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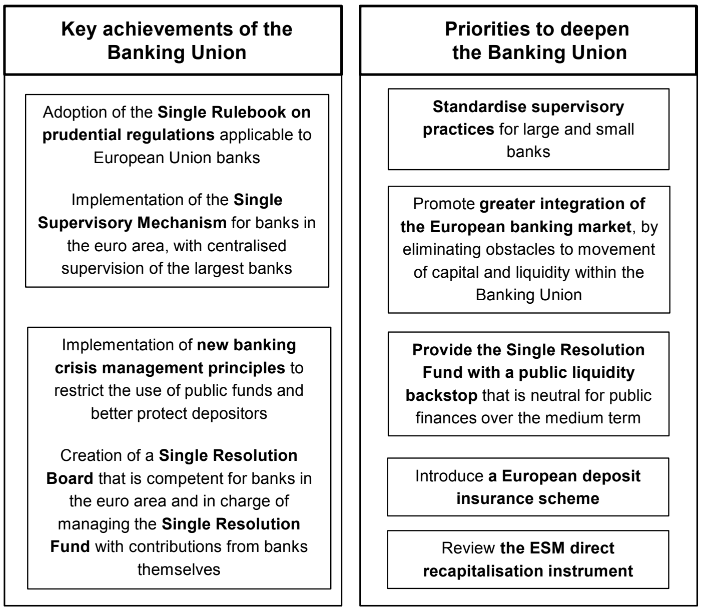
A contribution to the work on deepening the Banking Union

- Creation of Banking Union was spearheaded by the European Council, which opted for this approach on principle in 2012, in response to the financial and sovereign debt crisis, while also bolstering prudential requirements for banks at the same time. Its establishment reflects an in-depth change to the supervision and structure of the European banking system, aiming at better financing the euro area economy and promoting financial stability. The Banking Union comprises new European authorities to ensure single supervision and shared Europe-wide resources to handle banking crisis at central-level. It marks a major step in further deepening European integration and in ensuring the proper functioning of the Economic and Monetary Union (EMU), by making the banking system more resilient to asymmetric shocks.
- The foundations of the Banking Union were laid in a short space of time and the full impact in terms of the operation of regulation and supervision has not yet been totally grasped. Crisis management resources are not yet fully shared and European banking systems still carry a hefty domestic bias, partly due to the persistence of difficulties that emerged before the implementation of the Banking Union and that have not yet been resolved. Moreover, the Banking Union does not yet offer full protection against contagion between banking risks and sovereign risks and is therefore incomplete.
- Full completion of the Banking Union is a key priority to consolidate the European supervisory framework and fully derive the expected benefits for integration of the internal banking services market. It must further improve financial stability via more robust, intrusive and standardised banking supervision, and by limiting domestic bias. It must continue reducing the risks of contagion between banking and sovereign risks and further safeguard European taxpayers' money, primarily by providing the banking crisis resolution fund (Single Resolution Fund made of shared banking contributions) with the support of a public liquidity backstop which would be neutral for public finances over the medium term, and also by providing the Union with a European deposit insurance scheme. This will promote a more unified European banking system and foster bank restructuring. Thus more solid and efficient banks will finance the euro area economy. Lastly, the institutional framework of the Banking Union could be simplified in order to reduce the risk of responsibilities being excessively divided out among the various European authorities.
- The transition period until full implementation of these mutualized mechanisms (2024 at the latest) should be used to deal with the enduring effects of the crisis on some banking systems and round out the Banking Union by creating new crisis prevention and management systems, working in a balanced and parallel way towards fresh measures to share and reduce banking risks.



Key achievements of the Banking Union

Adoption of the **Single Rulebook on prudential regulations** applicable to European Union banks

Implementation of the **Single Supervisory Mechanism** for banks in the euro area, with centralised supervision of the largest banks

Implementation of **new banking crisis management principles** to restrict the use of public funds and better protect depositors

Creation of a **Single Resolution Board** that is competent for banks in the euro area and in charge of managing the **Single Resolution Fund** with contributions from banks themselves

Priorities to deepen the Banking Union

Standardise supervisory practices for large and small banks

Promote **greater integration of the European banking market**, by eliminating obstacles to movement of capital and liquidity within the Banking Union

Provide the Single Resolution Fund with a public liquidity backstop that is neutral for public finances over the medium term

Introduce **a European deposit insurance scheme**

Review **the ESM direct recapitalisation instrument**

Source: DG Trésor.

