



Monika Joanna Swaczyna-Pruchnik

**"Openness clauses" in the mechanisms establishing the
European Union's banking union**

Ph.D. thesis written under the supervision of
prof. dr hab. Jan Barcza

Warsaw 2021

Summary

The following summary presents the results of the analysis conducted in this Ph.D. thesis responding to the detailed research questions and the main thesis.

1) Were the EU institutions and the *ad hoc* measures and mechanisms in place sufficient to ensure the financial stability of the euro area as a whole, and would they enable the project of a "real" EMU to be completed?

There are four main arguments that the *ad hoc* measures and mechanisms were not sufficient to ensure the financial stability of the euro area as a whole or to enable a "real" EMU.

Firstly, the measures taken at the time, given the need for a quick reaction under financial, political and social pressure, were transitory in nature. They took the form of:

- stimulus packages to reflate the economy;
- interbank financial injections from central banks to restore liquidity to the markets;
- government loans and guarantees to financial institutions.

Secondly, such solutions did not ensure resilience to future financial crises. *Ad hoc* measures did not have the character of permanent, structural reforms, the need for which was unveiled by the financial crisis. In particular, the EU lacked dedicated institutions and comprehensive legal and institutional solutions of a safety net for the financial sector.

Thirdly, these measures did not cover all of the EU Member States. This concerned both measures of the EU derived law, as well as intergovernmental measures (international agreements), concluded outside the EU institutional and legal system. In particular, the increasing recourse to intergovernmental measures may reflect the weakness and inefficiency of the EU procedures. To some extent, this may be justified by the need to overcome the lengthiness of procedures in the EU and the problems that could arise in negotiations with non-eurozone states.

Fourthly, the measures taken - particularly those taken outside the EU's institutional and legal framework - have created the risk of the systemic fragmentation of the European Union. With the adoption of each successive piece of legislation of this kind, the eurozone consolidated further. In the long run, however, this could lead to its autonomy vis-à-vis the

rest of the European Union. Therefore, reaching for intergovernmental measures raised doubts as to the extent to which the reform leads to the “emancipation” of the eurozone from the EU, or perhaps even to a fragmentation of the European integration process. As a result, clauses were introduced into intergovernmental measures obliging the content of the measure to be incorporated into the EU *acquis* after a certain period of time, on the one hand, and "openness clauses" on the other. The latter allowed, to some extent, non-euro area states to participate in such measures.

The overall conclusion would therefore be that the *ad hoc* measures of the euro area rescue period did not ensure the lasting stability of the euro area as a whole. On the other hand, measures taken during the period of euro area consolidation, could (despite their “openness clauses”) lead to fragmentation of the European integration process. The "common path" strategy has been the answer to those challenges.

2) Is the banking union a sufficient and effective project that will guarantee the consolidation of the euro area?

The finalised banking union project will be an effective project to support the euro area consolidation. However, the banking union is not, as such, a sufficient project to fully guarantee this process.

Firstly, the financial crisis of 2007-2008 negatively affected public finances through the risk of subsidising the banking sector with public funds (the so-called bail out). In the case of the euro area, the problem was further complicated by the existence of mismatches. On the one hand, the existence of a highly developed international banking sector within the EU internal market. On the other hand, EU Member States were left with the competence to supervise and regulate the financial sector. There was therefore a dualism in supervision and subsidising of the private sector. To ensure the cohesion and stability of the euro area, it was therefore necessary to harmonise *ex post* and *ex ante* acts at Member State and EU level. Therefore, it was necessary to find a permanent solution that would mitigate the risks to the financial sector, but at the same time would not jeopardise EU political stability. Hence, the next stage after sanation, the consolidation of the euro area, of which the banking union *sensu stricto* is the main element.

Secondly, the banking union *sensu stricto* is a permanent (not *ad hoc*) project consolidating the euro area. The banking union *sensu stricto* introduced: i) new institutional and legal provisions, ii) new institutions (the Single Resolution Board) and iii) new competencies of the European Central Bank. These competencies made it possible to harmonise the activities of the various national competent authorities. As a result, the banking sector has become safer and cooperation between the participating Member States strengthened.

