EUROPEAN BANKING SYSTEM
- BEFORE AND AFTER BREXIT -

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Abstract:
The history of the last 15 years has been marked by many events at European level, some which led to the last wave of EU enlargement in 2013, with the accession of Croatia, others that led European authorities to take radical action in order to overcome the crisis of 2007-2008, and recently the pandemic crisis of 2020, and the others that marked the first contraction of the European Union since its establishment, together with the decision of Great Britain to no longer be part of the European Union, a phenomenon known as Brexit. Starting from the important role that Great Britain played in the European Union, London being a famous financial and banking center, through this paper we propose to analyze the evolution of the banking system before and after Brexit, in order to highlight the impact that the Brits’ decision had on the European Union banking system. The broad context of the impact of Brexit on the European banking system, which has effects on both British and EU banks, will also be analyzed in this paper.

Key words: European Union, banking system, Brexit

1. Introduction

The European Union is a construction that has taken time to think about the architecture of a heterogeneous community, in order to establish the way in which countries work for a common goal, while maintaining national sovereignty. This approach was a permanent one sprinkled with challenges, coming from outside or inside the European Union, to which the leaders in the governing institutions had to find solutions. One of the biggest challenges is the decision to leave the European Union by one of the strongest countries in the European bloc, namely the United Kingdom. Starting from a brief foray into the history of European construction, we will highlight the position of Great Britain in the European Community from the very beginning and the context of Brexit, so that we could further analyze the European banking system before and after Brexit.
2. Brief historical foray

The idea of the emergence of the European Community came from the desire to create a united, prosperous, and peaceful Europe, after many wars between neighboring countries, which culminated with World War II. Beginning in 1950, European countries began to unite politically and economically within the European Coal and Steel Community to ensure lasting peace. The six founding countries are Belgium, France, Germany, Italy, Luxembourg and the Netherlands. The 1950s are marked by the Cold War between East and West, with protests against the communist regime in Hungary being repressed by Soviet tanks. In 1957, the Treaty of Rome laid the foundations of the European Economic Community, known as the common market. (https://europa.eu/european-union/about-eu/history_ro).

On 25 March 1957, two treaties were signed - the Treaty establishing the European Economic Community (EEC) and the Treaty establishing the European Atomic Energy Community (EAEC or Euratom). The European Economic Community (EEC), which brought together six countries (Belgium, Germany, France, Italy, Luxembourg and the Netherlands), was set up to work for integration and economic growth through trade. This created a common market, based on the free movement of goods, persons, services and capital. The aims of the EEC and the common market were to transform the conditions of trade and manufacturing in the six member states and to serve as a step towards closer political unification of Europe. (https://www.europarl.europa.eu/about-parliament/ro/in-the-past/the-parliament-and-the-treaties/treaty-of-rome). In 1973, Denmark, Ireland and the United Kingdom joined the European Union, bringing the number of Member States to nine. In 1981, Greece became the 10th member state of the European Union, followed five years later by Spain and Portugal. With the fall of communism in Central and Eastern Europe, the four freedoms were added to the single market: the free movement of goods, services, people and capital. The Maastricht Treaty on the EU was signed in 1993, and the Amsterdam Treaty in 1999, with people becoming increasingly concerned about environmental protection and common security and defense measures. In 1995, the European Union received three new members: Austria, Finland and Sweden. At the same time, the Schengen area emerged, an agreement that gradually allowed Europeans to travel without having their passports checked at the border. (Șerban, R., 2004) The first decade of the 2000s brings with it the adoption of the euro currency by several countries and at the same time becomes synonymous with the intensification of EU countries’ cooperation in the fight against crime. Since 2004, no less than 11 countries have gradually joined the European Union, including Romania and Bulgaria in 2007, and in 2013, the number of EU countries reached 28, with the accession of Croatia. In 2008, a global economic crisis hit Europe hard, with the European Union helping several countries to cope with the difficulties and laying the foundations for the so-called banking union to make the banking sector safer and more reliable. The European Union has meant a construction of over 70 years, starting from great ideals, to contribute to the harmonious and convergent growth of all member states, but this history has been plagued by many challenges, manifestations of the individualities of the member countries, crises, and anti-crisis measures.
Great Britain's position in the European Union

In this entire complex context, one of the countries with an always atypical position, with manifestations of nationalist aspects, was Great Britain.

The United Kingdom is a constitutional monarchy and parliamentary democracy with its capital in London with a head of government (prime minister) and a head of state (king). The United Kingdom comprises four countries: England, Scotland, Wales and Northern Ireland, the last three having decentralized administrations with different powers. After the end of World War II in 1945, the United Kingdom was one of the Four Great Powers (Soviet Union, United Kingdom, USA and China) which met to bring order to the post-war world.

