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Clamour for change on Europe's banks

16

By Patrick Jenkins and Alex Barker

There is a growing clamour for change in the way Europe's banks are regulated and supervised.

Suggestions on Monday by José Manuel Barroso, European Commission president, that there should be a pan-European Union supervisor built upon comments last month by Mario Draghi, European Central Bank president. And on Tuesday Vitor Constâncio, his vice-president, went further, arguing that the ECB itself should take over bank supervision.

Stung by the weekend agreement of a Spanish banking bailout of up to €100bn, policy makers appear to believe that the supervision of banks that pose a systemic risk to Europe should rest with a centralised European authority, rather than national regulators.

The idea is part of a broader plan, advocated by architects of the next phase of European integration, to create a "European banking union", which would also involve a pan-European deposit guarantee scheme.

Critics question the viability of such deep-seated change, especially over the short timeframe of a year or so that Mr Barroso has suggested. But even if it is feasible, there remains the vital question of who should do the job.

Though rarely mentioned by reformers, there is already a fully fledged banking regulator in the form of the London-based European Banking Authority, which is answerable to the Commission.

Formed 18 months ago out of a smaller predecessor, it already has far-reaching powers to create rules and police them in collaboration with national regulators.

The EBA's highest profile work to date has been to stress test the continent's biggest banks and to force many of them to boost capital ratios to the tune of a combined €115bn by a deadline of this month – a process that made Andrea Enria, the EBA's chairman, a reviled figure in parts of Europe with the most thinly capitalised banks, including his native Italy.

That tension, and weakness in banking systems such as Spain's, has done nothing to help preserve a status quo whereby the EBA acts as a kind of umbrella body for still powerful national regulators.

"You probably need a new structure with better resourcing and the chance to start afresh," says one banking analyst.

In the meantime, many national regulators will resist any further loss of power. The UK's Financial Services Authority and Germany's Bundesbank would be among the biggest resistors of change.

"The key question is what is the standard for supervision? What will make a pan-European supervisor do a better job than national supervisors?" asks Tom Huertas, a former UK regulator now with Ernst & Young.

On Tuesday, Bundesbank vice-president Sabine Lautenschläger dismissed the idea of consolidated supervision and deposit guarantees, making clear that power could not be concentrated in one pan-European authority without first establishing a fiscal union. "Whoever accepts liability also has to have a right to control," she said.

Critics also point out a fundamental flaw in the plan for a consolidated approach to regulation.

While a new supervisory body would focus, for practical reasons, only on the biggest banks in Europe, probably the top 25, the key trigger for this whole debate – the blow-up of Spain's Bankia – would not have been caught, since it was formed only recently out of a merger of seven already troubled smaller savings banks.

All the same, reform seems inevitable, with a behind-the-scenes fight already under way over the design of a European banking union and the institutions that would stand to win and lose from the shake-up.

A first option is the EU banking union championed by Mr Barroso at the Commission, which would in principle involve all 27 member states using existing EU institutions such as the EBA.

National authorities would cede power to the EBA – an unpopular move after its troubles in recent months – which would directly supervise Europe's big banks. Central banks could act as resolution authorities, with summary powers to step in when banks are on the brink of failure.

However, increasing support, especially in Frankfurt and London, appears to be coalescing around a second option, to give supervision authority to the ECB, using a clause in existing EU treaties.

This restricts the union to the 17-member single currency club, while broadly keeping in place the rule making architecture of the EU.

"Folding the EBA into the ECB to give it added credibility looks like the main plan now," said one senior banker. A senior regulator agreed, citing the parallel with the UK's plan to fold the FSA's bank supervision work into the Bank of England.

Diplomats in Brussels do not expect EU leaders to make any definitive choices at a summit at the end of the month. But the battle to shape Europe's supervisory structure has begun and could come to a head by the end of the year.

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