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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

A Roadmap towards a Banking Union

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1. INTRODUCTION

Over the past four years, the EU has responded decisively to the economic and financial crisis. Significant improvements have been made to the Economic and Monetary Union (EMU), and a substantial financial reform agenda is being implemented, fulfilling commitments made in the G20 in response to the financial crisis, and to make financial institutions and markets more stable, more competitive and more resilient[1].

Completing this reform of the EU regulatory framework is essential but will not be sufficient to successfully address significant threats to financial stability across the Economic and Monetary Union. Further steps are needed to tackle the specific risks within the Euro Area, where pooled monetary responsibilities have spurred close economic and financial integration and increased the possibility of cross-border spill-over effects in the event of bank crises, and to break the link between sovereign debt and bank debt and the vicious circle which has led to over €4,5 trillion of taxpayers money being used to rescue banks in the EU. Coordination between supervisors is vital but the crisis has shown that mere coordination is not enough, in particular in the context of a single currency and that there is a need for common decision-making. It is also important to curtail the increasing risk of fragmentation of EU banking markets, which significantly undermines the single market for financial services and impairs the effective transmission of monetary policy to the real economy throughout the Euro Area.

The Commission has therefore called[2] for a banking union to place the banking sector on a more sound footing and restore confidence in the Euro as part of a longer term vision for economic and fiscal integration. Shifting the supervision of banks to the European level is a key part of this process, which must subsequently be combined with other steps such as a common system for deposit protection, and integrated bank crisis management. The report by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank (ECB) of 26 June 2012[3] endorsed this vision. For its part, the European Parliament has recommended steps in the same direction, for example in its report from July 2010 on cross-border crisis management in the banking sector[4]. This was also confirmed by the Euro Area Summit of 29 June 2012[5].

Ensuring that bank supervision and resolution across the Euro Area meets high standards will reassure citizens and markets that a common, high level of prudential regulation is

[1] http://ec.europa.eu/internal_market/finances/policy/map_reform_en.htm

[2] http://ec.europa.eu/commission_2010-2014/president/news/archives/2012/06/20120626_speeches_2_en.htm

[3] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

[4] European Parliament resolution of 7 July 2010 with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector (2010/2006(INI))

[5] "The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding". http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf

consistently applied to all banks. If banks get into difficulties in the future, the public should have the confidence that ailing banks will be restructured or closed while minimizing costs for the taxpayer. This future system will help build the necessary trust between Member States, which is a pre-condition for the introduction of any common financial arrangements to protect depositors and support orderly resolution of failing banks.

This communication accompanies two legislative proposals, respectively for the setting up of a single supervisory mechanism by conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and for adaptations to the Regulation setting up the European Banking Authority (EBA)[6]. These legislative proposals mark a first important step which will make a qualitative improvement in financial stability and confidence in the Euro Area in particular. This communication sets the single supervisory mechanism in context and indicates further work towards a banking union beyond these first proposals.

2. THE BANKING UNION AND THE SINGLE MARKET

The single market for financial services is based on common rules which ensure that banks and other financial institutions which under the Treaty enjoy rights of free establishment and free provision of services are subject to equivalent rules and proper supervision across the EU.

The creation of the banking union must not compromise the unity and integrity of the single market which remains one of the greatest achievements of European integration. Indeed, the banking union rests on the completion of the programme of substantive regulatory reform underway for the single market (the "single rulebook").

The single market and the banking union are thus mutually reinforcing processes. Work to strengthen the single market must continue across all existing areas covered by Commission proposals.

Moreover, in three areas of specific relevance to the banking union, this work should be accelerated and agreement between the co-legislators on the relevant proposals reached before the end of 2012:

– Stronger prudential requirements for banks have been proposed. With its proposals on bank capital requirements ("CRD4")[7], the Commission launched the process of implementing the new global standards on bank capital and liquidity. The creation of the single supervisory mechanism should not require substantive changes to the proposed regulation and directive, although in a limited number of areas, some fine-tuning may be required to reflect the new situation. During the final stages of the CRD4 negotiations, the Commission will pay particular attention to ensure that the texts agreed are technically compatible with the proposed Regulation setting up the single supervisory mechanism, and will work with the European Parliament and the Council in this perspective. This will include in particular ensuring that all provisions

[6] Regulation (EU) No 1093/2010

[7] http://ec.europa.eu/internal_market/bank/regcapital/new_proposals_en.htm

of the proposed CRD4 Directive are operational for application both at national level and by the ECB.

