

## **BANKING UNION**

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### *Abstract*

*The Banking Union is a project started by the European Union since 2010 for the financial stability of the euro area. After the **U.S. subprime mortgage crisis** in 2007, a radical revision of the bank control systems became manifestly visible in the EU regulatory framework. The Banking Union is based on a single set of rules that includes a Single Resolution Mechanism (SRM) and a deposit guarantee system centralized, whose supervision is assigned to the **European Central Bank (ECB)** through a Single Supervisory Mechanism (SSM). The **European Commission** has therefore taken an inclusive approach and proposed a **roadmap for the Banking Union** with different steps, potentially open to all Member States. Since the establishment of the European System of Financial Supervision (ESFS) in 2010, the overall goal of the European legislator in the Banking Union project is to avoid new crisis in the euro zone, to break the connection between financial crises and national public debts and rebuild investor confidence in the banking sector (see **Banking Union divides Europe**). At the global level, the project is linked with commitments taken by the EU in the **G20** and in the **Basel III**, as a set of measures approved on banking supervision in the financial crisis of 2007-08 with the aim of improving the existing prudential regulation of banks, the effectiveness of supervision and the ability of intermediaries to manage the risks they assume. The Union Banking is fundamentally based on three pillars: the Single Supervisory Mechanism (SSM), which entered into force in 2013 but functional from November 2014, the Single Resolution Mechanism (SRM) which will come into force in 2016 and the Single Fund Resolu-*

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*tion (SRF) that after a transitional phase, from 1 January 2015, will be fully functional in 2025.*

*European Central Bank (ECB) Supervisory Authority of Union Banking. Single Supervisory Mechanism (SSM)*

The first pillar is a union banking supervision system under the control of the ECB. It will be in operation in November 2014. In the meantime, the ECB is actively preparing to take up its new role of supervisor. The ECB is currently carrying out a comprehensive assessment of all banks, which will be under its direct supervision and the balance sheets of those banks. In parallel it is recruiting high quality supervisory staff and building up a new supervisory structure that integrates national supervisors before it commences its activities. The regulatory framework of the mechanism (R. 1022/2013-22/10/2013 and R.1024/2013-15/10/2013) provides direct supervisory tasks to the ECB for the European banks most significant (systemic) and decentralized supervisory tasks to the local authorities for the banks less relevant. It confers new supervision powers on the ECB for the banks of the euro area: the authorisation of all banks in Europe and the coherent and consistent application of the single rule-book in the euro area, the direct supervision of banks significant banks, including all banks having assets of more than €30 billion or constituting at least 20% of their home country's **GDP** (around 130 banks), the monitoring of the supervision exerted by national supervisors on less significant banks. The ECB may at any moment decide to directly supervise one or more of these credit institutions to ensure consistent application of high supervisory standards.

This new mechanism will modify the European System of Financial Supervision (ESFS), active since 2010.

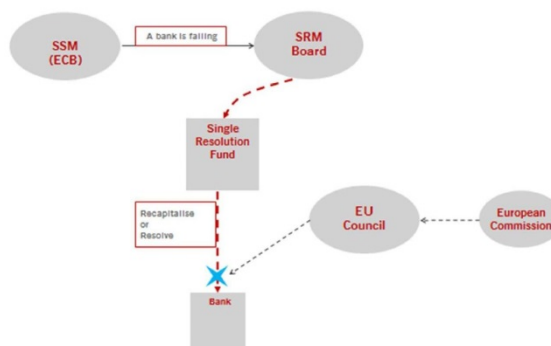
### Banking Crisis. Single Resolution Mechanism (SRM)

The second pillar of the Banking Union is represented by the Single Resolution Mechanism of banking crises. The Council of EU Finance Ministers reached an agreement on the general approach of these new rules on June 27 (MEMO/13/601). The report of the Committee on Economic and Monetary Affairs of the European Parliament was adopted on 20 May, opening the negotiations between the **Council** and the European Parliament for final adoption of the mechanism. This mechanism will allow troubled banks to receive bailout funds from the central bank in order to alleviate the impact on one nation's banks crisis. The resolution would establish a 55 billion Euro reserve fund for this purpose.

In addition, a committee of national authorities representatives, the Single Board Resolution, which will operate under the ECB, will have the task of checking the execution of bailing operations or failure of a bank. This new board will modify the duties of the already functioning **European Banking Authority (EBA)**.

As shown in (Fig. 1) the process of the new mechanism for resolution of banking crisis provides that the ECB will signal a bank which requires restructuring; the Single Resolution Board shall prepare a proposal on the measures of bank resolution; the Commission and the European Council will take a final decision. Finally, the national authorities will assist the Single Board Resolution on implementing the measures.

Fig. 1 Main steps of Single Resolution Mechanism (SRM):



In this regulation framework, the purpose of the European legislator is to create a close link between the implementation of a Single Supervision Mechanism (SSM) and the creation of common models of bank resolution crisis mechanism (Single Resolution Mechanism –SRM). In fact, the recent financial crisis has shown that the banks bailing by national governments, can have negative effects on sovereign debt, These effects can be extended, later, to the economies of other states of the monetary union, producing costs which must be supported by the taxpayers. Consequently, the existing European System of Financial Supervision (ESFS) and the subsequent ECB supervision (Single Supervisory Mechanism - SSM) could not be able to resolve these difficulties. For this reason, in order to resolve these gaps, in the purpose of the European legislator, the creation of Single Resolution Mechanism (SRM) is necessary to harmonize the policy instruments available to the European states and impose the cost of banks bailing to its shareholders and creditors and not to taxpayers.

#### *Who Pays for the Crisis. Single Resolution Fund (SRF)*

The third pillar of the Union Banking is closely connected to the second and is characterized by the Single Resolution Fund (SRF). In fact, it is connected to the SRM regulation and is part of the efforts pursued by the EU in the past years to adopt a number of legal acts “fundamental for the achievement of the internal market in the field of financial services and for guaranteeing the financial stability of the euro area and of the Union as a whole, as well as for the process towards deeper economic and monetary union.

The SRF is funded by levies on banks that will initially be managed at the national level, then gradually converge in 10 years in a single European fund. The Single Resolution Fund (SRF) provides the creation of a fund that will be about 55 billion euro over ten years and will serve to refinance the banking system to the European-

bank in crisis. In addition, the costs connected with the banking crisis will be paid, in order, by shareholders, bondholders and depositors with more than 100 thousand Euros. Overall, the private sector will necessarily have to cover the costs of the bank in default for an amount at least equal to 8% of the assets of the institution. Beyond this threshold, the SRF will intervene in the second round for a total of 5% of the assets of the bank. If they require additional resources the governments can intervene through the European Stability Mechanism (ESM).

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