



# Financial Union & Risk Sharing

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# Framing the Debate

“Financial cycles are more divergent and have caused greater risks at the eurozone level. Knowing this, we need to ask ourselves: what is the best way forward to strengthen our risk-absorbing capacity and assure built-in stabilisation tools? I see two ways. We need to complete our Banking Union and we need to establish a real Capital Markets Union. There is a clear trade-off between a banking union and a capital markets union on the one hand and the need for a fiscal capacity on the other. I strongly believe shock absorption through a strong and well-functioning Banking Union and a Capital Markets Union is preferred over additional budgetary means. I believe strongly in private risk buffering over public risk buffering.”

Jeroen Dijsselbloom, speech at Tatra Summit, 4 November 2015

# Current Status

- **Banking Union: incomplete**
  - Supervision: strong start, still many challenges
    - End country-level fragility → Italy
    - Ability to close a bank
    - Maintain “tough and fair” stance on SIs
    - LSI supervisory consistency / proportionality
  - Resolution: untested
  - Deposit insurance: on drawing board only
  - Bank-sovereign link reduced but still strong
- **Capital Markets Union: embryonic**
  - Inspiring vision, few policy initiatives so far
  - Brexit

# Brexit: Race to the Bottom?

“Finally, let me emphasize that **the locational decisions of financial firms within the euro area should not be driven by regulatory considerations. Rather, a common regulatory system and a genuine single EU-wide market in financial services** should allow firms to concentrate on the relative merits of alternative locations in relation to the standard factors identified in the economic geography literature.”

Central Bank of Ireland Governor Philip Lane, “The European Financial System after Brexit,” speech at Reuters Newsmaker Event, London, 28 October 2016 (emphasis added)

# Strengthening Banking Union

- Single rulebook
  - ONDs, Basel/TLAC... Bank insolvency frameworks
- Sovereign exposures
  - Euro-area-only challenge of home bias
  - Exposure limits, not risk-weights
  - Options to stabilize transition
- Crisis management instruments / resources
  - EDIS and backstop(s)
  - ESM precautionary recapitalization
  - Consistent approach to “private-sector bailouts” (including, but not limited to, IPSs)

# Brexit Transition

- Transition beyond Art.50 (to 2022 or 2023?)
  - Desirable for orderly redeployment
  - Time needed to define proper EU27 Markets Regime
- The EBA question
  - UK was anchor of dual ECB / EBA system
    - Euro area  $\approx 2/3$  of total EU28 assets;  $\approx 9/10$  in EU27
  - But not all (if any) member states will enter Close Cooperation in near future
  - Urgent decision needed on future location
  - Medium-term governance overhaul

# EU27 Markets Regime

- Prudential supervision of market infra.: ECB?
- Challenges other than prudential
  - In UK terms: scope of FCA + FRC (mainly)
- Status quo not fit for purpose
  - Scope for harmful regulatory competition
  - Opportunity: removal of UK veto
- Case for beefing up ESMA
  - Governance + resources + authority
  - Hub-and-spokes as in SSM (or competition policy)
- Consumer protection challenge



