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The Single Supervisory Mechanism in the context of a European Banking Union under construction: bridging the Euro debt crisis with defences designed for the future

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ABSTRACT: Set up in the past few years under the shadow of the Euro debt crisis, the European Banking Union (EBU) has been taking its first steps, aiming to prevent the dreaded repetition of the recent shortcomings of the several components of the European Monetary Union (EMU). By revisiting some specific events that led to the Euro crisis, this paper seeks to provide some insights on the understanding of the set-up of the Single Supervisory Mechanism (SSM), in the context of the broader conjunction of the several instruments put forward to provide the EBU with the resilience to prevent future crises. The text provides a brief background of the events that triggered the need for setting up the EBU, followed by an overview of its different constitutive elements and, finally, a critical analysis of the most prominent aspects of the SSM.

KEYWORDS: European Banking Union – euro – Economic and Monetary Union – bank supervision – Single Supervisory Mechanism.

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1. Context and pretext: the Euro debt crisis

The Euro debt crisis, a perfect storm of unforeseen proportions that followed a global financial crisis,[1] took over media attention during the last decade, and the responses designed to address it, in the context of an EU unprepared to face its outcomes and implications,[2] have given strength for further steps to be taken in order to deepen the European Monetary Union (EMU), a problematic affair in itself.[3]

This was the backdrop for the set up of the European Banking Union (EBU), a fish out of water originally submerged in a legal territory bounded by EU Treaty constraints that would predictably struggle to adjust to the political environment of the last few years, and whose success will necessarily depend on its capacity to help stabilize the Euro area and prevent the reversal of persistent and long lasting trends towards fragmentation and renationalization of financial markets.

The sovereign debt crisis in the Euro area was, in fact, initially regarded as the dreadful milestone that could prompt closer fiscal integration in the EU and force the hand of the EU institutions to sort out the shortcomings of the EMU.[4] What is more, growing public attention over the staggering numbers on debt also explains the unwillingness of governments in fiscally rather strong EU Member States[5] when it comes to confronting their electorates with into accepting the need for bolder steps towards a broader and deeper economic, fiscal and political integration of the Euro area, that could be perceived as an unconditional bail out of irresponsible foreigners, a view that has been prevalent amongst populist opposition parties. A pragmatic approach was therefore also perceived, at the EU level, as the most sensible option for the steps to be taken,[6] acknowledging, however, the convoluted association between

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[1] For a full chronology and description of the early stages of the global financial crisis, see the 79th Annual Report of the Bank for International Settlements, Basel, 29 June 2009, accessed January 10, 2018, available at http://www.bis.org/publ/arpdf/ar2009e0.pdf.

[2] For a critical analysis on this subject, see Rui do Carmo, "*The early days of the euro debt crisis revisited: historical, legal and institutional overview of the role of the ECB in the context of an Economic and Monetary Union in mutation*", in UNIO EU Law Journal, CEDU - Centre of Studies in European Union Law, vol. 1, nº. 1 (2015): 94-109; accessed January 10, 2018, available at http://www.unio.cedu.direito.uminho.pt/Uploads/UNIO%201/The%20early%20days%20of%20the%20euro%20debt%20crisis%20revisited_UNIO.pdf.

[3] For a full chronology and description of the events regarding the set up of the European Monetary Union see H. K. Scheller, *The European Central Bank – History, Role and Functions* (Frankfurt am Main: ECB edition, 2006) and H. Ungerer, *A Concise History of European Monetary Integration – From EPU to EMU* (Westport: Quorum Books, 1997).

[4] See, for several pre sovereign solvency crisis analysis of the pros and cons of the addition of a banking component to the EMU, Martin Čihák & Jörg Decressin, "*The Case for a European Banking Charter*", Int. Monetary Fund, Working Paper nº. 173 (2007): 7-12; accessed January 10, 2018, available at http://www.imf.org/external/pubs/ft/wp/2007/wp07173.pdf; Nicolas Véron, "*Is Europe Ready for a Major Banking Crisis?*", Bruegel Pol'Y Brief nº 3 (2007): 4-6; accessed January 10, 2018, available at http://www.bruegel.org/download/parent/234-is-europe-ready-for-a-major-banking-crisis/file/659-is-europe-ready-for-a-major-banking-crisis-english/.

