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# POLAND AND THE EUROPEAN BANKING UNION: TO JOIN OR TO WAIT?

## Abstract

The aim of the article is to analyze the opportunities and risks for Poland related to the banking union. Opting in would allow Poland to strengthen integration with the European Union. Its participation in the SSM as a host country could translate into enhancing the positive image of the Polish banking market for foreign investors. Considered as a response to the global financial crisis and a mechanism to tighten the integration of the euro area, the banking union is still an incomplete project that does not include all EU Member States. Its third pillar, i.e. the Single Deposit Guarantee Scheme (SDGS), is yet to start operating. Therefore, in the case of Poland, the so-called close cooperation should be preceded by a balance of benefits and costs.

**Keywords**: European Union, banking union, financial system, opt-in

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## Introduction

The concept of the European Banking Union was developed in response to the global financial and economic crisis that broke out in 2007. Although it began with the collapse of the mortgage market in the US, the crisis quickly reached Europe, exposing the weaknesses of not only the banking sector but also the supervisory mechanisms. Institutions which were part of the safety net disregarded a growing risk in the financial system and failed to prevent the bankruptcy of the institutions at risk. The materialization of the systemic risk accumulated in the financial system led to a financial crisis, which quickly moved to the real sphere of many economies. As a result, for example, the United States was forced to recapitalize its banking sector to 24 trillion USD, and the European Union allocated 20 trillion USD for this purpose.[1] Nevertheless, since 2008 over 1,500 banks have ceased to operate in the EU.[2] The European Union's response to these events was the creation, in June 2012, of the concept of the European Banking Union.

The aim of the article is to analyze the opportunities and benefits for Poland related to the participation in the banking union. Conceived as a response to the global financial crisis and a mechanism to tighten the integration of the euro area, the banking union is still an incomplete project, which does not include all the EU countries. Its third pillar, i.e. the Single Deposit Guarantee Scheme (SDGS),[3] is yet to start operating. Additional risk is also posed by the fact that the European Union member states which do not belong to the euro area have not been included in the banking union, since the European Central Bank does not have sufficient competence to influence the banking systems outside the euro area.

## 1. The construction of the European Banking Union

The concept of the European Banking Union for the first time appeared in the document *Towards a Genuine Economic and Monetary Union*, published on 5 December 2012 by the European Council. It presented a project for the Economic and Monetary Union (EMU) which consisted of four elements:[4]

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1 *Banking union: protecting savers, strenghtening banks*. Press release of the European Parliament, 1 March 2018.

2 Ibid.

3 M. Zaleska, Zintegrowane ramy finansowe – koncepcje i wyzwania, [in:] *Europejska unia bankowa*, M. Zaleska (Ed.), Difin, Warszawa 2015, p. 15.

4 *Towards a Genuine Economic and Monetary Union*, Brussels, 5 December 2012.

1) providing the necessary democratic legitimacy and responsibility for decisions taken, i.e. decisions made within the framework of the EMU will be based on solidarity and joint exercise of sovereignty over common policies;
2) an integrated economic policy framework, i.e. implementation of mechanisms ensuring stable growth, employment and competitiveness as well as counteracting macroeconomic imbalances;
3) an integrated budgetary framework, i.e. sound budgeting at national and European levels, coordination, joint decision-making and effective enforcement, as well as actions aimed at joint issuance of debt and various forms of fiscal solidarity;
4) an integrated financial framework, i.e. transfer of responsibility for supervision to the European level and the provision of common bank resolution mechanisms and guaranteeing consumer deposits.

As early as in December 2012, the President of the European Council in cooperation with the President of the European Commission, the President of the European Central Bank and the Presidents of the Eurogroup prepared an action plan to create a real Economic and Monetary Union, where the Banking Union played a major part.[5] In March 2013, the European Parliament and the European Council reached an agreement on the creation of the Single Supervisory Mechanism (SSM), which is the first pillar of the banking union. Meanwhile, in April 2013, the European Parliament adopted the CRD IV / CRR regulatory package setting out prudential requirements for credit institutions and investment firms. Before the SSM was launched, the ECB had conducted stress tests and carried out a comprehensive assessment of 130 banks operating in the euro area. Their results, published on October 27, 2014, showed that as many as 25 out of the 130 banks surveyed suffered capital shortages. Launched on November 4, 2014, the SSM covered all banks operating in the euro area. Additionally, on November 23, 2016 the European Commission announced a comprehensive reform package aimed at strengthening the resilience of banks operating in the EU.

