

BANKING UNION – ROMANIAN PERSPECTIVE

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Abstract: The financial crisis showed that banks were not able to face the loss, because there is no framework for a resolution, so that it intervened with money from taxpayers. So, it has been highlighted the need to update the regulations applicable to the banking sector. Creating a single supervisory mechanism in the fall of 2014 was a time reference point to achieve a banking union in Europe. Banking Union is one of the four foundations for a genuine Economic and Monetary Union. The paper's purpose is to analyze the Banking Union structure, based on three pillars: (i) The Single Supervisory Mechanism - the transfer of the main responsibility regarding banking supervision from national to European level, (ii) The Single Resolution Mechanism - introduction of common provisions to ensure legal support required to manage bank failures problem, (iii) The Deposit Guarantee Schemes - harmonization of deposit guarantee rules. These measures were adopted at European Union level to ensure the stability of the European banking system and to prevent future crises. Because countries that are not part of the euro area are not required to join the Banking Union, the dilemma of these countries lies in the decision to join the Banking Union quickly or to wait. It is the case of Romania, also, so, this paper analyze the opportunity of Romania's accession to the Banking Union before adopting the euro. There are analyzed the advantages and disadvantages of Romania's participation in the Banking Union, showing that, in the context of single currency introduction, Romania's participation is required. So far, there are reduced debates regarding the need, advantages and disadvantages of Romania's participation in the European Banking Union, the top representatives of the National Bank of Romania being among the few who expressed their views in public and published papers on the subject.

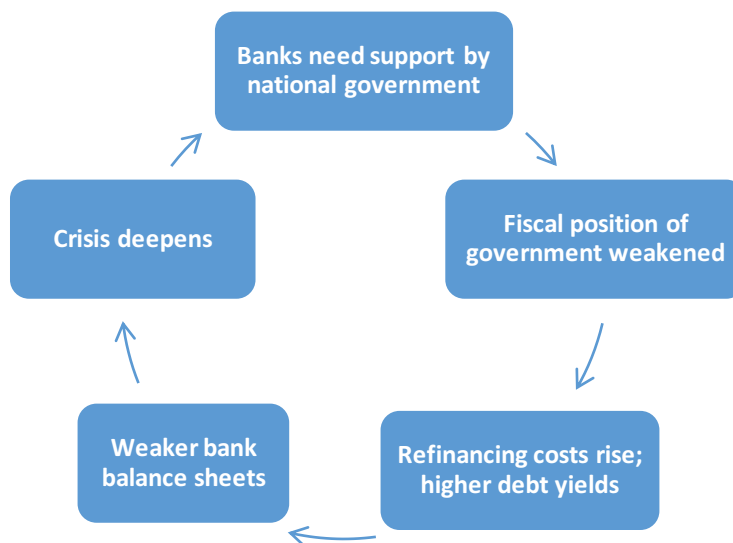
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1.Introduction

As the financial crisis evolved and turned into the Eurozone debt crisis in 2010-2011, in the case of countries with a single currency, some measures had to be taken, in particular to break the vicious circle between banks and national finances (See Figure 1). Therefore, in June 2012, Heads of State and Government agreed to create a banking union, completing the economic and monetary union. This will unify the EU banking rules, mandatory measure for banks in the euro area and optional for any non-euro Member States (http://europa.eu/rapid/press-release_MEMO-14-294_en.htm).

Figure 1: The vicious circle between banks and national finances



Source: http://europa.eu/rapid/press-release_MEMO-14-294_en.htm

The banking union will help to break the link between banks and sovereigns:

- Banks will be stronger and more immune to shocks: Common supervision will ensure effective enforcement of stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. This will make EU banks more solid, strengthen their capacity to adequately manage risks linked to their activities and absorb losses they may incur.
- Failing banks will be resolved without taxpayers money, limiting negative effects on governments' fiscal positions: bank resolution will be financed by banks' shareholders and creditors and by a resolution fund financed by industry. Banks should not be bailed out and government fiscal position will not be weakened further.
- Banks will no longer be "European in life but national in death" as they will be supervised by a truly European mechanism and any failure will also be managed by a truly European mechanism. (http://europa.eu/rapid/press-release_MEMO-14-294_en.htm)

The necessity of the Banking Union is based on the following arguments:

- Stopping the current trends of fragmentation of financial markets in the European Union, which is incompatible with the existence of an Economic and Monetary Union;
- Prevention of bankruptcy, strengthening financial stability and restoring market confidence in the euro;
- Unique surveillance is a prerequisite for applying the direct capitalization of euro area banks by the European Stability Mechanism;
- Breaking the vicious circle of distressed banks and debt of the states (Georgescu, 2014);
- Breaking the link between banks and governments, so that to be eliminated the need for support of the financial institutions, to the detriment of the public interest. European Central Bank supervises banks in the Eurozone and banks from the EU countries, who wish to be included in the bank project (Dăianu, 2014).