[5] Several Member States consistently exhibit debt to GDP ratios beyond the 90% threshold that was regarded as a peril to long term prosperity: for an influential, yet contested contribution, see Carmen Reinhart & Kenneth Rogoff, "*Growth in A Time of Debt*", 100 AM. Econ. Rev., Papers & Proc., 573 (2010); and for an opposing view, see Thomas Herndon, Michael Ash & Robert Pollin, "*Does High Public Debt Consistently Stiffle Economic Growth? A Critique of Reinhart and Rogoff*", U. of Mass. Amherst, Pol. Econ. Res. Inst., Working Paper nº. 322 (2013); accessed January 10, 2018, available at http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_301-350/WP322.pdf.

[6] As an emblematic illustration of the referred mind set, see For an account of the broader political agenda of the European "four presidents" see Herman Van Rompuy, José Manuel Barroso, Jean

a successful banking union and a reinforced fiscal and political integration in the EU.[7] The reasoning behind such a mind set was that a European banking union, which would ensure an impartial and uniform implementation of a stringent regulatory and supervisory framework for all Euro area banks could if ultimately fulfilled, lead to a welcome outcome.[8] However, even with thorough set of demanding substantive rules for the governance of banks' operations and their risk taking behaviour, an effective and rigorously enforced supervisory and resolution regime along with common safety nets (i.e. a reliable deposit guarantee scheme and a clearly defined central bank lender of last resort obligations) could not do much to overcome the past mishaps, but should be apt to make future crises less likely and limit their impact if all elements of the banking union deemed essential were to be ultimately introduced. A regulatory intervention[9] should constitute a step forward in creating a more resilient financial system and in recovering the lost confidence in the financial system's stability as an indispensable foundation for sustainable growth in the long term.

Additionally, the banking union was explicitly set up as an instrument to "*break the vicious cycle between banks and sovereigns*",[10] since the potential for mutual reinforcement between financial and sovereign crises had already been acknowledged.[11]

2. Triggering progress towards the European Banking Union

As mentioned *supra*,[12] a series of specific events intertwined to give rise to the

Claude Juncker & Mario Draghi, "Towards a genuine economic and monetary Union" (2012), accessed January 10, 2018, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf.

[7] See, particularly, Jean Pisani Ferry et al., "*What Kind of European Banking Union?*", Bruegel Pol'y Contribution nº. 12 (2012): 15-19, accessed January 10, 2018, available at http://www.bruegel.org/download/parent/731-what-kind-of-european-banking-union/file/1595-what-kind-of-european-banking-union/; Nicolas Véron, "*Europe's Single Supervisory Mechanism and the Long Journey Towards Banking Union*", Bruegel Pol'y Contribution nº. 16 (2012): 3-4, accessed January 10, 2018, available at http://www.bruegel.org/download/parent/752-europes-single-supervisory-mechanism-and-the-long-journey-towards-banking-union/file/1614-europes-single-supervisory-mechanism-and-the-long-journey-towards-banking-union/.

[8] In agreement with this position see e.g. Rishi Goyal et al., "*A Banking Union for the Euro Area*", Int'l Monetary Fund Staff Discussion Note 13/01 (2013): 7-10, accessed January 10, 2018, available at http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf; for an opposite view, see Douglas C. Elliot, "*Key Issues on European Banking Union: Trade Offs and Some Recommendations*", Brookings Global Econ. & Dev. Working Paper nº. 52 (2012): 45-46, accessed January 10, 2018, available at http://www.brookings.edu/~/media/research/files/papers/2012/11/european-banking-union-elliott/11-european-banking-union-elliott.pdf.

[9] As a *pro* banking regulation and supervision position, see Sudipto Bhattachary, Arnoud W. A. Boot & Anjan V. Thakor, "*The Economics of Bank Regulation*", J. Money Credit Bank, 745 (1998); as a critical view of stringent and complex regulation, see Jonathan R. Macey, "*The death of corporate reputation: how integrity has been destroyed on Wall Street*" (2013): 254 259.

