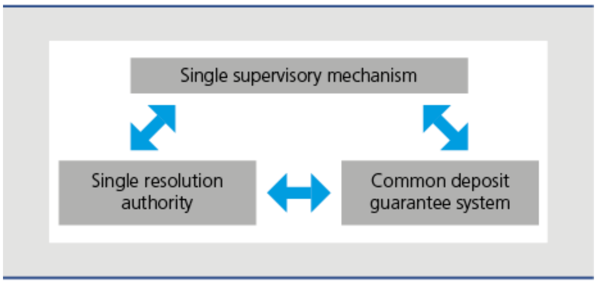
The banking union

In the euro area, the spreading of the crisis to certain sovereign debt markets showed that a monetary union requires not only closer coordination of fiscal and economic policies but also unified supervision and, more generally, an integrated financial framework.
Such a structure, called a "**banking union**", is essential to reduce the negative feedback between the public sector and the banking sector and to limit the fragmentation of markets. Moreover, bank supervision generally extends beyond domestic borders, in view of the existence of cross-border groups and the more general integration of markets. In that sense, the banking union is a cornerstone for the further construction of EMU.

The banking union rests on three pillars:

THE THREE PILLARS OF THE BANKING UNION



1. THE SINGLE SUPERVISORY MECHANISM (SSM)

1.1. PREPARATION

The SSM operating procedures were set out in a draft Framework Regulation and a supervisory manual. Moreover, in accordance with the Regulation implementing the SSM, the ECB, in close collaboration with the national competent authorities, initiated the comprehensive assessment process for credit institutions which will come under the direct supervision of the ECB from **4 November 2014**. That exercise aims to determine the risk profile and identify any structural weaknesses in these institutions in order to promote the transparency and consolidation of the European banking sector with a view to the lasting restoration of market confidence in the European banking system.

1.1. TASKS

1.1.1. Microprudential task

The ECB's responsibilities relate to institutions deemed significant, i.e. those that meet one of the following criteria :

(1) the total value of its assets exceeds 30 billion euros, or
(2) the ratio of its total assets to the GDP of the Member State of establishment exceeds 20 % (unless the total value of its assets is below 5 billion euros), or
(3) in the view of the national competent authority the institution is considered to be of significant relevance to the domestic economy, and the ECB confirms that opinion, and
(4) it has requested or received support from the European Financial Stability Fund (EFSF) or the European Stability Mechanism (ESM).

In the case of institutions considered less significant, the competent national authorities remain responsible for supervision.

Nonetheless, the ECB will exercise horizontal supervision in order to detect potential vulnerabilities. It will also be able to take over the direct supervision of those institutions if that proves necessary to ensure the consistent, rigorous application of the supervision rules.

Nevertheless, one exception was introduced for “common” procedures : for the grant or withdrawal of credit institution authorisation and for decisions relating to qualifying holdings, the ECB will be responsible for all banks, whatever their significance. However, the national authorities will remain responsible for preparing decisions on these subjects.

The ECB will have to ensure that credit institutions respect the minimum prudential requirements set by the CRD IV and the CRR[1] notably in regard to capital, liquidity, governance and major risks. Thus, it will have to make sure that institutions hold sufficient own funds in relation to the minimum prudential rules but also considering their intrinsic risk profile. In this context, the ECB will also be responsible for the individual risk assessment under pillar 2.

In addition, the ECB will have the task of applying the qualitative requirements intended to guarantee that credit institutions have sound structures, processes and governance mechanisms. That includes the procedures for checking the integrity and expertise requirements for people in charge of managing credit institutions, but also examination of the internal control systems and remuneration policies and practices.

In view of the importance of the large financial groups, the ECB will have to exercise supervision on both a consolidated and a non-consolidated basis. Thus, the ECB will participate in the colleges, without prejudice to the right of the national authorities to take part as observers. Moreover, in the case of financial conglomerates for which the banking arm is the dominant activity, the supplementary supervision will likewise be the responsibility of the ECB, which will thus take on a coordinating role.

