

Two proposals to resurrect the Banking Union:

The Safe Portfolio Approach and SRB+

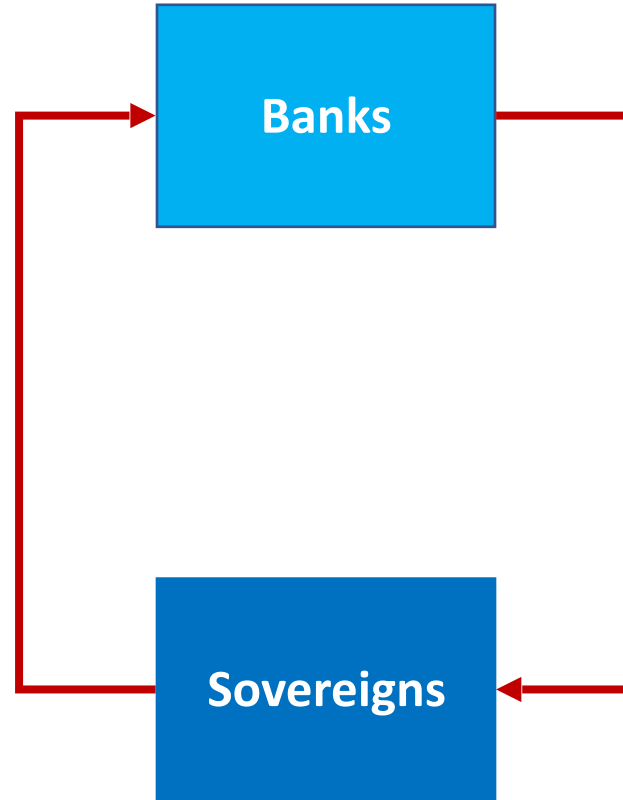
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The doom loop remains strong

