IMPACT STUDY OF PARTICIPATION OR NON-PARTICIPATION OF THE CZECH REPUBLIC IN THE BANKING UNION

SUMMARY REPORT

Prepared by the Ministry of Finance of the Czech Republic in cooperation
with the Ministry of Foreign Affairs of the Czech Republic, the Office of the Government of the Czech Republic
and the Czech National Bank

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1. Introduction

The project of the so-called Banking Union was undertaken as a response to the decline in the market confidence in the euro area banking system, as well as a response to the collapse of the systematically important banks and cross-border banking groups based in the euro area, whose bailouts have represented a significant public expense. The Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), a part of which will be the Single Resolution Fund (SRF), are primarily designed for the euro area Member States, whose participation in the SSM and the SRM is a result of the directly applicable EU regulations. Member States outside the euro area may join the Banking Union by entering into an agreement on the so-called close cooperation with the ECB. They may thus decide whether to join the Banking Union immediately or join later, before having adopted the euro. Therefore, the Czech Republic, like other Member States outside the monetary union, has the option to be a member of the Banking Union by entering into the close cooperation with the ECB in accordance with the SSM Regulation and join the SSM and SRM, or to postpone its entry into the Banking Union under the current conditions. The final decision will be made by the Government of the Czech Republic.

Harmonized rules and procedures in the area of financial markets apply to the whole EU in accordance with one of the fundamental principles of the EU - to maintain the integrity of the internal market - regardless the euro area or the Banking Union membership. The introduction of the Banking Union has resulted in a relatively new situation in the internal market in the area of banking supervision and the resolution where three groups of Member States could be recognized: the euro area Member States, the Member States outside the euro area, which join the Banking Union at their own request, and Member States outside the euro area, which will stay outside the Banking Union. Hence, the Czech Republic may decide whether it joins the Banking Union and becomes a member of the second group of Member States, i.e. a non-euro area participating Member State, or postpones such a decision and remains in the third group of Member States.

With respect to the above, the Committee for European Union[1] requested on 17 March 2014 preparation of an impact study (hereinafter the Study) analyzing the implications of a potential participation or non-participation of the Czech Republic in the Banking Union. This Study was prepared by the Ministry of Finance of the Czech Republic in the cooperation with the Ministry of Foreign Affairs of the Czech Republic, the Office of the Government of the Czech Republic and the Czech National Bank. The Czech National Bank did not participate in the preparation of the chapter summarizing the political aspects.

This summary contains only the main outputs of the specific parts of the Study and recommendations for the next steps. A detailed analysis of the relevant aspects, including

[1] The Committee for the European Union is a working body of the Government of the Czech Republic determining and coordinating Czech position in the European Union. It is composed of the members of the Government or of their deputies at working level.

partial results of this analysis, is presented in the individual chapters of the Study (available in the Czech language only).

With respect to the fact that the Czech Republic is not currently a member of the euro area, the Study is primarily focused on the impacts of the participation or non-participation in the Banking Union before having adopted the euro. It should also be borne in mind that in case of euro adoption the Czech Republic would automatically become a member of the Banking Union.

The Study is divided into six chapters containing a general introduction and five fundamental aspects analyzed in the Study. The first chapter summarizes the motivation for the introduction of the Banking Union, a description of its Pillars and the related legislation. The second chapter summarizes the findings of selected, earlier published expert analyses focused on the setting of the Banking Union and its potential implications for the non-euro area participating Member States. The third chapter analyzes the specifics of the Czech banking sector that represent important aspects as well as forms the basic context relevant for determining the potential benefits that would be gained by the Czech Republic, if it would join the Banking Union. The fourth chapter deals with the banking supervision and provides a practical comparison of the situations, where the Czech Republic is a participating or non-participating member of the Banking Union, including related consequences. Due to the complexity of this issue, this chapter is further sub-divided into a part focusing on functioning of the supervision in times of financial stability and financial instability. The fifth chapter is dedicated to the bank's resolution within and outside the Banking Union. Due to the fact that this issue is brand new for the whole EU with some of its elements still not fully in place, the area of resolution is in particular compared with focus on general aspects of transfer of competencies and associated financial costs. The sixth and final chapter deals with the political aspects associated with the decision on potential participation or non-participation of the Czech Republic in the Banking Union as a decision to join the Banking Union must also be made in terms of a geopolitical context, the strategic direction of the Czech Republic within the EU, as well as the approach adopted by the other non-euro area Member States. An important aspect, which is reflected across different chapters of the Study, is the fact that, due to the specific euro area mechanisms, the non-euro area participating Member States do not exactly face the same conditions as the euro area countries. As an effort not to undermine the EU internal market, the Banking Union is set up in such a way so that it could be joined under comparable conditions by the non-euro area Member States. Despite this, the position of non-euro area Member States might not be completely equal, due to their non-participation in the Governing Council of the ECB. The Czech Republic, a country promoting a level playing field in the EU´s internal market, may consider this to be an important aspect.