The Framework Regulation and the supervisory manual stipulate that a Joint Supervisory Team (JST) will be associated with each significant bank or banking group and will supervise that bank or banking group.

The ECB will have to apply the European and national laws derived from the EU legislation. Some supervisory tasks are not entrusted to the ECB and remain the responsibility of the national authorities. These include consumer protection and measures to combat money laundering. Furthermore, the macroprudential powers are shared between the ECB and the national competent authorities. In view of the importance of these policies for the stability of the financial system as a whole, it will be necessary to establish efficient coordination with all the authorities concerned.

If the ECB finds any shortcomings or defects, it will be able to impose appropriate measures or sanctions, as defined by the Framework Regulation which spells out the respective roles of the ECB and the national competent authorities. In addition, wherever possible, the allocation of powers to impose sanctions is aligned with the allocation of supervisory powers and therefore takes account of the distinction between significant and less significant institutions. In accordance with the SSM Regulation, the ECB’s power to impose sanctions is confined to imposing fines and periodic penalty payments. The ECB may ask the national competent authorities to impose additional sanctions. Moreover, on finding a serious deterioration in the financial situation of a credit institution, the ECB will

[1] Directive 2013/36/EU of the European Parliament and the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

be able to take early intervention measures as defined by EU law. Those actions will have to be coordinated with the competent resolution authorities.

1.1.2. Macroprudential task

The single supervisory mechanism, which has a microprudential task, will have to coordinate its action with that of the macroprudential authorities responsible for ensuring the stability of the financial system as a whole.

This macroprudential dimension calls for specific competence, because it requires not only the development of an aggregate view of the functioning of the financial markets, but also a clear grasp of the interactions between the real and financial spheres of the economy. The causes of instability in the system are not solely linked to endogenous factors but may also come from developments in the structure of economic activities, featuring – at global level – structural imbalances in the current account balance or, at national level, abnormal growth of certain categories of expenditure and investment, notably in the real estate sector.

The European Systemic Risk Board (ESRB), which was set up in 2010, has the task of coordinating the conduct of macroprudential policy within the EU and, via its warnings or recommendations, prompting national or European authorities to take action in this area. So far, the ESRB has made six recommendations. Four of them concern specific topics, namely lending in foreign currencies, funding of credit institutions in dollars, monetary undertakings for collective investment, and funding risk assessment and follow-up. Two more specifically concern the establishment of appropriate structures for exercising macroprudential policy.

The first of these two recommendations calls on all EU Member States to designate a national authority specifically responsible for this policy.
Another ESRB recommendation asks the Member States to develop a strategy for the conduct of macroprudential policy by defining intermediate objectives, using specific instruments and periodically assessing those objectives and instruments.

In Belgium, the NBB was given this mandate and these tools by the law of 25 April 2014 establishing the mechanisms of a macroprudential policy and spelling out the specific tasks devolved to the NBB in connection with its task of contributing to the stability of the financial system.

This macroprudential responsibility and the special powers of the NBB in relation to the so-called systemic institutions were given to it as early as in 2011, when the so-called « twin peaks » model was introduced.

The centralisation of the prudential supervision of credit institutions in the future SSM means that the NBB will coordinate its macroprudential action with the ECB to a greater extent than in the past. Up to now, that coordination was based essentially on existing interactions between financial stability and price stability, the primary objective of the ECB's monetary policy. On taking direct responsibility for the individual supervision of systemic financial institutions in the euro area, the ECB will supervise the use for microprudential purposes of many instruments which could also be mobilised in the macroprudential sphere. That will not remove all need for more targeted use of these tools by the national authorities, in the event of developments threatening the financial stability of one of the Member States. The SSM Regulation stipulates that both the national competent authorities and the ECB may, subject to prior mutual notification, impose additional solvency requirements for systemic purposes. Consequently, these respective powers will reinforce and supplement each other in order to raise the level of requirements if appropriate, but not to reduce it so as to prevent the conduct of macroprudential policy leading to a relaxation of the prudential rules.

