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The Prospects of the European Banking Union and the Hellenic Banking Sector Challenges: A Preliminary Exercise

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Abstract

Establishing a Banking Union was a rallying issue in the European Union the last years. In the December 2012 Summit it was decided to set up a Banking Union that will streamline and standardize procedures in the eurozone across banking system and prevent national debt crisis that affects the common currency. At least 200 large and multinational banks will be placed under a Single Supervisory authority controlled by the European Central Bank and if needed it will be empowered to monitor all 6000 banking in the European Union. The scope of this paper is to present briefly the progress towards the Banking Union agreement and to sketch a preliminary exercise program of the Hellenic Banks' adaptation, rescheduling and recapitalization needs. Bank of Greece estimated that the amount of €50 billion earmarked under the Economic Adjustment Programme is appropriate to cover the Greek banking sector's recapitalization and restructuring costs. Therefore, banks' institutional and private shareholders will be required by July 2013 to cover a minimum of 10% of new common equity capital as to keep credit institutions privately run. Still, there is no agreed time schedule on banks' recapitalization.

Keywords: European Banking Union, sovereign debt crisis, European Central Bank, single supervisory mechanism, Hellenic banking system, recapitalization

1. Introduction

The European crisis has exposed the lack of institutional mechanisms to deal with macroeconomic shocks. The European Union countries suffered from two interrelated crises: a banking crisis stemming from losses in capital market securities and sovereign debt crisis exacerbated by recession, transfers to help banks and poor fiscal management (Blundell-Wignal & Slovik, 2011). The concept of the European Banking Union was put forward by the European Heads of State and Government on 23 May 2012 as a key component for solving the euro area economic and fiscal crisis.

The European Commission envisaged a European Banking Union on three main pillars: a) a Single Supervision Mechanism, covering all banks b) a European Deposit Insurance Scheme, and c) a Common Resolution System. Article 127 TFEU provides for the European System of Central Banks (ESCB) to intervene in maintaining price stability and support general economic policies in the Union while para 3 provides for the power to the ESM (after prior consultation of the Commission, the Council and the European Parliament) to undertake the prudential supervision of all EU credit and other financial institutions.

The scope of this paper is to present briefly the progress towards the Banking Union agreement, the initial considerations before and after the June and December 2012 historical Summits, as well as, to sketch a preliminary exercise program of the Hellenic Banks' adaptation, rescheduling and recapitalization needs.

2. Historical Steps Leading to Important Concessions

In June 2012 the Presidents of the Council, the Commission, the Eurogroup and the European Central Bank prepared a detailed proposal for a stage-based process towards a genuine Economic and Monetary Union to ensure stability and sustained prosperity. The proposal consisted of the following four building blocks offering a coherent and complete architecture necessary for the next decade: 1) an integrated financial framework to ensure financial stability in particular in the euro area and minimize the cost of bank failures to European citizens; 2) an integrated budgetary framework to ensure fiscal policy making at national and European levels; 3) an integrated economic policy framework which has sufficient mechanisms to ensure that national and European policies are

in place that promote sustainable growth, employment and competitiveness and are compatible with the smooth functioning of the European Monetary Union (EMU) and 4) ensuring the necessary democratic legitimacy and accountability of decision making within the EMU based on the joint exercise of sovereignty for common policies and solidarity (EUCO 120/12, 2012).

In September 2012, the Commission presented three proposals on the Banking Union: 1) a Communication for 'A Roadmap towards a Banking Union', covering the single rulebook, the single supervisory mechanism and the involving single bank resolution mechanism, 2) a proposal for a Council Regulation to create the single supervisory mechanism of all banks in the euro area with a central role conferred on the ECB, with a mechanism for non-euro area countries to join on a voluntary basis and 3) a proposal for a Regulation of the European Parliament and the Council to amend the Regulation (EC) No 1093/2010 establishing the European Banking Authority (EBA) to adapt it to the creation of the SSM (COM 511, 2012; Veron, 2012; Sapir et al., 2012).

In October 2012, the European Council reiterated its firm commitment to take resolute action to address financial markets tensions, restore confidence and stimulate growth and jobs. It also called for work to proceed on proposals on the Single Supervisory Mechanism as a matter of priority with the objective of agreeing on the legislative framework by 1st January 2013 (European Council Conclusions, 2012).