[10] In agreement with this position see e.g. Rishi Goyal et al., "*A Banking Union for the Euro Area*", Int'l Monetary Fund Staff Discussion Note 13/01 (2013): 7 10, accessed January 10, 2018, available at http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf; for an opposite view, see Douglas C. Elliot, "*Key Issues on European Banking Union: Trade Offs and Some Recommendations*", Brookings Global Econ. & Dev. Working Paper nº. 52 (2012): 45-46, accessed January 10, 2018, available at http://www.brookings.edu/~/media/research/files/papers/2012/11/european-banking-union-elliott/11-european-banking-union-elliott.pdf.

[11] Press Release, European Council, Euro Area Summit Statement (June 29, 2012), accessed January 10, 2018, available at http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf.

[12] Cf. supra notes [1] and [2].

crisis that pushed the setting up of the EBU, namely the constrains that put the EMU under stress and the re fragmentation of the Internal Market for financial services. Particularly, during the summer of 2012, widening of return spreads for Euro area government bonds and incrementally diverging money and capital market rates across the Euro area mounted up to sovereign and private sector imbalances that were perceived as a sign of the critical status of the EMU,[13] events that hindered the implementation of a uniform monetary policy within the EMU, as, for instance, cuts in monetary policy rates had limited effect in certain Member States.[14] Banks business' costs were relatively dependant on their home Member State's fiscal strength and the consequential credibility of its backstops, therefore establishing a pro cyclical link between sovereign and private borrowing costs.[15]

The general loss of confidence in the banking sector's viability that brought Member States' bail out capacity to the limelight could be attributed to that palpable loss of a level playing field for the provision of financial services in the Internal Market.[16] Independently of short term crisis management measures, the long term counterstrategy to rebuild trust in the stability of financial institutions also required no less than effective prudential supervision and a functional resolution regime that would prevent future sudden rises of risk concentrations befitting to put systemic stability at stake. In other words, centralization was required by the recent episodes in the Euro area only if and where the alternatives were less effective.[17]

It seems intuitive, though that the increasingly transnational nature of current banking should have a parallel in an equivalent supervisory architecture that minimizes negative cross border externalities.[18] The build up of dangerous risk concentrations in favourable periods could be limited by the lower susceptibility to national preferences, a broader information base, and cross country comparisons.[19] A

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[13] European Central Bank, Financial Integration in Europe (April, 2012): 17-28 and 31-35, accessed January 10, available at http://www.ecb.eu/pub/pdf/other/financialintegrationineurope201204en.pdf.

[14] For the ECB's assessment, see European Central Bank, *Monetary and Fiscal Policy Interactions in a Monetary Union*, July Monthly Bulletin, 51 (2012), accessed January 10, available at http://www.ecb.eu/pub/pdf/mobu/mb201207en.pdf; see, additionally, Jean Pisani Ferry and Guntram B. Wolff, "*Propping Up Europe?*", Bruegel Pol'y Contribution nº. 7 (2012): 7-12, accessed January 10, available at http://www.bruegel.org/download/parent/721-propping-up-europe/file/1572- propping-up-europe/.

[15] Goyal et al., [7], supra note [8].

[16] Chiara Angeloni and Guntram B. Wolff, "*Are Banks Affected by their Holdings of Government Debt?*", Bruegel Working Paper, 7 (2012), accessed January 10, available at http://www.bruegel.org/download/parent/717-are-banks-affected-by-their-holdings-of-government-debt/file/1564-are-banks-affected-by-their-holdings-of-government-debt/.

[17] Uwe H. Schneider, "*Inconsistencies and un-solved Problems in the European Banking Union*", 24 EUR. J. BUS. L. (2013): 454.