The ECB will also have to liaise with the ESRB, which will retain its own macroprudential powers. They are more limited than those of the ECB, since the ESRB only has power to issue warnings or recommendations, with no direct control over the actual use of the instruments. At the same time, those powers are more extensive in that the ESRB's mandate covers the whole of the EU and extends beyond just the credit institution segment to encompass the whole of the financial sector (see Crisis management).

The new European prudential supervision architecture and the interaction between the various European and national supervisory authorities can be represented schematically as follows :

EUROPEAN PRUDENTIAL SUPERVISION ARCHITECTURE

	Microprudential supervision		Macroprudential supervision		Prudential regulation
	Euro area	Rest of the EU	Euro area	Rest of the EU	EU
Banks	SSM / national authorities	National authorities	SSM / national authorities / ESRB	National authorities / ESRB	EC / EBA
Other financial institutions	National authorities		National authorities / ESRB		EC / EIOPA / ESMA

Source: NBB.

1.2. GOVERNANCE

GOVERNANCE OF THE SINGLE SUPERVISORY MECHANISM

The **Governing Council** is the ECB's top decision-making body, including for the performance of the new tasks resulting from the SSM.

For the preparation and performance of the ECB's tasks in the SSM, a new body called the **Supervisory Board** was set up at the ECB.

All proposals for decisions by the Supervisory Board are subject to the approval of the Governing Council. Decisions relating to the performance of the prudential tasks may take the form of individual measures or guidelines, recommendations or decisions. The ECB may also adopt Regulations, but only to the extent necessary to organise or specify the arrangements for carrying out the SSM tasks.

Supervisory Board meetings will be prepared by a **Steering Committee**. Its composition will be laid down in the Supervisory Board's rules of procedure, but in any case must ensure a fair balance and a rotation between the national competent authorities.

The Governing Council and the Supervisory Board may arrange joint meetings in order to ensure that the microprudential and macroprudential perspectives are effectively combined. Those joint meetings should mean that proposals for decisions prepared by the Supervisory Board with a view to activation of the macroprudential tools are generally approved by the Governing Council without amendment.

The **ESCB Financial Stability Committee (FSC)** will also meet in a composition adapted to the SSM. As the macroprudential tools are still largely held by the national authorities, the members of this Committee, with their experience gained at national level, will make an important contribution towards assessing the macroprudential risks. In this area, the ECB will also work with the **European Systemic Risk Board (ESRB)[2]** which performs key functions in the coordination of macroprudential policies at the level of the European Union.

1.3. IMPACT ON THE NBB'S PRUDENTIAL SUPERVISION AND ON CREDIT INSTITUTIONS

Owing to the substantial market share in Belgium of financial groups meeting the criteria defining significant credit institutions, the NBB will be very closely involved in the implementation of the SSM. Indeed, around 95 % of the sector's total assets are held by Belgian credit institutions deemed to be significant, and therefore falling within the competence of the ECB from 4 November 2014.

