PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

“Completing Banking Union” in the euro area

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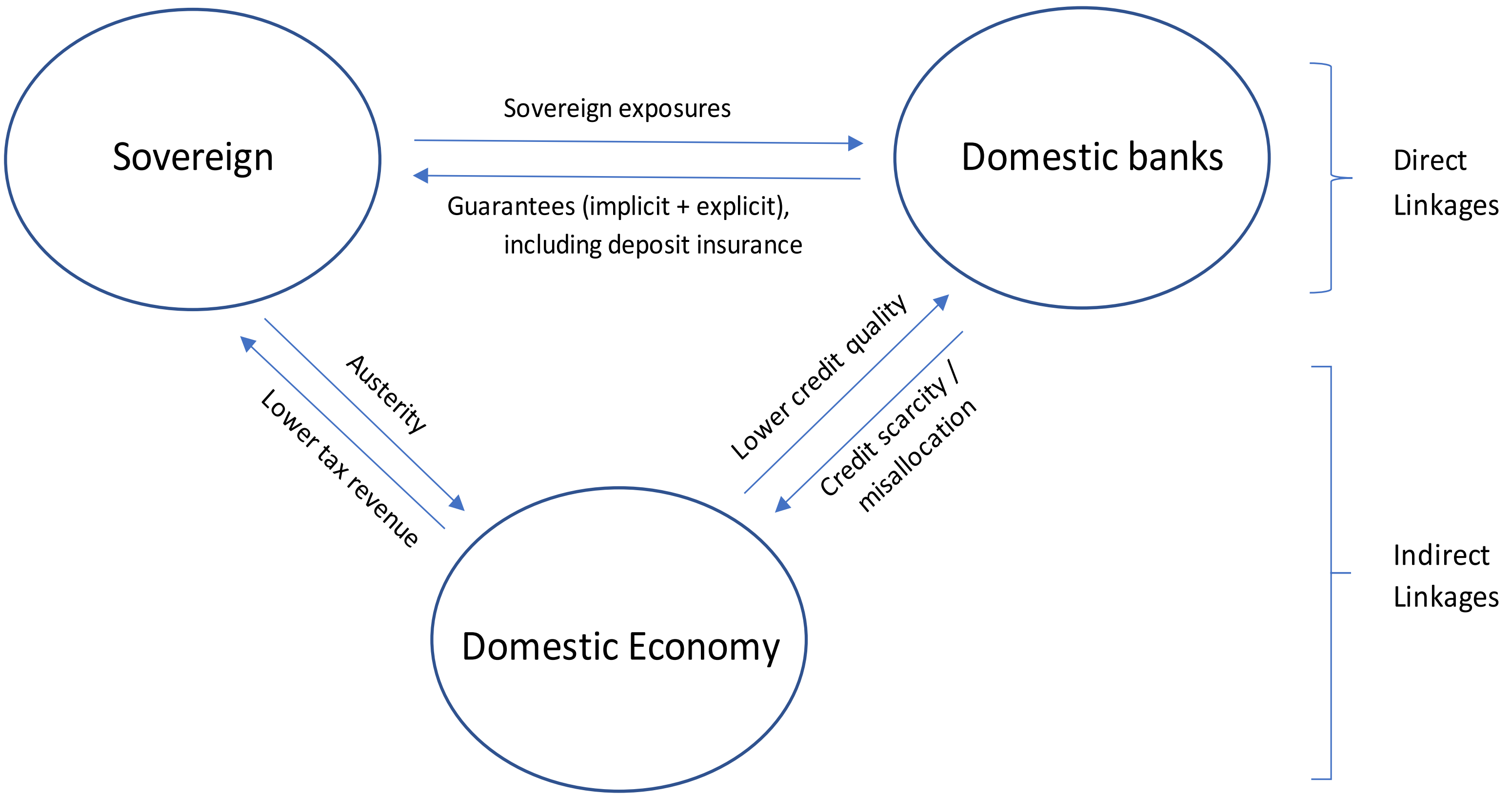
Banking Union So Far

- Euro area summit, 06/12/2012: “We affirm that it is imperative to break the vicious circle between banks and sovereigns.”
- Single Supervisory Mechanism
- Single Resolution Mechanism

Bank-Sovereign Vicious Circle



Reform Stalled Since 2014

- Backstop to Single Resolution Fund
- European Deposit Insurance Scheme (EDIS): European Commission proposal Nov. 2015
- Deadlock on sovereign exposures
- Arguments about “legacy”

Our Proposed Way Forward

- Acknowledge (and accelerate) progress on restoring banking system soundness
- “Little grand bargain” to break the bank-sovereign vicious circle
  - Sovereign Concentration Charges
  - Smart EDIS design
- “Capital markets union”

Sovereign Concentration Charges

- Binding, euro-area-specific capital rule

- Concentration risk not credit risk
  - No expected impact on aggregate euro-area sovereign exposures
  - No capital charge if exposures are diversified

- Calibration, transitional arrangements

Smart EDIS Design

- Country-blind for the insured depositor
  - Fully integrated institutional framework
- Country-dependent for the contributing banks
- Key to cross-border banking integration

“Complete” Banking Union?

- Breaking bank-sovereign vicious circle / redenomination risk
- Further steps for borderless market
- Lessons from US experience