The work on creating the second pillar of the banking union, i.e. the Single Resolution Mechanism (SRM), had already been underway. The European Council and the European Parliament reached an agreement on its creation in March 2014. It was established that the main body of this particular pillar of the banking union was to be the Single Resolution Board (SRB). It started to operate on January 1, 2015 and became fully operational in January 2016. It is worth recalling that earlier in December 2015, countries participating in the banking union had agreed

[5] *A blueprint for a deep and genuine economic and monetary union.* Launching a European Debate, Brussels, 28 November 2012.

to establish a single bank resolution fund. On 24 November 2015, the European Commission presented a legislative proposal[6] on the creation of the third pillar of the banking union, i.e. the European Deposit Insurance Scheme (EDIS; the Single Deposit Guarantee Scheme – SDGS).

According to the document *Towards a Genuine Economic and Monetary Union*, the integrated financial framework, for which the term 'banking union' has been adopted, should consist of three elements:

1) the Single Supervisory Mechanism;
2) the Single Resolution Mechanism;
3) the Single Deposit Guarantee Scheme.

It should be emphasized that the components of the banking union were listed in the order of their implementation and the level of advancement. While the first two elements are already in place, the Single Deposit Guarantee Scheme has yet to be designed.

### 1.1. The Single Supervisory Mechanism

The Single Supervisory Mechanism has three main objectives: to check that credit institutions meet prudential requirements; to detect risks at the initial stage and to conduct corrective actions to prevent threats to the stability of the financial system.[7] Under the Single Supervisory Mechanism, the ECB exercises direct supervision over Systemically Important Financial Institutions (SIFIs) operating in the euro area, including Systemically Important Banks (SIBs). Such institutions meet at least one of the following conditions: the value of the assets exceeds 30 billion EUR or represents at least 20% of the GDP of the state in which they are based, or they have applied for or received assistance from the European Financial Stability Facility (EFSF) or/and the European Financial Stabilization Mechanism (EFSM). The ECB may also supervise credit institutions which it considers systemically important or which are indicated as such by the national supervisory authority. At the time of launching the SSM, these conditions were met by 120 banks, with around 85% of the euro area assets.

6 Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme. Press release of the European Commission, 24 November 2015.

7 M. Zaleska (Ed.), *Świat bankowości*, Difin, Warszawa 2018, pp. 56–59.

## 1.2. The Single Resolution Mechanism

The institutional framework for the Single Resolution Mechanism and rules for its operation were included in the BRR (Bank Recovery and Resolution) directive,[8] and detailed solutions for countries participating in the banking union were set out in the SRM Regulation.[9] In the banking union, the resolution authority is the Single Resolution Board (SRB). Resolution is a solution applied to troubled banks, i.e. undergoing restructuring or orderly liquidation without the need to declare bankruptcies of banks and paying their depositors the guaranteed amounts. In this mechanism, the burden of restructuring or orderly liquidation rests first with creditors and shareholders of banks, and then – with deposit holders of over 100,000 EUR. The purpose of the resolution is: to increase the credibility of the banking sector; prevent bank panic (run) and the domino effect; minimize the negative link between the banking sector and the real sphere of economies.

The resolution mechanism has transferred the responsibility for crisis management of banks to the level of the EU. The introduction of a common approach to banks facing bankruptcy is intended to enhance the stability of the financial systems of the countries participating in the banking union, as well as to prevent the spread of systemic threats to non-participating states. In this way, the risk of making inconsistent decisions with respect to cross-border banking groups is eliminated in the case of restructuring or orderly liquidation.

The idea behind the resolution is the belief that the liability and consequences of bank insolvency cannot be transferred to taxpayers or the budgets of the countries in which these institutions function.[10] Therefore, the main part of the resolution is the Single Resolution Fund (SRF) used to manage resolution in the cases where other bank options, such as debt conversion or redemption, will be used against the bank on the brink of bankruptcy. The SRF is financed from contributions collected from banks ex ante and ex post. Its amount is to correspond to 1% of the amount of insured deposits accumulated in banks operating within the countries participating in the banking union.

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8 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) 1093/2010 and (EU) 648/2012, of the European Parliament and of the Council, The Official Journal of the EU L173 of 12 June 2014.

9 Regulation (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) 1093/2010, The Official Journal of the EU L 225 of 30 July 2014.

10 Cf. J. Koleśnik, *Jednolity mechanizm restrukturyzacji i uporządkowanej likwidacji*, [in:] *Europejska unia bankowa*, M. Zaleska (Ed.), Difin, Warszawa 2015, pp. 113–114.