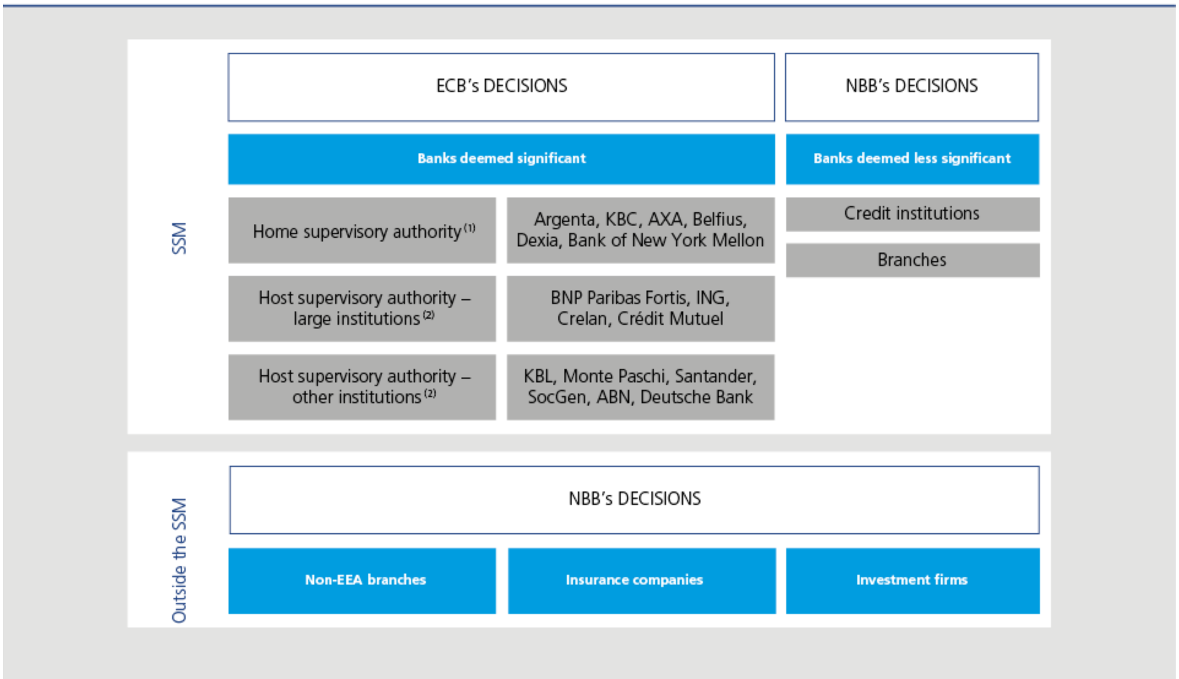
There will be a **Joint Supervisory Team** (JST) for each significant credit institution or banking group. For each JST, the Supervisory Board will appoint a coordinator and decide on the team's size and composition. The national competent authorities of the countries where a bank is established will appoint the staff members to form part of the JSTs. For the national competent authorities, they form the key resource for assisting the ECB in the preparation of its supervisory tasks. In fact, in the case of banks subject to the ECB's direct supervision, the files are to be prepared by the JSTs in accordance with clearly defined procedures harmonised at SSM level. While the final decision will now rest with the Supervisory Board and the Governing Council, the NBB will nevertheless be informed in advance of all proposals for decisions relating to significant credit institutions, both via the JST members who will report regularly to the Bank on the work of the SSM bodies, and via the national representatives on the Supervisory Board and the Governing Council.

For banks considered less significant and for institutions not subject to ECB supervision, such as branches directly subject to the law of a non-EEA Member State, the NBB retains full responsibility for the final decisions[3]. However, the supervision methods must be harmonised with those developed for banks deemed significant, with due regard for the principle of proportionality.

[2] The European Systemic Risk Board (ESRB) has been in charge since 1 January 2011 of monitoring and analysing risks to the stability of the financial system as a whole (macroprudential oversight). To this end, the ESRB issues early warnings in cases where system risks are building up and, if necessary, makes recommendations for corrective measures to be taken and issues warnings to Member States (including the national supervisors) and to the European authorities, which will have to comply or else explain why they have not done so. The heads of the European Central Bank (ECB), national central banks, the European Supervisory Authorities, and national supervisors, will participate in the ESRB.

[3] Except for decisions relating to "common" procedures, where the final decision rests with the SSM decision-making bodies.

IMPLICATIONS OF THE SSM FOR THE NBB IN TERMS OF DECISION-MAKING PROCESSES CONCERNING INSTITUTIONS SUBJECT TO ITS SUPERVISION



Source: NBB.
(1) Home supervision concerns supervision in the bank's country of origin at the highest consolidation level.
(2) Host supervision concerns supervision in the host country of branches or subsidiaries of banks of foreign origin.