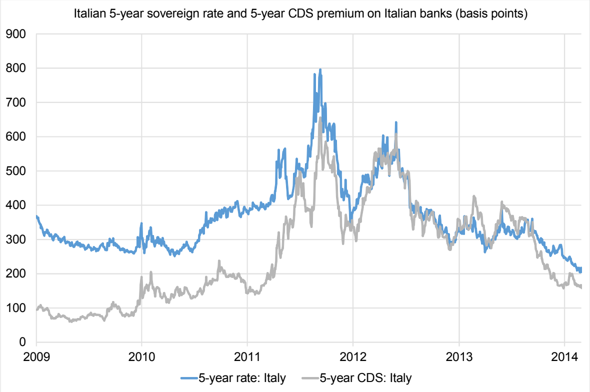
MINISTÈRE DE L'ÉCONOMIE
ET DES FINANCES

1. The Banking Union, a considerable deepening of the Economic and Monetary Union

1.1 The Banking Union is one of the responses to a twofold crisis, both financial and sovereign, which revealed the inadequacies of the euro area's current architecture from 2010 onwards

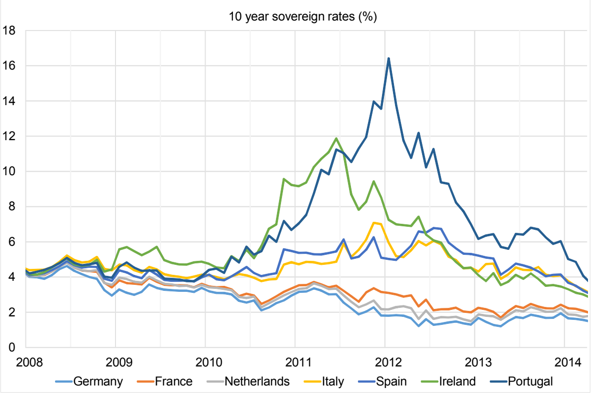
The euro area was faced with a twofold crisis from 2010 onwards, both banking and sovereign. Being key links in the economy's financing chain in the European Union[1], banks were hit by uncertainty on the impact of the subprime crisis in the US. This led to a freeze on the European interbank lending market, which is vital to banks' short-term funding. Some banking systems suffered a swift deterioration in the quality of their assets, with real estate bubbles bursting e.g. in Ireland and Spain. States took emergency measures (sometimes uncoordinated) to stabilise their banking sectors in order to tackle investor concerns on European banks, with a very high cost for public finances in several States, in particular the UK, Germany, Ireland and Spain[2]. Some States were hard hit, with debt rising swiftly at a time when European economies were in a cyclical trough and when financing needs had already increased following stimulus policies implemented from 2008-2009 onwards. This led to a deterioration in the value of sovereign debt portfolios on banks' balance sheets, thereby highlighting the negative feedback loop between the banking crisis and the sovereign debt crisis. Each side of the crisis was worsened by the other, with widespread contagion from autumn 2011 onwards and a widening of spreads on European sovereign yields to the German rate (see charts 1 and 2).

Chart 1: feedback loop between sovereign risk and banking risk: example of Italy



Source: Reuters datastream.

Chart 2: 10-year sovereign rates (as %)



Source: Reuters datastream.