× High concentration in sovereign debt holdings



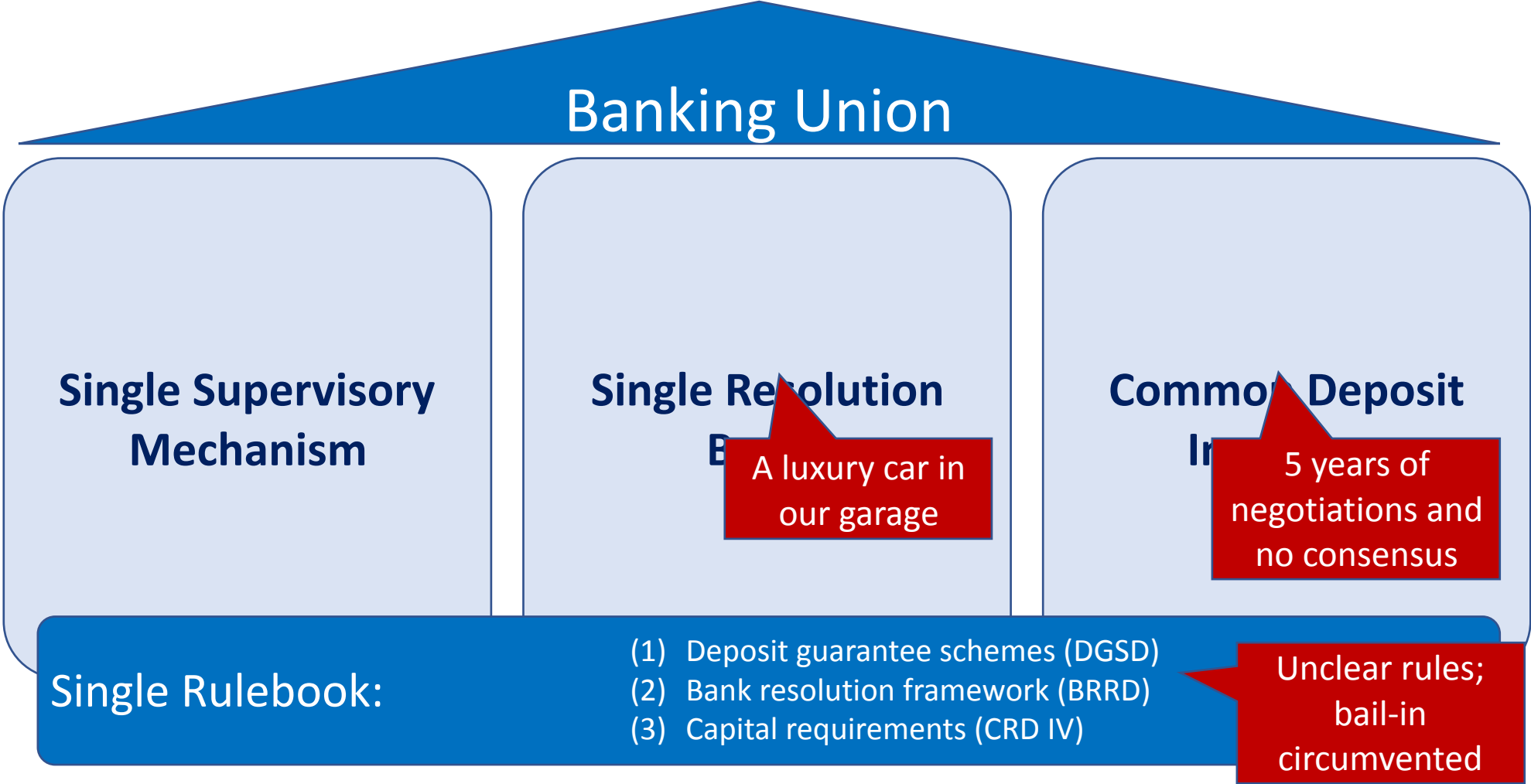
× National resolutions

× State aid

× National liquidations

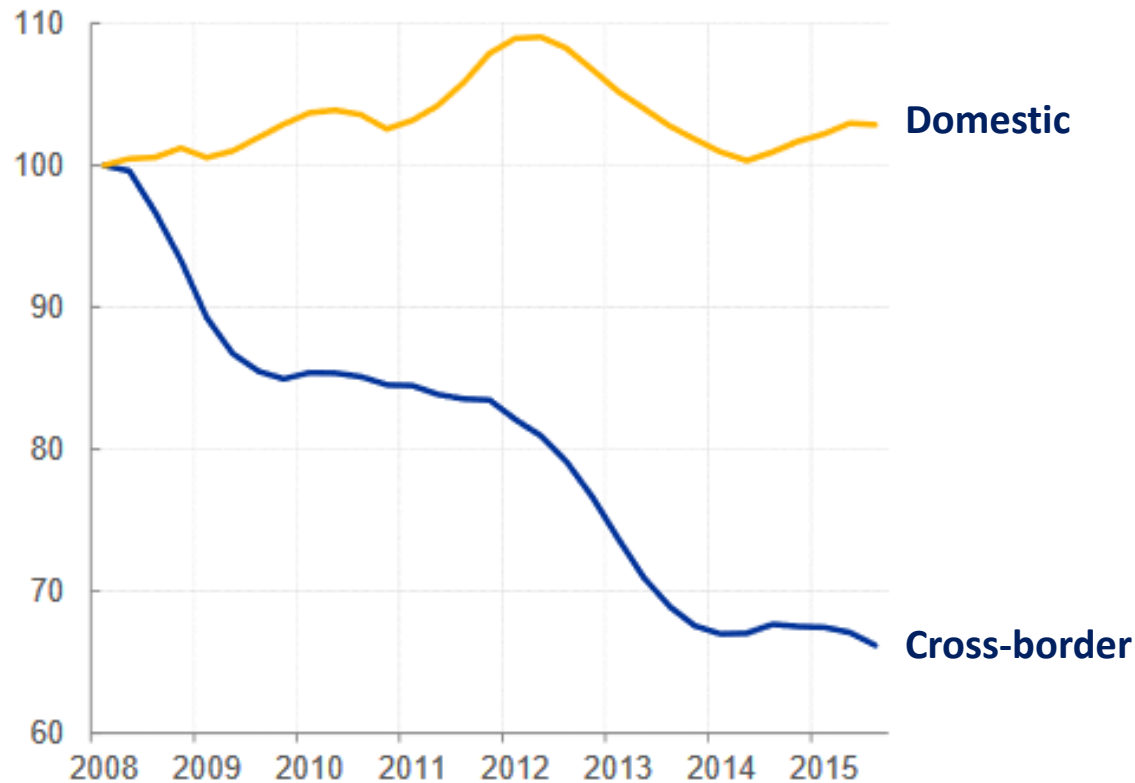
× National deposit insurance

The Banking Union is agonizing

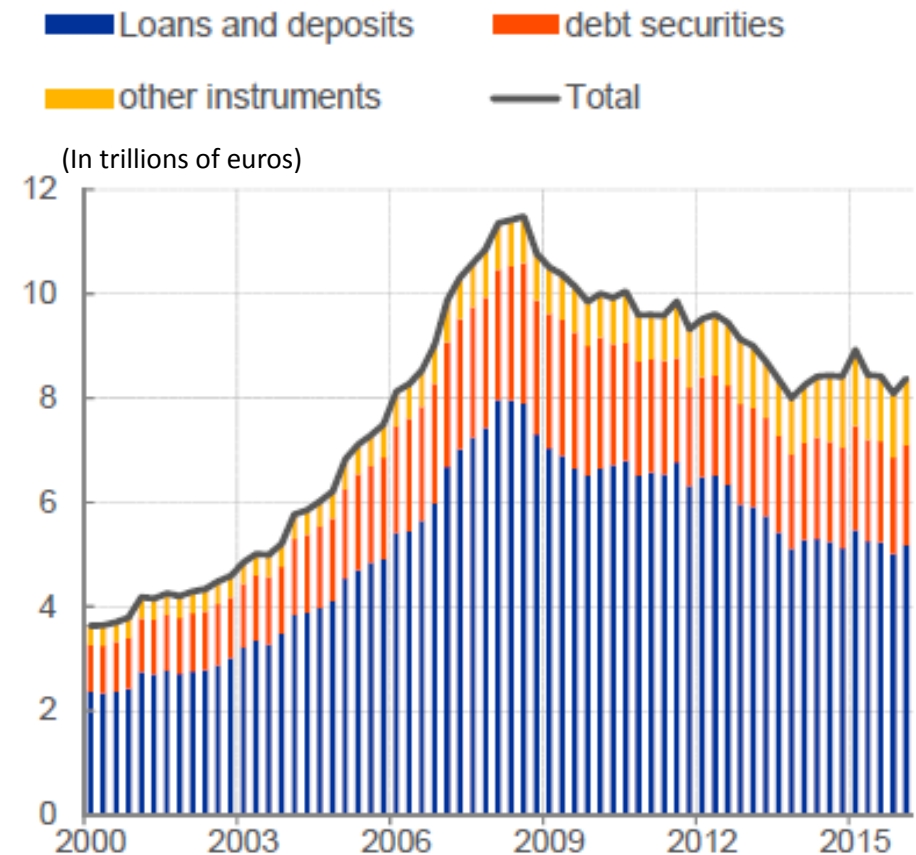


A more fragmented banking market

Cross-border and domestic lending in the EU



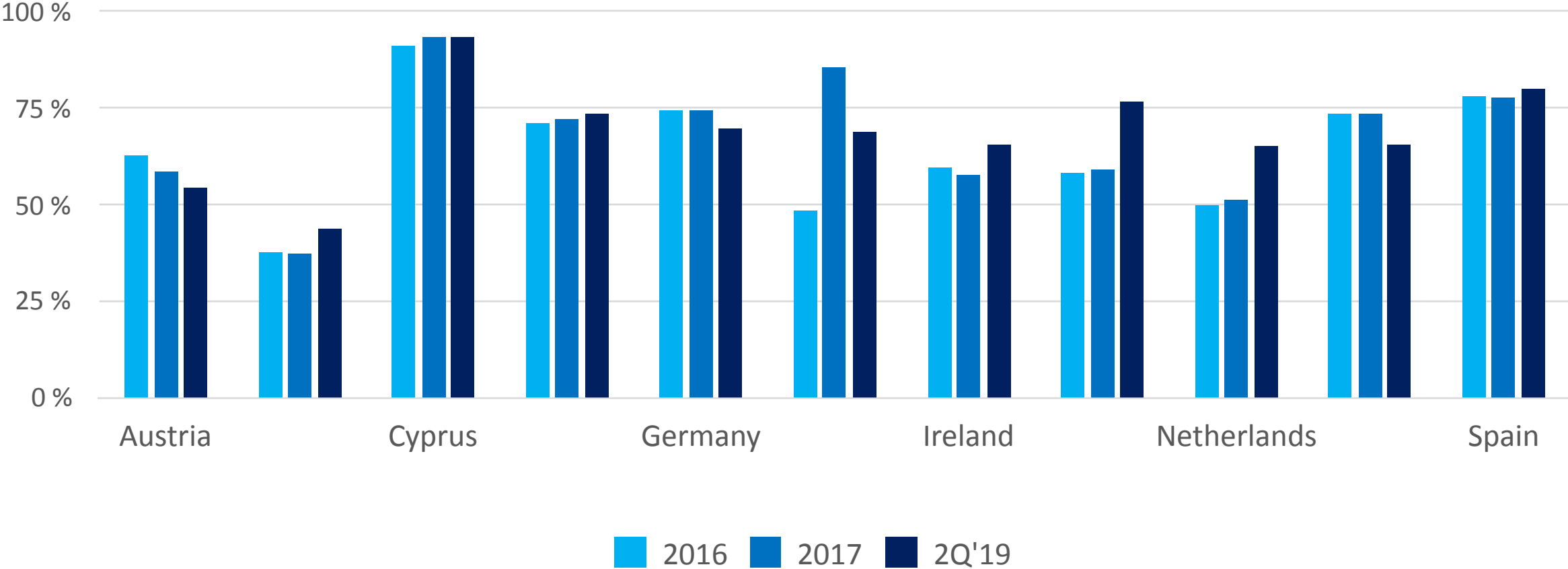
