Banking Europe: Strength in the Union?

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On 4 November 2014, the European Central Bank became the single supervisor of banks in the euro zone. This was the first step in the banking union.

The economic and financial crisis that started in 2007 has exposed several European weaknesses:

1. The national bank markets, though seemingly compartmentalized, proved to be highly interdependent, as was seen in the high level of propagation-contamination;
2. There was often a lack of coordination in the national support provided;
3. Given the context of high public indebtedness, State support for the bank system led to a strong correlation between bank risk and sovereign risk;
4. The absence of fiscal transfer mechanisms strongly limited European solidarity.

In 2012, the idea of a banking union arose out of a triple necessity: to break the link between the banking crisis and the sovereign debt crisis by enabling the direct recapitalization of troubled banks through the European Stability Mechanism; to prevent bank runs; and to prevent the euro zone banking markets from fragmenting.

The banking union is being built on three pillars: a single supervision mechanism (SSM); a single resolution mechanism (SRM), with a resolution fund and a bail-in process; and a single deposit guarantee system with a guarantee fund.

The banking union sets out new solutions. Nevertheless, grey areas remain, and the European solidarity provided by the banking union could prove insufficient to deal with major shocks.

The latest *Note de l'OFCE* (no. 46 of 18 November 2014) reviews the context surrounding the establishment of the banking union and takes stock of the advantages and limitations of the progress made in constructing the union. This Note was produced as a special study entitled "Comment lutter contre la fragmentation du système bancaire de la zone euro?", [How can the fragmentation of the euro zone banking system be fought?] *Revue de l'OFCE*, no. 136 (2014).