Professor CHRISTOS HADJIEMMANUIL
University of Piraeus & London School of Economics
Advisor to the Governor, Bank of Greece

Close Cooperation: Dilemmas of BU's Outsiders

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BU insiders & outsiders

- Geographic scope of BU: to start with, confined to the euro area
  - Direct ECB supervision / SRB resolution: significant EA-based institutions, including EA subsidiaries & EA/non-EA branches
  - Credit institutions in non-EA MSs / third countries: not covered (with the exception of significant EA subsidiaries & branches, on host basis)
- Supervisory cooperation with non-EA MSs
  - MoUs
  - Supervisory colleges
- 'Sweeteners' to non-euro area MSs in the road to the BU
  - EBA double-majority arrangements (EBA Reg, Art 44)
  - Possibility of joining the BU, despite derogation / opt-out
  - Not applicable to EEA MSs
- Form of participation: 'close cooperation agreements'
  - None concluded as yet!

BU's outsiders: non-euro area MSs

Non-BU MSs	Competent authority
Bulgaria	Bulgarian National Bank
Croatia	Croatian National Bank
Czech Republic	Czech National Bank
Denmark	Finanstilsynet
Hungary	Central Bank of Hungary
Poland	Polish Financial Supervision Authority
Romania	National Bank of Romania
Sweden	Finansinspektionen
UK	Prudential Regulation Authority, BoE

Legal framework for close cooperation

- SSM Regulation: Council Regulation (EU) No 1024/2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions
- Decision of the ECB on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (ECB/2014/5)
- SSM Framework Regulation: Regulation (EU) No 468/2014 of the European Central Bank establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (ECB/2014/17)
- Other SSM arrangement also relevant
  - Investigations
  - Powers of ECB to impose sanctions
  - Framework for supervisory fees (ECB/2014/41)

Conditions & procedure for opting in

- SSM Regulation, Art 7(2)–(3); and Decision ECB/2014/5, Arts 2–5
- ECB decision, based on request by the government of the MS concerned
- Conditions for approval:
  - MS must ensure that its NCA will abide by any guidelines / requests of the ECB
  - MS must provide all information necessary to enable a comprehensive assessment (although the approval does not depend on the results)
  - National legislation must ensure that the NCA will be obliged to adopt any measure requested by the ECB in relation to credit institutions

Adjustments to normal supervisory framework

- Legal acts of the ECB cannot apply in non-EA MSs (MSs with derogation); Statute of the ESCB, Arts 34 and 42)
- This also applies to acts pursuant to the SSM Regulation; accordingly, need for indirect approach to implementation of ECB's supervisory decisions
- Adaptation of the general framework:
  SSM Regulation, Art 7(1), (4); SSM Framework Regulation, Arts 106–117
  - The general framework with regard to information exchange, supervisory procedures and decision-making, the classification of banks as significant or not, authorization, investigations and sanctions, and cooperation on macroprudential matters, applies *mutatis mutandis*
  - The ECB may give instructions, make requests and issue guidelines (either general or specific in relation to significant institutions, or general in relation to categories of less significant institutions)
  - NCAs operationalize the ECB instructions by issuing decisions, conducting investigations and initiating proceedings under national law

Safeguards / exit

- SSM Regulation, Art 7(5)–(8); Decision ECB/2014/5, Art 6; and SSM Framework Regulation, Arts 118–119
- Exit clause
  – MSs can exit close cooperation at will, but stating reasons, after three years; readmission is possible only after three more years
- Reasoned disagreement with Governing Council's objection to draft supervisory decision
  – If Governing Council insists, the MS may notify its intention not to apply the final decision; the ECB may then consider suspension;
  – But may also accept equally effective alternative solutions
- Reasoned disagreement with draft supervisory decision
  – Notification of objection to the Governing Council or request to terminate the close cooperation
- ECB warning, potentially leading to suspension or termination, when the conditions are no longer met or the NCA does not comply

The decision to join: reasons in favour

- Improved supervision, esp. for cross-border groups
  - Better home-host cooperation / coordination / information-sharing
  - Harmonization of supervisory approach / single reporting requirements
  - Seat in SSM decision-making process
- Financial stability benefits
  - Improved risk-sharing (esp. if cycle is not synchronized with EA)
  - Avoidance of home bias in supervision
  - Greater discipline / de-politicization of supervision / no forbearance
  - Signalling effect: credibility gains for weaker MSs / banking systems
- Cross-border coordination of resolution actions
  - Modicum of burden-sharing in resolution
- Step towards participation in EMU
- Largely theoretical / untested benefits
- Of uneven importance to non-EA MSs

The decision to join: reasons to abstain

- Concerns about operation of SSM
  - Technical reasons: unwieldy / overly complex decision-making process
  - Unequal participation: no representation in ECB Governing Council
- Concerns about crisis management
  - Lack of access to ECB liquidity
  - Complicated / unconvincing design of resolution process in SRM
  - Potentially detrimental redistributive effects of SRF
  - Lack of access to common fiscal backstop / ESM
- Loss of decision-making autonomy: supervisory; regulatory / elimination of many ODs; with regard to crisis management
- Direct costs of participation in BU: fees and contributions
- Loss of advantage in EBA (rarely mentioned reason)
- All in all, significant downside risks and uncertainties!
  - Preferences depend on country-specific factors / resilience of financial system and policy space