– The coverage of national Deposit Guarantee Schemes (DGS) has already been raised to a harmonised level of €100,000 per depositor, per institution, effective as of 31 December 2010. In July 2010, the Commission proposed[8] going further, with the harmonisation and simplification of protected deposits, faster pay-outs and improved financing, notably through the ex-ante funding of deposit guarantee schemes paid for by contributions from banks and a mandatory borrowing facility between national schemes within certain fixed limits.

– The Commission's proposal on recovery and resolution tools for banks in crisis, adopted on 6 June 2012[9], is the last in a series of proposed measures to strengthen Europe's banking sector and to avoid the spill-over effects of any future financial crisis with negative effects on depositors and taxpayers. To ensure that financial stability is upheld while bank shareholders and creditors bear their full share of bank losses and recapitalisation costs, the Commission has proposed a common framework of rules and powers. This will help Member States prevent bank crises from emerging in the first place and, if such bank crises still emerge, to manage them in a more orderly and effective way. Member States would be required to establish an ex-ante resolution fund paid for by contributions from banks, and provision is made for a mandatory borrowing facility between national schemes, again subject to clear limits.

These rules will therefore constitute a common foundation across the single market on which the banking union proposals can build. This single rulebook is needed for the stability and integrity of the EU's internal market in financial services. It provides a common foundation which allows a move to the banking union without any risk of fragmenting the single market. Swift delivery of the outstanding reforms on capital requirements, deposit guarantee schemes, and bank resolution by the co-legislators by the end of the year, is therefore paramount.

These rules also have to be applied in the same way across the whole Union, through coherent and convergent supervision of credit institutions by national supervisors and the ECB. The European Banking Authority (EBA) has a crucial role in delivering this objective, in particular, by the set of instruments and powers provided by its founding regulation (addressing breaches of Union law, mediation, binding technical standards, guidelines, and recommendations). It is therefore critical that the EBA plays fully its role to build a common legal framework and supervisory culture across the whole Union.

Moreover, in order to avoid any divergence between the Euro Area and the rest of the EU, the single rulebook should be underpinned by uniform supervisory practices. Different supervisory handbooks and supervisory approaches between the Member States participating in the single supervisory mechanism and the other Member States pose a risk of fragmentation of the single market, as banks could exploit the differences to pursue regulatory arbitrage. The EBA should develop a single supervisory handbook to complement the single rulebook.

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[8] http://ec.europa.eu/internal_market/bank/docs/guarantee/200914_en.pdf

[9] http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm

Any measures adopted by the ECB – for example to spell out further details on how prudential supervision is carried out in the context of the specific supervisory structure created by the single supervisory mechanism – must be in line with the single rulebook including the technical standards set out by delegated acts adopted by the European Commission. Finally, it should be noted that today's proposal maintains the current balance between home and host Member States, including as regards participation in supervisory colleges.

The effective impact and implications of the single supervisory mechanism on the operational functioning of the EBA will be further examined in the forthcoming review on the functioning of the European Supervisory Authorities to be presented by the Commission by 2 January 2014[10]. In that context, the Commission will in particular examine whether the role of the EBA with regard to stress testing exercises needs to be strengthened, to avoid making the authority too dependent on information and contributions by those authorities competent for assessing the effective resilience of the banking sector across the Union.

In parallel, the Commission will continue to strengthen financial stability and ensure a level playing field in the EU single market for banking through its control of state aid and conditionality for economic adjustment aid.

Key actions

The Commission calls on the European Parliament and the Council to reach agreement by end-2012 on:

(i) the CRD4 proposals, making them applicable both across the single market and within the context of the single supervisory mechanism;

(ii) the proposal for a Directive on Deposit Guarantee Schemes as proposed by the Commission;

(iii) the proposal for a Directive on bank recovery and resolution.