Over the next three decades, most colonies in the British Empire gained independence. Many became members of the Commonwealth of Nations. In the following decades, the United Kingdom became a more multiethnic society than before. In 1960 the United Kingdom was one of the seven founding members of the European Free Trade Association (EFTA), but in 1973 it left this bloc to join the European Communities (EC). When the EC became the European Union (EU) in 1992, the United Kingdom was one of the 12 founding members. Towards the end of the twentieth century, major changes took place in the government of the United Kingdom, with the emergence of autonomous administrations for Scotland, Wales and Northern Ireland. Statutory incorporation has led to the acceptance of the European Convention on Human Rights. The United Kingdom is a key player in world diplomacy and the military. It plays leading roles in the UN and NATO. However, British overseas military deployments, especially in Afghanistan and Iraq, are shrouded in controversy. (Martin, F., 1997).

Member of the European Union since 1973, the United Kingdom has negotiated a non-participation clause in the euro area, therefore it is not obliged to introduce this currency, the pound sterling not being included in the Exchange Rate Mechanism established by the competent EU institutions. It also signed a non-participation clause in the Schengen are.

In the European Parliament, the United Kingdom had 73 members. The European Council does not have a permanent president, its work being led by the country holding the presidency of the Council, which changes every 6 months. The presidency of the EU Council reverted to the United Kingdom between January and June 1977, July-December 1981, July-December 1992, January-June 1998, July-December 1995. The United Kingdom had 24 representatives on the European Economic and Social Committee. The United Kingdom had 17 representatives in the European Committee of the Regions, the European Union assembly of local and regional representatives. Communication between the United Kingdom and the EU institutions took place through the Permanent Representation in Brussels acting as an embassy of the United Kingdom, the main task being to ensure that the interests and policies of the EU are taken into account as efficiently as possible in the EU. (https://europa.eu/european-union/about-eu/countries/member-countries/unitedkingdom_ro). Therefore, the European Union and the United Kingdom have an important relationship based on subordination and collaboration, especially since the UK was one of the founding members of the EU.
BREXIT – the EU’s first contraction

Brexit, a term derived from the combination of the words British and exit means the planned withdrawal of the United Kingdom from the European Union. On 23 June 2016, the citizens of the United Kingdom decided that their state should leave the European Union, officially notifying the European Council on 29 March 2017 of its intention to leave the EU by initiating the procedure provided for in Article 50 of the Lisbon Treaty. Article 50 of the Treaty on European Union provides for the procedure whereby a Member State may withdraw from the European Union if it so wishes. The Member State must notify the European Council of its intention to leave the Union. On 29 October 2019, European leaders agreed with the British Prime Minister to extend the deadline imposed by Article 50 of the Treaty on European Union until 31 January 2020, thus extending the period during which the United Kingdom remains an EU member state. If the Withdrawal Agreement is not ratified / approved in time to enter into force on 31 January 2020, the United Kingdom would leave the European Union without an agreement. (https://www.mae.ro/brexit). Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union without an agreement will mean a return to the provisions of multilateral trade agreements, under the auspices of the World Trade Organization.

Regarding this referendum in 2016, it should be mentioned that it is not the first through which the opinion of the British people is requested, regarding the relationship with the EU. In 1975, at the first referendum in Great Britain, citizens were asked if they wanted to stay in the European Community that existed then. The decision at the time was to remain in the European Community, the reasons being both political and related to the period of economic downturn, inflation and unemployment that Britain was going through at the time. (Clarke, H., Goodwin, M. Whiteley, P., 2017).

By comparison, the 2016 referendum, which caused the UK to leave the European Union on 31 January 2020, makes this economically challenging situation overlap with the coronavirus crisis, which makes decisions even more difficult to integrate.

We will further analyze the banking system before and after Brexit, in order to highlight both the size of the British banking system within the European banking system, but also to highlight the main elements that will be impacted by Britain’s exit from the EU.