Each chapter of the Study is based on the current state of both the Czech financial sector and the Banking Union structure itself, which may be subject to further changes. Any potential adjustments to the system would go beyond the scope of this Study.

This summary includes the conclusions of the particular aspects and focuses on their evaluation for the purpose of the Czech Republic's decision on potential participation or non-participation in the Banking Union under the current conditions, and recommendations for further action (see text in the boxes). The summary in the sub-chapters of each chapter follows the Study itself.

2. Conclusions of selected International Analyses focused on the Banking Union

In the past, numerous analyses of the Banking Union were published by respected institutions and organizations. A review of the selected publications indicates that opinions on the advantages of joining the Banking Union are mixed. The main points could be summarized as follows:

- Some of the benefits and risks of joining the Banking Union are uncertain in terms of both probability and the size of their occurrence.
- Joining the Banking Union is often being linked with the adoption of the euro as the domestic currency. For instance, the authors of a report, published by the International Monetary Fund, are of the opinion that some of the drawbacks generally associated with the entry into the Banking Union, could be reduced, if the country concerned simultaneously adopted the euro.
- There are doubts that the Banking Union will exist in its current shape in the future. Therefore, the Banking Union should be perceived as a dynamic and evolving project, which is still in its initial phases of operation. Some of its mechanisms may, and according to some opinions, will have to be modified, because of a potential need to respond to, inter alia, developments in the financial markets. Furthermore, the situation in each Member State also may vary over time. Consequently, the factors influencing the decision of the Member States about its potential entry into the Banking Union may change as well.
- Moreover, absence of a fiscal union in the EU is being mentioned as one of the shortcomings of the Banking Union.

From the perspective of the international analyses reviewed in this Chapter of the Study, it does not follow a recommendation for the Czech Republic to seek a membership in the Banking Union under the present conditions, but rather to wait for and follow its future developments, and after their evaluation to reconsider further steps.

3. Conclusions of the Evaluation of the Czech Banking Sector's specifics

Implications of a country's entry into the Banking Union should be always considered in the context of the domestic banking sector´s position, particularly in terms of its structure, relative size, cross-border activities, or interconnectedness via equity and debt with banks in the euro area. A key issue is also the different role of banking sector in various Member States in securing of the financing for the real economy and the public sector. In the case of the Czech Republic, it is rather higher, due to a lower importance of the domestic capital market.

The overarching issue, nevertheless, is the financial stability of the banking sector, which is crucial for the future development and growth of the real economy, as well as for the stability of the public finance. According to a generally accepted notion, the entry into the Banking Union tends to be more beneficial for Member States, where the domestic banking sector is less stable. On the other hand, the entry into the Banking Union may be less beneficial for Member States, whose financial sector is more stable.

During the global post-2007 financial crisis, the Czech banking sector, as a whole, was clearly more stable in comparison to many other Member States. Moreover, it is crucial to analyze the current situation in the Czech Republic and evaluate it in comparison to other Member States. To conduct such an evaluation, a set of fifteen indicators was selected, characterizing the Czech banking sector in aggregate, as follows:[2]

- a relatively high rate of capital adequacy and profitability of the banking sector,
- a rather lower proportion of non-performing loans during the past decade,
- a relatively high level of liquid assets on the balance sheet of the banking sector – a factor increasing the ability of the banking sector to withstand potential sudden withdrawals of deposits or liquidity shortages,
- a high proportion of banks' funding coming from client deposits and the ability to provide financing of the domestic economy without tapping cross-border financing compared to some other Member States,
- a low share of encumbered assets,
- a low reliance on central bank funding,
- a low level of households' and non-financial corporations' indebtedness – a factor supporting the resilience of the financial sector,
- a low level of households' and non-financial corporations' foreign currency debt and a low level of foreign currency liabilities of the domestic banking sector,
- a lower size of the banking sector's balance sheet as a percentage of GDP,
- a higher concentration of the banking sector – a factor potentially amplifying the negative consequences of resolution,
- a dominant role of subsidiaries with the parent banks in the euro area,

[2] Some of the characteristics reflect more than one indicator.

