Banking Union

New payments and contributions in the institutional context of the Banking Union

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The Banking Union requires financial institutions to support the administrative cost of the new institutions and finance the new resolution fund. Current regulatory debate is focused on how to define a methodology to compute these new payments and charge them to banks. For banks this new reality implies new costs, however even if in the short run the profits of the European banking system may be affected, in the long run the benefits of a robust banking union will clearly overcome the financial costs.

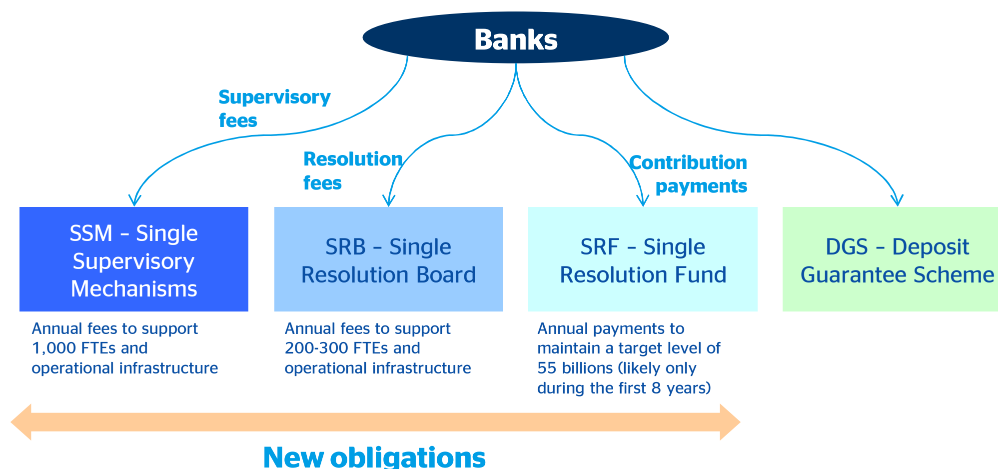
New banking payment requirements in the Eurozone

The Banking Union represents a decisive institutional change for the European financial system. This new infrastructure would be based, mainly, on four pillars: i) common regulatory rules, ii) a common supervisory system; iii) a common resolution process and iv) a common deposit guarantee fund.

These four pillars would be backed by a new institutional framework formed by the Single Resolution Board (SRB), the Single Resolution Fund (SRF), and the Single Resolution Mechanism (SRM) which will be the backbone of the Banking Union. **The administrative costs of maintenance of this new organizational framework and the finance of the new resolution fund would be charged directly to the financial institutions**.

The current regulatory and institutional debate is **how to define a methodology to compute these new payments** and charge them to banks. As a general principle, this methodology should respect the required level playing field in Europe but at the same time should remain simple and transparent. On top of this, financial institutions will continue to contribute to national Deposit Guarantee Schemes (DGS), albeit with changes in terms of amount and payments' timing; and in some cases financial institutions would still have to contribute to their national supervisory authorities.

Figure 1
New banking payment requirements in the Eurozone



Source: BBVA Research

As Figure 1 shows the new contributions that will be assumed by banks are the following:

- **SSM supervisory fees**: The ECB will levy an annual supervisory fee on directly and indirectly supervised banks to cover supervisory, mainly administrative costs, which are estimated to be around €260 million for 2015. Additionally €40 million would be added up to cover expenses for the remaining of 2014 since the launch of the SSM in November 2014. A preliminary analysis of the ECB estimates that the allocation of the overall cost on SSM fees will be split 15% for the less significant entities and 85% for the significant banks. That means that the fees for most banks directly supervised by the ECB will range between €0.7 million and €2 million per year.

  The draft regulation on supervisory fees was first published on May 27, 2014 and it will be open to public consultation until 11 July 2014. The ECB will hold a public hearing on the consultation document on 24 June 2014. Finally, the regulation on supervisory fees will enter into force before the ECB assumes its supervisory tasks on 4 November 2014.

