

# Fiscal backstop: the missing pillar of the banking union?

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# Rationale for ‘banking union’

“We affirm that it is imperative to break the vicious circle between banks and sovereigns.”

(Euro Area Summit statement, 29 June 2012)

- To strengthen the banking sector
- To detach government budgets from balance sheets of individual banks
- ECB is considered less politicised and subject less to ‘supervisory capture’

# Three elements of 'banking union'

## 1. **Single Supervisory Mechanism**

'SSM': ECB + National Supervisory Authorities

– Regulations 1024/2013 and 1022/2013, 15 October 2013

## 2. **Single Resolution Mechanism**

– Council Legal Service opinions, 11 September & 13 October 2013

– Presidency compromise text (15503/13), 4 November 2013

– ECB Opinion (CON/2013/76), 6 November 2013

(very interesting: supervisory vs. resolution responsibilities, use of 'bail-in' tool before 2018, protection of covered deposits, public backstop, application of state aid rules by analogy, etc.)

## 3. **Single Deposit Guarantee System**

(no proposal yet)

**Based on single rule book** (CRR, CRD-IV and other EU supervisory law, including BRRD, harmonising bank resolution)

# Backtracking

- Joint Statement of the Ministers of Finance of Germany, the Netherlands and Finland, 25 September 2012:  
“the ESM can take direct responsibility of problems that occur under the new supervision, **but legacy assets should be under the responsibility of national authorities**”

[http://www.vm.fi/vm/en/03\\_press\\_releases\\_and\\_speeches/01\\_press\\_releases/20120925Join](http://www.vm.fi/vm/en/03_press_releases_and_speeches/01_press_releases/20120925Join)

# Connection and urgency

- **Mario Draghi**, Washington, D.C., 12 October 2013: “The effectiveness of this exercise will also depend on the availability of necessary arrangements for recapitalising banks, if and when needed, including through the provision of a public backstop, if private funds cannot be acquired. These arrangements must be in place before we conclude our [comprehensive balance sheet] assessment, in line with the declaration of the European Council of June 2013.”
- **ECB Opinion**, 6 November 2013: “(...) the SRM is a necessary complement to the SSM in order to achieve a well-functioning financial market union (...) such a system must therefore be established by the time the ECB assumes its supervisory authority in full.”

# ESM: direct bank recapitalisation

- ESM Treaty does not yet provide for direct bank recapitalisation
- Euro Group agreement on ESM direct bank recapitalisation instrument, 20 June 2013 – *called into question by SPD (German Labour Party)*
- Application of Article 19 ESM Treaty - € 60 billion limit
- Outline of direct recapitalisation:
  - *State unable to provide financial assistance in full or bank bail-out may endanger its market access and lead it to request for ESM loan*
  - *Systemically relevant financial institution...*
  - *... that is (potentially) in breach of ECB capital requirements & unable to attract capital from private sources*
  - *Viability of financial institution to be assured by capital injection & restructuring plan*
  - *Commission state-aid conditionality to be applied*
  - *State capital injection required (legacy assets, proper alignment of incentives)*
  - *Creditors' contribution ('bail-in')*

# Issues

- ESM option open? German veto in ESM decision-making // Need for German domestic legislative change? // Sufficient funds? (€ 60 billion)
- Single Bank Resolution Fund (SBRF) part of SRM proposals – to be funded by banks but having access to fiscal resources – principle of ‘fiscal neutrality’ over the medium term: recoupment of public assistance from finance industry by ex post levies on the finance industry
- ECB: “essential” – participating Member States to “cater for a joint and solid public backstop upon entry into force of [SRM] regulation” – “a credit line granting SRM access to joint fiscal resources from participating States”: ESM

# Fiscal backstop legal issues

## Other possible future fiscal backstops:

- ❑ A Euro Area Treasury (Jean-Claude Trichet)
- ❑ Fiscal union element in 'Genuine EMU' ideas
- ❑ Call for an economic government for Europe ('Towards a Euro Union', call by eleven German economists, political scientists and jurists, so-called Glienicker Group, 17 October 2013)

## Legal issues

- ❑ No legislative basis for including backstop obligation in SRM Reg. (States' fiscal sovereignty) – Art. 114 (+352?) TFEU insufficient
- ❑ Treaty change (TFEU)
- ❑ A separate treaty to avoid unanimity, later to be incorporated into EU law (like 'Fiscal Compact')