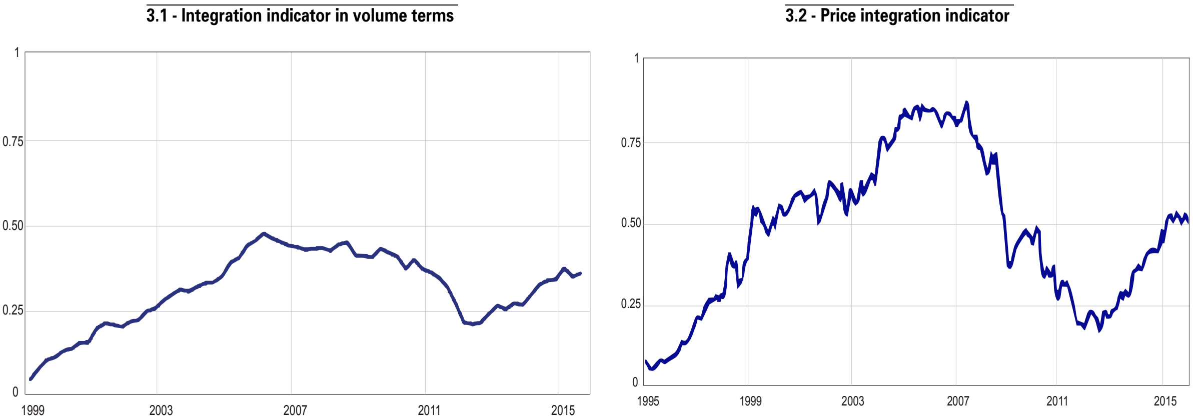
The magnitude of the euro area crisis can partly be attributed to the fact the the EMU architecture is incomplete[3]. The crisis in particular revealed that financial integration in the Eurozone was fragile and only partial (see chart 3). While the interbank market where most short-term transactions between banks take place was rapidly unified across the eurozone, cross-border asset holdings and cross-border bank credit did not develop much. With low interest rates, the disappearance of exchange rate risk and a belief in the spontaneous convergence of peripheral economies towards core countries, the markets paid less attention to the development of major macroeconomic imbalances (particularly on real estate, for example in Spain and Ireland), as reflected by large current account deficits. These deficits were financed to a large extent by short-term capital flows from core Eurozone countries (more through debt than capital), while truly integrated cross-border banking groups failed to emerge. When the financial crisis broke out, current account deficits in peripheral countries no longer appeared to be the natural consequence of these economies' "catch-up" process but rather they pointed to an unsustainable allocation of savings between euro area core countries and peripherals. This led to a sudden stop in capital flows and a renationalisation of bank financing circuits, while the under-developed European capital markets were unable to cushion the shock.

[1] Around two thirds of European corporate external financing comes from banks, while in the US the figure is only 20% as the financial markets are more active in financing the economy.

[2] According to European Commission data, between October 2008 and December 31, 2014, Member States provided the financial sector with capital aid (in the form of recapitalisation measures and asset relief programmes) of €641.8bn (4.6% of the Union's GDP in 2014). Countries that allocated the most aid were Germany (€144bn), the UK (€140bn), Spain (€95bn), Ireland (€65bn), Belgium (€43bn) and Greece (€41bn).

[3] See Bara YE., Castets L., Ernoult T. and Zakhartchouk A. (2017), "A contribution to the work on the strengthening of the euro area", *Trésor-Economics* No. 190.

Chart 3: ECB financial integration indicators (volume and prices)



3.1 - Integration indicator in volume terms

Source: Reuters datastream.

3.2 - Price integration indicator

Source: Reuters datastream.

Note to the reader: the ECB compiles quarterly data on various financial integration indicators in terms of volume (proportion of cross-border financing on the various capital markets) and price (interest rates on loans) in order to measure the convergence of financing conditions in the euro area. These indicators are rebased between 0 (no integration) and 1 (full integration).

1.2 The European Union's first response involved strengthening banking regulation and coordination between supervisors in the EU 28 framework

In line with G20 recommendations and following on from the report by Jacques de Larosière presented on 25 February 2009, reforms were targeted on three main areas:

- the strengthening of microprudential rules and the standardisation of banking supervision practices;
- the creation of a macroprudential supervision framework aimed at detecting and, where necessary, diminishing macroeconomic imbalances due to credit expansion;
- the strengthening and standardisation of bank deposit insurance schemes.

1.2.1 A new micro- and macro-prudential supervision framework was implemented to better manage banking risks

A new prudential regulatory framework was implemented. The principles were elaborated by the Basel Committee on Banking Supervision and transposed into European law via two pieces of legislation adopted in 2013 (CRD IV and CRR), with the aim of both reducing differences between national frameworks in the definition and application of regulatory standards, and rounding out prudential tools. For example, a liquidity ratio was introduced to increase banks' resilience in the event of short-term liquidity drying up on the markets[4]. These reforms led to the creation of a unified body of regulation for banking services, the Single Rulebook, which ensures that banking risks and capital requirements to address them are assessed uniformly across the entire European Union.

To help implement and give credibility to these new prudential rules, **coordination between European banking supervisors was increased and supervision methods standardised.** The aim is to safeguard against the risk of development of pockets of banking risks within the EU due to more lax national practices, which could have major consequences for national public finances and for the financial stability of the euro area as a whole due to contagion.

With this in mind, the European Banking Authority, which was set up in 2010, drafts regulatory technical standards, promotes the convergence of practices between the various supervisory authorities and coordinates supervisory colleges for cross-border groups to ensure that their supervision is coherent. In order to reduce the mistrust that reigned on the interbank markets while also giving credibility to the new European supervision architecture, further initiatives to shore up the banking sector and make it more transparent were taken by the EU, with stress tests carried out under the responsibility of the European Banking Authority.