[18] Goyal et al., 7, 8 and 14, supra note [8]; specifically regarding crisis management, see Guido Ferrarini and Luigi Chiarella, "*Common Supervision in the Eurozone: Strengths and Weaknesses*", Eur. Corp. Governance Inst. Law Working Paper nº. 223 (2013): 6-19, accessed January 10, available at http://ssrn.com/abstract=2309897; regarding an overview of banks' risk-taking behaviour under nationally fragmented supervision and resolution, see Dirk Schoenmaker, "*Banking Supervision and Resolution – the European Dimension*", 6 L. and Fin. Markets Rev., 52 (2012): 53 54.

[19] However, informational advantages of a supranational supervisor only come up with regard to banks with sizable cross border operations, Pisani Ferry *et al.*, 9, *supra* note [14]. It is possible, though, that parallel behaviour and/or risk exposure of many small and medium sized may pose systemic risks of wider proportions, André Sapir, Martin Hellwig and Marco Pagano, "*A contribution from the Chair and Vice Chairs of the Advisory Scientific Committee to the discussion on the European Commission's banking union proposals*", Reports of the Scientific Advisory Committee, nº. 2 (October 2012): 3, accessed January 10, available at http://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_2_1210.pdf?abc5e4da5bbc

transnational perspective would counter desires to deplete foreign activities in order to stabilize the national banking system in periods of crisis and would, therefore, prevent the (re) fragmentation of financial markets.[20]

Considering that a banking union, as a crisis response, has to be set up carefully with due regard to its long term implications for pan EU institutions, the desirability of more centralization remained, however, a topic of dispute among EU political actors. The breaking out of the Spanish and Cypriot banking crises ended up being turning points that determined the epilogue of that intransigence.

In fact, once the first rumours of a private sector participation in the efforts to reduce the Greek sovereign debt load to sustainable proportions had undermined the trust in the viability of the European banking sector in July 2011, the European Banking Authority (EBA) run a capital exercise to control the markets. Consequently, the overall need for its additional funds at the relevant Spanish banks was estimated at €26.17bn.[21] Yet, the burst of the bubble in the residential construction market in May 2012 revealed that then nationalized Bankia S.A., the nation's largest mortgage lender, needed to be bailed out with a capital up to €19 bn, after the Spanish government had converted an earlier €4.5 bn rescue loan into voting stock.[22] Dynamic provisioning, or "*cookie jar accounting*", i.e., obscuring accounting practices,[23] and dubious pre insolvency debt restructurings (liquidity management exercises),[24] that were later revealed as having at least been tolerated by the competent supervisor (Bank of Spain), had helped to disguise a problem that festered for years and eventually needed an overall reorganization of the problematic portions of the banking sector. Euro area Member States provided additional funds of up to €100bn to back the bail outs,[25] with an initial transfer of €39.5bn from the European Stability Mechanism

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[20] See e.g. Rachel Epstein and Martin Rhodes, "*International in Life, National in Death? Banking Nationalism on the Road to the Banking Union*", Working Paper (April 2014): 9 14, accessed January 10, available at http://www.ecpr.eu/Filestore/PaperProposal/ebcf60c9-0053-4f10-b60a-633a07c93e9e.pdf.

[21] European Banking Authority, The EBA Publishes Recommendation and Final Results of Bank Recapitalisation Plan as Part of Coordinated Measures to Restore Confidence in the Banking Sector, December 8 (2011), accessed January 10, available at http://www.eba.europa.eu/-/the-eba-publishes-recommendation-and-final-results-of-bank-recapitalisation-plan-as-part-of-co-ordinated-measures-to-restore-confidence-in-the-banking.

[22] Christopher Bjork and Jonathan House, "*Spain Moves to Rescue Bankia*", WALL St. J. (Online) May 9 (2012), accessed January 10, available at http://online.wsj.com/article/SB10001424052702304070304577394220289946192.html#; Tommy Stubbington and David Roman, "*Bankia Bailout Hits Spanish Bonds*", WALL ST. J. (Online), May 28 (2012), accessed January 10, available at http://online.wsj.com/article/SB10001424052702303807404577431784097492256.html.

[23] For a comprehensive critical review of these accounting practices, see Fiona Mann and Ian Michael, "*Dynamic Provisioning: Issues and Applications*", Fin. Stability Rev. 128 (2002): 133, accessed January 10, available at http://www.bankofengland.co.uk/archive/Documents/historicpubs/fsr/2002/fsr13art6.pdf.