However, as the banking union is not yet complete, its potential to support the consolidation process of the euro area is not fully exploited. While the first two pillars, the Single Supervisory Mechanism and the Single Resolution Mechanism, are already fully functional, the last one, the European Deposit Insurance Scheme, is still politically under negotiation. The first two pillars have already managed to prove their effectiveness in preventing further banking crises, yet a full and completed banking union *sensu stricto* will be necessary to meet the next challenge of the scale of the 2007-2008 financial crisis.

Thirdly, while a fully completed banking union will significantly strengthen the consolidation process of the euro area, it is not in itself a sufficient project to guarantee full consolidation. To this end, further steps are crucial, involving initiatives already underway, such as i) Capital Markets Union, ii) the European Monetary Fund, iii) the European Ministry of Finance, or iv) the next (non-financial) stage of integration: fiscal and political union.

An earlier introduction of the banking union arrangements in the strict sense could have contributed to the creation of truly pan-European banks and facilitated cross-border banking integration. Implementing banking union regulations in parallel with the introduction of the euro could also pave the way for more harmonious European fiscal, economic and political integration. Undoubtedly, the political union building block would give democratic legitimacy to the other three foundations of a consolidating EMU. In particular, the four pillars of EMU - that is, monetary, banking, fiscal and political - would improve the welfare of citizens across the EU in the long run, as well as giving eurozone states an enhanced framework for operating financial and economic policies.

3) Whether and to what extent states with a derogation may participate in the mechanisms and structures of the banking union in the mechanisms and structures of the banking union *sensu stricto*?

"Openness clauses" allow the Member States outside of the euro area to participate in banking union activities *sensu stricto*. This eliminates, to some extent, the threat of fragmentation of the European integration process and constitutes significant facilitation for the implementation of the "common path" strategy, i.e. the gradual admission of all EU Member States into the euro area.

First, the basic "openness clause" in the banking union is the close cooperation mechanism. It allows states outside the euro area to participate in most, but not all, instruments of the three pillars of the Banking Union *sensu stricto*. A non-euro area state wishing to participate in close cooperation has to fulfil several requirements and conditions. It should adhere to the guidelines as well as implement legal acts providing competent authorities with the powers to adopt supervisory measures with respect to the supervision of credit institutions that would be required by the European Central Bank. The close cooperation mechanism covers all three pillars of the banking union *sensu stricto*. In the second pillar, and possibly in the third, closely cooperating states have equal rights with euro area states. However, a non-euro area state can opt-out of such cooperation.

Second, however, states with a derogation can, even without joining the close cooperation mechanism, participate in the banking union, albeit to a much reduced extent. First of all, under the first and second pillar, representatives of Member State authorities can participate in colleges at the banking union level (supervisory colleges and resolution colleges). In addition, Member States' competent authorities and resolution authorities sign memoranda of understanding with the Single Council or the European Central Bank. These set out the rules for their cooperation and exchange of information. The proposed third pillar, the European Deposit Insurance Scheme, is likely to include the possibility of mutual lending between the deposit guarantee schemes of non-euro area Member States and the European Deposit Insurance Scheme.

Third, it should also be taken into account that "openness clauses" are also included in intergovernmental measures which are important for the consolidation of the euro area and constitute an important context for the establishment of a banking union.

TEMS differentiates between the rights of euro area and non-euro area members. An EU Member State, upon the entry into force of the EU Council's decision to lift its derogation

status, is admitted to the ESM on the same terms as its existing members. However, the mechanism remained open to the other Member States to participate on an *ad hoc* basis. Member States with derogation who wish to participate in the ESM on an *ad hoc* basis will be able to obtain observer status at the meetings of the ESM decision-making bodies. On 27 January and 8 February 2021, ESM member states signed an agreement amending the ESM agreement. This agreement provides the legal basis for a number of new tasks entrusted to the ESM. The reformed Treaty will enter into force after ratification by all 19 ESM members (euro area).