On 14 December 2012, the EU Finance Ministers clinched a decision on the Single Supervision Mechanism (SSM) which will be supervised by the European Central Bank and will be operational from 1 March 2014. The ECB will have direct oversight of eurozone banks, although in a differentiated way and in close cooperation with national supervisory authorities. Non-eurozone member states wishing to participate in the SSM will be able to do so by entering into close cooperation arrangements (European Council, 3214 meeting, 2012). Regulation 1093/2010 establishing the European Banking Authority (EBA) was modified, as EBA failed to see the Spanish banking problems in time and gave them a clean bill of health in its so-called stress tests. Lately, EBA powers were watered down by member-states, so that it cannot run its own audits and check national supervisors' reports.

The European Council adopted these proposals on 14 December 2012 (European Council Conclusions, 14 Dec. 2012) paving the way for bail-out funds to directly recapitalize ailing banks and making the first stage of a longer-term plan to introduce a full Banking Union. From 2014, the European Central Bank will be responsible for overseeing some 200 of the regions' biggest banks (out of 6200 in the EU), having the power to step in when smaller banks run into trouble. More precisely, the ECB will directly supervise only those banks with assets of €30 billion or more than 20% of their country's economic output (around 200 eurozone banks).

24 hours after agreeing on the modalities of the SSM, the EU agreed to take the next steps towards banking union: the establishment of a Single Resolution Mechanism (SRM). SRM aim is to reduce risks for taxpayers and for the economy, by making sure that any bank failures are dealt with in a swift and orderly way, in the best interest of all (Van Rompuy, 2012). The European Banking Union is expected to start its operation in March, 2014.

3. Past Literature

The initial proposal for a European Banking Union received several positive comments, leaving negative comments mainly to those who see banking union as a threat to their country's sovereignty.

Sibert (2012) considered Banking Union as an essential component of a well-functioning monetary union. Whelan (2012) stated that while there are some arguments for a common bank supervisor across the European Union (EU), such a proposal is unlikely to ever work, leaving the euro area a long way from a coherent and workable banking union. Eijffinger (2012) argued that although the proposal put forward moves the euro area towards a banking union several components are missing, like inability of ECB to supervise 6000 banks, loopholes between euro and non-euro members, lack of cooperation protocol and accepted funding mechanism for banks' restructuring. De la Dehesa (2012) although admitted that the banking union changes the institutional framework of the euro area, he worries that the support for this project starts to vane and slows down or even fails.

Schoenmaker (2012) and Schoenmaker and Gros (2012) observed that banking supervision first and resolution and deposit insurance at some undefined later stage leads to an unstable banking union. They state that any attempt at banking union must include an integrated deposit insurance and resolution authority in order to be successful. Goodhart (2012) proposed a banking supervision shifted to the European level, as well as, resolution authority and recapitalization costs.

Buch and Weigert (2012) stated that a banking union should be part of a long-run institutional framework. On the other hand, they acknowledge that the transition is blocked by legacy problems. Wyplosz (2012) argued that a partial banking union is no better than no banking union at all and possible worse. Beck (2012) concludes that the euro zone crisis is as much banking as it is a sovereign debt crisis. Therefore, it is time to act for the Euro zone governments. Finally, Pissany-Ferry et al. (2012) discussed how a future banking union could be organized and what transitional steps should be taken from the current state to the future banking union.

4. Banking Union Press Reception

The European Union press received the agreed text on the European Banking Union with a starting enthusiasm which gradually vanished according to the geographic area they are situated. The widespread feeling that ground was ceded under pressure from the 'Diktat' of Germany, which insisted that the single European supervisor would have no oversight of its local banks, has spurred criticisms.

The British press criticized the agreed Banking Union formula as good in theory but perhaps not in practice. Analysts' main questions were linked to the protection of the independence of U.K. regulation over EU law: Could Banking Union is used as cover to force euro-trading out of London? Will the ECB, as regulator for the zone's biggest banks, come to out-gun the pan-EU European Authority and thus establishing rules ill-suited for UK banks (Pratlen, 2012)? There are concerns that if European banks join together Banking Union they could challenge London's hegemony in that area (Salisbury, 2012). The European Central Bank power to supervise the eurozone's bigger banks sounds horribly technical and dull, mapping a future for the UK in an EU increasingly dominated by currency union members acting as a unified bloc (Peston, 2012). Although the UK will not join banking union, there are fears that London's premier position as a financial center will be undermined by the 17 euro nations voting en bloc on the European Banking Authority which sets banking rules throughout the EU (Grice, 2012).