Gross cross-border bank exposures



References: Emter, L., Schmitz, M. and Tirpák, M. 2018, 'Cross-border banking in the euro area since the crisis: what is driving the great retrenchment?' European Central Bank Financial Stability Review, *Working papers 2130* (also sourcing previous drafts of the working paper by Schmitz and Tirpák).

Sovereign to bank contagion

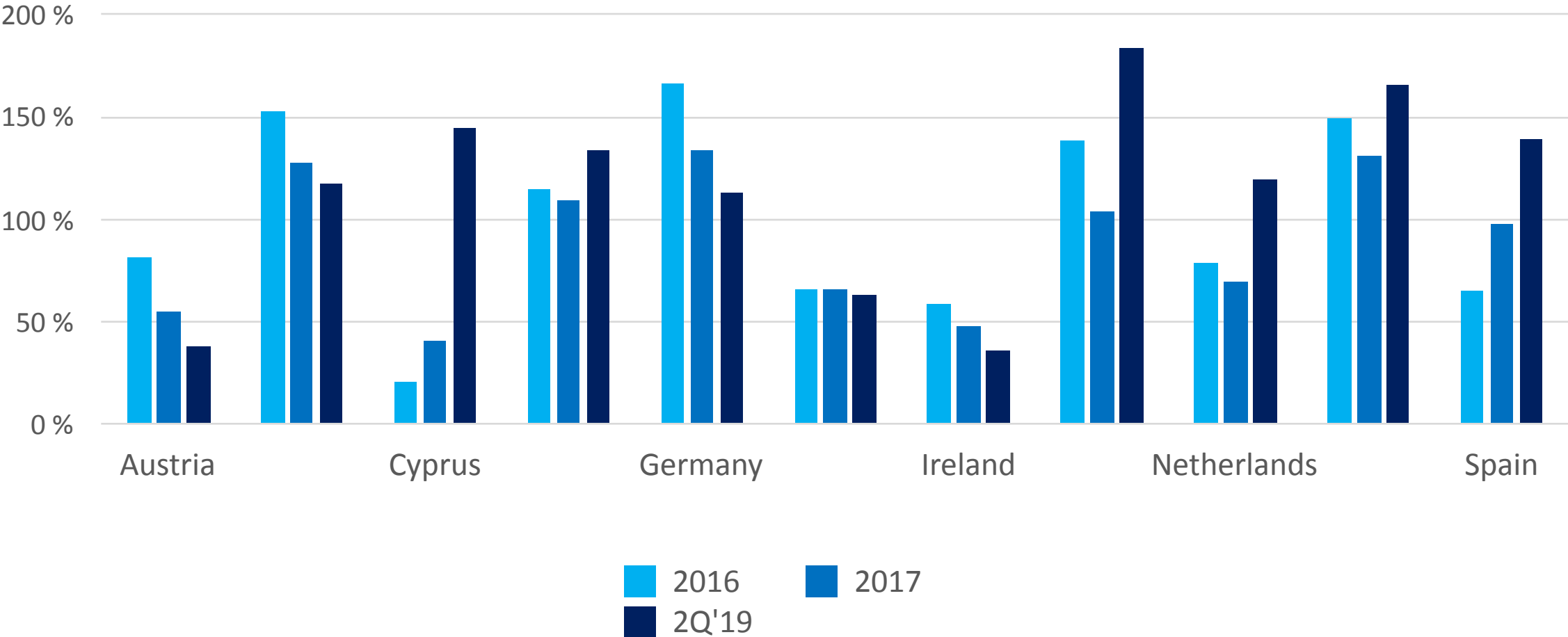
Own Sovereign as a % total EU-Area Exposure