The case of Sweden

- Large banking sector in relation to economy
- Extensive cross-border activities / major outward linkages
  - Fully integrated banking systems in Nordic-Baltic region (non-EA, EA, EEA MSs)
  - Dominant players in Baltic republics (Swedbank, SEB), Finland (Nordea)
  - Developed / pioneering structures for supervisory cooperation since late '90s: MoUs, supervisory colleges, crisis simulation exercises
- Structurally, Sweden would appear to have strong incentives to join
  - Supervisory effectivess and efficiency
  - Stefan Ingves, 2006: proposed pan-European agency for cross-border banks
- Reasons for abstaining (cross-party support)
  - BU decision-making structures
  - Potential redistributive consequences of SRM
  - National *regulatory* discretion / ODs
- BU "through the back door": Swedish groups partially within the SSM's net, via their Baltic subsidiaries

The case of Denmark

- Large / highly sophisticated banking sector
- Potential interest in joining / pivotal case; but
- Strong sceptical tendencies of national public opinion
- Domestic banks not necessarily in favour
  - Do not want to contribute to SRB; fear of redistributive consequences
  - Value regulatory discretion / ODs
  - Agains further harmonization of capital requirements / risk weights
  - World’s largest covered mortgage bond market
- Wait-and-see approach
  - Before 2015 general election, ministerial statements in favour of joining and MoJ declaration that joining BU is not a constitutional issue / does not require referendum
  - Brexit: loss of ally / fear of marginalization in regulatory debates
  - Will this provide an incentive to join / fight from within?

Positions of CEE MSs

- CEEs: divergent country experiences during the crisis
  - Hungary and Romania were early victims / programme countries
  - Bulgaria faced hardship; more recently (2014), major bank collapse
  - Poland and Czech Republic as EU outliers: came out of the crisis unscathed
- CEEs MSs: inward cross-border banking dominates
  - Extensive euroization of the region's economies
  - Common banking problem: extensive scaling down of foreign-owned groups' exposure; countries had to resort to ring-fencing measures
  - Even today, weak loan-to-deposit ratios / dependence on foreign funding
  - Wide variance in bank performance indicators (profitability, NPL ratios)
- Mixed stance on question of joining BU
  - Romania: early candidate (also eager to join EMU)
  - Bulgaria: declared intention to join
  - Czech Republic, Hungary, Poland, Croatia: very sceptical, have adopted wait-and-see policy

CEE MSs: banking structure

BU & non-BU share of assets in CEE's banking sector, end-2014

Countries	Total assets	Cross border	Branches v subsidiaries		BU	Rest of EU	Rest of world
Czech Rep.	195.5	88%	10%	78%	99%	0%	1%
Croatia	56.6	80%	0%	80%	97%	0%	3%
Bulgaria	47.4	77%	7%	71%	82%	17%	1%
Romania	90.5	69%	9%	60%	91%	3%	6%
Poland	379.6	66%	2%	64%	90%	0%	10%
Hungary	109.6	45%	7%	39%	95%	0%	5%
'Out' MSs	879.2	70%	5%	65%	93%	1%	6%

Source: Hüttl & Schoenmaker, 2015

Economic & political motivations & trade-offs

- Uncertainty about operation of BU framework in practice
- SSM: emphasis on overall state of significant groups
  - Domestic banks may not matter much in SSM
- Concern that local financial stability concerns may be disregarded
  - Home-country interests may prevail
  - Potentially harmful impact of ECB macroprudential stance
  - Lack of access to ECB refinancing
  - Retention of ability to ring-fence liquidity *v* smoother integration / access to cross-border liquidity at attractive prices in normal times
- SRM: specific costs, but no fiscal backstop or EDIS
  - Fear of losing out in resolution burden-sharing
- Self-confidence: belief that national supervisory system is effective
- Banking nationalism: political incentives of national governments
- Negative overall cost-benefit assessment trumped by immediate problems / lack of policy space in certain cases (Romania, Bulgaria)

Resolution as critical parameter

- Significance of bank-sovereign diabolic-loop
  - Central driver of euro crisis
  - Main reason for moving to BU
  - Less important for non-EA MSs, which retain monetary sovereignty
- Actual BU set up fails to deliver on promise of effective burden-sharing
  - Complexity and uncertainty of arrangements
  - SRM decision-making does not guarantee respect for national interests
  - Costs of contributing to SRF
  - SRF: probably insufficient (but this may not affect smaller outsiders
  - No EDIS
  - No fiscal backstop for non-EA MSs
- Risk-sharing without clear benefits?
  - Strong disincentive to join, albeit for different reasons in each MS
  - In contrast, the costs / complexity of the supervisory structure does not seem to raise major concerns

Thank you for your attention

CHRISTOS HADJIEMMANUIL

Professor of Monetary and Financial Institutions, University of Piraeus

Visiting Professor of Law, London School of Economics

Advisor to the Governor, Bank of Greece

Attorney at law, ABLaw, Athens

e-mail: c.hadjiemmanuil@ablaw.gr

tel: +30 6936 161770