[24] For a detailed description of the events at Bankia, see Hans Joachim Dübel, "*The Capital Structure of Banks and Practice of Bank Restructuring*", Center for Fin. Stud., Working Paper nº. 04 (2013): 22 31, accessed January 10, available at https://www.ifk-cfs.de/fileadmin/downloads/publications/wp/2013/CFS_WP_2013-4.pdf.

[25] Charles Forelle and Garbriele Steinhauser, "*Latest Europe Rescue Aims to Prop up Spain*", WALL ST. J., June 11 (2012); Sara Schaeffer Muñoz, David Enrich and Christopher Bjork, "*Madrid's Handling of Bankia Repeats a Pattern of Denial*", WALL ST. J., June 11 (2012).

(ESM)[26] occurring in December 2012[27] and Spain's successful exit from the assistance program without further sizeable transfers taking place in January 2014.[28]

In the end, the political will to initiate a banking union among the Euro area Member States at the end of June 2012.[29] Arose as the result of politically induced lax governance and oversight,[30] the repeated pattern of insufficient and delayed information, and the evident moral hazard problems[31] created by an irresponsible national banking sector that can rely on international aid.

3. The architecture of the European Banking Union: an overview

A more centralized system of financial supervision and resolution was, therefore, deemed necessary, as an outcome of the described context and events, to restore credibility and stability to the Euro area banking system, and to break the referred doom loop between banks and sovereign states, and thereby to help address the fundamental problems of the Euro area and the EU.[32] As mentioned before, a supervisory development was pointed out as a necessary precondition for the unlocking of the ESM funding for direct bank recapitalization.[33] The EBU started to gain a concrete shape in the form of the Single Supervisory Mechanism (SSM), with the ECB as its hub. The legal framework for the establishment of the SSM was agreed in September 2013 and entered into force on 30 October 2013.[34] The ECB fully assumed its supervisory tasks in November 2014, subject to implementation

[26] The European Council first agreed on the need for euro area Member States to establish a stability mechanism of a permanent nature in December 2010 (cf. Conclusions of the European Council of 16 and 17 of December 2010, accessed January 10, 2018, available at https://www.cvce.eu/en/obj/conclusions_of_the_brussels_european_council_16_and_17_december_2010-en-4aaeea91-2e6b-47dc-9d6b-a098c6567b6f.html. However, the Treaty Establishing the European Stability Mechanism, comprising the details regarding the functioning of the ESM, concluded exclusively by Eurozone Member States, only came into force on 27 September 2012 in its second version. In fact, a first version had been agreed upon in July 2011 but was further developed largely in result of the deepening of the euro debt crisis. For further details on the ESM, set up as an international organisation located in Luxembourg, and the consolidated version of the ESM Treaty cf. http://www.esm.europa.eu/index.htm, accessed January 10, 2018.

[27] Art Patnaude, "ESM Issues Debt for Spanish Bank Recapitalization", WALL ST. J. (Online), December 5 (2012), accessed January 10, 2018, available at http://online.wsj.com/article/SB10001424127887324640104578160753000745828.html#.

[28] European Commission, Post programme surveillance for Spain, accessed January 10, 2018, available at https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-spain_en.

[29] Press Release, European Council, Euro Area Summit Statement, June 29 (2012), accessed January 10, 2018, available at http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf.

[30] The Bankia Disaster, WALL ST. J. (Online), January 1 (2013), accessed January 10, 2018, available at http://online.wsj.com/article/SB10001424127887323320404578215392185006694.html.

[31] Goyal *et al.*, 12; *supra* note [8].

[32] European Commission, A Roadmap Towards a Banking Union (COM(2012) 510); European Council.Conclusions (14/15 March 2013), para 13.

[33] Euro Area Summit Statement, 29 June (2012).