The European banking system before Brexit

The origin of European banking, in the modern sense of the word, is found in the Middle Ages and the Early Renaissance in Italy, in cities such as Florence, Venice or Genoa, until the twentieth century its banking activity spread to many European countries such as England, Holland, Germany, or Spain. (Homer, W., 2010). The treaties signed at the level of the European Community have always targeted regulations related to the banking sector, in order to create an architecture prepared for the management of a single European currency and a single monetary policy, of the European Central Bank. Each country, as it has acceded to the European Union, has taken the necessary steps to adapt to the community acquis in banking matters, and subsequently has taken the necessary steps to adopt the euro, at the appropriate time for each country, depending on the degree of convergence to European standards.
The banking system of the European Union is organized as a Banking Union, a system of banking supervision and resolution at EU level that operates on the basis of rules valid throughout the Union. It aims to ensure that the euro area banking sector and the EU as a whole are secure and reliable and that non-viable banks benefit from resolution without recourse to taxpayer funds and with minimal impact on the real economy. The members of the Banking Union are all euro area countries and non-euro area Member States that have chosen to participate. In the European Union, structural reform of the financial system has been a priority on the Lisbon agenda and in particular through the Action Plan of the European Commission in the Field of Financial Services. This Plan, implemented until 2005, in the member countries, established the full integration of financial services as an important objective.

From the perspective of the legal framework of the banking system in the European Union, the Single Regulatory Framework is the foundation of Banking Union and financial sector regulation in the EU in general. In June 2009, the European Council recommended a single regulatory framework approach to eliminate legislative differences between Member States and to ensure an identical level of consumer protection and a levelled playing field for banks across the EU. It is made up of legal acts that must be complied with by all financial institutions, including the approximately 8300 banks in the European Union. The Single Regulatory Framework sets out capital requirements for banks, ensures greater protection for depositors and regulates the prevention and management of banks' difficulties.

The Single Regulatory Framework has three pillars (those legal acts that are most relevant to the banking union), namely: the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation, the Amended Deposit Guarantee Schemes Directive (CRR) and the Bank Recovery and Resolution Directive of Banking Institutions (BRRD). The first pillar is designed to increase the capacity of the EU banking sector to withstand economic shocks, improve its risk management and ensure normal lending in times of economic downturn.

Regarding the institutional framework of the banking system in the European Union, there are three main categories of institutions: the Governing Council of the ECB, the Macro-Prudential Forum and the Financial Stability Board. The Governing Council of the ECB is responsible for making decisions on macro-prudential policy. These decisions apply to all countries and banks subject to the Single Supervisory Mechanism, i.e. to euro area countries and those EU countries whose national authorities have signed close cooperation agreements with the ECB.

The role of the European Central Bank is to manage the euro area, being also responsible for the elaboration and application of the economic and monetary policy of the European Union. Another important responsibility of the ECB is to maintain price stability in the euro area, in order to maintain the purchasing power of the euro, which requires keeping inflation under strict control. In its areas of responsibility, the European Central Bank shall be consulted on any draft Union act as well as on any draft regulation at national level and may issue opinions. The European Central Bank cooperates with the central banks of all the Member States of the European Union, forming together the European System of Central Banks. The role of the European Central Bank at European
level is of particular importance, as an independent EU institution, the ECB monitors banking supervision by establishing a common approach to day-to-day supervision, adopting harmonized corrective supervisory measures and ensuring consistent enforcement and supervisory policies. (Scheller, H., 2006).

Following the financial crisis of 2008, measures were taken at the level of the European Banking System to prevent similar situations. One of the measures is the creation of the Single Supervisory Mechanism (SSM) which refers to the banking supervision system in Europe and consists of the European Central Bank and the national supervisory authorities of the participating countries. SSM is one of the two pillars of the EU Banking Union, along with the Single Resolution Mechanism. The main objectives of the Single Supervisory Mechanism are to ensure the security and solidarity of the European banking system, to increase the degree of integration and financial stability and to ensure a consistent supervisory process. The aim of European banking supervision is to restore confidence in the European banking sector and increase the resilience of banks.

To highlight the way the banking system looks after Brexit, we will show the importance that the UK has in the European banking system.

Analyzing the numerical evolution of credit institutions in the EU (Figure 1), we observe the decrease of 29.84% in 2019 compared to 2008, on average the number of institutions decreasing by 231 institutions per year, the main cause being related to the financial crisis of 2008. This crisis, considered one of the most resounding in the world, has led to a contraction in the European banking system. Given the fact that the banking system in the UK is a very strong one (which we will analyze below), the result of the 2016 referendum also contributed to the decrease in the number of banks, although in 2014-2015 the European Union showed signs of recovery, this context again affected economic and banking developments.

Figure 1. Evolution of the number of credit institutions in EU in the period 2008 - 2019
Another element that has contributed to the decrease in the number of credit institutions is the widespread use of internet banking, respectively the increase of the percentage of users from 25% in 2007 to 58%. This aspect also justifies the decrease in the number of branches at European level by 31.31%, the direct interaction with customers is no longer so necessary (Figure 2).