On the contrary, analysts from the Continent welcome the Banking Union agreement stating that it should have happened 10 or 15 years ago. European banks operate transnationally, investors buy neighboring countries' bonds, citizens set up accounts in other member states and it is only the financial watchdogs that remain national (Smoczynski, 2012). Therefore, a banking supervisor is the first step in a broader plan to have a banking union which could improve the eurozone's ability to respond to any new future financial crisis (Dilorenzo & Casert, 2012). The banking Union's great leap forward aimed at preventing not war but the death of euro.

Some analysts criticized the agreement as incomplete. The agreed Regulation is but a first requirement and must be accomplished by a European mechanism for crisis management and bailouts. A European Deposit Insurance scheme would be the banking union's crowning achievement. This is desirable but was rejected by Berlin. It is still far away, as far away as a federal Union (Le Monde, 2012). Germany succeeded in limiting ECB supervision to systematically important institutions, banks with total assets of more than €30 billion, thus excluding its regional banks from ECB's direct supervision (Malhere, 2012).

5. Hellenic Banks Recapitalization Plan

International banking institutions entered the financial and debt crisis with capital that was insufficient both in quantity and in quality, leading to unprecedented support from national authorities. With its proposal on capital requirements for banks (CRD IV) made in July 2011, the European Commission launched the process of implementing for the European Union (European Commission, MEMO/12/662) the new global standards on bank capital agreed at G20 level in November 2010 (Basel III agreement). The so-called Basel III agreement, concluded by the Basil Committee on Banking Supervision, strengthens bank capital requirements, introduces a mandatory capital conservation buffer and a discretionary countercyclical buffer and foresees a framework for new regulatory requirements on liquidity and leverage (Council of The European Union, 9399/12). Banks and Investment firms are obliged to hold common equity tier (CET 1) capital at 4.5% of risk weighted assets and total capital requirement at 8%.

As well known, Greece is undergoing severe debt problems, domestic banks are state big lenders, so banks got sucked into the sovereign debt vortex. The country's economy is monitored by economic adjustment programs and official lenders require the implementation of ambitious structural reforms. Thus, a banks mergers & acquisitions marathon has started while the completion of a sizeable domestic banks' recapitalization plan constitute a significant structural benchmark. Worth mentioning that banks' recapitalization is considered as a key precondition for a gradual restoration of domestic financial conditions.

On this line, the Bank of Greece (BoG) further increased Core Tier 1 ratio in banks from 8% to 9%, requesting domestic banks to immediately reach the new requirement of 9%. Due to the fact that banks had missed the 8%

Core Tier 1, as a result of the rise in default loans, the 3 new systemic banking groups (National Bank of Greece + Eurobank, Alpha Bank + Emporiki Bank, Piraeus Bank + Agricultural Bank) were granted 6.5 to 6.7 billion Euros by the Hellenic Financial Stability Fund (HFSF) in order to achieve the new requirement for 9% in Core Tier 1. It is no coincidence that the ECB reduced liquidity provisions towards Greek banks from 30 to 6.5 billion Euros.

On the recapitalization and restructuring issue, the BoG announced in December 2012 that under reasonable levels of economic uncertainty, the amount of €50 billion earmarked under the Economic Adjustment Programme is appropriate to cover the Greek banking sector's recapitalization and restructuring costs (Bank of Greece, 2012, p.10). According to this report, the level of public resources required as a backstop facility for the Greek banking sector's recapitalization needs and restructuring costs over the 2012-2014 period (Financial Envelop) is estimated to €40.5 billion, €1.4 billion correspond to net impact of completed resolutions and recapitalization, €3.1are considered as costs of potential future restructuring and €5 billion as capital buffer. It is worth mentioning that out of the €40.5 billion capital needs for all commercial banks, the €27.5 billion correspond to the four 'core banks' (Table 1). Banks' total share capital increase in common stocks of €27.5 billion (Table 1) and is expected to be take place between April and July 2013.