2. THE SINGLE RESOLUTION MECHANISM (SRM)

The single resolution mechanism aims to strengthen the cohesion of the banking union by centralising resolution responsibilities at European level by analogy with the planned centralisation of responsibility for supervision. That alignment is necessary because supervision, early intervention and resolution form a continuum. It ensures that the implications of supervision responsibilities exercised at central level do not have to be borne by the national authorities in the resolution framework.

The SRM consists of (i) a European resolution authority – the Single Resolution Board – which will decide on the central management of future banking crises and (ii) a Single Resolution Fund (SRF), which will be financed by the banks established in Member States participating in the Banking Union.

The Single Resolution Board is composed of an Executive Director, a Deputy Executive Director, and representatives of the European Commission, the European Central Bank, and the national resolution authorities. It will be responsible for drawing up resolution plans for all banking groups established in Member States participating in the SSM, and for banks not forming part of a group. As a corollary, it will also assess resolvability and stipulate the minimum own funds requirements. In addition, it will determine the liabilities to be taken into account in the bank's bail-in, taking care not to jeopardise financial stability. Finally, the Board is to define the approach to be adopted where, in cooperation with the SSM, it finds that a group or a bank actually meets the conditions for resolution. In particular, that implies determining the use to be made of the various resolution tools, namely (a) sale of the business, (b) use of a bridge institution, (c) asset separation, and (d) bail-in.

The approach proposed by the Single Resolution Board will be validated by the European Commission, while it will be implemented by the national resolution authorities concerned, under the supervision of the Single Resolution Board.

The definition of a resolution approach is governed by a set of principles designed to ensure continuity of the critical functions performed by the institution but without resorting to public funding and taking care to avoid certain forms of moral hazard. The Single Resolution Board has to ensure that the shareholders are the first to bear the losses, followed if necessary by the institution's creditors, according to the order of priority for bankruptcy cases and giving equitable treatment to creditors in the same class. In particular, no creditor may incur greater losses than would have been the case if the institution had been the subject of bankruptcy proceedings. Finally, the Single Resolution Board will ensure that the institution's management is dismissed, except where retention of the management is necessary for the achievement of the resolution objectives.

The Single Resolution Fund is to be financed by credit institutions and investment firms established in Member States participating in the Banking Union. The aim is to gradually increase the contributions to 1% of the covered deposits. The Single Board will be able to borrow in order to increase its fire power, an ability particularly crucial in the first years when the Fund will only have a small capitalisation. This Fund will gradually replace the national resolution funds of the participating Member States and will take on their role.

The European Commission intends the Single Resolution Mechanism to take effect on 1 January 2015, while the entry into force of the SRF is scheduled for 1 January 2016.

The European Parliament reached an agreement on the SRM and the SRF on 15 April 2014.

3. THE COMMON DEPOSIT GUARANTEE SYSTEM

Progress on this third pillar, namely the common deposit guarantee system, has hitherto been confined to harmonisation of the national systems. According to the new directive adopted in late 2013, bank deposits of up to 100,000 euros will be covered by deposit guarantee systems which are to be established in all European States.

Deposit guarantee funds reimburse a limited amount of deposits to depositors whose bank has failed. From the depositors' point of view, this protects a part of their wealth from bank failures. From a financial stability perspective, this promise prevents depositors from making panic withdrawals from their bank, thereby preventing severe economic consequences.

In order to restore confidence during the recent financial crisis, the deposit guarantee in Belgium was increased substantially from 20,000 to 100,000 euros. That guarantee applies per depositor for the total accounts held per bank. It covers all deposits denominated in a currency of the European Economic Area, plus investment accounts and debt certificates issued by credit institutions (e.g. savings notes). A guarantee scheme for certain life insurance policies was also devised, similarly covering up to 100,000 euros. The guarantee covering financial instruments and securities held with a depository (e.g. shares, bonds, investment funds) remains at 20,000 euros.