2. Pillars of the Banking Union

The three pillars of the Banking Union are:

- The Single Supervisory Mechanism (SSM) – The transfer of the main responsibility regarding banking supervision from national to European level;
- The Single Resolution Mechanism (SRM) - Introduction of common provisions to ensure legal support required to manage bank failures problem;
- The Deposit Guarantee Schemes (DGS) - Harmonization of deposit guarantee rules.

These pillars must be implemented simultaneously to establish banking union.

2.1. The Single Supervisory Mechanism (SSM)

The unique supervision will be realized by the European Central Bank, which will have the role to monitor the situation of euro area banks and of the banking union acceding countries, and the risks they assume and to intervene when problems arise.

European Central Bank will directly supervise only 'significant' banks, the rest remaining the attribute of the national authorities. In the euro area, there are approximately 130 'significant' banking groups, which are separated from the rest of the banks, according to their size, their importance to the national economy or to the EU and the importance of cross-border activities.

The European Central Bank (ECB) will supervise direct the following, also:

- banks that have applied for or have received public financial assistance;
- banks less significant, when it is necessary to ensure consistent application of high standards of supervision;
- three of the largest banks from each participating member state (Georgescu, 2014). The ECB will directly supervise about 85% of banking assets of the Eurozone. However, the activity will be governed by a single monitoring manual and all data of supervisory will be sent to the ECB. The European Central Bank will be able to directly supervise any bank or group of banks that represents a potential source of systemic risk.

Prudential supervision by SSM is systematically presented in Table 1.

The regulation regarding the Single Supervisory Mechanism came into force in November 2013, and the ECB has provided 12 months for its operationalization. In April 2014 the ECB published the Framework Regulation which establishes SSM conduct business. ECB has already assumed full supervisory duties from November 4, 2014 (Isărescu, 2014).

Potential conflict of interest generated by the dual role of the European Central Bank, as monetary authority and supervision, was settled by:

- Implementing a decision flow that completely separates the two activities by establishing the Supervisory Board;
- Building institutional capacity of ECB for supervision activity – ensure the specialized staffing;

The Single Supervisory Mechanism aims to restore the medium and long term confidence of investors and depositors in the European banking system, because non-performing assets will no longer be hidden in other jurisdictions, and by identifying and monitoring exposures and international financial linkages, it should be reduced systemic risk (Cărmădăriu, 2015).

Table 1: Prudential supervisory by SSM

National authorities	European Central Bank
<ul style="list-style-type: none"> ➤ Consumer protection; ➤ Combating Money Laundering; ➤ Supervision of entities belonging to credit institutions headquartered outside the EU. 	<ul style="list-style-type: none"> ➤ Authorization of credit institutions; ➤ Ensuring compliance of the banks' capital adequacy and liquidity requirements; ➤ Consolidated supervision of financial conglomerates; ➤ The ECB and the national banking supervisory authorities will act as a system.

Source: Isărescu, 2014

2.2. The Single Resolution Mechanism (SRM)

The second pillar of Banking Union establish a European authority of resolution, which will decide whether a bank with problems should be saved or should enter into bankruptcy.

During the recent financial crisis, a number of European banks had to be supported by public funds (bail-out). Use of public funds for this purpose, although it was considered necessary, is not sustainable in the future. (Georgescu, 2014).

The transnational consequences of a banking crisis justify building a resolution mechanism at European level.

Its objective is impartial and effective management of banking crises so as to minimize negative impacts on the economy and call for public funds.

The principles governing SRM are:

- A functioning market economy requires exit from the market in case of failure;
- Resolution cost to be support first by shareholders and creditors. "Resolution" involves restructuring a bank / financial institution by a resolution authority, using specific tools.
- The involvement of public funds should be only one last resort and accompanied by measures to ensure medium-term fiscal neutrality;
- Avoiding a potential conflict between the goals of structure decision by administration of this mechanism by a single authority resolution different from the ECB, but with a similar broader institutional and geographical coverage (Ferran and Babis, 2013); SRM will include all banks from the euro area and the Member States participating. It involves the distribution of responsibilities between the Single Board Resolution and the National Authorities Resolution.

Single Board resolution is directly responsible for the cross-border banks and for the 'significant' banks. National Authorities Resolution is responsible for all other banks and for decisions of resolution for them, on condition of non-involvement in solving their fund resources.