References: European Banking Authority 2019, 'EU-wide transparency exercise'.

Sovereign to bank contagion

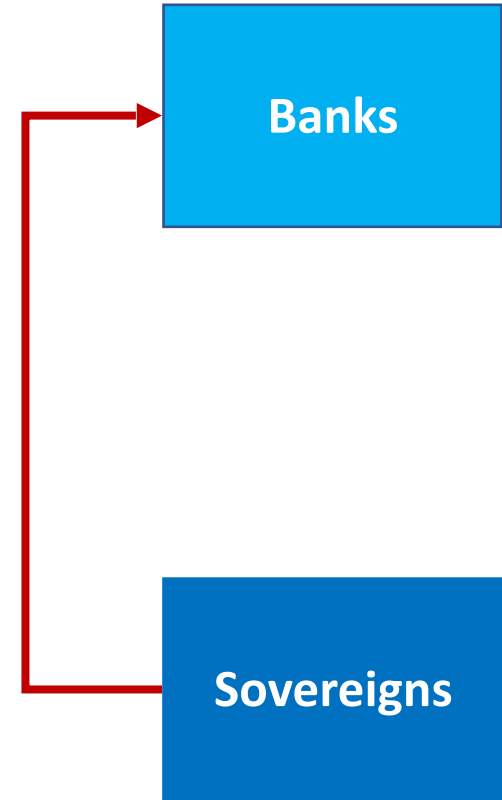
Own Sovereign Exposure as % of Tier 1



References: European Banking Authority 2019, 'EU-wide transparency exercise'.

Two proposals to resurrect the Banking Union

2. The Safe Portfolio Approach and the path to the Safe Asset



Traditional sovereign risk weights proposals

Credit risk based charges

Sovereign rating	AAA to A-	BBB+ to BBB-	Below BBB-
Applicable risk weight	25%	50%	100%

- Risk weights based on country's sovereign rating
- Noisy and ineffective due to arbitrariness of rating agencies
- Highly pro-cyclical

Inadmissible by most countries

Recent concentration-based proposals

Veron's proposal

Sovereign exposure relative to Tier 1	< 33%	33% - 50%	50% - 100%	100% - 200%	200% - 300%	300% - 500%	> 500%
Applicable risk weight	0%	15%	30%	50%	100%	200%	500%

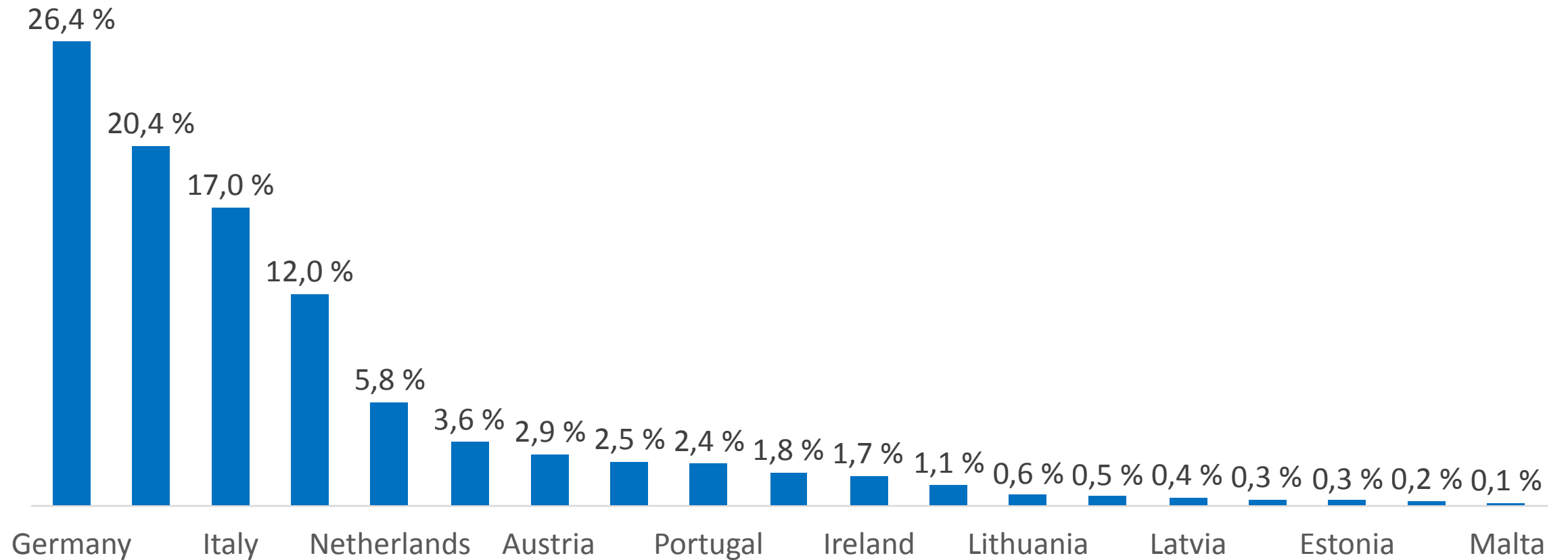
Minister Scholz's proposal

- Risk weights based on sovereign credit rating, but also factors in degree of concentration

$$RW_{ij} = RW_j^{Credit} \times CF_{ij}$$

My proposal: The Safe Portfolio Approach

Eurozone Capital Key of the ECB



My proposal: The Safe Portfolio Approach (continued)