3. COMPLETING THE BANKING UNION

As set out by the Commission[11] before the June 2012 European Council and in the report of the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012[12], completing the banking union will require further work to deliver a single supervisory mechanism, a common system for deposit guarantees and an integrated crisis management framework. The establishment of the single supervisory mechanism is a crucial and significant first step.

[10] Pursuant to Article 81 of the Regulations establishing the European Supervisory Authorities [Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010, and Regulation (EU) No 1095/2010]

[11] http://ec.europa.eu/europe2020/banking-union/index_en.htm

[12] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

3.1. A Single Supervisory Mechanism

The single supervisory mechanism which the Commission is proposing today is based on the transfer to the European level of specific, key supervisory tasks for banks established in the Euro Area Member States. While retaining ultimate responsibility, the ECB would carry out its tasks within the single supervisory mechanism composed of the ECB and national supervisory authorities. This structure will provide strong and consistent supervision across the Euro Area, while making best use of the local and specific know-how of national supervisors. This will ensure that supervision remains highly aware of all national and local conditions relevant for financial stability. The Commission also proposes a mechanism which will allow Member States which have not adopted the Euro, but would like to participate in the single supervisory mechanism, to cooperate closely with the ECB.

Under the single supervisory mechanism, the ECB will become responsible for supervising all banks within the banking union, to which it will apply the single rulebook applicable across the single market. Recent experience has shown that difficulties, even in relatively small banks, can have significant negative impacts on the financial stability of Member States. Therefore, from the first day, the ECB will be empowered to take over the supervision of any bank in the Euro Area if it so decides, in particular if the bank is receiving public support. For all other banks, ECB supervision will be phased in automatically: on 1 July 2013 for the most significant European systemically important banks, and on 1 January 2014 for all other banks. Therefore, by 1 January 2014 all banks in the Euro Area will come under European supervision.

The ECB will be granted key specific supervisory tasks which are indispensable to ensure detection of risks threatening the viability of banks. It will be empowered to require banks to take the necessary remedial action. The ECB will, inter alia, be the competent authority for authorizing credit institutions, assessing qualifying holdings, ensuring compliance with the minimum capital requirements, ensuring the adequacy of internal capital in relation to the risk profile of a credit institution ("Pillar 2 measures"), conducting supervision on a consolidated basis and supervisory tasks in relation to financial conglomerates. The ECB will also ensure compliance with provisions on leverage and liquidity, apply capital buffers and carry out, in coordination with resolution authorities, early intervention measures when a bank is in breach of, or is about to breach, regulatory capital requirements.

The ECB will be vested with the necessary investigatory and supervisory powers to perform its tasks. Active involvement of national supervisors within the SSM is provided for to ensure the smooth and efficient preparation and implementation of supervisory decisions as well as the necessary coordination and information flow regarding issues of both local and European reach, in order to ensure financial stability across the Union and its Member States.

All tasks not explicitly conferred upon the ECB will remain with national supervisors. For example, national supervisors will remain in charge of consumer protection and the fight against money laundering, and of the supervision of third country credit institutions establishing branches or providing cross-border services within a Member State.

The ECB must be able to carry out its new supervisory functions in full independence whilst being fully accountable for its actions. The Commission proposal contains strong accountability safeguards, notably vis-à-vis the European Parliament and the Council, to ensure democratic legitimacy. In addition, the proposal lays down a number of organisational principles to ensure clear separation between monetary policy and supervision. This will mitigate potential conflicts between different policy objectives, while at the same time allowing full advantage to be taken of synergies. All preparatory activities and policy execution will therefore be carried out by bodies and administrative divisions separate from monetary policy functions through a supervisory board established within the ECB for this express purpose.

Finally, the proposed amendments of the EBA Regulation will ensure that the EBA can continue to fulfil its mission effectively as regards all Member States. In particular, EBA will exercise its powers and tasks also vis-à-vis the ECB. Voting arrangements within the EBA will be adapted to ensure EBA decision-making structures continue to be balanced and effective reflecting the positions of the competent authorities of Member States participating in the single supervisory mechanism and those which do not, and thereby preserving fully the integrity of the single market._Amendments of voting arrangements have been targeted to those areas where the EBA takes binding decisions on the application of the single rulebook when pursuing breaches of law and settling disagreements. In other areas, existing procedural safeguards are considered sufficient to ensure balanced and effective decisions making in those areas. For example, draft technical standards are submitted to the Commission for adoption, and the Commission can decide not to endorse or to modify them, in particular when they are not in full conformity with the fundamental principles of the internal market for financial services. Finally, a targeted review clause has been inserted in the draft Regulation amending Regulation 1093/2010 so as to take into account in particular any developments in the number of Member States whose currency is the Euro or whose competent authorities have entered into a close cooperation and examine whether in light of such developments any further adjustments of those provisions are necessary to ensure that EBA decisions are taken in the interest of maintaining and strengthening the internal market for financial services.