The Single Fund Resolution will be financed by contributions from the banking sector and will replace the national resolution funds of the states that are participating in Union Banking.

Implementing the Single Resolution Mechanism will be done in two stages:

- January 1, 2015: partial entry into force, that will come into effect the provisions of the resolution planning preparation, collection of information and cooperation with national authorities;
- January 1, 2016: Full entry into force of the unique mechanism of resolution, that

the entry into force of the provisions relating to the planning resolution, early intervention, actions and resolution tools, including bail-in, on condition entering into force of the Intergovernmental Agreement on the Single Fund Resolution. (<http://www.europarl.europa.eu/news/ro/newsroom/content/20140410STO43248/html/Uniunea-bancar%C4%83-pe-scurt-ghid-despre-noile-reguli-UE>).

2.3. The Deposit Guarantee Schemes (DGS)

This mechanism has the following objectives:

- EU harmonization of categories and level of guaranteed deposits;
- Reduction of payout;
- Harmonization of information provided to depositors;
- Establish monitoring requirements of deposit guarantee schemes.

Completing the Banking Union with a single deposit guarantee scheme seems difficult to achieve. There is a major controversy between the member states on the need and on design it. Obvious, asymmetry between North and South in terms of its financing costs raises difficulties to policy issues.

Larosi re report does not support the idea of mutualisation the resource of the deposit guarantee schemes in the Member States, considering that the harmonization the sets of related rules should be sufficient (High Level Group on Financial Supervision in the EU, Report February 25, 2009 - De Larosi re Report).

The compromise that was reached at the European level provides for the harmonization of national guarantee schemes.

Steps in this direction have already been implemented:

- Coverage of national deposit guarantee schemes - harmonized level of 100 000 EUR / depositor / credit institution;
- Simplifying procedures for reimbursement of covered deposits: reduce payment periods and improved financing arrangements.

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European directive adopted by the European Parliament in April 2014 imposed ex ante funding of all national guarantee schemes in the EU (Sibeltein, 2007). The main advantages of harmonization of deposit guarantee schemes are:

- Ensuring the equal treatment of depositors in all EMU countries complementarity with single supervisory mechanism;
- Increasing confidence in the banking system; A larger volume of resources is likely to grow considerably the resistance of the system on shock.
- Limiting moral hazard and disposal of potent pro-cyclical effects; Contributions banking institutions are set according to their size and the risks involved (Ilie Mihai, 2003).

3. Romania and Banking Union

Countries that are not part of the euro area are not required to join the Banking Union. In this context, the dilemma of these countries lies in the decision to join the Banking Union quickly or to wait.

So far, there are reduced debates regarding the need, advantages and disadvantages of Romania's participation in the European Banking Union, the top representatives of the National Bank of Romania being among the few who expressed their views in public and published papers on the subject.

The Commission proposal did not provide the voting rights for the non-euro area countries, generating skepticism for countries like Poland or Sweden. Summit requires that all participating states in single supervisory system to have the right for vote in a new decision making body of the ECB - Supervisory Board, but not in the Governing Council, which retains the veto decisions of the Supervisory Board. (http://europa.eu/rapid/press-release_MEMO-12-656_en.htm).

To alleviate the concern of countries like Britain and others countries outside the euro area related to the fact that the Banking Union divide EU in decision makers and passive viewers, it has been modified the voting procedure. This requires a dual majority, both in the group of countries inside and outside the euro area. Although the new proposal to structure single supervisory mechanism reduces the danger of Europe in the 'two-speed', only apparently solve the initial dilemma of countries from the CEE region: of losing the powers of supervision of the banks in countries that foot the bill in case of bankruptcy.

An argument in favor of joining a non-euro countries in the EU Banking refers to this massive capital Eurozone national banking structure. In Romania, euro area banks hold over 70 percent of net assets and the capital of the Romanian banking system. In this context, it is necessary and carrying out cross-border regulation and supervision. Given the massive presence of foreign capital in the domestic banking system, the contagion effect is major. Participation in Banking Union reduce costs of contagion, providing greater capacity reaction most appropriate mechanisms and greater resources.

As mentioned, the banking system in Romania is dominated by subsidiaries of multinational banks of the euro area. These subsidiaries are systemically important for the host country (Romania), but not for the mother country (Austria, France, Italy). Over 70% of the Romanian banking sector was held by foreign banks, similar to other countries in the region, while only about 15% of banking assets in Western European countries were owned by foreign banks.

