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Integrating banks spurs last-minute fears in E.U.

BRUSSELS

Changes or delay sought as countries question expanded E.C.B. powers

BY JAMES KANTER

Even as European Union officials were putting the final touches Tuesday on their historic plan for placing the euro zone's 6,000 banks under a central supervisor, prominent Germans and some leaders in Central and Eastern Europe were trying to modify or even delay the proposed system.

José Manuel Barroso, the president of the E.U.'s administrative arm, the European Commission, plans on Wednesday to present the proposal, which aims to ease the region's three-year debt crisis by imposing new scrutiny and discipline on Europe's banking system. E.U. leaders in June agreed in theory to more tightly integrate the region's banks.

The main elements of the plan Mr. Barroso will describe are expected to include transferring regulatory oversight of all banks in the 17-nation euro currency union to the Frankfurt-based European Central Bank. The E.C.B. would have the power to fine lenders that did not follow its rules and withdraw the licenses of substandard banks. The new system starts going into place in January, with all euro zone banks required to join by the beginning of 2014.

But various countries are now fearing the devils that some see in the details.

Paradoxically, some of the strongest opposition has come from within Germany, usually a cheerleader for any measure that promotes economic rigor. But some German officials, including the finance minister, Wolfgang Schäuble, say that the new system should apply only to the euro zone' biggest banks that could pose a threat t

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the entire European financial system. Extending the system to all euro zone banks would expose smaller regional and local institutions to unprecedented scrutiny.

There has also been a surge of concern in some countries in Central and Eastern Europe that are part of the 27-nation European Union but have not joined the euro currency union that the new system might pose unfair competition to their banks, which would not have access to the E.C.B.'s lines of credit and European bailout funds. Among the nations most concerned is Hungary.

The plan's adoption would require its approval from all 27 members of the European Union.

Any delay could have a painful impact on countries like Spain, which badly needs to recapitalize its bombed out banking sector. E.U. leaders have made direct injections to such banks from the new bailout fund, the European Stability Mechanism, contingent on giving the E.C.B. a leading role in banking supervision.

''The political barriers are nontrivial,'' said Roberto Henriques, a credit analyst at JPMorgan Chase in London, said this week. ''We believe that the target the region has set itself — implementation to begin from January 2013 — is unrealistic,'' he said.

On a separate front, the E.S.M. bailout fund's very future could also be depend on a decision expected Wednesday morning in Karlsruhe, Germany. There, the nation's Constitutional Court is expected to rule on whether and under what conditions Germany can contribute money to the fund.

The creation of the single bank supervisor for the euro zone is a first step in what voguish policymakers call EMU 2.0. The goal is to revise the Economic and Monetary Union — the euro union — by combining crossborder budget management with possible jointly issued debt and more central economic policymaking, while trying to ensure democratic accountability. Those are all goals strongly supported by the German chancellor, Angela Merkel.

But how quickly all of this can happen has become a delicate and political balancing act for Mr. Barroso and for Michel Barnier, the E.U. commissioner in charge of trade within the 27-member bloc.

In Central and Eastern Europe, where about 60 percent of banks are controlled by lenders based inside the euro zone, there were even warnings on Tuesday of an increased danger of bank runs, as depositors fled to the perceived safety of banks under the new E.C.B. regulator, with access to the European bailout fund.

The new bailout fund ''would serve as a backstop, and someone might conclude that a bank is so much more secure in Austria'' compared with a country like Hungary, said a senior E.U. official, who spoke on condition of anonymity on Tuesday because negotiations with the worried countries were being conducted in private.

Despite some critics's concerns about relinquishing oversight to a central regulator, national authorities would in fact retain much influence over the new system, including day-to-day supervision banks and responsibility for enforcing banking rules.

In many cases, the E.C.B. would rely on existing regulatory institutions to flag serious difficulties, help assess applications for new banks and oversee adoption of new financial models.

Even so, the plans could do much to bulldoze barriers between national banking systems. And the E.C.B. would have the power to fine banks for breaching its orders, carry out on-site inspections and supervise any new rounds of so-called stress tests to check the vulnerability of individual lenders.

The proposals would also modify the powers of another agency, the European Banking Authority, but still give it a role, partly as a way to give countries like Britain outside the euro zone some assurance that policies governing their banking systems cannot be automatically set by central bankers in Frankfurt. Those plans are separate, though, and would need agreement of the European Parliament and a majority of E.U. member states before becoming law.

By beefing up supervision under the auspices of the E.C.B., one of the few European institutions to emerge from the euro crisis with its reputation intact, officials in Brussels are seeking to end the so-called doom loop, in which some nations have racked up enormous debts by bailing out their banks.

But France, for one, has been particularly wary of using public money to bail out banks at the expense of its other public objectives. That is why the French finance minister, Pierre Moscovici, has sought to maintain momentum for the new European banking proposal.

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''When I say as soon as possible I mean in 2012,'' Mr. Moscovici said in a speech at Bruegel, a research organization in Brussels, last week, referring to the establishment of a single supervisor and urging the European Commission to finish plans this year for common European rules for guaranteeing bank deposits and shutting down failed banks.

But the timetable proposed by the commission and Mr. Moscovici was ''ambitious'' and even ''radical,'' said the senior E.U. official who would speak only on condition of anonymity.

Some Germans, meanwhile, are reluctant to give up authority over some of their larger public banks that are partly controlled by states — the landesbanks that have long dovetailed banking with politics in Germany.

The European Commission has already outlawed state guarantees that used to permit the landesbanks to borrow money cheaply, giving them a cost advantage over commercial banks. How much longer the landesbanks can survive without that competitive advantage is a question thrown into sharper focus by the financial crisis.

There is also concern at thousands of smaller institutions that finance many of Germany's midsize and family-run businesses that are a backbone of the country's economic motor.

These lenders, or sparkassen, usually owned by municipalities, say the stability of their businesses could be jeopardized if they are drawn into a regional euro zone system requiring them to help cover the risks taken on by larger institutions that invest in international capital markets.

''Europe should use the German structure as an example, instead of seeking to destroy it,'' said Georg Fahrenschon, the president of the German Savings Bank Association.

Jack Ewing contributed reporting from Frankfurt and Melissa Eddy from Berlin.