In turn, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union distinguishes two categories of parties. The first and foremost are the euro area Member States, which are bound by the Fiscal Union Treaty in its entirety. The second category is the non-euro area Member States that have expressed their wish to join the Fiscal Compact. They are bound by the institutional provisions of the TEU, but may also declare participation in other parts of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

What is important is that both treaties are to be incorporated into the EU *acquis*, although this process is constantly being extended.

In conclusion, it can therefore be said that the "openness clauses" contained in the measures establishing the banking union and in the intergovernmental measures mentioned above, fulfil an important function in ensuring the participation of non-euro area states. They can ensure the cohesion of the European Union during the period of building a "real" EMU, in particular to weaken fears of fragmentation of the European integration process. Above all, they can greatly facilitate the implementation of the "common path" strategy.

4) Do the mechanisms and structures of the banking union (particularly when undertaken outside the EU institutional and legal framework) ensure respect for the principle of non-discrimination against non-euro area EU Member States and the principle of loyalty?

The mechanisms and structures of the banking union ensure respecting of the principles of non-discrimination and the principle of loyalty. The question of whether the principle of loyal cooperation is respected, is crucial in the process of consolidating the euro area, especially in light of the fact that the euro area does not yet comprise all EU Member States.

The inclusion of a close cooperation mechanism in the design of the banking union gives the banking union itself a degree of flexibility. It offers a number of options within which non-euro area Member States can pursue their interests and participate in selected banking union measures. This (close cooperation) mechanism, combined with the possibility to adopt individual banking union measures *sensu largo* (e.g. found in the Single Rulebook), protects the EU as a whole from excessive euro area autonomy and weakens or fragments the integration process.

However, a non-euro area state applying to join the banking union, may face the possibility of having second-class member status (especially in the decision-making process of the Single Supervisory Mechanism). In particular, being outside the euro area means that a non-euro area state is not represented in the ECB Governing Council. This is one of the steps in the decision-making process of the Single Supervisory Mechanism. Furthermore, non-euro area credit institutions do not have access to emergency liquidity assistance from the European Central Bank. Moreover, unlike euro area states, for which participation in the banking union is mandatory, close cooperation can be terminated at the initiative of the European Central Bank.

The extension of the Single Supervisory Mechanism to non-euro area states would create the conditions for the consolidation of a larger group of EU Member States within the banking union and would help to bring forward the finalisation of a genuine EMU.

However, differentiating the status of the euro area and non-euro area Member States within the banking union is justified. There were three options when setting up the banking union:

- either not to include "openness clauses" and limit the possibility of membership to euro area states only. However, such a solution would have risked further fragmentation,
- or to open the banking union unconditionally, also to states with a derogation. This solution would not risk further fragmentation, but would create additional financial stability challenges,
- or the inclusion of "openness clauses", as included in the final draft of the European Commission.

The problem of taking action outside the EU's institutional and legal framework, especially in measures of the sanitation of the euro area, could have called into question compliance with the principle of loyalty. This concern was expressed in the conclusions of

the European Council. They stressed that the process towards a deepened Economic and Monetary Union should be characterised by transparency towards the Member States that are not part of the euro area and respect for the integrity of the internal market. That is why it was so important to ensure equal treatment between those euro area Member States and those outside the euro area during the successive reconsolidation and consolidation initiatives of the euro area.

The Court of Justice, in its judgment in Case C-370/12 Pringle, addressed the legality and respect for the principle of loyal cooperation of agreements concluded between a group of Member States. It set limits to the recourse of Member States to intergovernmental measures. The Court of Justice has clarified the tests for analysing the compatibility with Union law of a measure taken by a group of Member States outside the EU. The first condition established by the Court is compliance with the provisions of material EU law (the action must be taken in a sphere outside exclusive EU competence and in accordance with the provisions of the TFEU). The second condition is that the degree of involvement of the EU institutions in the intergovernmental measure must guarantee respect for EU law. The position of the Court of Justice is important in the light of the banking union as it opened the way for the possible further use of intergovernmental measures.