Figure 2. Evolution of the number of branches of EU banks in the period 2008-2019 (thousands of branches)


As a natural consequence of the decrease in the number of branches, and the number of employees in the banking sector decreased by almost 20%, the countries where we find the largest number of bankers are: Germany (578.5 thousand employees), France (399.3 thousand employees) and the United Kingdom (344 thousand employees) (www.ebf.eu).

Analyzing the performance in the European banking system, using Return on Equity (ROE), we can see on the one hand a large discrepancy between countries, ROE values fluctuating between 0.7% in Greece and 16% in Hungary and on the other hand an improvement in the values of this indicator at the aggregate level, in 2019 it was positive at 5.4%, although at half the return that European banks generated in 2008, according to data provided by the European Banking Federation (EBF).

This, on the one hand, reinforces the differences in financial power that exist at European level and, on the other hand, the significant impact that the 2008 crisis had on European countries, but the recovery of some of them has taken place more quickly and others heavier. The variation around the average levels of the performance indicator was high, which confirms this aspect.

At the level of the European banking system, there has been an improvement in the quality of the loan portfolio in the last 5 years, the weighted average ratio of non-performing loans and advances (NPL) falling from 6.5% in 2014 to 2.5% at the end of 2020 (Figure 4). This reflects either the recovery of non-performing loans or their sale to
foreclosure companies, with banks, through their actions, trying to reduce the burden of provisions and thus contribute to increasing the efficiency of their business.

![Figure 3. Return on equity by country, in EU, in 2019 (%)](source: www.ebf.ro)

![Figure 4. The evolution of the NPL at the level of the European banking system](source: processing after https://www.statista.com/statistics/1122984/non-performing-bank-loans-in-europe/)

**The European banking system after Brexit**

After analyzing the European banking system as a whole, at an aggregate level, we will further analyze the British banking system and the impact that Brexit will have on the European banking system. We will start the analysis from the current situation of the British banking system, within the European banking system, in order to then highlight possible effects of Brexit in this sector.
The English banking system has historically gone through various events and circumstances over time, changing and influencing the role and responsibilities of banks. They helped shape the culture and traditions of the UK banking system, which gave it supremacy, especially in the 19th century, worldwide, through the London market and the role of the pound sterling. (Stevenson, 1987).

Today, the UK banking system is one of the most developed systems in the world. Its good organization and branched infrastructure provide various classification criteria for banking institutions, which demonstrates the degree of specialization of the system. A first classification criterion is the one related to the type of operations and services offered. From this perspective there are: merchant banks, accepting houses and discount houses, banking institutions whose activity consists mainly in the sale of national and international services and less in the placement of own funds or their collection. (Fitch, T., 1990).

The UK banking sector in 2020 is dominated by several very large banks, including HSBC (capitalization of $ 161 billion), Lloyds Group ($ 60.95 billion), Barclays ($ 41.23 billion) and, in terms of market shares for all business categories, the market is oligopolistic.

Banks in the UK, as in the United States and the European Union, are subject to much stricter regulations, where regulators need to balance the need for financial stability and ensure that banks can pass the “stress” tests and to ensure that financial markets remain competitive. In the UK, the Financial Conduct Authority is responsible for ensuring the proper functioning of financial markets. At the same time, the UK banking system has undergone several analyzes of competition over the last 10 years, concluding that the market is overly concentrated.

Although in terms of the percentage of credit institutions in the UK compared to the total in the EU, the UK is only in 6th place with about 6.7% (after Germany which has 25.63% of the total number of credit institutions, Poland with 11%, Austria with 8.7%, Italy with 8.2% and France with 6.8%), in terms of the percentage held by British banks in total banking assets (Figure 5) Great Britain is in first place, and the percentage held in total capital and reserves is in second place (Figure 6).

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**Figure 5.** The share of credit institutions in EU assets

- United Kingdom: 20.70%
- Germany: 18.20%
- France: 20.50%
- Italy: 8.20%
- Spain: 5.90%
- Netherlands: 6.30%
- Denmark: 2.96%
- Belgium: 2.66%
- Switzerland: 2.59%
- Other EU members: 2.30%
- Non-EU members: 8.15%

**Figure 6.** The share held by credit countries in total institutions in EU countries in capital and reserves

- United Kingdom: 18.45%
- Germany: 17.70%
- France: 18.51%
- Italy: 10.39%
- Spain: 7.67%
- Netherlands: 4.17%
- Austria: 2.33%
- Ireland: 2.57%
- Poland: 2.18%
- Other EU members: 2.04%
- Belgium: 2.21%

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Therefore, the analysis of the position of the European banking system in the EU highlights a strong, dominant system, including internationally renowned banks, being an important employer of labor force in the EU.

