

Fiscal backstop: the missing pillar of the banking union?

Presentation at the Conference

The Future of Banking Regulation and Supervision in the EU

jointly organised by LEGCO (the Legal Committee of the ESCB) and
MOCOMILA (the Committee on International Monetary Law of the
International Law Association)

European Central Bank, Frankfurt am Main (D), 15 November 2013

Professor Dr. René Smits

Jean Monnet Professor of the Law of Economic and Monetary Union,
University of Amsterdam

Legal Consultant, RS Law & Society Consulting B.V.

Rationale for ‘banking union’

“We affirm that it is imperative to break the vicious circle between banks and sovereigns.”

(Euro Area Summit statement, 29 June 2012)

- To strengthen the banking sector
- To detach government budgets from balance sheets of individual banks
- ECB is considered less politicised and subject less to ‘supervisory capture’

Three elements of 'banking union'

1. **Single Supervisory Mechanism**

'SSM': ECB + National Supervisory Authorities

– Regulations 1024/2013 and 1022/2013, 15 October 2013

2. **Single Resolution Mechanism**

– Council Legal Service opinions, 11 September & 13 October 2013

– Presidency compromise text (15503/13), 4 November 2013

– ECB Opinion (CON/2013/76), 6 November 2013

(very interesting: supervisory vs. resolution responsibilities, use of 'bail-in' tool before 2018, protection of covered deposits, public backstop, application of state aid rules by analogy, etc.)

3. **Single Deposit Guarantee System**

(no proposal yet)

Based on single rule book (CRR, CRD-IV and other EU supervisory law, including BRRD, harmonising bank resolution)

Backtracking

- Joint Statement of the Ministers of Finance of Germany, the Netherlands and Finland, 25 September 2012:
“the ESM can take direct responsibility of problems that occur under the new supervision, **but legacy assets should be under the responsibility of national authorities**”

http://www.vm.fi/vm/en/03_press_releases_and_speeches/01_press_releases/20120925JointS/name.jsp

Connection and urgency

- [Mario Draghi](#), Washington, D.C., 12 October 2013: “The effectiveness of this exercise will also depend on the availability of necessary arrangements for recapitalising banks, if and when needed, including through the provision of a public backstop, if private funds cannot be acquired. These arrangements must be in place before we conclude our [comprehensive balance sheet] assessment, in line with the declaration of the European Council of June 2013.”
- [ECB Opinion](#), 6 November 2013: “(...) the SRM is a necessary complement to the SSM in order to achieve a well-functioning financial market union (...) such a system must therefore be established by the time the ECB assumes its supervisory authority in full.”

ESM: direct bank recapitalisation

- ESM Treaty does not yet provide for direct bank recapitalisation
- Euro Group agreement on ESM direct bank recapitalisation instrument, 20 June 2013 – *called into question by SPD (German Labour Party)*
- Application of Article 19 ESM Treaty - €60 billion limit
- Outline of direct recapitalisation:
 - *State unable to provide financial assistance in full or bank bail-out may endanger its market access and lead it to request for ESM loan*
 - *Systemically relevant financial institution...*
 - *... that is (potentially) in breach of ECB capital requirements & unable to attract capital from private sources*
 - *Viability of financial institution to be assured by capital injection & restructuring plan*
 - *Commission state-aid conditionality to be applied*
 - *State capital injection required (legacy assets, proper alignment of incentives)*
 - *Creditors' contribution ('bail-in')*

Issues

- ESM option open? German veto in ESM decision-making // Need for German domestic legislative change? // Sufficient funds? (€ 60 billion)
- Single Bank Resolution Fund (SBRF) part of SRM proposals – to be funded by banks but having access to fiscal resources – principle of ‘fiscal neutrality’ over the medium term: recoupment of public assistance from finance industry by ex post levies on the finance industry
- ECB: “essential” – participating Member States to “cater for a joint and solid public backstop upon entry into force of [SRM] regulation” – “a credit line granting SRM access to joint fiscal resources from participating States”: ESM

Fiscal backstop legal issues

Other possible future fiscal backstops:

- ❑ A Euro Area Treasury (Jean-Claude Trichet)
- ❑ Fiscal union element in 'Genuine EMU' ideas
- ❑ Call for an economic government for Europe ('Towards a Euro Union', call by eleven German economists, political scientists and jurists, so-called Glienicker Group, 17 October 2013)

Legal issues

- ❑ No legislative basis for including backstop obligation in SRM Reg. (States' fiscal sovereignty) – Art. 114 (+352?) TFEU insufficient
- ❑ Treaty change (TFEU)
- ❑ A separate treaty to avoid unanimity, later to be incorporated into EU law (like 'Fiscal Compact')