In summary, the banking union, unlike the *ad hoc* mechanisms of the euro area's sanation period, adheres to the principle of loyalty. Unlike *ad hoc* mechanisms, it has permanent "openness clauses", in the form of the close cooperation mechanism. These give non-euro area states similar rights and obligations to euro area states. The differences in rights stem from the need to ensure the financial stability of the euro area, and do not carry the threat of discrimination by states participating in the banking union *sensu stricto*. The euro area also remains open to the Member States outside the euro area, and the "common path" strategy unambiguously states the objective of having all EU Member States in the euro area.

5) What are the attitudes of individual EU Member States with a derogation (including Poland) towards participation in the banking union or its various mechanisms?

The EU Member States outside the eurozone can be divided into four groups with respect to their stance on participation in the banking union or its specific mechanisms. It is worth noting that states with a derogation may join the banking union either earlier, on the basis of

close cooperation, or with the adoption of the euro (automatic membership).

The first group includes Bulgaria and Croatia. These states have a positive attitude towards both the euro area and the banking union. In 2018 and 2019, when applying to join the euro area, they simultaneously expressed their willingness to join the close cooperation mechanism of the banking union. Both states joined the close cooperation mechanism on 1 October 2020 and Bulgaria plans to enter the euro area in 2024 while Croatia in 2023.

The second group includes states that have a negative attitude towards the banking union and the euro area (Poland, Hungary, and the Czech Republic). These states are reluctant to participate in the euro area. The reservations regarding the adoption of the common currency include: the issue of changing the constitution, fears that the level of development of these economies is too low in relation to the other states of the euro area, or the lack of proper synchronisation of economic cycles. When it comes to the banking union, the three states mentioned are reluctant to participate in the close cooperation mechanism. They mainly point to the unequal treatment within the Single Supervisory Mechanism and the loss of full supervisory control over their home credit institutions. As a result, at this stage, these states are focusing on cost-benefit analyses.

The third group consists of Denmark and Sweden. Sweden has a wait-and-see strategy with respect to the euro area, while Denmark has a permanent derogation. In terms of banking union, these states regularly review changes to the structure of the banking union and remain open to participating in the close cooperation mechanism, leaving the final decision to a referendum or to successive governments. However, they stress that they are aware of the risks of staying outside the banking union. The problem for them, however, is the still unclear structure and shape of the third pillar of the banking union. If a state were to join the close cooperation mechanism, this would also include the European Deposit Insurance Scheme, in which the rights and obligations of non-eurozone states are not yet defined.

Romania falls into the **fourth** category. It declares its willingness to join both the euro area and the close cooperation mechanism, but for political, legal and economic reasons, it is not yet able to do so.

In summary, the attitude of Member States with a derogation towards the banking union *sensu stricto* is not clear-cut. For non-euro area states, the key arguments are: i) which

authority (national or EU) has competence in the financial sector and ii) the uncertainty about the final shape of the third pillar of the banking union. The analysis of the positions of representatives of non-euro area states also indicates that in these states the decision to join the banking union *sensu stricto* has political nature to a large extent.

The results of the analysis of the detailed research problems allowed the verification of the main thesis of the doctorates, which reads as follows: The establishment of a banking union is an important element in the reform of the euro area. "Openness clauses", allowing the participation of EU Member States with a derogation in various banking union instruments, play an important role in maintaining the cohesion of the European Union.

With regards to the first element of the thesis, as shown in response to the second question, especially included in Chapter 1 of this doctorate, the establishment of a banking union is an important element in the reform of the euro area. Indeed, in the post-financial crisis period, the banking union is a major element of euro area consolidation.