The distance metric

$$\begin{pmatrix} key_{DE} \\ key_{FR} \\ key_{IT} \\ key_{ES} \\ \dots \\ key_{MT} \end{pmatrix} - \begin{pmatrix} exposure_{i,DE} \\ exposure_{i,FR} \\ exposure_{i,IT} \\ exposure_{i,ES} \\ \dots \\ exposure_{i,MT} \end{pmatrix} = \begin{pmatrix} d_{i,DE} \\ d_{i,FR} \\ d_{i,IT} \\ d_{i,ES} \\ \dots \\ d_{i,MT} \end{pmatrix}$$

$$d = \sqrt{d_{i,DE}^2 + d_{i,FR}^2 + d_{i,IT}^2 + d_{i,ES}^2 \dots}$$

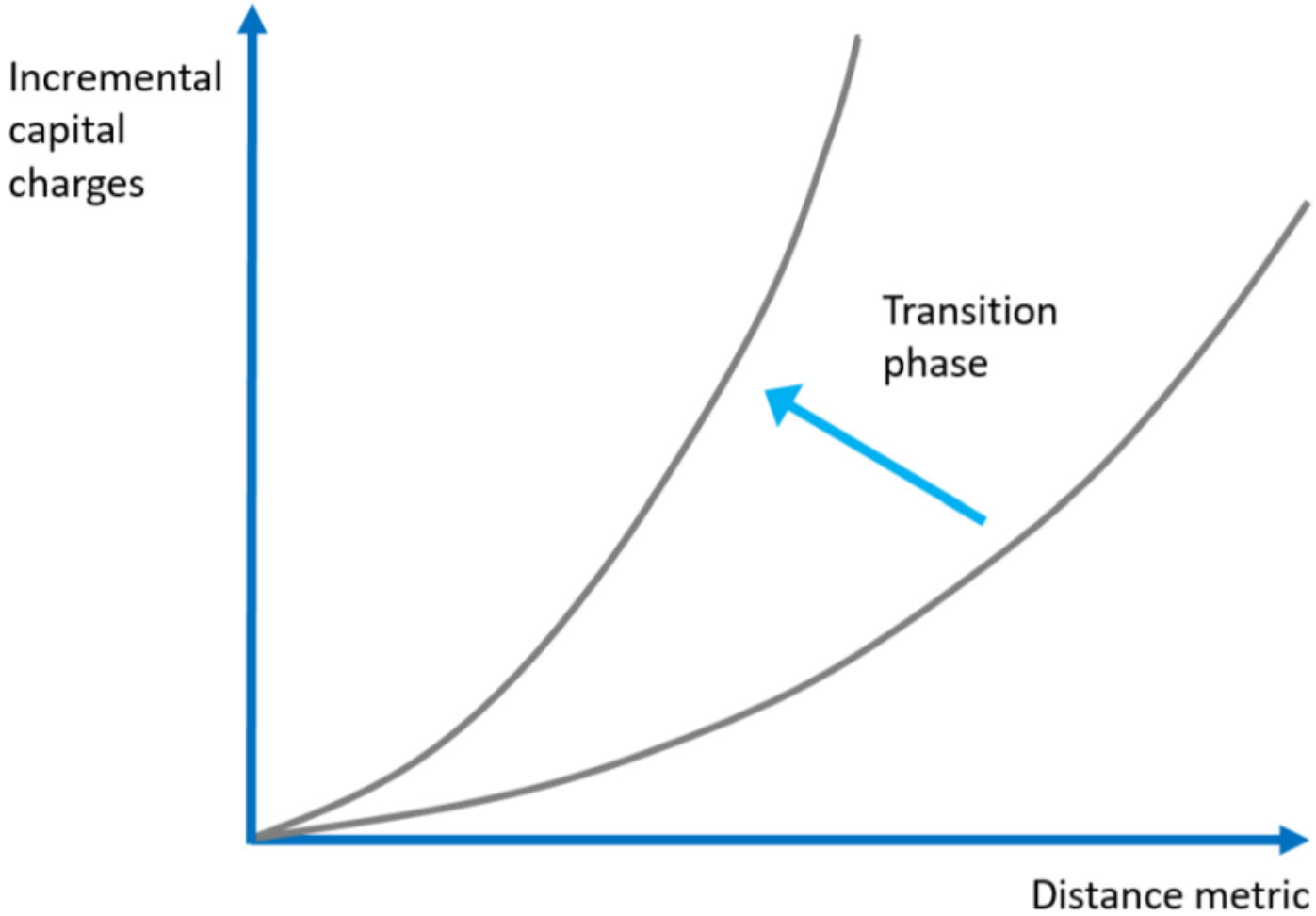
Applied to



BNP PARIBAS

$$\begin{pmatrix} 26,4\% \\ 20,4\% \\ 17,0\% \\ 12,0\% \\ \dots \\ 0,1\% \end{pmatrix} - \begin{pmatrix} 10,9\% \\ 31,8\% \\ 21,2\% \\ 9,2\% \\ \dots \\ 0,0\% \end{pmatrix} = \begin{pmatrix} 15,4\% \\ -11,4\% \\ -4,2\% \\ 2,7\% \\ \dots \\ 0,1\% \end{pmatrix} \Rightarrow d_{BNP} = 24,3$$