- a lower reliance of the domestic banking sector on the financing from euro area banks compared to other Member States in the CEE region, and
- an important role of the banking sector as the holder of the domestic government bonds.

The abovementioned characteristics demonstrate a higher degree of stability of the Czech banking sector compared to other Member States. Under the current conditions, this implies lower benefits from a potential entry of the Czech Republic into the Banking Union in terms of additional increase in financial stability of the domestic sector, which could be caused by a potential strengthening of solidarity in banking resolution within the Banking Union (in comparison with other countries). None of the selected indicators was evaluated as a recommendation to enter into the Banking Union under current conditions, three indicators deliver a neutral result, and according to the twelve indicators, the entry into the Banking Union is not advantageous under the current conditions.

Due to the fact that the individual indicators reflect only the current conditions and do not imply predictions of the future, it is appropriate to update this sub-analysis in some time in the future.

According to the evaluation based on a selected set of indicators, the Czech banking sector might be characterized as a more stable in comparison with many other Member States. None of the indicators leads to a recommendation for the Czech Republic to seek the membership in the Banking Union under the current conditions. On the contrary, the vast majority of indicators lead to recommendation for the Czech Republic not to join the Banking Union under the current conditions. This sub-analysis should be updated after a certain time period.

4. Conclusions of the Comparison of the Functioning of the Supervision of the Banking Sector

The SSM is one of the pillars of the Banking Union. If a Member State has chosen to participate in the SSM, the supervision over the national banking sector is no longer conducted by the national supervisory authority (in the Czech Republic, it is the Czech National Bank, hereinafter the CNB) but in the so-called close cooperation between the national supervisory authority and the ECB. The new approach would particularly affect the banking supervision of large and significant financial institutions (most probably including Komerční banka, a.s., Československá obchodní banka, a.s., Česká spořitelna, a.s.) operating in the Czech Republic, as the supervisory powers would be transferred from the national supervisory authority to the ECB. Conversely, the small and medium-sized financial institutions would remain under the direct supervision of the national supervisory authority, although they would be subject to some changes as well. For instance, the CNB would be obligated to respect and take into account any regulations, instructions and guidelines introduced and imposed by the ECB in order to ensure a consistent approach to supervision in the Czech Republic (e.g. the application of regulatory rules, including discretions), particularly in times of financial instability.

The introduction of the SSM does not alter the existing regulatory rules governing the business activities of financial institutions in the EU. The supervision will remain exercised in accordance with the regulatory rules set in the CRD IV, CRR and BRRD, which are binding for both the ECB and the national supervisory authorities of the participating Member States, i.e. the supervisory authorities within the Banking Union, as well as other supervisory authorities of non-participating Member States. In the SSM, the supervision will also be exercised in accordance with other EU regulatory rules and national legislation of a participating Member State, which as well empowers and obliges the national supervisory authority to accept and act in accordance with the imposed measures issued by the ECB.[3]

The comparison of the supervisory function of the banking sector should be performed at two levels – firstly, for times of market stability and secondly, for times of market instability – as these two periods show certain differences. Financial costs of the participation of the Czech Republic in the SSM are an additional aspect.

Factors, whose weights have not been set,[4] listed in the following table, are based on the detailed analysis contained in the Chapter four of the Study. In fact, many factors are discussed across different parts of the Chapter. The table below is evaluating each factor, i.e. as to whether individual factors are for or against the entry into the SSM under the current conditions, although some factors have been found in the evaluation process as neutral or inconclusive. Moreover, in relation to the evaluation of some factors, a common view was not reached by the authorities (the Ministry of Finance, the Ministry of Foreign Affairs, the Office of the Government and the CNB), which have taken part in the preparation of the Study (therefore, there is, in some cases, more than one view stated in the table below). However, a synthesis of all individual factors is crucial for the overall evaluation and drawing a conclusion (see the text bellow the table).

[3] The ECB will conduct the supervision by acting through the national supervisory authorities of participating Member States, whose currency is not the euro. The ECB has no direct competencies in relation to institutions outside the euro area.

