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Four Key Principles for the European Banking Union Supervisory Regime

POSITION STATEMENT

The American Chamber of Commerce to the European Union (AmCham EU) supports the EU Institutions and the eurozone Member States in their efforts to develop a long-term strategy for Economic and Monetary Union. Such a vision for the long-term, with banking, fiscal, economic, and political pillars, has the potential to make an important contribution to restoring investor confidence in the short term, to restoring the long term financial stability that is essential to growth, and to re-engaging citizens with the single currency and with the European Union.

As representatives of businesses with significant investments in the European Union, employing hundreds of thousands of its citizens, we have a strong interest in the success of this new supervisory regime and of the single currency more broadly.

In this paper we focus on the Banking Union, and even more specifically on the 29 June decision of eurozone leaders to pursue a single supervisory mechanism, involving the European Central Bank (ECB).

Principles

We believe that in developing this new regime EU leaders should ensure that 4 key principles are observed. The new regime must:

1. deliver *high-quality* supervision of those banks that are within its remit
2. *preserve and deepen* the EU single market
3. contribute to *global convergence* in financial regulation
4. contribute to the restoration of *confidence* in the eurozone

Deliver High-Quality Supervision

The crisis that emerged in 2008 demonstrated a number of weaknesses in financial markets, including in the way in which banks were supervised[1]. Since that time many jurisdictions – in Europe and elsewhere - have undertaken significant reform of their structures and approaches to financial supervision,

[1] *"Insufficient supervisory and regulatory resources, combined with an inadequate mix of skills as well as different national systems of supervision made the [emerging financial crisis] worse"* – De Larosiere report, paragraph 28

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with the EU itself creating the three European Supervisory Authorities and the European Systemic Risk Board.

As the eurozone now looks at a new regime for banking supervision it is essential that the end-result is demonstrably superior to the mechanisms that it replaces. In particular there must be clarity about decision-making processes, so that it is clear to banks themselves, to their clients and to investors where key supervisory decisions will be taken, and on what authority.

This is important during 'business as usual', but is critical during times of crisis, market stress and potential bank failure. Although the political decision to transfer responsibility from the national to the eurozone level may not be an easy one for Member States, it is essential that there is no ambiguity or uncertainty over where authority resides.

This will be particularly important if the regime that is put in place applies in a differentiated way to eurozone banks, depending on their size and systemic importance. If the smaller banks that are not deemed to be of systemic importance are to continue to be supervised on a day-to-day basis at the national level, but with a central body retaining an ultimate power to intervene, it must be clear to all of those impacted how this regime will function in practice. Even small banks can generate impacts beyond their own borders and any new system must be able to tackle these cross-border effects.

The uncertainty over how the constraints imposed by Article 127.6 will impact on the 'banc assurance' model will also need to be settled, so that there is clarity about how such entities will be supervised.

Delivering a high-quality supervisory regime is not only about clear chains of accountability and responsibility. There must also be adequate resources and appropriate expertise available to those operating this new regime. Any new body that is created must have enough people, with the right knowledge and experience to perform this vital function.

The ECB already has extensive expertise in relation to many aspects of financial markets, whether from its responsibilities for the payments system or its overall role in ensuring financial stability. But if it is to take on a new role in this regime a full assessment should be made of the additional resources that it will need to perform this new role, reflecting the qualitatively different nature of financial supervision, and a firm commitment must be made to the timely delivery of these resources.

The establishment of any new supervisory regime takes time, but we believe that alongside the legal and jurisdictional discussions early attention should be given to the operational challenges that this change of approach will bring.

Preserve & Deepen the EU Single Market

This new supervisory regime is being conceived with the primary objective of delivering greater stability to the eurozone. Weaknesses in the banking sector

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impair its capacity to fund growth in the rest of the economy. Given the close link between banks and their sovereign, such weaknesses ultimately call into question the health of eurozone Member States' public finances and of the euro area more broadly.

AmCham EU supports efforts to break the link between eurozone banks and their sovereigns, and sees this new supervisory regime and the related plan to allow direct recapitalization through the European Stability Mechanism as important contributors to this goal.

At the same time this new supervisory regime will have implications for the EU single market for financial services. We believe that the preservation and deepening of the wider single market should be an explicit objective of the new regime, to ensure that supervision takes appropriate account of the need to facilitate banking activity that flows across the 27 Member States.