A **macroprudential European framework** was also developed in order to monitor the risk borne by the banking sector as a whole. Hence the European Systemic Risk Board was set up in 2011, under the auspices of the ECB, with the aim of monitoring and assessing systemic financial risks and, where appropriate, issuing recommendations to the competent authorities. In addition, national macroprudential authorities (High Council for Financial Stability in France) can adjust the capital requirements for banks on the basis of the expansion of bank credit nationwide.

Lastly, **the directive implementing shared European rules for national deposit guarantee schemes (DGSD) was reviewed in 2014** in order to increase protection for depositors. This text, which provides for standardised guarantee schemes that are pre-financed in each Member State, protects depositors' savings by guaranteeing deposits of up to €100,000 per person across all banks of the European Union, and helps contain the risk of bank runs in the event of a crisis.

In addition to more robust regulatory rules and supervisory practices, and as a counterpart to the extensive public financial resources used to stabilise banking sectors during the first years of the crisis, it was deemed necessary to develop rules for managing future banking crises with a view to minimise the use of taxpayers' money. The Union therefore set up a banking crisis resolution framework, based on the key principle of prior contributions from shareholders and private creditors to absorb losses (bail-in), thereby limiting the use of public funds (bail-out). This principle was first implemented via decisions on State aid from the European Commission[5]. A new and more comprehensive legal

[4] The short-term liquidity ratio aims to ensure that a bank has sufficient high-quality liquid assets that can be converted into liquidity to cover needs over a period of 30 calendar days in the event of severe financing difficulties.

framework was then set up via the BRRD, a directive that came into force on 1 January, 2015: banks whose default would have major consequences on the financial stability of the euro area must be resolved according to a specific process whereby the bank's shareholders and creditors are the primary contributors to losses absorption (up to at least 8% of the bank's balance sheet). Secondly, mutualised funds that are made of contributions preventively levied on national banking sectors may be used to support the bank if necessary (for a maximum amount of 5% of the bank's balance sheet).

1.2.2 However, these responses looked insufficient to address the sovereign debt crisis in the euro area from 2011

When the first financial assistance programs were implemented (Greece, Ireland, Portugal), and largely used to support banks, it appeared that the euro area needed an integrated supervision and banking crisis management mechanism. When the sovereign debt crisis worsened in 2011, particularly in Spain where difficulties in the banking sector required hefty public intervention, it became necessary to take integration of supervision to a new level while at the same time building shared financial capabilities to manage banking crises in order to limit the risk of moral hazard. Despite steadily increasing coordination between national supervisory authorities, markets remained unconvinced of the effectiveness of these measures, so more standardised and intrusive supervision became necessary, as did more convincing stress tests than those organised thus far by the European Banking Authority (EBA – and its predecessor the CEBS), which failed to anticipate the Irish crisis in 2010, the difficulties encountered by Dexia, or the weakness in the Spanish and Cypriot banking sectors from 2011 and 2012 onwards.

1.3 Initiated by the June 2012 European Council meeting, the creation of the Banking Union allowed for the very swift creation of new European authorities in charge of implementing a new body of banking and banking crisis management regulations for the euro area

Creation of the Banking Union was announced at the euro area summit on June 29th 2012, with the aim of providing the Economic and Monetary Union with integrated capabilities to prevent and manage banking crises, just as euro area States were about to set up a major financial assistance programme for Spanish banks. The decision involved two major areas: firstly, European integration of banking supervision, with the implementation of a single supervisory authority, supported by the ECB; secondly, the creation of an instrument allowing the European Stability Mechanism (ESM) to directly recapitalise a bank if its difficulties are a threat to the Eurozone's financial stability. These two aspects were designed to be complementary from the outset. Economic integration of the euro area requires mutualisation of financial resources in order to avoid a shock on one country leading to systemic difficulties for the entire zone. As a counterpart, banking supervision must be integrated and carried out thoroughly and intrusively, with no domestic bias.