[34] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63 (SSM Regulation). Related changes were made to the legal framework for the European Banking Authority (EBA): Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 [2013] OJ L287/5.

arrangements.[35] A central part of the preparatory work was comprised by the ECB's "*comprehensive review*", a health check of significant banks' balance sheets and risk profiles, that aimed to address legacy issues by outlining the transparency of bank balance sheets, identifying, and implementing corrective action (such as recapitalization or bank closure), and rebuilding investor confidence lost prior to the ECB taking over its supervisory tasks.[36] Any proposed corrective action that could involve State aid would require authorization from the Commission and would, therefore, be closely scrutinized in accordance with the Commission's framework for support measures in favour of banks.[37] In parallel, the ESM was prepared for direct bank recapitalization in order to become operational at the time of the SSM's effectiveness.[38]

The other institutional elements of the EBU are a single bank resolution mechanism (SRM), which includes a single bank resolution fund (SRF) alongside a common system for deposit protection, which is the most controversial component of the unfolding EBU.[39] In July 2013 the Commission published proposals for the SRM to apply in the participating Member States,[40] but the design of the SRM developed significantly during an intensive legislative process, which was completed in 2014.[41] The SRM Regulation is complemented by an Intergovernmental Agreement between the Member States that participate in the EBU on the transfer and mutualisation of contributions into the SRF (SRF IGA).[42]

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[35] Which included: MoU between the Council and the ECB on practical aspects of the exercise of democratic accountability of the supervisory tasks of the ECB *vis-à-vis* the Council (December 2013); Inter institutional Agreement covering practical aspects of the exercise of democratic accountability of the supervisory tasks of the ECB *vis-à-vis* the European Parliament (November 2013); Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities [2014] OJ L141/1 (SSM Framework Regulation); Regulation (EU) No 469/2014 of the European Central Bank of 16 April 2014 amending Regulation (EC) No 2157/1999 on the powers of the European Central Bank to impose sanctions (ECB/1999/4) [2014] OJ L141/51.

[36] ECB, Comprehensive Assessment (2014), accessed January 10, 2018, available at http://www.ecb.europa.eu/ssm/assessment/html/index.en.html.

[37] SSM Regulation, Article 33(4); Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication") 2013/C 216/01 [2013] OJ C216/1.

[38] Statement by the President of the Eurogroup on the ESM direct recapitalisation instrument, 10 June 2014. The ESM DRI was to become operational when the 18 euro area MSs completed national procedures and the ESM Board had taken an unanimous decision to create a new instrument.

[39] The EU28 harmonized framework for deposit guarantee schemes was revamped: Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on Deposit Guarantee Schemes [2014] OJ L173/149. Changes include the introduction of *ex ante* financing arrangements, borrowing between national schemes on a voluntary basis, and adjustments linked to the Bank Recovery and Resolution Directive.

[40] European Commission, Proposal for a Regulation of the European Parliament and of the Council for the resolution of credit institutions and certain investment firms in the context of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 (COM(2013) 520).

[41] Regulation (EU) No 806/2014 of 15 July 2014 of the European Parliament and of the Council for the resolution of credit institutions and certain investment firms in the context of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1 (SRM Regulation).

[42] Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund (May 2014).

The pan EU so called *single rulebook in banking* – the Capital Requirements Regulation (CRR), the Capital Requirements Directive IV (CRDIV), the Bank Recovery and Resolution Directive (BRRD) and the recast Deposit Guarantee Schemes Directive - provides the regulatory framework for the EBU.[43] Although the denomination "single rulebook" is useful, it is not entirely accurate. There are implications for the EBU resulting from the retention of national discretions in the banking rulebook. The EBU is set up, as we have seen, on the need for centralization of responsibilities but it is heavily dependent on a rulebook that has been structured for a different objective, namely harmonization between the EU28, which allows for flexibility to accommodate certain national requirements.[44] Conflict may occur between these two strategies.[45]

4. SSM: provisional remarks on an unfolding design

It was particularly challenging to conciliate the SSM with the existing Treaty framework, demanding exceptional political skills and an extremely pragmatic decision making process. The outcome was a complex structure with peculiar organizational features.[46] There is a Single Supervisory Mechanism, not a Single Supervisory Authority or, in other words, responsibility for banking supervision within the participating Member States is not completely denationalized. In fact, there is a distribution of day to day supervisory tasks for banks between the ECB and national authorities, although the ECB, overall, is in charge on the prudential side.