Another very important aspect related to Brexit is the abandonment by the Bank of England of the European System of the Central Bank, and implicitly the withdrawal of the contribution to the capital of the ECB. The Bank of England was the largest contributor to the ECB’s capital among non-euro area countries, with a pre-Brexit stake of 14.3%. This percentage will be allocated both between the National Central Banks of the euro area countries and between the rest of the NCBs non-euro area. Lately (the last years and the last months), the European Central Bank has taken steps to prepare for any unforeseen situations and will continue to closely monitor developments in financial markets in order to maintain stability. At the same time, the European Central Bank and the Bank of England activated in March 2019 an agreement through which the Bank of England will lend Euros per week to banks in the United Kingdom. Under the same agreement, the Eurosysten will be prepared to lend pounds sterling to euro area banks, if necessary, in order to reduce possible sources of tension in the financial system.

In terms of banking supervision, the European Central Bank has processed about 25 authorization procedures for banks transferring their activities to the euro area and assessed Brexit-related plans of a number of 42 euro area banks that will maintain their branches in the United Kingdom, after this country will have left the European Union.

Another impactful aspect is that the EU passport system for banks and financial services companies allows companies that are authorized in any EU or EEA state to trade freely in any other with a minimum additional authorization. These passports are the foundation of the EU’s single market for financial services. Once Britain leaves the EU and the EEA, it will become a third country and these limited regimes may, in principle, be available. In essence, there were three broad options for Brexit and banking under discussion: continuing current passport provisions, negotiating a new EU equivalence or leaving the EU without agreement and, subsequently, the arrangement of equivalence agreements. (https://www.financialdirector.co.uk/2019/11/13/impact-of-brexit-on-banks-and-banking/). Now that the transition period is over, the issues of how credit institutions operate in the UK have been clarified. Thus, EEA companies currently operating with a passport in the United Kingdom in accordance with the existing European passport framework will require an authorization under the Financial Services and Markets Act (FSMA) in order to continue their regulated activities in the United Kingdom. This led to the enactment of a Temporary Permit Scheme (TPR), which came into force. The purpose of the TPR is to allow companies not based in the United Kingdom to continue operating in the United Kingdom for a limited period of time, requiring the authorization of the UK regulatory authorities.

Regarding payments, the United Kingdom remains a member of the Single SEPA Payments Area, i.e. payments in Euros will be made in the same way as before, except that they may be settled with a delay compared to the pre-Brexit period. Also, starting with January 2021, banks and payment operators should provide more details about the parties involved in each payment. Cash withdrawals can also be made in the EEA, but possibly with higher fees. Deposit guarantees also continue to have an effect.
Regarding how UK banking providers will be able to provide services to EU or EEA consumers, here the work varies depending on the attitude that each country will adopt, respectively 3 scenarios are possible: countries that will not allow British banks to open accounts for residents, some banks will close EU accounts, others will continue to serve European customers, but will not open accounts for new EU customers.

3. Conclusions

Throughout history, the European Union has been a bold but cumbersome construction, a community that has always tried to find the best solutions in the context of significant heterogeneity between member countries, in terms of financial, cultural and political interests. There were many challenges for the EU, but certainly an unexpected and difficult one to assimilate was the political decision of the British government to give the people the right to choose whether to stay in the EU or not. Most chose that the UK leave the EU, an issue that took the front page from 2016, until the Covid crisis in 2020. There have been many negotiations between the UK government and European officials, and following the analysis we conducted in this article we can say that the British banking system was the strongest in the EU until Brexit, and to maintain rapid financial flows, the agreements aim to maintain most of the facilities that existed between the UK and the EU, with a few elements that will be different, such as transaction fees, authorization procedures, waiting times. Both the Bank of England and the ECB (although forced to request a redistribution of the British share of capital between other European countries) have taken all necessary steps to make the transition from EU relations, including the UK to EU relations and a state that it is no longer a member to perform as smoothly as possible, with minimal disruption and inconvenience to all parties involved. The measures targeted both UK banks with branches in EU member states and banks with branches in the UK. Thus, a memorandum of understanding has been concluded which will allow supervisors to continue the exchange of information and coordinate the supervision of cross-border banking groups. The subject will continue to be a concern in our research, and we will be interested in analyzing in time the difference between the UK, which was a member of the EU, but had derogation from the adoption of the euro, without penalties, and the United Kingdom which is no longer a member of the European Union, but which may benefit from many advantages related to the European Economic Area.

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