The first pillar of the Banking Union, the Single Supervisory Mechanism (SSM) was set up, and consists of a European authority and national authorities. Since January 1, 2014, the SSM has on the one hand had an overarching role to ensure standardised supervision of all banks in the euro area (around 3,300 banks) along with accreditation for all credit institutions, while on the other hand, it directly supervises the 130 largest banking groups in the euro area, while national supervisors continue to supervise small and medium-sized banks. Supervision decisions are taken by a Single Supervisory Board consisting of the chair, members of the ECB board and representatives of national supervisory authorities. This single supervisor was placed under the auspices of the ECB for legal and operational reasons. This mechanism was set up in record time: the founding text was adopted in October 2013 and the SSM was fully operational by November 2014, after a European comprehensive assessment involving an asset quality review and stress tests for banks that it would directly supervise, thereby reinforcing its credibility. The SSM only covers the euro zone for the moment, but other Member States can opt in, on a so-called "close cooperation" basis.

To round out single supervision within the Banking Union, the euro area bolstered its capabilities for centralised crisis management, with the creation of the Single Resolution Board and a gradually mutualised resolution fund, forming the second pillar of the Banking Union. While the ESM direct recapitalisation system marked the beginnings of an integrated crisis management mechanism Eurozone-wide, it was initially set up to be a last-resort mechanism to be used in a very constrained way[6]. **A Single Resolution Mechanism (SRM) was set up** in July 2014, including a new authority, the Single Resolution Board (SRB), which is in charge of the resolution[7] of large banks in the euro area in the event of a crisis. It is also responsible for planning resolution upstream, by drafting resolution plans and setting loss-absorbing and recapitalisation capacity requirements for banks. A Single Resolution Fund (SRF), which is entirely financed by the euro area banking sector and replaces the national resolution funds provided for in the BRRD. The full mechanism has been operational since January 1, 2016. The SRF will be gradually funded over the period 2016-2024, when it will be pre-financed for a total amount of around €55bn.

After the triggering of resolution tools (in particular internal loss absorption through the bail-in and asset disposal measures) and, where necessary, the use of the SRF, if capital requirements are still such that they require additional public intervention, ESM shared bank recapitalisation instruments can be used. These

[5] As part of the monitoring of State aid, the Commission published a series of communications on State aid to the banking sector, including the communication on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), which demands prior contributions from the bank's capital and subordinated debt holders if State aid is granted.

[6] The ESM direct recapitalisation instrument, which has been operational since 2014, enables the ESM to directly recapitalise a bank if its default would be a threat to financial stability, thereby avoiding intervention by the State where the bank is domiciled. So in theory it is a powerful instrument in preventing contagion of bank risk to sovereign risk, but it also includes very strict conditions: the limit is set at €60bn, use of the instrument requires bail-in higher than the minimum outlined in the BRRD, and it can only be used as part of a wider financial assistance programme that can carry related conditions on both the banking sector and other sectors of the economy.

[7] This procedure is aimed at enabling orderly resolution for non-viable banks, with a view to bear upon the real economy (maintaining the bank's critical functions) and taxpayers money as little as possible.

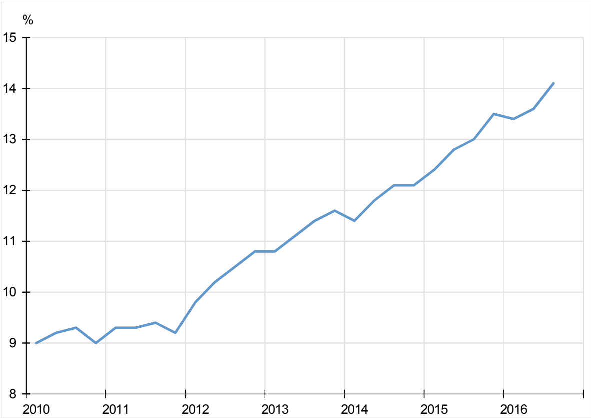
carry substantial restructuring conditions for the banks that use them. The ESM indirect recapitalisation instrument is aimed at providing the State in question with the funds required for public intervention if the State itself is solvent but is encountering difficulties in achieving funding, while the direct recapitalisation instrument enables the ESM to directly capitalise a bank if the State in question cannot do so without jeopardising the sustainability of its own debt.