[4] The SSM is a new supervisory mechanism. Therefore, the weights of individual factors were deliberately not set, as their assessment would include, among other things, a lot of subjectivity. In the case of some of these factors, it would not be possible or it would be very difficult to determine their weights, as the SSM was launched just at the end of 2014 (thus, there is not enough information to make a proper evaluation). For this reason, it is not possible, in many cases, to determine the importance of some of these factors for the Czech Republic, including their impact on the Czech Republic. Thus, assigning of individual weights to these factors could be misleading. As a result, presently, the purpose of the table is to provide information (informative purpose) about different parts of the Chapter four. Granting weights to individual factors will be considered in the forthcoming update of the Study.

BANKING SUPERVISION AND REGULATION AND FINANCIAL STABILITY			
	Factors in favor of the entry of the Czech Republic to the SSM under the current conditions	**Neutral factors (not able to evaluate as to whether the factor is for or against the entry of the Czech Republic to the SSM under the current conditions)**	**Factors against the entry of the Czech Republic to the SSM under the current conditions**
SUPERVISION IN TIMES OF FINANCIAL STABILITY			
The supervision of significant (subsidiary) institutions and groups - the loss of autonomy by the CNB relating to the supervisory powers			x
The supervision of less significant institutions and groups - the loss of autonomy by the CNB relating to the supervisory powers			x
The supervision of the branches (banks)			
Branches from other Member States operating in the Czech Republic		x	
Branches of institutions established in the Czech Republic operating in other Member State		x	
Branches from third countries		x	
Change of legal form of subsidiaries to bank branches of other Member State		x	
Prudential requirements			
Transfer of the CNB's powers, rights and competencies to the ECB			x
Liquidity			x
Large exposures limits			x
Macro-prudential supervision and requirements		x	CNB
Authorization (in terms of the Czech market)			x
Assessment of acquisition of qualified holdings (in terms of the Czech market)			x
The role of the EBA and settlement of disputes between national supervisors			x
The College of Supervisors and the decision-making process			
The ECB as an active participant in the College of Supervisors representing the CNB (the CNB is an observer)			x

The CNB as an active participant in the College of Supervisors (if the Czech Republic is not a member of the Banking Union)			x
The CNB participating in the Supervisory Board			
Access to timely and all (depth and range) information	OG,[5] MFA	MoF	CNB
Participation in the decision-making related to supervision of the parent institutions and other institutions within the Banking Union	OG, MFA	MoF	CNB
Authorization – participation in the approval process of all applications for the authorization within the Banking Union	x	CNB	
Assessment of acquisitions of qualified holdings – participation in the approval of acquisition of the qualified holdings within the Banking Union	x	CNB	
Safeguards for participating Member States of the Banking Union (currency is not the euro)			
Regulatory rules		x	
Administrative Board of Review – internal administrative review of the decisions in the area of supervision		x	
Mediation Panel ECB		x	
EBA (appeal against the breach of the EU/Czech law)		x	CNB
Termination of close cooperation between the ECB and the non-euro area participating Member State			x
Governing Council of the ECB - non-participation of the Czech Republic			x
Responsibility for supervision - ECB and CNB - in relation to the Czech Republic			x
Democratic control - the national Parliaments of the participating Member States		x	
Regulatory supervisory framework SSM - not (yet) completed		MFA	x
Credit rating		x	CNB
SUPERVISION IN TIMES OF FINANCIAL INSTABILITY			
Prudential supervision			
Preparation and approval of recovery plans for the institutions operating in the Czech Republic			x
Approval of early intervention measures			x
Approval of the provision of intra-group financial support			x
Macro-prudential supervision		x	
Banking group - the supervision		x	

[5] "OG" stands for the Office of the Government of the Czech Republic, "MFA" for the Ministry of Foreign Affairs of the Czech Republic, "MoF" for the Ministry of Finance of the Czech Republic.

Parent institutions - the option of providing financial assistance to subsidiaries	MFA, OG	CNB, MoF	
Stronger links between the parent institution and other members of the group - easier transfer of financial contagion			x
Lender of last resort		x	CNB
FINANCIAL COSTS ASSOCIATED WITH PARTICIPATION IN THE SSM			
Institutions - operational and other costs		x	
Annual supervisory fees (ECB)			x
Supervisory authorities		x	

Introduction of the SSM represents a significant change to the supervisory architecture towards a centralized supervision, especially in the case of significant financial institutions of participating Member States. The SSM will have direct implications for the efficiency and effectiveness of supervision in Member States participating in the Banking Union, and it might have an impact on the whole EU banking sector.