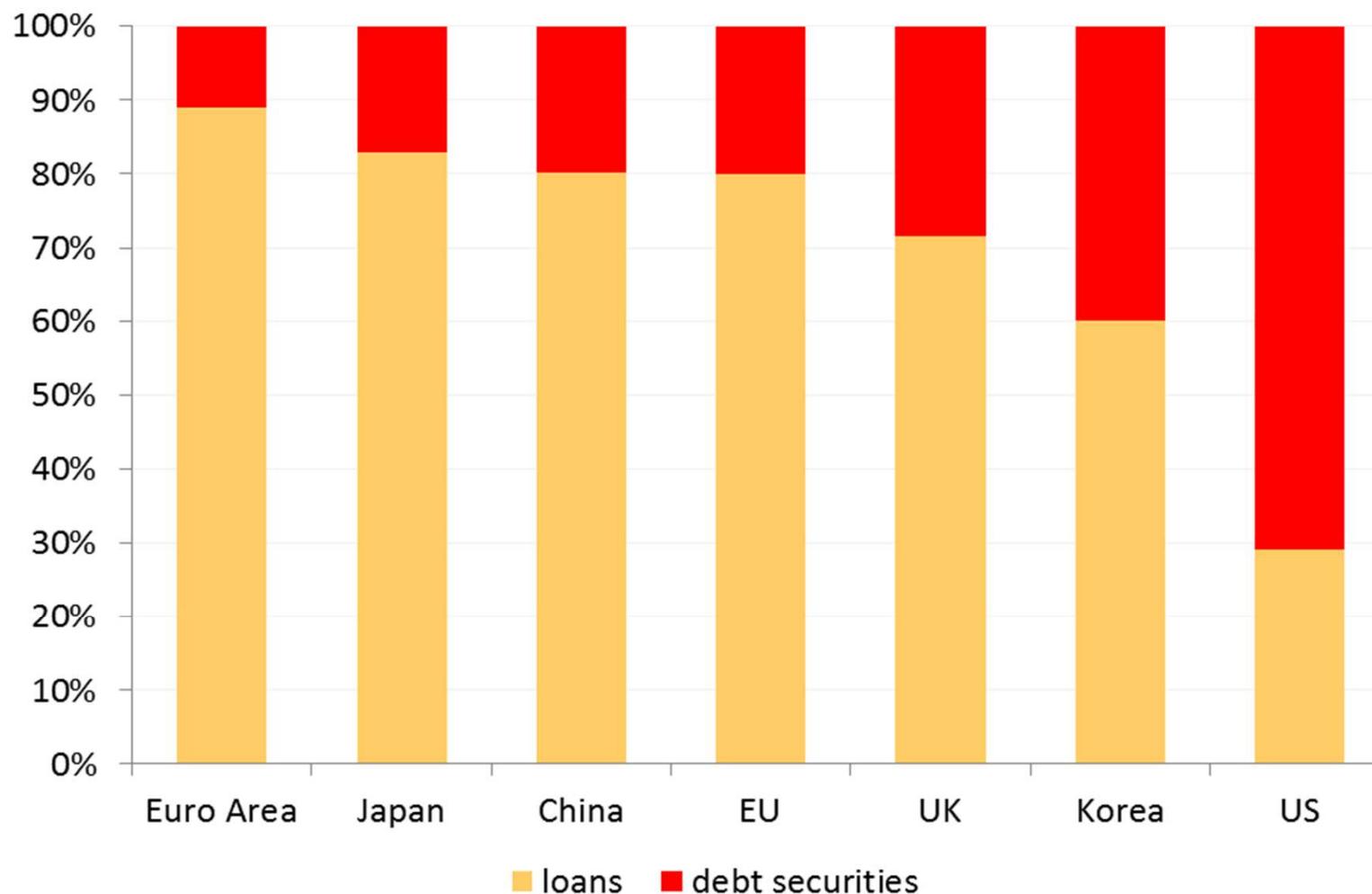
# Thank You For Your Attention

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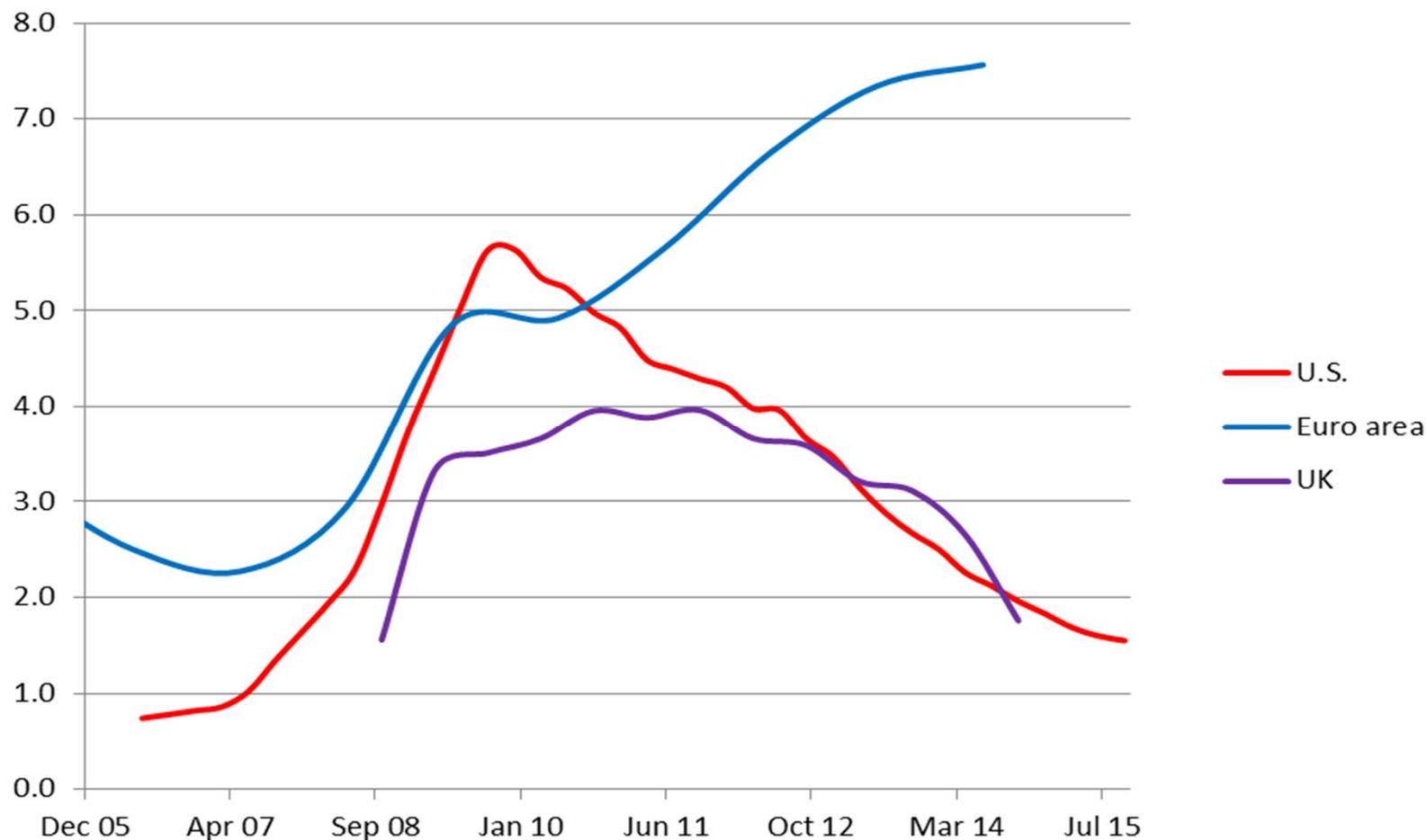
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# Financial System Structures