Regarding the second element of the thesis, concerning the role of "openness clauses" in maintaining the cohesion of the European Union, the answer is more complex. The most important role in assessing the functioning of the "loyalty clauses" will be played by the course of implementation of the "common path" strategy, i.e. striving for all EU Member States to become eurozone states within a reasonable time. Then the fundamental problem associated with the consolidation of the eurozone and the resulting threat of fragmentation of the European Union will disappear.

At the same time, it must be realised that the implementation of the "common path" strategy will not be an easy matter, and in any case will still take a number of years. This must take into account not only the different status of the EU Member States outside the eurozone, their different attitudes to joining the eurozone and to participating in close cooperation within the framework of the banking union. One should also take into account the growing problems with the rule of law primarily in two states of this group (Poland and Hungary). As a result, the assessment of the role of "openness clauses" in maintaining the cohesion of the European Union should be evaluated on three levels.

1) As a "temporary" mechanism to ensure EU consistency in the process of euro area consolidation, in particular the building of a banking union:

- As demonstrated in the answers to the specific questions (1, 3, 4 and 5), "openness clauses", which allow states with a derogation to participate in the banking union instruments, play a key role in preserving EU cohesion.
- In particular, measures adopted outside the EU institutional and legal framework can lead to fragmentation of the European integration process; hence the important role of the "openness clauses" contained in TEMS and the European Fiscal Compact; especially important are the clauses committing to the incorporation of TEMS and the European Fiscal Compact into the EU acquis.
- In summary, the "openness clauses" contained in the banking union instruments play an important role in maintaining the cohesion of the EU as a whole; by allowing the participation of non-euro area states, they reduce or inhibit the process of euro area autonomy and potential fragmentation of the EU.

2) As a "target" mechanism, playing an important role in the implementation of the "common path" strategy (as a vehicle to facilitate the smooth entry into the euro area of states that are currently still outside the euro area):

- "Openness clauses" in the banking union can indeed facilitate smooth entry into the euro area for Member States that are currently outside the euro area.
- Firstly, these mechanisms allow proximity to the decision-making centre. They give influence on the direction of integration, including the further development of the banking union (subject to certain limitations). In turn, this reduces the risk of euro area autonomy, which in turn would significantly impede the realisation of a genuine EMU.
- Second, the close cooperation mechanism facilitates institutional harmonisation and (in effect) material integration. The former is achieved through closer cooperation between administrative bodies. The second is achieved as a result of the aforementioned institutional harmonisation and results in the convergence of

banking sectors.

- Institutional harmonisation and (resulting) convergence of banking sectors will facilitate the process of a state's entry into the euro area in administrative terms. It should also make it easier for candidate states to meet the convergence criteria, which are in turn highly correlated with the stability and efficiency of the banking sectors.

3) As a "permanent" mechanism that will play an important role in the future with regard to the states acceding to the European Union (in the transition period between EU membership and entry into the euro area):

- The "common path" strategy will also concern the states that will join the EU in the future (in a realistic perspective, the Western Balkan states). These states will have a temporary derogation after accession. Thus, the "openness clauses" will also in the future constitute an important mechanism for the implementation of the "common path" strategy.
- At the same time, however, the "openness clauses" alone are not sufficient to guarantee the maintenance of EU cohesion. The EU's cohesion guarantees consist not only of the financial sector and public finance policies, but include a number of other issues that are difficult to reconcile due to conflicting interests of individual Member States. Such challenges may include issues of migration policy, international trade agreements, or the rule of law, which has been frequently raised recently. This list does not exhaust the potential issues that could lead to a political crisis within the EU, which could eventually lead to the separation of the eurozone. In this light, the "openness clauses" contained in the banking union are an example of a compromise procedure that in a modified form, could be used to resolve other, mentioned conflict areas.
- The design of the close cooperation mechanism in the banking union may be used in other areas and cover relations not only between euro area states and states with a derogation. It could also be applied to the relationship between the European Union and candidate states for EU membership, especially if the prospect of membership is distant.