European Single Supervisory Mechanism for banks – a first step on the road to a banking union

The current financial crisis has exposed flaws in the architecture of banking supervision in the euro area. To solve this problem, a fundamental political decision was taken in 2012 to transfer extensive supervisory tasks and powers, including the right to take sovereign measures, to the European level.

The European Council and the European Parliament have since reached a consensus on a regulation establishing a European Single Supervisory Mechanism (SSM). This will confer extensive supervisory powers on the European Central Bank (ECB); the SSM itself will comprise the ECB and the national supervisory authorities of the euro-area countries. EU member states outside the euro area are entitled to opt into the SSM.

The distribution of tasks within the SSM depends on whether an institution is classified as significant or less significant; the ECB will have direct supervisory powers over significant institutions, receiving assistance from national authorities in verification activities and the preparation of decisions. For less significant institutions, by contrast, these powers will lie primarily with national authorities, although they must be exercised in accordance with the ECB's general instructions. In addition, the national authorities will be represented on the SSM's boards, panels and committees.

The SSM is only one component of the banking union; another key pillar will be a Single Resolution Mechanism (SRM) establishing uniform rules and procedures for the resolution of banks. Work has already begun on these components of the banking union, too.

Although the banking union cannot solve the current crisis, it can play a valuable role in making crises less likely in the future. To achieve this, it is important to establish effective governance structures, a clear-cut separation between monetary policy and prudential tasks and a sound legal basis for the new framework. Ongoing work on the banking union should therefore also involve examining the legal basis of the SSM and investigating potential improvements.

Background to the Single Supervisory Mechanism

Motivation for creating a banking union

Link between public finances and bank balance sheets …

After its onset in 2007, the global financial crisis exposed a whole range of flaws in the institutional and economic architecture of European economic and monetary union (EMU). In the early years of the single currency, investors made less of a distinction between the euro-area countries and among the different banking sectors than they had before the euro was launched. This development was reflected, not least, in narrowing yield spreads between euro-area government bonds and a shrinking gap between money market and capital market rates. The onset of the crisis reversed this trend and led to growing concerns that the euro-area money and capital markets would become fragmented again.

… prompted calls for a euro-area banking union

The crisis revealed a fatal negative feedback loop between public finances and banking systems. Doubts about the soundness of bank balance sheets prompted governments to bail out systemically important institutions. This worsened the fiscal positions of these countries, which, in turn, put pressure on the profitability and solvency of domestic banks through the wide-ranging ties they share with the finances of their home governments, eg via government bond holdings.[1] Government bond downgrades influenced how investors perceived the risks affecting national banking systems, while the woes of these banking systems also became a burden for the single monetary policy.

… and posed the danger of a "home bias" among national supervisors

In view of the significant links among Europe's credit institutions and given the cross-border effects of banking crises, a banking union with European-level supervision as one of its key pillars may prove especially useful in a monetary union, as the SSM should ideally benefit from a broader perspective which extends beyond national borders. More effective and transparent cross-border supervision of banking groups could allow risks to the financial system to be identified at an earlier stage and counter "home bias", ie the tendency for supervisors to be more lenient with certain banks because they are embedded in their national perspective.

The European Commission[2] therefore launched an initiative to set up a "banking union" to achieve further integration among the national banking sectors and thus complete the project of monetary union. This banking union will need to take account of the unique circumstances in Europe's monetary union – notably the sovereignty of the member states over many policy areas, some of which are important to financial stability, the danger of conflicts of interest (particularly with monetary policy goals), and requirements under EU primary law, which will place certain constraints on the institutional structure of the banking union. The proposed legislation on the banking union also reflects efforts to accommodate these circumstances.

The "four presidents"[3] developed this concept further in a dedicated report, and the project was endorsed at the highest political level – that of the heads of state or government – at the European Council's June 2012 summit. The summit statement called on the European

1 For more information on the negative feedback loop between bank balance sheets and government bonds, see, among other sources, "Stabilitätskultur im Lichte der Staatsschuldenkrise", speech by Bundesbank President Dr Jens Weidmann at the North Rhine-Westphalian Academy of Sciences, Humanities and the Arts, Düsseldorf, 8 October 2012, and European Central Bank, Monetary and fiscal policy interactions in a monetary union, Monthly Bulletin, July 2012, pp 51-64.

