

# European Financial Union

Nicolas Véron

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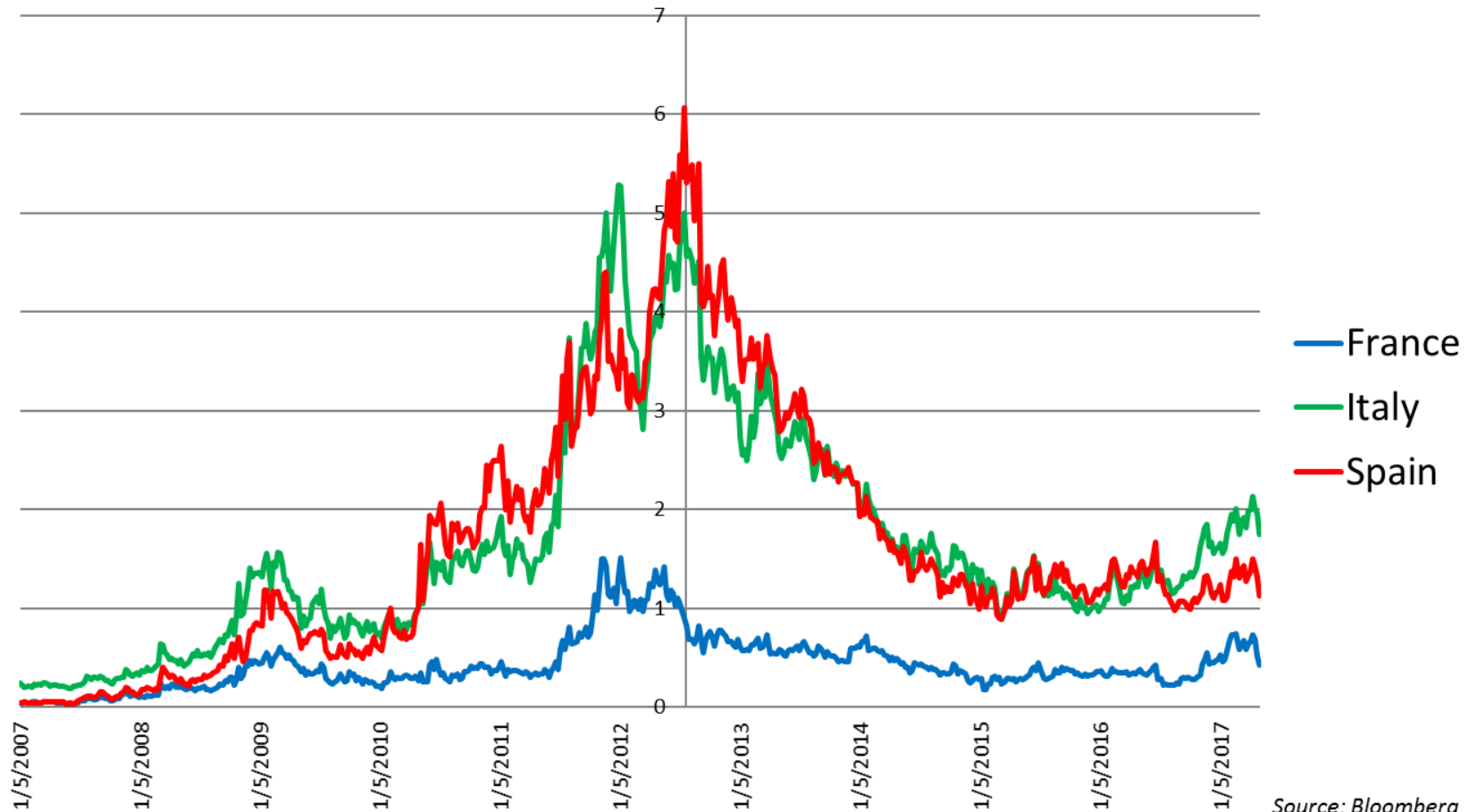
# Unfinished Transformation

- Long history of national financial systems
- Single financial market build-up since 1990s
- Crisis lesson: bank-sovereign vicious circle
- Banking Union announced mid-2012
  - Eur. Banking Supervision by ECB (Nov. 2014)
  - New resolution framework (Jan. 2016)
- Capital Markets Union: more talk than action



# Mid-June 2012: Turning Point

## 10Y Spreads vs Germany



Source: Bloomberg



# Does Banking Union Work?

- Structural shift; still early days
- Quality of ECB supervision
- Pockets of weakness, addressed gradually
  - Greece 2015, Portugal 2016, Italy 2017
- New resolution model still untested
  - “Bail-in” is priced in for junior debt, not senior
- Bank-sovereign linkages persist



# Brexit Impact

- London is EU's wholesale finance hub
- Trade-off: interdependence vs relocation
  - Benefits of cross-Channel integration
  - Predictable future misalignments of interests
  - Shared desire for orderly transition
- From hub-and-spokes to distributed network
- Adds urgency to debate on supervisory arbitrage / architecture



# Vision: A Single Financial System

- **Stability:** reduce bank-sovereign linkages
  - Shock absorption by financial system in U.S.
- **Efficiency:** minimize cross-border frictions
- **Existing banking union as proof of concept**
  - Early achievements and lessons
  - Strong European supervisory institutions for consistent implementation / enforcement



# Next Policy Steps

- Immediate legislative response to Brexit
  - Financial infrastructure + EBA relocation
- ESMA reform and further empowerment
  - Governance and funding overhaul
  - Enhanced authority e.g. accounting & auditing
- “ $\frac{3}{4}$  Banking Union” package
  - Sovereign exposure limits
  - Risk-sharing: EDIS, ESM bank recap, backstops
  - Harmonization: prudential, bank insolvency, tax