The participation in the Banking Union will represent not only the transfer of supervisory powers from national supervisory authorities to the ECB; it will also involve a considerable administrative change from the current approach to the supervision, which may result in a complex and expensive process. Therefore, it is very important to proceed carefully with the decision about the participation of a Member State in the SSM, as this decision should be viewed as a permanent one (an exit from the SSM is generally allowed, but only for exceptional reasons as it is associated, among other things, with high costs).

The supervisory framework within the SSM has not yet been finalized. A supervisory framework should ensure the efficiency and effectiveness of supervision that would be conducted in the close cooperation between the ECB and the national supervisory authorities of the participating Member States. Therefore, the SSM, a new and untested supervisory regulatory framework, leaves a number of open questions for voluntarily entering Member States, including the Czech Republic. Consequently, at this point, it is not possible for these Member States to draw a clear conclusion about all the potential benefits and risks associated with their participation in the SSM. Presently, the loss of the CNB's competences over the significant financial institutions (large banks operating in the Czech Republic) is viewed as the key drawback associated with the participation in the SSM, as these institutions would be supervised by the ECB, as well as weakening of the voting rights in the EBA and the increase in the potential risk of the spillover effect affecting the subsidiaries operating in the Czech Republic without the Czech authorities having the ability to adopt their own solutions. Some weakening of the CNB's supervisory powers would result even in the case of less significant institutions. In particular, the loss of supervisory powers would be seen in the area of prudential requirements or in approval of new entrants to the national market. Other negative aspect, which should not be omitted, is the obligation of the financial institutions operating in the Czech Republic to pay an annual supervisory fee to the ECB, if the Czech Republic participates in the SSM.

The main opportunity that the Czech Republic would gain from participation in the SSM is its participation in the ECB Supervisory Board and all other SSM's bodies involved in the supervisory function. For that reason, the Czech Republic might be, in particular, involved in the process of decision making about the supervision of the parent institutions and other financial institutions in the Banking Union. Moreover, the Czech Republic might also have an access to timely and complete information regarding all financial institutions in the Banking Union and the information related to the functioning of the SSM as well. However, the CNB does not share this view.

Finally, it should be said that, under current conditions, the negative aspects mentioned above are not sufficiently balanced by the identified positives.

In terms of the impact on the supervision of the financial institutions (banks) operating in the Czech Republic and risks identified, the study shows that joining the Banking Union is not, under the current conditions, appropriate for the Czech Republic. It is recommended to wait for further developments, which have to be evaluated, and then possibly reconsider further steps.

5. Conclusions for the Comparison of Banking Resolution

The second pillar of the Banking Union is the SRM. It will be based on the Bank Recovery and Resolution framework, the so-called Crisis Management (BRRD), which is just about to be used across the EU. By joining the Banking Union, the competencies relating to the banking resolution for systemically important institutions and cross-border groups will be transferred from the national level to the supranational level. In particular, the powers will be transferred from the national resolution authority to the Single Resolution Board (SRB). The SRB will conduct its activities through the national resolution authorities, including the CNB in the case of the Czech Republic, although its decision will be subject to approval by the European Commission or (in some cases) the Council.

In addition to the transfer of competencies to the supranational level and becoming represented at this level, there are other relevant issues to be analyzed from the SRM's point of view when assessing the implications of a potential entry into the Banking Union: the issue of securing resolution funding and the issue of potential associated costs.

5.1 Competences in Banking Resolution

If the Czech Republic remains outside the Banking Union, most resolution powers applicable to the credit institutions established in the Czech Republic will be retained at the national level. There are certain exceptions, such as the preparation of group resolution plans, adopting the resolvability measures in the case of cross-border groups and determining the minimum requirements for own fund and eligible liabilities. Any disputes in these areas might be resolved, at the request of the relevant authorities, by a binding mediation of the

EBA. As long as the Czech Republic remains a non-participating Member State, any solution(s) regarding the resolution that would be detrimental to the Czech Republic, cannot be approved unless authorized by a Czech representative. However, it is necessary to take into account that the decision about the resolution of a cross-border group that will be accepted at the EU level and without the involvement of the Czech Republic, due to its non-participation in the Banking Union, may have an impact on the subsidiaries established and operating in the Czech Republic.

