

Financial services

Building a banking union given top priority

By Manon Malhère | Tuesday 08 January 2013

Making progress on the construction of a banking union will be an Irish Presidency priority. It intends to finalise some heavy dossiers, including the package creating a single supervisory mechanism (SSM) for banks. A European Commission legislative proposal on restructuring of the banking sector is also expected.

BANKING SUPERVISION

The first priority will be to wrap up negotiations between the European Parliament and the Council on reform of the CRD IV-CRR (Capital Requirements Directive-Capital Requirements Regulation) prudential banking rules that adapt the Basel III rules to the European level. The parties are well behind schedule on this. The initial date of entry into force of the reform was set for 1 January 2013 in order to meet the timetable set by the Basel III Committee (gradual application of the rules from 2013 to 2019). The negotiations are, however, coming to an end and the parties are planning to reach an overall agreement at their next political meeting in January.

The European Parliament and Council will be heavily involved in the package creating an SSM for the 17 eurozone countries (EU17) and which is also open to EU member states outside the eurozone. The first step towards a banking union, this package gives the European Central Bank (ECB) a central role in terms of supervising banks. It consists of a draft regulation conferring supervisory powers to the ECB (this requires the agreement of all 27 EU member states after consulting the European Parliament) and a proposal amending the regulation setting up the European Banking Authority (subject to co-decision).

The European Parliament and Council have planned political three-way talks from early January with the hope of reaching a compromise agreement on the legislation as quickly as possible. It will then be up to the ECB to take the necessary steps to implement the mechanism.

Effective establishment of this SSM is a necessary, but insufficient, condition for the direct recapitalisation of banks by the EU17's European Stability Mechanism. In the next six months, the operational framework that structures this recapitalisation will need to be set, including in particular the thorny issue of the definition of 'historical assets' (which amounts to agreeing on the debts that will be targeted).

Before the end of March, the EU27 will also need to agree on draft directives on the recovery and resolution of failing banks as well as deposit guarantee systems – the two other elements of a banking union alongside supervision. The Council and the European Parliament will have to conclude negotiations on the two texts by June 2013.

In the course of 2013 (the date is still to be specified), the Commission will propose a single settlement mechanism for countries taking part in the future SSM. This text will go further than the

draft directive on the recovery and resolution of failing banks currently on the table and which targets the EU27 (see above). In substance, the word is that it is expected to focus on setting up a single bank settlement authority.

BANKING SECTOR

Among the other dossiers, a Commission legislative proposal on restructuring banking activities is expected. This is the first time that this issue is being dealt with at the European level. The institution is due to base itself on the report by a group of experts on the reform of the EU's banking sector structure chaired by Erkki Liikanen, the governor of the Bank of Finland and former European commissioner. Presented in October, this text contains several recommendations, including the obligation for banking groups to separate some of their high-risk market activities (such as trading on the bank's own account) into a separate legal entity. This is a controversial measure within the industry.

In the spring, the EU executive will tackle the parallel banking system (shadow banking), ie non-banking financial activities. A communication will be published on the subject and this is expected to be accompanied by a legislative proposal. The sector, which is constantly growing, offers advantages, such as the creation of sources of financing or alternative solutions to banking deposits for investors, but given that it is scarcely regulated or supervised, throws up the potential for real systemic risks.

A legislative proposal is also due to be presented by the Commission aiming to create a stronger framework for the creation, production, use and supervision of reference indices following the scandal involving the manipulation of the LIBOR (London Interbank Offered Rate) that came to light several months ago. The aim is to put an end to self-regulation of these reference indices.

MIFID II-MIFIR

As for legislation on the financial markets, the Council will have to work hard to press on with discussions that have ground to a standstill on the reform of the regulation of financial instruments, known as MiFID II-MiFIR. The Commission presented two legislative proposals in October 2011: a draft directive amending Directive 2004/39/EC on markets for financial instruments (MiFID II) and a draft regulation on OTC [over the counter] derivatives, central counterparties and trade repositories (MiFIR). This reform is designed to strengthen the regulation and transparency of financial markets as well as to improve investor protection.

MEPs have already adopted amendments to this reform by an overwhelming majority (rapporteur Markus Ferber, EPP, Germany) in a plenary session on 26 October. The vote, which is essentially symbolic (it is not a vote in first reading), gives a solid mandate to the rapporteur to start talks with the Council when the member states are ready.

A European Commission legislative proposal on restructuring of the banking sector is also expected