The Safe Portfolio Approach illustrated



The path towards a Safe Asset

1

Safe Portfolio Approach

- Avoid using risk-based criteria
- Define the Safe Portfolio as the ECB's Capital Key
- Concentration charges based on distance to Safe Portfolio

3

Complementary measures to ensure market development of asset

- Eliminate capital charges for sovereign securitizations with the “right” concentrations (Non-neutrality principle does not apply)
- European Debt Distribution Instrument (EDDI) Initiative

2

Raise concentration charges as desired

- Meaningfully increase concentration charges to smoothly lead banking sector towards diversification

4

Safety in tranching

- Commitment to tranching required from step 1, with a deadline (to avoid renegeing): only the asset with seniority in the common portfolio should have 0% risk weight. No implicit or explicit guarantee (as in the Sovereign Bond Backed Securities Parliament position)

Sovereign Bond Backed Securities

Assets

Diversified portfolio of sovereign bonds

Pooling brings diversification

Liabilities

Senior bond (ESBies)

Junior Bond (EJBies)

Tranching brings seniority



Under my proposal only the Senior Bond would have a 0% risk weight after a certain period

Ending sovereign to bank contagion

Safe Portfolio Approach

SRB+

✓ Diversified sovereign debt holdings

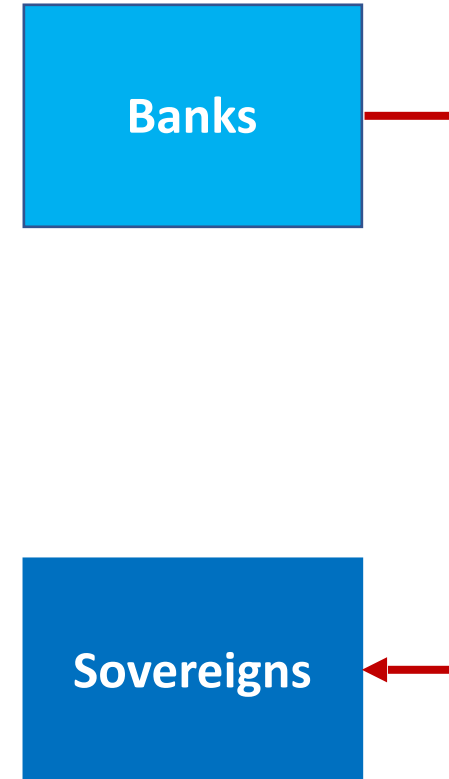


- × National resolutions
- × State aid
- × National liquidations
- × National deposit insurance

Two proposals to resurrect the Banking Union

2. SRB+:

Towards a European FDIC



Controversial cases since implementation of BRRD

Date	Bank	Transaction	Bail in	Capital injection	Asset Guarantees	Other	Total bail out
Dec-15	Banca Tercas ⁽¹⁾	Recapitalization by DGS (State Aid)		295	35		330
Aug-16	Caixa Geral	Recapitalization on market terms		2.500		1.445 ⁽²⁾	2.500
Dec-16	Monte dei Paschi	Precautionary recapitalization	4.300	3.900	1.500		5.400
Jun-17	Veneto Banca / Vicenza	Liquidation	1.100 ⁽³⁾	4.800	12.000		16.800
Jun-17	Banco Popular	Resolution	2.000 ⁽⁴⁾				0
Feb-18	ABLV	Liquidation					0
Sep-19	Banca Carige	Guarantees on T2 issuances			3.000		3.000
Jan-19	Nord LB	Restructuring aid on market terms		2.835 ⁽⁵⁾	800		3.635
Dec-19	Banca Popolare di Bari	State-owned bank injection		710		500 ⁽⁶⁾	710
Total			7.400	15.040	17.335	1.945	34.320

1) Transaction annulled by Commission.

2) Considers conversion of CoCos (945mm) and transfer of Parcaixa shares (500mm).

3) Estimated subordinated debt at the time of liquidation, net of 200mm in compensation to investors affected by mis-selling.

4) Considers bail-in only of subordinated and convertible securities.

5) Does not include purchases of stakes in complementary businesses by the Lower State of Saxony (100mm) nor the future capital investments to be provided (approximately 341mm).

6) Considers capital guarantees from Mediocredito Centrale.

Resolution for the many, not the few

Nord LB: Supervisory Forbearance

Key lessons from cases

- Bank allowed to operate below CET1 requirements for almost a year
- SSM and SRB did not make FOLTF determination



To ensure Resolution for the Many

- Time limits
- FDIC Prompt Corrective Action

Veneto Banks: Public Interest Assessment

- Negative PIA despite +60bn in assets and 1.5mm depositors
- Ratio of positive PIA / FOLTF
 - Euro Area: 7.7%
 - Non Euro: 40%



- Rules-based PIA. Positive for:
 - All SSM banks
 - Cross border groups
 - Objective thresholds (assets or depositors)