2. Completing of the Banking Union is a priority towards consolidating the European banking supervision and resolution framework, and strengthening integration of the internal market

2.1 The after-effects of the crisis, whose ensuing negative effects persist in certain banking sectors, have not been fully overcome

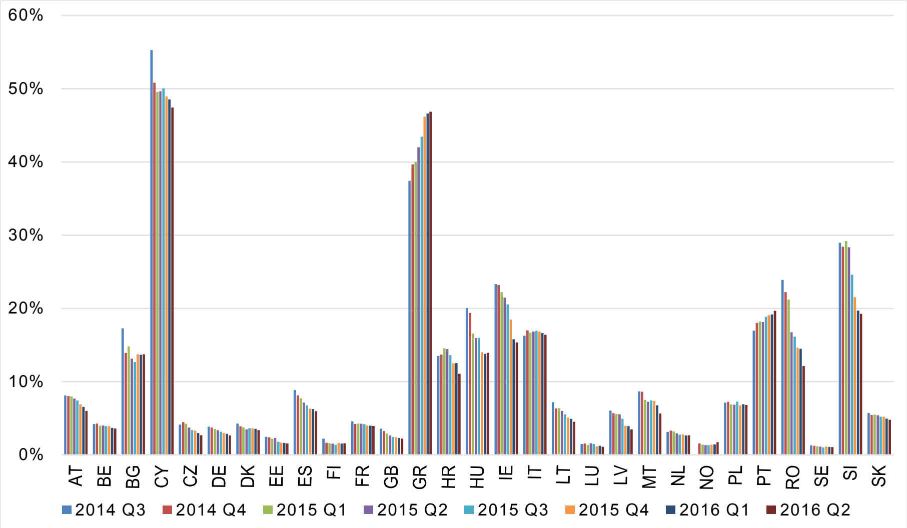
The Banking Union, under the impetus of the single supervisor and via the necessary bank restructuring, must contribute to this. Even if the European banking system is more adequately capitalised than before the crisis (see chart 4) and more resilient overall, the problems inherited from the crisis and imbalances that predate that period have not been resolved in some parts of the European banking sector, where it is taking a long time to clean up balance sheets. The magnitude of the recession and the weakness of the European recovery have severely dented the quality of banking assets across several European countries, leading to high levels of non-performing loans on banks' balance sheets, with substantial variations depending on banks and countries (see chart 5).

Chart 4: CET1 ratio for large European banks (sample from European Banking Authority)



Source: ESRB.

Chart 5: non-performing loans[8] in European Union Member States since 2014



Source: European Banking Authority data.

This situation can be attributed to economic and structural factors, related in particular to the quality of banks' credit origination procedures (ex-ante effects), the effectiveness of insolvency legislation regimes to restructure loans, or carry out debt recovery and collateral realization procedures, and can also be explained by other factors such as the extent of development of the secondary markets to sell this type of asset (ex-post effects). Yet high levels of non-performing loans drag down banks' profitability and their ability to finance the economy. They can lead to viability problems if the banks concerned do not have the necessary capital base to absorb losses on bad debts and sell their portfolios on secondary markets. These banks can then encounter difficulties in accessing the markets and gaining investor confidence to successfully carry out their capital increases. Addressing this problem is a challenge for the European single supervisors, which must provide comprehensive solutions (i.e. developing secondary markets for non-performing loans, cleaning up banks' balance sheets, improving bad debt recovery and restructuring procedures, etc.). In March 2017, the Single Supervision Mechanism issued supervisory guidance on banks' management of non-performing loans, showing that it was taking action with the banks in question, which will have to draft plans for managing their non-performing

[8] Non-performing loans are loans that have been in default for more than 90 days (quantitative criterion) or that will probably not be recovered without realizing the collateral, whether they are in default or not (qualitative criterion).

loans and set targets to reduce them.

In addition to the specific challenges on the quality of banking assets, banking restructuring will be necessary for the most fragile institutions in terms of level of capital or business model viability to finish cleaning up the European banking sector and reduce the fragmentation of some banking systems. The Banking Union can contribute to this in several ways: the SSM's powers on banking supervision and authorisation of capital operations (i.e. mergers and acquisitions), the strengthening of transparency initiatives on the situation of banks with the market and investors (stress tests, publication of financial data on banks) and where necessary management of orderly resolution strategies for failing banks.

2.2 To create an integrated European banking market free of any home bias, the single supervisor must standardise supervision practices for all banks and draw the necessary conclusions from the creation of the Banking Union by removing obstacles to the movement of capital and liquidity in cross-border groups

At the outset, the SSM primarily focused on implementing direct supervision of the 130 largest banking groups in the Banking Union. Its set-up is indeed based on a practical distinction between banks that are considered significant and are supervised directly by the ECB, and banks referred to as non-significant, which are supervised by the national authorities under the control of the SSM. In this respect, the SSM, which is responsible for the standardisation and the quality of supervision for all banks, should play a more important role in the development of supervision strategy for all banks. Smaller banks, which are directly supervised by national authorities (particularly as regards the methodology for setting prudential requirements and assessing risk), also carry risks for financial stability, and are assessed by national supervisors with the potential risk of national supervision bias. This aspect is key in ensuring the alignment of practices on the best supervision standards, equivalent treatment of credit institutions and the proper functioning of the internal market.