- **SRB fee**: The administrative costs (among others human resources, infrastructure and technology cost) of the establishment of the SRB should be financed through annual contributions from all banks subject to the SRM. Although the SRB shall be established as from January 2015, the preparatory work has already started. For these reasons, the funding needs of the SRB during the first two years of operations (2014 and 2015) are estimated to be around €25 million.

  The methodology of contribution has not been published yet and the European Commission (EC) will develop a delegated act defining a precise formula which would be presented to the Expert Group before the summer break.

- **SRF contributions**: As the SRM states[1] the SRF must reach an ex-ante target level of at least 1% of total covered deposits of all the credit institutions in the Eurozone (i.e.: c€55 bn based on an EU Commission primary assessment.[2]) in an eight year-period. This new fund will be built up from annual individual contributions of banks.

  Although the SRM already defines the general principles, the details on how to distribute the €55bn among the European institutions are still pending. In fact, the EC is empowered to develop a Delegated Act by end-year. The current timeline to design a bank-contribution methodology is as follows: i) by the end of June the EC will release a public consultation; ii) during August and September the delegated act will be discussed at in the EU Council's implementing act; and iii) finally, by December the delegated act would be approved.

- **DGS contributions**: DGS requirements are not new in the European context; however the review of the Deposit Guarantee Directive[3] introduces several new requirements that could have a significant impact on some Member States. In particular, there are significant changes in how the contributions should be assessed – covered deposits instead of eligible deposits – and the timing of the payments – ex-ante instead of only ex-post payments.

[1] See article 66 (3 a) of the Single Resolution Mechanism
[2] See Commission Services Non-Paper. Working Document nº7. January 2014
[3] Directive 94/19/EC

Preliminary Assessment

- **For banks this new reality implies new costs** in the form of contributions for financing the new Banking Union architecture. At this point in time it is difficult to assess precisely the financial burden for each institution since the definitive contribution methodology have not been defined yet (it is expected very soon as has been explained above).
- The two principles of the new methodology to calculate the fees (SSM and SRB) and the contributions (SRF and DGS) are clear: i) **the methodology should be consistent** across the four elements, and ii) it should be based on **two bank-specific factors: balance sheet (flat component) and risk profile**.

  The debate circulates around these two factors. Both should be carefully factored in the final methodology in order to not hamper the level playing among Member States and jeopardize a concrete banking model. However, the devil is in the details. First, the size factor should reflect the part of the balance sheet that would be supervised or would be "financed" in a resolution episode. As such those geographies outside of the scope of resolution and supervision should be taken out. Second, risk exposure should go beyond risk weighted assets and additional features should be used to measure this factor. Last but not least, the relative weight between both should also be carefully assessed giving more prominence to the size factor in order to reduce volatility and enhance the predictability of the contributions.
- **The nature and timing of the contributions is diverse**.
  - In the case of the SRB and the SSM fees, the payments should cover the operational and administrative costs of this new infrastructure (i.e.: human resources, IT and other costs), Therefore, they should inherently be considered as perpetual costs. To put it bluntly they will be costs that financial institutions should have to face permanently. In this case here the debate of the sufficiency or the optimum size of the overall contribution will be highly correlated with the services provided by the new institution,
  - On flip side, banks will have to contribute to the Single Resolution Fund until the target level is reached – let's say, for example, €55bn over the first 8 years unless a significant failure occurs. Once the target level is reached, banks should only pay annually in the amount of the organic balance-sheet growth at Eurozone level.
- On top of this, these **new contributions will be added to other payment obligations** as the DGS contributions, as well as existing and future taxes that might be levied over banks, such as the new FTT currently under discussion by 11 Member States or any new levy over deposits or banking activities. The accumulated costs of all these extra payment obligations can be quite significant and will certainly add to the regulatory burden of other prudential rules (i.e: CRDIV, etc.), putting further pressure over the EU banks' P&L.
- **In a nutshell, even if in the short run the profits of the European banking system will be affected, in the long run the benefits of a robust banking union will clearly overcome its financial burden.**

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