk.

Disclaimer

This information is provided to Members of Parliament in support of their parliamentary duties. It is a general briefing only and should not be relied on as a substitute for specific advice. The House of Commons or the author(s) shall not be liable for any errors or omissions, or for any loss or damage of any kind arising from its use, and may remove, vary or amend any information at any time without prior notice.

The House of Commons accepts no responsibility for any references or links to, or the content of, information maintained by third parties. This information is provided subject to the [conditions of the Open Parliament Licence](#).