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Banking Union – spillover effects for non-Euro countries

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Financial crisis undermined the foundations of the monetary union

- Fragmentation of the euro-area financial market
 - Balance of payments crisis within the euro area (stopped financial flows from North to East)
 - Reduction of cross-border lending
 - Disintegration of the interbank money market
 - ECB replacement of the interbank market
- Sovereigns' solvency concerns affected banks and banks' solvency concerns have affected sovereigns (vicious cycle)
- Fragmented (domestic) approach to banking policy increased public cost
 - Fear of contagion resulted in asset ring-fencing and risk –shifting
 - Lack of policy coordination led to diversification of credit risk

Which EU Countries should participate in the banking union?

- Coherent with fiscal reforms agenda of the banking union
 - Integrated banking regulations and supervision
 - Resolution and recapitalization
 - Deposit insurance
- Which EU Countries should participate in the banking union?
 - European Banking Union will be built to:
 - ensure viability of the monetary union
 - preserve financial integration within the European single market.
 - “While the banking union is desirable at the EU27 level, it is critical for the euro 17” (IMF 2012)
 - “A banking union – in other words, a union that stands behind the stability of Eurozone banks and their deposits in return for common supervision, [is] natural consequence of a single currency” (George Osborne, 2012)

Are Eastern European banks highly integrated with euro area?

- Subsidiary banks (SBs) owned by European SIFs constitute a significant part of the financial sector
 - Management of SBs: credit policy and liquidity risk management are coherent with rules established by headquarters SIFs,
 - Supervision by owners of SBs: direct supervision (headquarter staff designated as members of a management board of SBs) and indirect supervision (reporting system for headquarters)
 - Liquidity of SBs: liquidity backstop from parent company
 - Financial product integration: financial products are designed at headquarters
 - Common infrastructure: such as IT network, settlement systems, HR

Are Eastern European banks highly integrated with euro area?

- Host-home relations from the host banking supervisory perspective
 - Supervision of SBs by host banking supervisor
 - Formally binding recommendations
 - Insight supervision inspections
 - Shareholder agreements
- Liquidity support (domestic central bank)
- Separate domestic deposit insurance schemes

Macro stability of advanced versus emerging European countries

- Macro stability risk of emerging market economies
 - Higher and volatile inflation
 - Risk of sudden inflow and outflow of foreign capital
 - Higher risk of credit boom and bust
 - Lending in foreign currency
 - Risk of balance of payments crisis
- Prerequisite of macro stability regulations
 - Imperfections of monetary and fiscal policy
 - Limited impact of capital requirements to contain stability risk
- Micro prudential regulations as an instrument of macro stability policy

Experience of banking union

- Potential benefits from the banking union membership
 - Simplified relations between subsidiary management and supervision authorities (termination of supervision schizophrenia: SIF's supervision vs. domestic supervision)
 - ECB liquidity backstop through parent banks (not clear)
 - Access to banking resolution system through parent banks (not clear)
- Emerging Europe perception of banking union policy
 - Main task of the banking union is the maintenance of stability of European banking groups as a whole and SIF's impact on stability on common financial market
 - Stability of a part of banking group may be ignored even this part would have a negative impact on domestic financial sector stability
 - Lack of clear approach to local banks which are systemically important institutions for the stability of the domestic financial market

Banking union - lessons for emerging market countries

- Harmonized rule book with core standards
- Macro stability policy in hands of domestic authority
- General rules for macro prudential regulations
- List of micro-prudential instruments used for macro stability policy
- Partnership framework for cooperation of supervisors
- Implementation of comply or explain rule
- Basic elements of resolution mechanism supported by international financial backstop



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