Europe Flash

Progress on banking union, fiscal union left behind

The European Council of 13-14 December provided, as expected, only advances on the banking union, and was disappointing on fiscal union. Progress made on the banking union was positive, broadly in line with expectations. Political supports to the Single Supervisory Mechanism and new deadlines for next actions have been announced. Since the October European Council, the new information refers mainly to two issues: operational conditions for direct recapitalization will be presented in the first semester of 2013 and a Single Resolution Mechanism (SRM) proposal will be delivered during the course of 2013. The SRM will be based on industry's contributions. There is no mention to the fourth pillar of the banking union (single deposit guarantee scheme). The fiscal leg of the roadmap to complement the monetary union seems to have been completely dropped, beyond what has been already approved (mostly the Six Pack and the Stability Treaty). There is no mention of central control of national budgets, any form of debt mutualisation, and even the recent proposal of a countercyclical shock absorber has been dropped.

- **On Banking Union, key milestone with agreement on Single Supervisory Mechanism**

1. **First Pillar: Harmonized regulation:** the European Council urges co-legislators (Council and Parliament) to reach a rapid agreement and adoption on the CRDIV (possibly before year end) and calls for a final agreement on the Resolution Directive (RRD) and the Deposit Guarantee Scheme Directive before June 2013. Finally it confirms that it looks forward to the Commission's follow-up to the Liikanen report.

2. **Second Pillar: Single Supervisory Mechanism (SSM).** As expected the European Council welcomes the agreement reached within the Council on 13 December and calls on the co-legislators to rapidly agree as to allow its implementation as soon as possible. This agreement was reached after weeks of tough negotiation and strikes a balance between the different interests of Member States and European Institutions. The endorsement of the SSM proposal marks a breakthrough for the European Union by giving a legal form (and concrete calendars) to the implementation of the second pillar of the Banking Union. On the negative side, there has been considerable delay in the implementation calendars implying that the SSM will not be fully operative before March 2014 at the earliest (for further analysis see attached Regulatory Watch). The document discussed at the ECOFIN established that the ECB would directly supervise the institutions considered "significant". An institution will be deemed as significant if any of the following criteria are met: (i) total assets over €30bn, or (ii) total assets to domestic GDP over 20%, or (iii) two or more subsidiaries or branches in another Member State or (iv) the national supervisor considers an institution of domestic relevance at the domestic level. Moreover, the ECB will also supervise those entities having requested or received European public financial assistance. The agreed scope of SSM is less ambitious than the far reaching Commission proposal, but seems to be balance compromise.

3. **Third Pillar: Common Resolution.**
   - **Direct recapitalization**. For the first time a deadline (June 2013) has been given for the definition of operational criteria that would govern this framework, including the definition of legacy assets (which has a symbolic relevance). This set of criteria is a necessary but not sufficient condition for any direct recapitalization, which will only occur once an effective SSM is established and always following a regular decision by the ESM.
   - **Single Resolution Mechanism (SRM).** The calendar remains unchanged so a concrete proposal is expected for 2013. Some interesting details are given regarding the SRM funding, which should be primarily private (from banks participating in the SSM) but relying on a credible, strong public backstop (that would be recovered ex-post through some form of bank levy, widely in line with the provisions of the EU Recovery and Resolution Directive).

4. **Fourth Pillar: Single Deposit Guarantee Scheme.** There is no mention to this goal partly because is a medium/long term objective but also because is the most difficult one to achieve.

Disappointing on fiscal integration

- The Council asked President Van Rompuy at its June meeting to present proposals to advance in both areas (fiscal and banking) for this meeting, but after the interim October summit it was already clear that the focus was going to be put on banking integration. The expectations of further integration towards further control of national budgets at EU or Eurozone level in exchange for any form of mutualization of public debt, which have been subject to debate over the past two years, have been definitely left behind. A recent document by the European Commission included several options of debt mutualization (eurobills and the German-inspired Debt Redemption Fund, among others), but this issue has not been mentioned, not even as a possibility in the long-term, and it is unlikely that it reappears until after the coming German elections in the Autumn of 2013.

- More recently, the blueprint presented by President Van Rompuy (in cooperation with the presidents of the ECB, the EC and the Eurogroup) included less ambitious proposals, focused on two areas already hinted in the October summit: A stabilization fund to compensate countries that suffer asymmetric macreoconomic shocks, which would have been financed by a new fiscal capacity of the EU, and an mechanism of financial incentives to complement a contractual approach for structural reforms ("solidarity mechanisms"). The first mechanism has already been dropped from the agreement, while the second has been retained, but it will require further consultations and will be analysed by the Council in June 2013. Such mechanism may be useful, especially as it may help to compensate the short-term costs attached to structural reforms, which typically show their benefits only the longer term. However, unless the quantities involved are large, they are unlikely to become a game changer in the always difficult political process of adoption of reforms.

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