Streamlining decision making in SRB+

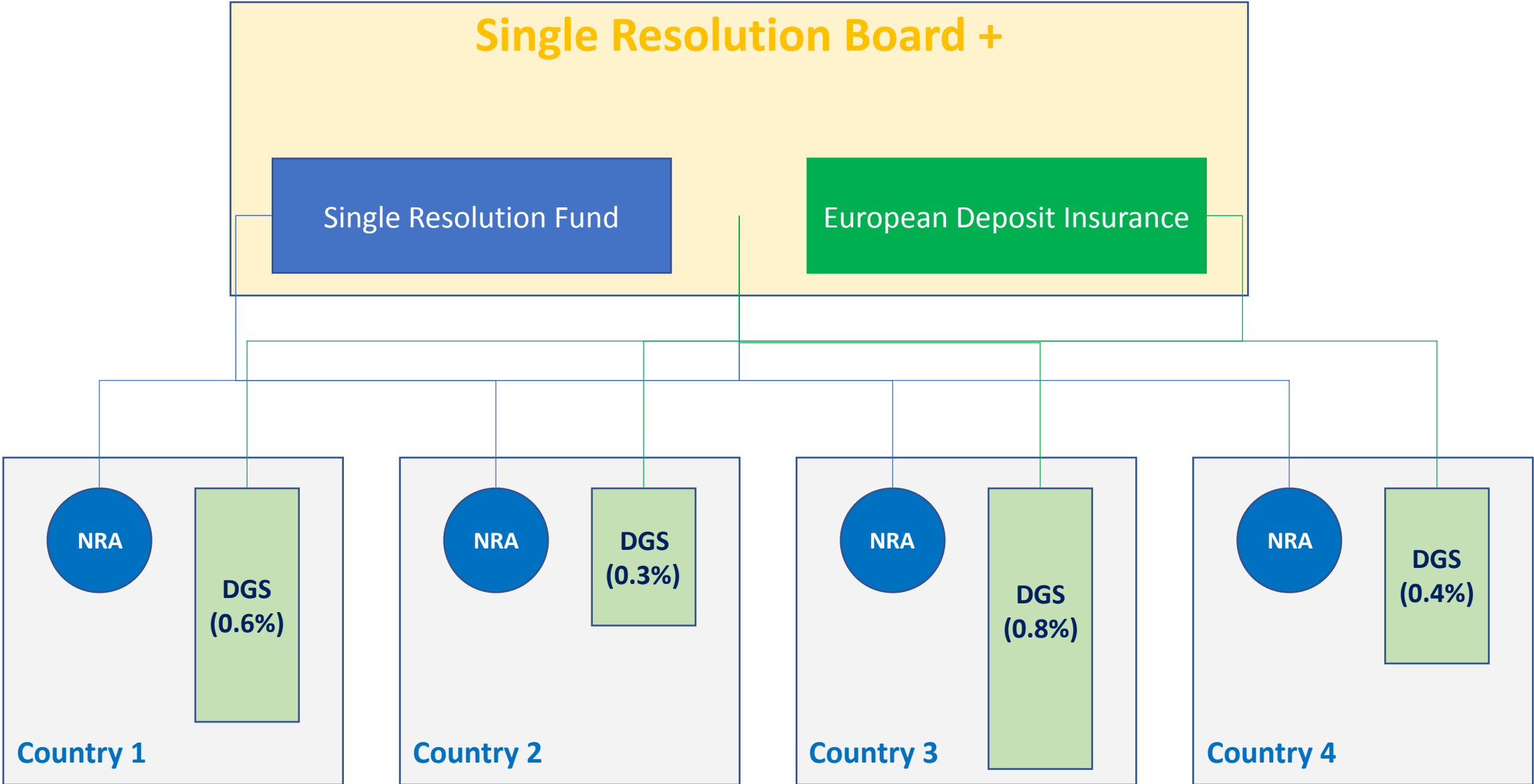
National Resolution Authorities (NRAs)

- **Coordination powers to NRAs**
 - Transition to an SRB with an “outpost” model
 - NRA to become local branches of SRB+

National Deposit Guarantee Schemes (DGSs)

- **Co-decision powers on DGS funds**
 - Ensure consistency in the use of DGS funds
 - Depoliticize use of DGS funds

Visualizing SRB+



A common deposit insurance

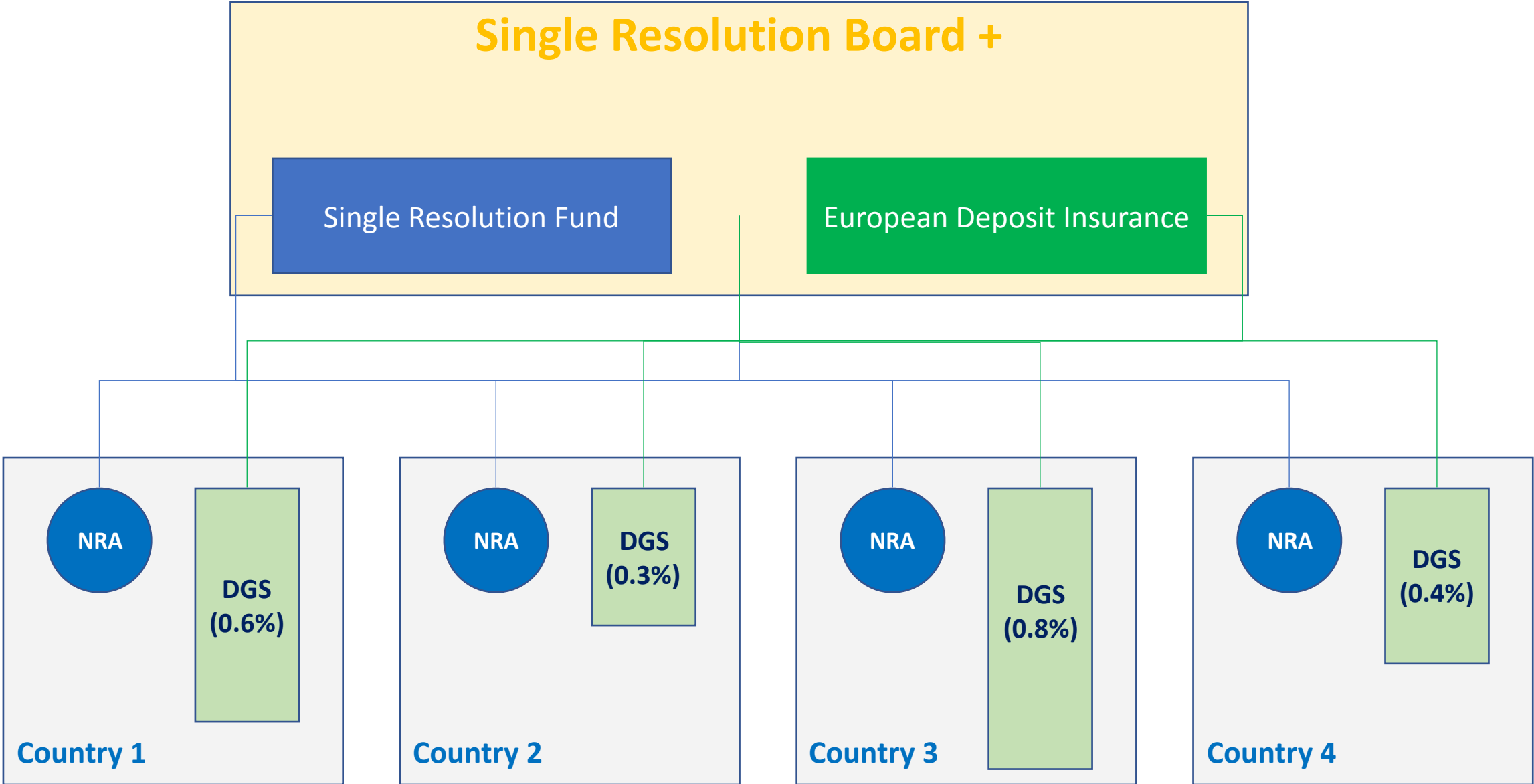
Payout:

