2018: a key year for progress toward banking union

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Europe closed 2017 with a discussion at the Euro Summit on the future of Economic and Monetary Union (EMU) and banking union. There was wide consensus among European leaders regarding the need to complete banking union, in order that it might realise its full potential as a cornerstone of a strong EMU and complement the Capital Markets Union.

Banking union forms a part of the EU plan to redress monetary union institutional shortcomings and resume the project which seeks greater European financial integration and growth over the coming decade. The aim is not to mutualise past problems (such as legacy assets), but rather to deal with future issues. A well-designed banking union will be the best catalyst to ensure a strengthening of financial integration, by breaking the sovereign debt-bank debt vicious circle and creating a framework that facilitates swifter resolution of future crises.

The banking union that was set up in 2012 represented the greatest transfer of sovereignty since the creation of the euro, and was of paramount importance when tackling the currency's worst crisis to date. In record time, European authorities put in place a single regulatory system and a new institutional framework for a transfer of competences from national authorities to supra-national authorities (in supervisory and resolution matters), ensuring unified criteria and mutualising part of banking risk.

Nevertheless, the new framework remains unfinished. Of the four key banking union elements - regulation, supervision, resolution and deposit insurance - only the first three can be said to be fully functional (albeit with certain aspects that can be improved upon). This framework needs to be completed with the creation of a single deposit guarantee fund and the establishment of a common backstop to the Single Resolution Fund that finally breaks the close relationship between government bond and banking sector risk, the so-called “sovereign-bank circle of doom”. It would also be beneficial to review how banking union elements function, in order to ensure equal implementation in form and spirit in the various eurozone jurisdictions.

In 2017, the European Commission compiled all views on the need to complete banking union in a series of reports and plans, the aim of which was to ensure an agreement on all pending elements in 2018, with risk reduction and distribution measures.

The successful implementation of the measures under consideration will depend on the result of political negotiations between member states in the eurozone, where there are significant discrepancies regarding the priorities which need to be resolved first. While central European countries are in favour of a reduction in current risk before considering mutualisation, other countries have underlined the importance of not losing the reforming momentum. This is especially true when dealing with the proposal to set up a single deposit guarantee fund in Europe, which is essential to completing banking union.

In its most recent communiqué, prior to the December Euro Summit, the European Commission outlined a reform package with specific initiatives designed to move EMU forward over the next 18 months, including the proposal to turn the European Financial Stability Facility (EFSF) into a European Monetary Fund, with the capacity to bail out countries and banks without any problem.

Nevertheless, the package of measures presented at the Summit only featured an agreement to move forward in three areas. Firstly, this involved setting up a common protectionary mechanism for the Single Resolution Fund, possibly in the form of a line of European Financial Stability Facility credit. Secondly was a proposal to move ahead with the implementation of EFSF, possibly as something which could be called the European Monetary Fund. Thirdly, the agreement sought to move banking union forward with the gradual introduction of a single deposit guarantee fund.

In order that banking union might be successful, Europe must not lose momentum, completing the project with a single deposit guarantee fund which ensures full mutualisation after a period of transition, as together with the Capital Markets Union this will result in a more stable and integrated financial system. For this reason, Europe should seize the opportunity presented by the currently favourable economic panorama to move forward with the necessary reforms.

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