Given the terms of Article 127(6) TFEU, post crisis learning favouring an objectives based supervisory structure and strong central bank involvement in prudential supervision is contingent on the EBU. However, not allowing the scope of the SSM to extend to all the financial market actors that may require prudential oversight because of their propensity to cause systemic harm[47] constitutes a deficiency of the existing Treaty framework. The SSM reflects, indeed, a traditional and narrow view of the sources of systemic risk but, despite the fact that the benefits of a more elastic approach, such as the enhanced prudential regulatory frameworks of the UK

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[43] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/1 (CRR); Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338 (CRDIV); Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 [2014] OJ L173/190 (BRRD); Directive 2014/49/EU (deposit guarantees). CRR/CRDIV constitute the improved EU prudential regulation framework, implementing the Basel III international standards. BRRD puts in place a (minimum) harmonization regulatory regime for intervention in banks under pressure and some other financial firms.

[44] E.g., CRR, Articles 7 10 and CRDIV, Articles 129 130; see further Andrea Enria, "*The New Role of the European Banking Authority in the Banking Union*", Speech, ESE Conference, Frankfurt (26 September 2013).

[45] Andrea Enria, *supra* note 44.

[46] Eilís Ferran and Valia Babis, "*The European Single Supervisory Mechanism*", Journal of Corporate Law Studies, 13 (2013): 255

[47] For instance, the 2008 collapse of AIG, a multinational insurance company, was a systemic event.

and the US, would be better, this imperfection does not preclude, by itself, the overall developments of the design.

The same can be said regarding the ECB's organizational, governance and accountability arrangements.[48] One of the standard arguments against central bank involvement in supervision is the risk of conflicts of interest between monetary and supervisory policy functions. However, synergistic advantages going the other way can also be identified. In the absence of a winning argument, the focus shifts to ensuring that such conflicts of interest as may arise when the functions are combined in a single organization are managed by appropriate internal governance arrangements. The fact that the current ECB Treaty framework is not ideally designed to set up internal safeguards to prevent cross contamination is not debated[49] but, a lot has been put in place to strengthen its structure.[50] The position of participating Member States that are not part of the Euro area is also not satisfactory[51] but, the "*close cooperation*" arrangement mechanism, set up by an ECB decision with a two way mechanism for termination, and the procedure for a non-Euro Member State to decide not to be bound by a decision of the ECB Governing Council, are reasonable compromises, taking into account the limitations of the available legal space.[52]

The position regarding the distribution of competences between the ECB and the national competent authorities (NCAs) requires a more in depth analysis and, as an introduction, the complicated nature of this arrangement needs to be briefly explained.[53] Under Articles 4 and 6 of the SSM Regulations, the ECB has exclusive competence within a predetermined framework to carry out a specified list of tasks for prudential supervisory purposes in relation to all banks established in participating Member States.[54] Tasks not specifically conferred on the ECB remain with NCAs.[55] There is a wide range of issues that have both prudential and conduct of business dimensions and that, therefore, potentially require ECB NCA cooperation.

Regarding exclusive competences of the ECB from the list of prudential tasks under Article 4, the ECB is responsible, regardless of the size or systemic significance of the institution, for the granting and withdrawal of banking licences, and for assessing the suitability of bank owners.[56] Regarding the remaining prudential tasks enumerated in the list, for which the ECB has exclusive competence under Article 4, broadly speaking, the Article 6 framework gives the ECB the responsibility for carrying out those tasks in relation to more significant banks. Differently, for less significant banks, the NCAs have primary responsibility.[57] While those will continue to be prudentially supervised on a day to day basis by NCAs, the ECB retains the general oversight of the system, as well as certain specific powers, including a power to take an institution into direct supervision when it considers this to be necessary to