This new regime will create some significant differences in the ways in which EU banks are supervised, with some supervised directly by an EU Institution and others supervised by purely national bodies. This must not lead to discrimination between EU banks – or other market infrastructure - based on their location or the identity and status of their supervisor. EU regulation and technical standards should be applied equally to *all* banks, with *all* EU supervisors held to consistent, high standards.

The European Supervisory Authorities (particularly the European Banking Authority) should retain responsibility for determining the technical standards applicable in all 27 Member States, with an appropriate mechanism found to ensure that decision-making provides a suitable balance between the new eurozone central supervisor and those that are outside the new regime. The ESAs role in mediating between supervisors should continue and should be applied symmetrically to eurozone and non-eurozone supervisors, as should the power to intervene directly in banks where EU law is not being observed. It is essential that the principle of equal treatment is maintained fully to avoid creating any distortions to the single market.

Global Convergence & Openness

Both the EU and the eurozone banking sectors operate in wider, global markets. These markets are a source of competitive discipline and of efficiency that help to ensure that companies have access to capital and to the wider financial services that are essential to their growth.

We believe that the new supervisory regime has great potential to facilitate improvements to the functioning of these global markets. It can further simplify the supervisory decision-making processes in the eurozone, providing third country supervisors with a single interlocutor and providing a coherent eurozone voice in international standard-setting organisations.

As with the EU single market, we believe that global convergence and openness should be specific objectives of the new supervisory arrangements. This is not

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a substitute for high standards and a clear focus on financial stability, but rather a recognition that eurozone banks and the wider eurozone economy benefit from full participation in a global financial market that is based on high, common, standards.

Contribute to the Restoration of Confidence in the Eurozone

Any new approach to banking supervision in the eurozone must lead to a stronger supervisory system than that which it replaces. If investors, depositors and clients, and the banking sector itself, do not believe that the new arrangements are robust and reliable then confidence in eurozone banks – and thus in the single currency more broadly, given the strong link between banks and sovereigns – will not be restored.

We therefore understand the ambition of eurozone leaders to give the ECB an important role in the new architecture, given the considerable (and hard-won) credibility that it has acquired over more than a decade of operation.

But if it is to be given supervisory responsibilities the ECB will – as President Draghi has already acknowledged[2] - have to develop a new relationship with those Member State and EU institutions that provide democratic legitimacy and accountability. Without appropriate oversight and accountability there is a danger that the new supervisory regime is seen as overly remote, and thus unable to command the support of those European citizens and taxpayers on whom this new regime must ultimately rest.

Equally any new, additional role for the ECB in this area would have to be developed in a way that preserved confidence in the delivery of the monetary policy mandate. The independence (both formal and perceived) of the ECB in this core function has been critical both to the delivery of price stability in the eurozone over the last decade and to market confidence in its crisis-intervention role in more recent times. The ECB has proven credibility with market participants, and its independence (set within an appropriate legal framework) is a critical component of this.

Mechanisms must be found to ensure that there is appropriate oversight of any banking supervision function that the ECB is granted, without this altering (or being perceived by market participants to have altered) its independence on monetary policy. This is not a new dilemma, as those national central banks with both monetary policy and supervisory responsibilities can attest, but given the key role of the ECB at the current time it must be handled sensitively.

Whether the eurozone chooses a full organizational separation (e.g. the creation of a free-standing supervision division of the ECB with day-to-day autonomy and an arms-length Executive Director) or a more integrated solution (e.g. with a designated ECB Vice President accountable for the supervisory function) can be debated in the coming months. But an appropriate balance must be found.

[2] Comments to the EP's Economic and Monetary Affairs Committee July 2012

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Conclusion

AmCham EU believes that a stable euro area banking sector is essential not only to ensuring stability and confidence in the eurozone, but also to restoring growth in the wider EU and global economies.

A centralized supervision system, coupled with a mechanism allowing direct recapitalization of banks, is a necessary component of this and we support prompt action, in line with the conclusions of the 28 / 29 June European Council.

But in putting a robust system in place to enhance the stability of the eurozone banking sector we must not lose sight of the need to continue to develop the EU single market for financial services, to deliver existing aspects of the reform agenda such as the Directive on Bank Resolution and Recovery, and to nurture global convergence around high regulatory standards. The creation of this new regime provides a real opportunity to deliver on all of these objectives.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate U.S. investment in Europe totaled $2.2 trillion in 2010 and directly supports more than 4.2 million jobs in Europe.

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