The sphere of political economy is an argument in favor of a rapid accession to the Banking Union. Insider participation to the construction of a mechanism offers the advantage of having a say on the adoption of decisions. At the same time, offers the advantage of direct access to first-hand knowledge, thus avoiding holding partial or distorted information, provided by parent banks in line with interests in the financial group.

From the political point of view, who do not participate to the negotiating table, will not be able in the future to claim the new decision-making structures, and therefore will not have a voice in terms of future priorities for action. A Banking Union membership will strengthen the position of Romania in such negotiations.

Entry into Banking Union provides an incentive for deleveraging and removing the foreign banks. For Romania, the Banking Union membership is a natural choice.

Banking Union membership is closely related to the adoption of the euro. From a financial stability perspective, it is essential that Romania to participate in the single supervisory mechanism as a first step towards a long-term political project, the Banking Union.

Changeovers mobilize the membership of the Bank automatically. So the question of membership in the Banking Union designation is just one moment. Becoming a member of the Bank will be at the changeover time or as soon as possible?

Romania has already expressed support for the formation of the Bank. In December 2012, the Romanian Government adopted a memorandum containing a number of elements of Romania's position regarding the proposals to strengthen economic and monetary union. The document says that Romania supports efforts aimed at strengthening of the EU and creating a genuine banking, fiscal and economic union. Romania supports the process of strengthening governance of the euro area, but considers that this process should not be detrimental to the states outside the euro area and lead to fragmentation of the Union.

Government action was prefaced by statements of the governor BNR, who in September 2012 said: "The Union Banking is an inevitable process, and Romania will have to enroll in it ... this is the orientation of the central bank, noting that this depends not only on the

central bank, but also by the Government to Parliament." (<http://www.bnro.ro/Interven%C8%9Bie-la-Conferin%C8%9Ba-'Uniunea-Bancara-Europeana-%C8%99i-Noul-Model-Bancar'-organizata-de-Grupul-de-Presa-Bursa-10813.aspx>)

For Romania, Banking Union membership is expected to have the following effects:

- Enhance financial stability;
- Increased confidence in the national banking system;
- Supporting a sustainable increase in lending and economic activity barriers of entry.

Domestic banking system through a disciplined process of recalibration of their activities in accordance with the new European vision on establishing a healthy financial intermediation:

- Issuance of bad loans sheet;
- Redirecting funding sources to domestic saving;
- Strengthening credit fundamentals recovery assumptions and healthy destination, to sustainable economic development.

The disadvantage is a contribution to a fund of assistance in case of banking crisis, especially if applying a subscription key that disregards the degree of financial intermediation (Isărescu, 2013).

Restricting the perimeter of the Banking Union at the euro-zone countries has the risk of underestimating the importance of financial connections in the EU banking sector.

For the banks outside the euro area, there is a risk that a uniform approach to be a wrong solution. For example, foreign currency loans are a major source of vulnerability for Romanian banks, which is why the central bank continuously monitors and limits foreign currency loans of banks in Romania. On the other hand, increased dependence on short-term interbank loans in combination with exposure to so-called "toxic assets" have caused problems in the euro area banks during the financial crisis of 2007-2008. From the perspective of financial stability, addressing such risks require different instruments.

Romania's accession to the Banking Union is a landmark in the course of the single currency. It is desired the reinforcing of financial stability, including reducing the risk of regional contagion and removing an incentive of disintermediation from banks with foreign capital. Banking Union facilitates recovery of lending on a path consistent with sustainable development-economic activity in accordance with the economic resources released by structural reforms. This will enhance real convergence, which will lead to sustainable performance criteria for joining the euro area.

4. Conclusions

The international financial crisis has reminded us that the European project is incomplete. Strengthening the institutional and economic reform of the EU are conditions for longevity of the Union.

EU return path of smart, sustainable and inclusive growth, generating jobs and enhanced competitiveness is supported by a thorough reform of the European financial system regulation and supervision, in line with the international agenda in the field. Exuberance or excessive conservatism cannot be found in the new European outlook on financial intermediation. Counteract regional contagion risk requires further integration of European banking.

Banking Union is one of the fundamental pillars of the new economic governance framework at EU level. Romania's accession to the Banking Union before adopting the euro is an option. From a financial stability perspective, it is essential that Romania to participate in the single supervisory mechanism as a first step towards the Banking Union. Romania's participation in the European Banking Union can strengthen the financial stability, can strengthen confidence in the banking sector and can contribute to sustainable

growth in lending and in economic activity in general.

Romania's participation in Banking Union requires a close cooperation between ECB and the National Bank of Romania, as well as a flexible approach, with local features.

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