[48] SSM Regulation, Recitals 54 76, and Articles 19 33.
[49] The fact that the position could be further improved is acknowledged in SSM Regulation, Recital 85.
[50] In particular SSM Regulation, Article 25 (requirement for separation of functions) and Article 26 (the supervisory board).
[51] Acknowledged in SSM Regulation, Recital 85.
[52] SSM Regulation, Article 7 and Article 26. See further Eilís Ferran, "*European Banking Union and the EU Single Financial Market: more differentiated integration, or disintegration?*", Legal Studies Research Paper, nº. 29, University of Cambridge - Faculty of Law, (2014).
[53] For a more comprehensive analysis, see Ferran *et al.*, *supra* note 46.
[54] SSM Regulation, Article 4.
[55] SSM Regulation, Recital 28 and Article 1.
[56] SSM Regulation, Article 4(1)(a) and (c) and Article 6(4).
[57] SSM Regulation, Article 6.

ensure the consistent application of high supervisory standards.[58]

Particularly relevant is the fact that the application of capital buffers and other macro prudential tools are not tasks conferred to the ECB.[59] However, the ECB may apply, if necessary, more demanding measures than those applied by national authorities.[60]

Macro prudential regulation and its respective instruments came to the fore in financial regulation as an outcome of the global financial crisis. One of the shortcomings of the previous system was that it was too focused on the soundness of individual institutions, not paying sufficient attention to risks resulting from the intertwining of the system, as a whole. The answer is now comprised of macroprudential tools, such as countercyclical capital and systemic risk buffers.[61]

These multi layered assortments of prudential responsibilities between the ECB and NCAs was set up during the legislative process, where intense political discussions ended up producing a complex legal text which may result in legal uncertainties.

Furthermore, the final position that has been adopted within the SSM could be perceived as the product of national efforts to resist interference with the *status quo* of close relationships between financial and political players at the local level. The complexity topic is controversial: on the one hand, complex rules can be criticised for originating opacity, uncertainty, and huge compliance costs;[62] on the other, activities as sophisticated and powerful as modern financial markets may require a flexible regulatory response that only a complex control system has the resilience to deliver. Supervisory design mirrors these arguments. A "simple" system of supervision is the integrated or single supervisor model, which used to have overwhelming support for being better suited for fragmented approaches in terms of clarity of purpose, comprehensiveness, scale and scope efficiencies, and accountability. But the post crisis experienced undermined this position, shedding light to the fact that prudential supervision is a specialized function in which central banks should play a prominent role.[63] The central question is whether the SSM is at risk of being compromised by the division of competences between the ECB and the NCAs, therefore becoming utterly ineffective.

5. Final remarks

The SSM assessment that we have briefly carried out does not bring to light clear evidence of its likely mid or long term failure. The fortuitous presence of Article 127(6) TFEU which added to the re calibration of the benefits of central bank involvement in prudential supervision, has paved the way for a supervisory framework that has certain oddities and potential weaknesses, but which does not look fatally flawed from the outset. However, it is of the utmost importance to underline the need for an effective coordination and alignment between bank

[58] SSM Regulation, Article 6.
[59] SSM Regulation, Article 5.
[60] SSM Regulation, Article 5(2).
[61] See further CRDIV, Articles 128 140.
[62] AG Haldane, "*The Dog and the Frisbee*", speech given at the Federal Reserve Bank of Kansas City's 36th economic policy symposium, 31 August (2012).
[63] Donato Masciandaro, "Back to the Future", European Company & Financial Law Review, 9 (2012): 112.

regulation and supervision, and particularly to the necessary support of a resolution framework that enables banks and other systemically significant institutions to fail without systemic disruption.

It suffices to recall the EBA's unfortunate experience with bank stress tests, which are meant to test the resilience of European banks in adverse scenarios, but that have historically struggled to come across as credible enough because of apparent insufficient rigor in the stress predicaments. Off course, fear of uncontrolled failure constitutes a consistent explanation factor underlying the hesitancy of the EBA's behaviour. The same problem could easily affect the ECB without the abovementioned robust institutional set up that provides for safe and efficient bank failure within the EBU. Therefore, the long term solidity of the EBU will most likely lie in the successful interconnectivity between the SSM and the SRM.