- **Hybrid model**
 - Coexistence of European Fund and national DGSs
 - European Fund only used when national compartment is depleted
- **Two phased-implementation**
 - Phase 1: Build of European Fund, liquidity coverage only
 - Phase 2: Full loss coverage

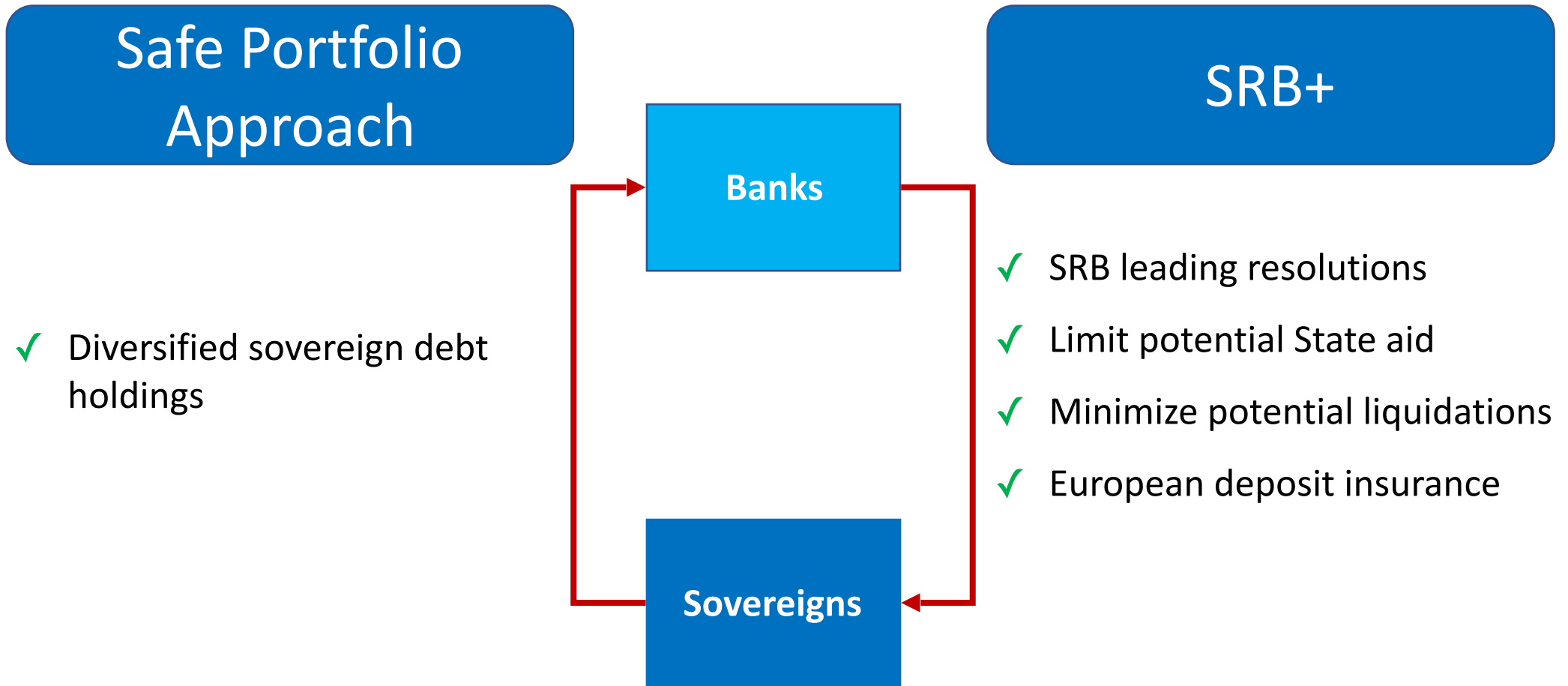
Funding:

- **Risk-based contributions**
 - Determined at Banking Union level
- **Variable deposit coverage targets in the transition**
 - Depending on risks and features of national system

Visualizing SRB+



The Banking Union Resurrected



Thank you

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