If the Czech Republic joins the Banking Union, the competencies of the national resolution authority – the CNB, would be limited, particularly the CNB's ability to influence the final decision on resolution. These final decisions will be made by the SRB which is composed of representatives from the national resolution authorities of all participating Member States and its permanent members. Moreover, the CNB will participate in the whole cross-border group resolution decision-making process, however, its decision making powers will be very limited. Yet, an important aspect could be seen in a higher probability that a common resolution strategy for the cross-border groups is being adopted. In the case of a failure to reach a consensus in the first round of the SRB's Executive Session, there is a risk of losing control over the final solution with all the possible implications for the Czech Republic. The SRB will also have a power over the less significant institutions established in the Czech Republic, if the ECB, at its discretion, becomes directly responsible for their supervision.

5.2 Resolution Funding

The need for a resolution funding from resolutions funds should be reduced by the bail-in tool; nevertheless a need for the resolution funding cannot be excluded in advance. From this point of view, there is a relevant question relating to the size of respective resolution funds. The relative size of the target level of the National Resolution Fund (NRF) and the Single Resolution Fund (SRF) is the same, amounting to 1% of covered deposits. However, it varies in absolute terms.

If the Czech Republic remains a non-participating Member State, the possibilities of the NRF (considering its target level in absolute terms) will be very limited in case of a necessity to finance a resolution of large banks established in the Czech Republic. On the other hand, joining the Banking Union would open up the possibility to draw resources from the SRF, whose target level, in absolute terms, is much higher. Indeed, given the limited possibilities of the SRF towards in order of magnitude larger banks of the euro area and given the rules for the distribution of funds, there is no guarantee that the necessary financial means will be available in the SRF at the time the Czech Republic needs them to finance a resolution of a domestic bank.

Joining the Banking Union means that besides transferring powers to the supranational level, there is also a partial transfer of responsibilities for the financial costs associated with the resolution. As mentioned above, it is clear that in the case of a resolution of a large bank established in the Czech Republic, the Czech Republic would have an opportunity to use the funds from the SRF. On the other hand, it would be obligated to participate in the financing of the resolution of banks in other participating Member States and to restore the collection of *ex ante* contributions in case of SRF´s depletion.

In connection with the limited capacity of the SRF, due to the size of large European credit institutions, the Member States discuss the possibilities of its temporary (bridge) financing and even permanent financing, which should be available to all participating Member States. So far, no agreement has been reached on the bridge financing for the SRF. Moreover, an agreement on a permanent common backstop which was postponed during the negotiations of the SRM should be reached by the end of the transitional period in year of 2024. The purpose of a bridge financing mechanism, which should be available once the SRF becomes operational, is to ensure a sufficient size of reserves for effective resolution of larger institutions or groups in the participating Member States. On the other hand, despite the fact that bridge financing should be fiscally neutral in medium terms, such a mechanism will most likely have some fiscal consequences – state guarantees or limited government credit lines to the SRF are considered, while their form will depend on agreement yet to be reached. At this point, it is not possible to draw conclusions on the possible impacts on the Czech Republic, including fiscal sharing, in the case of its participation in the Banking Union, as the form of the bridge financing mechanism is not yet known.

5.3 Options to Leave the Banking Union

Last but not least, in this context, it is necessary to consider also the possibility of terminating the membership in the Banking Union, for example in the case of a disagreement about the adopted decision regarding the resolution scheme. This option is available to all non-euro area Member States, which will enter into the close cooperation with the ECB. In this case, it is necessary to take into account all related costs associated with such a decision. Particularly, part of the contributions transferred to the SRF, which is subject to sharing, might not be returned back in full in case of leaving the Banking Union. At this moment, this potential loss cannot be specified or quantified.

From the perspective of the banking resolution and with regard to the results of the previous chapters devoted to the stability of the Czech banking sector, it might be stated that there is no evidence supporting the need for the Czech Republic to join the Banking Union under the current conditions. Conversely, the subsequent transfer of competencies to the European level, the obligation to contribute to the financing of future crises of banking sectors in other Member States and an unclear functioning of the bridge financing mechanism, that will probably have some fiscal consequences for participating Member States, point against the entry. On the other hand, the entry would appear beneficial, if there were potential financing needs for the resolution of a larger domestic bank, however, neither the evaluation of the stability of the domestic banking sector nor Czech National Bank's information currently indicate such a need. Moreover, it is uncertain whether there would be sufficient resources available in the SRF, when required.