Key Actions

The Commission calls:

(i) on the Council to consider and adopt urgently the proposal for a Council Regulation conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions taking into account the opinion of the European Parliament;

(ii) on the European Parliament and the Council to consider and adopt urgently the proposal amending Regulation 1093/2010 establishing the EBA.

Agreement on these two proposals should be reached before the end of 2012.

3.2. Next Steps in the Management of Bank Crises

Global financial integration and the EU single market have enabled the banking sector in some Member States to outgrow national GDP many times over, resulting in institutions which are "too-big-to-fail" and "too-big-to-save" under existing national arrangements. On the other hand, experience shows that the failure of even relatively small banks may cause cross-border systemic damage. Furthermore, bank runs across borders can critically weaken national banking systems, further damaging the fiscal standing of the sovereign, and hastening funding problems for both.

Reinforced supervision within the banking union will help improve the robustness of banks. If a crisis nonetheless occurs it is necessary to ensure that institutions can be resolved in an orderly manner and that depositors are assured their savings are safe.

Against this background, the Commission has underlined[13] that a banking union should include a more centralised management of banking crises. The European Parliament has also called for progress in this area. The need for "common mechanisms to resolve banks and guarantee customer deposits" was also referred to in the report by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012[14].

Therefore, the Commission envisages notably making a proposal for a single resolution mechanism which would govern the resolution of banks and coordinate in particular the application of resolution tools to banks within the banking union. This mechanism would be more efficient than a network of national resolution authorities, in particular in the case of cross-border failures, given the need for speed and credibility in addressing banking crises. It would be a natural complement to the establishment of a single supervisory mechanism. It would also entail significant economies of scale, and avoid the negative externalities that may derive from purely national decisions. It would take its decisions in line with the principles of resolution set out in the single rulebook which are consistent with international best practice and in full compliance with Union state aid rules. In particular shareholders and creditors should bear the costs of resolution before any external funding is granted, and private sector solutions should be found instead of using taxpayers' money.

Moreover, and based on an assessment of its functioning, such a single resolution mechanism could also be entrusted with further tasks of coordination regarding the management of crisis situations and resolution tools in the banking sector, as set out in the report presented in June 2012 by the Presidents of the European Council, the Commission, the ECB and the Eurogroup.

[13] http://ec.europa.eu/europe2020/banking-union/index_en.htm
[14] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

Key actions

Once agreement on the existing DGS and Bank Recovery and Resolution proposals is achieved, the Commission envisages to propose notably a single resolution mechanism to resolve banks and to coordinate the application of resolution tools to banks under the banking union.

4. NEXT STEPS

The European Union has the means to address its current weaknesses and set up the banking union as an essential step towards a genuine Economic and Monetary Union.

The Commission calls on the European Parliament and the Council to:

- give their full support to the banking union and endorse the orientations and roadmap described in this Communication;
- give the highest priority in the legislative process to the actions necessary for establishing the banking union;
- finalise, as soon as possible and in any case before the end of the year, the proposals on the table on:
  - Deposit Guarantee Schemes;
  - access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD);
  - prudential requirements for credit institutions and investment firms (CRR);
  - a framework for the recovery and resolution of credit institutions and investment firms;
  - conferring certain tasks on the ECB relating to the prudential supervision of credit institutions;
  - amending certain provisions of the EBA Regulation.

With this communication and the accompanying legislative proposals, the Commission has acted swiftly and responsibly in response to the mandate given by the European Council and the Heads of State and Government of the Euro area at the end of June. Other institutions now need to do their part to ensure the single supervisory mechanism is established by 1 January 2013.