### 1.3. The Single Deposit Guarantee System

The single supervisory and resolution mechanism is the basis for the functioning of the third pillar of the banking union, which is the Single Deposit Guarantee Scheme. The main objectives of the European Deposit Insurance Scheme (EDIS) are to provide the same protection to depositors across all European Union countries, preventing withdrawals of deposits brought about by market panic caused by information about the insolvency of a given bank as well as to increase the financial stability of the European Single Market (ESM).[11] Currently, EDIS consists of national deposit guarantee schemes. Their operation has been harmonized with the European Parliament's directive[12], which states that:

- national deposit guarantee funds are to be financed ex ante;
- the minimum coverage ratio (i.e. the relation of the guarantee system resources to the amount of the guaranteed deposits in the banking system) is to amount to 0.8%, by 2024;
- the deadline for payment of guaranteed deposits will be reduced to 7 working days;
- it is permissible to make loans between national deposit guarantee schemes on a voluntary basis.

In accordance with the adopted provisions, the guarantee covers all deposits of a bank belonging to EDIS, both private and corporate, up to the amount of 100,000 EUR. The following are also subject to protection: pension funds of small and medium-sized enterprises, deposits of public authorities with a budget not exceeding 500,000 EUR and deposits with a value of over 100,000 EUR for specific residential and social purposes.

The construction of EDIS has not been completed yet. In the release of October 2017, the European Commission proposed a schedule for introducing the system in two stages: reinsurance and co-insurance.[13] In the first stage, EDIS is to provide domestic DGSs only with liquidity coverage. Therefore, if the bank is on the verge of solvency, EDIS will provide it with funds to cover the full repayment of the depositors, while the national deposit guarantee scheme will be obliged to repay these funds and at the same time ensure that losses will be covered by the national system. The transition to the next phase of EDIS construction will depend on the progress in risk

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[11] Cf. M. Zaleska, *Budowa trzeciego filaru unii bankowej*, "Rzeczpospolita" 2 December 2015; M. Zaleska, *Finał unii bankowej*, "Rzeczpospolita" 24 April 2014.

[12] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, The Official Journal of the EU L 173 of 12 June 2014.

[13] *Commission calls for the completion of all parts of the Banking Union by 2018*. Press release of the European Committee, Brussels, 11 October 2017.

reduction. In the second stage, EDIS might gradually start to cover losses as well. The full operation of EDIS is to be achieved in 2024.

## 2. Poland's participation in the banking union

The global economic and financial crisis has revealed the existence of negative feedback between the banking crisis and the crisis in public finances. It turned out that the condition of the financial sector had a much greater impact on the real economy than it had been believed before, and price stability was a necessary yet insufficient condition to achieve financial stability.[14] Before its outbreak, the value of banking sector assets in countries belonging to the European Union had increased significantly, which had become particularly evident in countries such as Greece, Ireland, Portugal, Spain and Cyprus. In turn, in 2013, the ratio of banking assets to GDP was 334% – much higher than that of highly developed economies such as the United States (86%) or Japan (196%).[15] At that time, the conviction prevailed that governments could not allow for the collapse of the largest banks as it would lead to the collapse of economies. As the crisis was most severe in the countries of the euro area, the proposed reforms, including the banking union project, were to focus primarily on them. The crisis revealed, however, that the financial systems of individual European Union Member States were strongly interconnected, which meant that the situation in the euro area would also have an impact on the financial systems of non-eurozone countries, including Poland. Therefore, it was decided that countries belonging to the euro area were obliged to participate in the banking union, while those remaining outside the euro area might opt in. In the latter case, the opt-in can be established at the time chosen by the state and at its request. In the case of Poland, the opt-in should be preceded by a costs and benefits analysis, especially as its financial system is very stable. It seems worth making such an analysis even though at this stage the banking union is still an incomplete project.