6. Summary of the Political Aspects

The Czech National Bank disagrees with the content of the Chapter 6 because it did not participate in its preparation.

When assessing the participation of the Czech Republic in the Banking Union, political aspects represent an essential point of view. Political stance towards the Banking Union is also a signal of the Czech Republic to its partners not only within the EU, but also outside of it. The Government has already declared a fundamental change in its European policy; it particularly declared its support and interest in active participation in the process of deepening of integration in a wider context. Therefore, the decision not to join the Banking Union could be interpreted, in an extreme case, as an approach that is inconsistent with the Government's declaration and supporting rather opposite stance. Consequently, some effort and strategic aims of the Czech Republic might be weakened or compromised, e.g. in the area of deepening of the Single market for services.

The Czech Republic should be also interested in the steps taken by other non-euro area Member States. At present, only three Member States have announced their intentions in relation to the Banking Union. In particular, Bulgaria and Romania have decided to join the Banking Union, while the United Kingdom has decided to remain outside of it. Moreover, the general interest in joining the Banking Union has been expressed by Denmark as well, which is currently analyzing its potential entry. Denmark's position is still open and largely also depends on whether the decision about joining the Banking Union will be submitted to the referendum. Furthermore, Croatia is considering the entry into the Banking Union before the adoption of the euro, while Lithuania automatically became a member of the Banking Union when joining the euro area on 1 January 2015. Despite the positive perception of the Banking Union by the majority of non-participating Member States, it is clear that most Member States outside the euro area have not yet made their final decision about the entry into the Banking Union. They are still in the process of postponing their final decision, waiting for either the final resolving of all the needed related elements of the Banking Union or the experience with the functioning of the Banking union.

The views of third parties, and particularly financial markets, also play a significant role. The potential non-participation in the Banking Union does not imply that a different regulatory and supervisory conditions for the Czech banking sector would be created, but in terms of the market sentiment and the overall perception of it, a potential non-participation in the Banking Union may position the banking sector at a disadvantage and negatively affect its competitiveness in the European financial markets. The issue of market sentiment and its implications should be as well considered in the context of both, the capital markets and the inflow of foreign investment.

In terms of political aspects, the Czech Republic's entry into the Banking Union appears to be a decision that could have a number of rather positive impacts. Firstly, it could reinforce a greater potential in promoting national strategic interests at the EU level. Secondly, it generally could strengthen the competitiveness of Czech credit institutions in the European financial markets. Specific implications, however, cannot be conclusively estimated. The position of the other non-euro area Member States regarding the question of entry into the Banking Union is not entirely clear. Despite that, some Member States have expressed an intensive interest in the entry into the Banking Union. Bulgaria and Romania are the most advanced in the negotiations aimed at the joining the Banking Union.

Overall, however, a clear recommendation whether to participate in the Banking Union or not cannot be made even in the case of political aspects, because the benefits are not guaranteed at this time and the final involvement of the other non-euro area Member States remain uncertain. It is also not possible to assess the related risks. The wait and see approach seems to be more appropriate. This means that the practical functioning of the Banking Union should be followed and observed and also viewed in the context of its impacts for non-participation of the Czech Republic. After some time, it will be appropriate to make a new assessment.

7. Concluding Recommendations for Further Action

In light of the abovementioned partial conclusions, the entry into the Banking Union under the current conditions cannot be recommended as being beneficial. Some aspects of the Banking Union are not yet in place. Likewise, only the following months and years will determine whether the single supervisory mechanism is functioning as expected. Political factors, including attitudes of other non-euro area Member States are essential aspects of decision-making as well. Even from this point of view, there are not any significant positive effects of a potential entering into the Banking Union demonstrated.
Therefore, there are two key recommendations of the Study:

1. **Not to enter into the Banking Union under the current conditions.**
2. **To re-evaluate the particular aspects and impacts of the Czech Republic's non-entry into the Banking Union in the 18 months horizon and according to the results of that re-evaluation possibly revise the recommendation in point 1.**

(By the Government Resolution no. 84 of 9 February 2015 the Czech Government decided to shorten the period for re-evaluating the particular aspects and impacts of the Czech Republic's non-entry into the Banking Union to 12 months.)