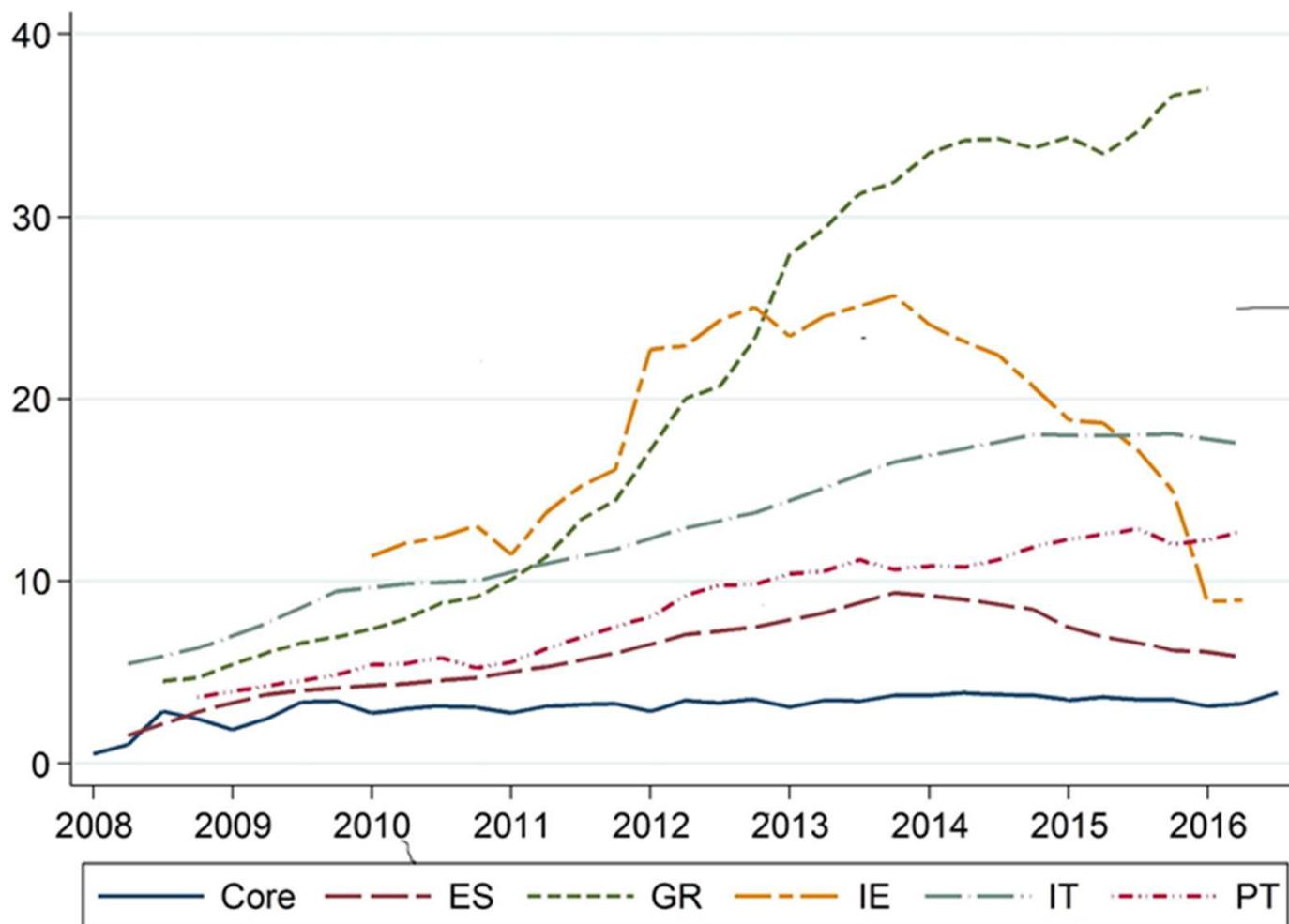
Percentage of total debt of non-financial companies. Source: Merler & Véron (2015)

# Non-Performing Loans



% of total loans. Source: Christian Odendahl (Centre for European Reform, London) based on Fed/FRED & IMF/FSI databases

# Non-Performing Loans



% of total loans. Source: Schoenmaker & Véron (2016) based on IMF/FSI database (updated)