The Banking Union must eliminate regulatory home bias[9], which hampers the proper functioning of an integrated European banking market, with a cross-border dimension. The development of pan-European banking activity would allow for greater geographical distribution of risks across the euro area. This would lead to better risk-sharing between private economic players and greater capabilities to absorb asymmetric shocks, which would continue to further weaken the feedback loop between banking and sovereign risks. Implementation of prudential regulation can provide incentivize banks to develop cross-border activities. Yet despite the implementation of single European supervision, capital and liquidity requirements applied to banks are still assessed on a national basis in cross-border groups (at the individual subsidiary level), and this does not encourage banks to develop pan-European operations. Other prudential obstacles to banking consolidation within the Banking Union could be eliminated: for example, it would be appropriate to restate intra-Eurozone flows, which are currently booked as cross-border flows, when calculating global systemically important banks' systemic scores (G-SIBs), in order to ensure equivalence between national and intra-banking union flows.

2.3 To strengthen prevention and banking crisis management instruments, the Banking Union must be rounded out with new instruments

Firstly, the SRF's financial firepower, funded by contributions from banking systems, must be reinforced as soon as possible by a public common backstop, which will boost its credibility, as outlined in the conclusions of the ECOFIN Council on 17 June 2016 on the completion of the Banking Union. The SRF will have around €55bn prefinanced when it reaches its target in 2024. In an extreme systemic banking crisis scenario where these resources may turn out to be insufficient[10], the backstop will ensure that the SRF has the necessary means to fulfil its role. These support measures will be repaid by contributions levied on the European banking sector.

Secondly, deposit insurance is currently based on European principles but is applied by national systems. Due to the implicit refinancing by the State in the event that national funds' resources are used up, there is a risk of contagion of a banking crisis to public finances, particularly in euro area peripheral countries, in the event of a major regional shock that exceeds national financing capacities of national funds. The gradual introduction of a European deposit insurance scheme would reduce this risk and therefore better safeguard against potential deposit outflows. The Commission made a legislative proposal on this in autumn 2015, the European Deposit Insurance Scheme or EDIS, which is under discussion in the Council and the European Parliament. To limit the risk of moral hazard related to the mutualisation of resources, efficient supervision of all banks must be guaranteed, including small and mid-sized banks, which are currently supervised only indirectly by the SSM and which are the most likely institutions to use the deposit guarantee in the event of a crisis. In addition to the stabilising effects on the banking systems in the euro area peripheral markets, a European deposit insurance scheme could also deepen the internal banking market by facilitating the elimination of regulatory obstacles to cross-border movement of capital and liquidity. The absence of a unified deposit guarantee system is often used as an argument to justify imposing requirements on national subsidiaries of cross-border groups, and this approach fails to provide incentives to develop pan-European banking activities (see above).

Furthermore, it is important to streamline the ESM recapitalisation system for banks as part of the crisis management procedure, in order to sever the feedback loop between sovereign risk and banking risk as much as possible. Against this backdrop, the use of the ESM direct recapitalisation instrument could be simplified and extended to precautionary recapitalisation for banks, following on from preventive supervision exercises[11]. This would enable the ESM to intervene early on to prevent any

[9] See Schoenmaker and Véron (2016), "European banking supervision: the first eighteen months".

[10] An economic research paper (De Groen, Gros (2015), *Estimating the bridge-financing needs of the Single resolution fund*) assessed the potential financing needs of the SRF to recapitalise the banking sector, based on statistics from the last financial crisis. According to the authors, the amounted required would be above the funding target for the SRF.

banking default that could threaten financial stability, on the request of any State that could not intervene without jeopardizing its own solvency, on condition that shareholders and creditors take on a minimum amount of losses. As these changes would force the ESM to carry greater risks on its balance sheet, hefty clauses required in return (conditionalities of the programme ensuring restructuring of the banking sector if necessary) would be necessary to ensure the effectiveness of the instrument, and maintain strong incentives for States and banks.