### 2.1. Potential benefits

Opting-in the banking union would allow Poland to strengthen its integration with the European Union. The participation in the SSM as a host country could translate into promoting the positive image of the Polish banking market for

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[14] *Ekonomiczne wyzwania integracji Polski ze strefą euro*, NBP, Warszawa 2014, pp. 71–78.
[15] Ibid., p. 78.

foreign investors. This is undoubtedly a considerable advantage, yet it should not be overestimated, because Poland as a stable banking system enjoys trust in international markets.[16] For the national supervisory authority, the convenience associated with the opt-in option is that it would stay in touch with one supervisory institution, i.e. the ECB, instead of many supervisory institutions from different countries.[17] Moreover, Poland's participation in the SSM would reduce the problems related to the divergent interests of home countries and supervisors in the host country, posing some risk for national macro-prudential supervision. It is often the case that the supervisor from the home country does not really intend to demonstrate a lack of will but rather has no possibility to supervise subsidiaries of a given bank abroad.[18]

A tangible benefit for Polish banks operating cross-border in the SSM countries would result from the unification of supervisory standards, thanks to reducing operational costs associated with ensuring compliance. What appears to be equally important is replacing the host country/home country relation with the host country/ European supervision relation, limiting the risk of nationalizing losses in the host country. For Polish supervision, participation in the SSM would mean an increase in the availability of information on parent banks belonging to the SSM, and thus a full assessment of their condition. It would also allow participation in the activities of teams supervising individual banking groups. Thus, the problem of coordination between the bank's home country (belonging to the euro area) and the host country – in this case Poland – would be overcome.

## 2.2. Potential risks

Opting-in to the banking union involves many limitations resulting from the construction of the SSM. By joining the banking union with the rights of the host country, Poland would find itself in an uncomfortable situation. On the one hand, it would transfer its competences related to supervision of the banking system to the supranational level, and, on the other, it would not have access to supranational funds. The host countries do not have access to the European Stability Mechanism (ESM) or to the liquidity in the euro from the ECB. Thus, it would be exposed to the risk of discrimination on the part of home countries. One should also take into account

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16 J. Koleśnik, *Stabilność polskiego sektora bankowego w świetle krajowych testów warunków skrajnych*, "Kwartalnik KES Studia i Prace" 3(23), 2015, pp. 203–205.

17 W. Kwaśniak, *Skutki dla polskiego systemu bankowego i polskiej gospodarki po wprowadzeniu unii bankowej*, [in:] *Unia bankowa – skutki dla UE, strefy euro i dla polski*,, "Zeszyty BRE Bank–CASE" 123, 2012, p. 34.

18 M. Liszewska, *Konsekwencje dla polskiego sektora bankowego wynikające ze wspólnego nadzoru bankowego*, [in:] *Konsekwencje przystąpienia Polski do unii bankowej*, Gdansk Institute for Market Economics, The Konrad Adenauer Foundation in Poland, Gdańsk 2014, p. 48.

the risks resulting from Poland's failure to join the banking union, the largest of which is related to the fact that decisions made under the SSM may have an indirect impact on the Polish banking sector. The banks operating in Poland that are in fact from the euro area will be incorporated into the banking union.[19] By remaining outside the banking union, Poland will not integrate with the founding countries of the European Union, despite having a stable and resilient banking system, which in turn, may translate into lower yields on domestic debt securities. Last but not least, one should also take into account the strategic risk related to being excluded from taking part in the processes of political integration of the European Union. The voice of Poland remaining not only outside the monetary union but also outside the banking union may have less significance in making key decisions for the entire European community.

## Conclusion

The banking union is still an incomplete project, therefore, the decision to opt in should not be made until it is finished and reaches its full operability. The banking union as a consistent and coherent project could be a system protecting against the emergence of macroeconomic imbalances by breaking the feedback loop between the struggling banks and the state of public finances. If, however, it covers only the countries belonging to the euro area, the remaining EU countries will face unpredictable consequences in the following areas:

- integration of the banking sector;
- the cost of raising capital for banks in these countries;
- the competitiveness of the banking sector;
- monetary policy stability, diversification of financial shocks;
- stability of financial systems.[20]

Poland should join the banking union only on condition that the anticipated benefits resulting from the entry exceed the potential costs and related challenges. This analysis should take into account the risk costs associated with entering the banking union and the risk price resulting from staying outside of it. It should also take into account the significant share of capital originating from the countries of the euro area in the assets of the Polish banking system.

[19] K. Waliszewski, Od koncepcji do realizacji – szanse i zagrożenia europejskiej unii bankowej dla sektora banków komercyjnych w Polsce, [in:] *Europejska unia bankowa*, M. Zaleska (Ed.), Difin, Warszawa 2015, p. 55.

[20] A. Hryckiewicz, M. Pawłowska, *Czy nowy nadzór spełni swoje zadanie*? *Zmiany w nadzorze finansowym w Europie oraz ich konsekwencje dla Polski*, NBP, Warszawa 2013, p. 24.

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