Table 1. Domestic Banks' capital needs (billion €)

Banks	Internal generation of capital	Total capital needs
NBG	4,681	9,756
Eurobank	2,904	5,839
Alpha Bank	2,428	4,571
Piraeus Bank	1,080	7,335
Emporiki Bank	114	2,475
Agricultural Bank of Greece (ATE)	468	4,920
Hellenic Postbank	-315	3,737
Millennium Bank	-79	399
Geniki Bank	-40	281
Attica Bank	15	396
Probank	147	282
N. Proton	34	305
FBBank	-29	168
Panellinia Bank	-26	78
Total	11,381	40,542
Total	**11,093**	**27,501**

Source: Bank of Greece

Bank of Greece also foresees that there may be an internal generation of capital of 11.3 billion Euros from banks in the 2012-2014 period. The amount of €11 billion Euros may come from bank operating income, from the sale of subsidiaries or from other activities, as submitted by the banks in the respective business plans for the 2012-2014 period.

Therefore, 450 thousands of bank shareholders will be required to cover a minimum of 10% of new common equity capital as to keep credit institutions privately run that equals to €1.75 billion and at the same time cover a black hole of €5 billion. The difference between 17.58 billion and 27.45 billion, which represents that total capital support of banks by the Hellenic Financial Stability Fund, will be covered by Contingent Convertible Bonds (CoCos). Other amounts will be necessarily offset with the above (deferred taxes), resulting in the amount of Contingent Convertible Bonds being less than €10 billion.

As far as the four core banks are concerned, the NBG-Eurobank scheme will require a share capital increase of 10.9 billion, while the minimum requirement of 10% amounts to 1.090 billion Euros. Alpha Bank will require a share capital increase of 1.8 billion Euros, while the minimum requirement of 10% amounts to 180 million Euros. Piraeus Bank will implement a share capital increase of 4.88 billion Euros, while the minimum requirement of 10% amounts to 488 million Euros (Table 2).

Table 2. Core banks recapitalization schedule (billion €)

Banks	Total funds	Core tier 1	Core tier 1	Share capital increase – common stock	Minimum required of 10%
NBG	9.7	10.3%	6.88	7.1	710
Eurobank	5.8	11.5%	4.35	3.8	380
Total NBG/ Eurobank	15.5	10.9%	11.23	10.9	1090
Alpha Bank	4.6	9%	5.5	1.8	180
Piraeus Bank	7.35	12%	5.74	4.88	488
Total	27.450	10.7%	22.47	17.58	1.75

Source: Bank of Greece

Finally, the Bank of Greece concludes that the recapitalization and the restructuring of the banking sector are expected to gradually restore depositors' and market confidence (Bank of Greece, 2012, p. 10).

6. Conclusions

The recent financial crisis highlighted major structural failures of the European Union banking system, like implicit and explicit public subsidy, competition distortions and banks' bail-outs at the expense of taxpayers.

International and European banking institutions entered the financial and debt crisis with capital that was insufficient both in quantity and in quality, leading to unprecedented support from national authorities.

The European Banking Union is an important step towards building a resilient EU banking sector and inevitably linked to pooling sovereignty at the EU level which can potentially lead to cross-border transfers. It is an ambitious project with substantial ramifications for financial sector stability, financial sector stability, liabilities and even the future of the European Union.

The compromised formula was considered as a policy framework to enable the formation of an integrated European Banking System based primarily on a Single Supervisory Mechanism (SSM) managed by the European Central Bank (ECB) and permitting the European Stability Mechanism (ESM) to play their discrete roles on centrally decided and managed banking and monetary policies. As mentioned, the Banking Union objective is much more than avoiding bailing out banks and bank failures

Greece is undergoing severe debt problems while country's economy is monitored by tough economic adjustment programs. Domestic financial institutions are asked for stricter prudential requirements on the level of own funds, capital conservation buffer, liquidity levels and risk weights. The Central Bank and Commercial banks seek ways for additional capital strengthening and adjustment to new financial environments. Banks are, also, making plans for the sale of real estate properties, subsidiaries and even healthy loan portfolios in order to increase their capital base and avoiding sinking.

The Bank of Greece estimated that under reasonable levels of economic uncertainty, the amount of €50 billion earmarked under the Economic Adjustment Programme is appropriate to cover the Greek banking sector's recapitalization and restructuring costs. Therefore, thousands of bank shareholders will be required by July 2013 to cover a minimum of 10% of new common equity capital as to keep credit institutions privately run. As mentioned, the improvement in the capital and liquidity position of Hellenic banks will enable them to continue supporting the real economy and contribute to the improvement of the business environment.

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