With this comprehensive backdrop, the Banking Union will have a continuum of instruments to address all these various situations:

- a uniform supervisory framework for all banks;
- a resolution framework for banks with use of the Single Resolution Fund where necessary, as well as a simplified ESM direct recapitalisation instrument in the event of extreme risk for financial stability of the euro area (with a possibility to intervene in the context of a precautionary recapitalisation;
- a European deposit insurance system to compensate covered depositors who benefit from protection after a bank's liquidation.

2.4 After the UK exits the European Union, the Banking Union will more than ever be the crux of the European single market, which advocates for a simplification of the European banking institutions' architecture

The Banking Union has been successfully launched from an operating standpoint, looking back three years after the implementation of the single supervisory meckanism. However, the fact that it has been built up in a number of stages – creation of a European Banking Authority in 2010 for the internal market, single supervision in 2013 with a new authority, the SSM, supported by the ECB, creation of a Single Resolution Board in 2014 – conducted to responsibilities beeing shared out and this can lead to a risk of fragmentation and impede the coherence of supervision of banking activities as a whole, alongside the Commission's full responsibilities (in particular the preparation of legislation and monitoring of State aid). So consolidation of the framework for Banking Union institutions will be a priority for the years ahead, as the operating foundations of the new authorities are now firmly laid.

The context is favourable to this institutional simplification. Following the UK's actual withdrawal from the EU, the Banking Union will account for more than 90% of banking assets in the European Union (with 27 Member States), making up the main core of the internal market. The Banking Union is currently restricted to the euro area, but other Member States in the internal market can opt in, by following a complex close cooperation procedure. Banking Union access procedures could be simplified in order to promote integration of the internal market. In keeping with the aims outlined in the de Larosière report[12], the Banking Union would then revert to its original purpose of promoting the proper functioning of the single financial services market, and its counterpart, the Capital Markets Union. This aim has sometimes been side-lined in the past, with parties focusing on another more Eurozone-specific target, breaking the feedback loop between sovereign and banking risk and increasing the area's resilience to asymmetric shocks. Yet this primary aim should be reconfirmed against the current very specific backdrop created by Brexit. The Economic and Monetary Union is now based on two groups: a core consisting of the euro area, with a single monetary policy, and a wider group with the European System of Central Banks, which includes the central banks of all Member States with the ECB at their centre. Simplification of European banking architecture could take its inspiration from this set-up. Clear organisation of single supervisory systems and their interaction with the European Banking Authority, along with consistency of single supervision and resolution also raise challenges in terms of clarity and effectiveness of the way overall banking supervision is organised and will be one of the European Council's priorities for the years ahead.

Vincent ALHENC-GELAS, Lucie CASTETS, Thomas ERNOULT, Nathanaël MASON-SCHULER

[11] Article 32(4) of the BRRD provides for the possibility of carrying out precautionary public recapitalisation of a viable bank following a supervisory exercise such as a stress test, and on condition that public funds involved are not used to cover the bank's effective or expected losses: in this case, the bank's capital shortfall in an adverse scenario is used to assess the recapitalisation amount authorised without the bank being resolved.

[12] http: //wwwtresor.economie.gouv.fr/3895_le-rapport-de-larosiere (article in French).

Appendix: **Timeline of the launch of the Banking Union**

June 2012: report from the President of the European Council, Herman van Rompuy, "Towards a Genuine Economic and Monetary Union", recommending a Banking Union and statement from Heads of State and Government at the euro area summit on June 29 in favour of the Banking Union

September 2012: roadmap from the European Commission on the Banking Union, presentation of proposal establishing the Single Supervisory Mechanism (SSM)

July 2013: presentation of the proposal for a Regulation establishing the Single Resolution Mechanism (SRM)

October 2013: publication of the Regulation establishing the SSM in the Official Journal, launch of a complete review of euro area banks' assets that will be supervised by the SSM

May 2014: signature of the intergovernmental agreement on the transfer and mutualisation of contributions to the Single Resolution Fund (SRF)

July 2014: publication of SRM Regulation in Official Journal

November 2014: full application of Single Supervisory Mechanism

November 2015: presentation of the communication from the Commission on the completion of the Banking Union and proposal for European Deposit Insurance Scheme

December 2015: agreement from Eurogroup finance ministers to implement bridge financing arrangements for the Single Resolution Fund until 2024, when the SRF will be fully funded (around €55bn)

January 2016: SRM fully operational, transfer of first contributions to Single Resolution Fund

June 2016: conclusions of Council adopting roadmap for completion of Banking Union

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