2 See the European Commission memo "The banking union" of 6 June 2012 and the speech held by the President of the European Commission, José Manuel Durão Barroso, at the European Policy Centre in Brussels on 26 June 2012. Both the memo and the speech already include the term "banking union". The term "financial market union" was also used occasionally at an earlier stage in the discussions; it appears to be broader in scope than "banking union" but is now used much less often in practice.

3 The presidents of the European Commission, the ECB, the European Council and the Eurogroup, who presented several reports and interim reports under the heading "Towards a genuine economic and monetary union".

Commission to present proposals for a Single Supervisory Mechanism (SSM) on the basis of Article 127 (6) of the Treaty on the Functioning of the European Union (TFEU) and asked the Council to consider these proposals as a matter of urgency by the end of 2012. Once an effective SSM has been established, the European Stability Mechanism (ESM) is to be given the possibility to recapitalise banks directly (bypassing the indirect route of an ESM loan to their home country, which would then have to put together a rescue programme).

Procedure

Two regulation proposals from September 2012 …

The Commission put the conclusion of the summit into action and presented a package of legislative proposals on 12 September 2012, comprising a regulation giving strong powers for the supervision of banks to the ECB on the basis of Article 127 (6) of the TFEU and a regulation reforming the European Banking Authority (EBA), which adapts the regulation establishing the EBA to the new supervisory framework.

… were amended and a political declaration added to the legislative package

The trialogue between the Council, the Commission and the European Parliament[4] involved a critical evaluation of whether taking Article 127 (6) of the TFEU as the legal basis for transferring supervisory powers to the ECB would offer a viable long-term solution. In the course of this process, a third, separate document was added to the legislative package: a declaration by the member states that they were ready to work constructively on a proposal for "treaty change" (to amend EU primary law). However, this is a political commitment and is not legally binding.

Compromise already reached but further procedural steps required before the regulations come into force

The Council approved the compromise reached through the trialogue at the meeting of the Permanent Representatives Committee on 18 April 2013. This did not constitute a formal decision; the legal opinion of Germany's governing coalition – based on a ruling by the Federal Constitutional Court[5] – is that Germany's permanent representative on the Council may only approve the SSM Regulation once he has been authorised to do so by legislation passed with a two-thirds majority by the Bundestag and the Bundesrat. The relevant draft legislation[6] was ratified by the Bundestag on 13 June 2013 and by the Bundesrat on 5 July 2013, clearing the way – under German constitutional law – for a formal decision by the Council. The European Parliament's final vote on the two regulation proposals is scheduled for 10 September 2013. Although the legislative procedure is not yet complete and the wording of the regulation proposals therefore still needs to be finalised, extensive changes to the proposals are unlikely given the political consensus among the institutions involved.

Description and explanation of the regulation proposals

Technical and geographical scope of the SSM

In principle, the ECB will assume overall responsibility for supervising the banking system of the SSM member states. However, the SSM's

4 There was no legal requirement to reach a consensus with the Parliament, as Article 127 (6) of the TFEU stipulates the use of a special legislative procedure which does not accord the Parliament decision-making rights (which it would usually possess in the EU legislative process), merely stipulating that the Parliament must be consulted. However, Article 114 of the TFEU, which was taken as the legal basis for the amendments to the EBA regulation that were negotiated in parallel, requires the use of the ordinary legislative procedure, which stipulates that the consent of the European Parliament must be obtained. Given that the subject matter of the two regulations is related, and in the interests of democratic legitimacy, the Parliament already presented its assessment of both regulation proposals during the negotiation process and insisted that the two documents be considered in parallel.
5 Primarily, the Federal Constitutional Court's "Lisbon ruling" of 30 June 2009, which declared Germany's ratification of the Lisbon Treaty to be constitutional and imposed conditions for the transfer of further powers to the European level (BVerfGE 123, 267). This legal opinion is somewhat controversial; in a hearing on 5 June 2013 before the Bundestag Committee on the Affairs of the European Union, doubts were raised over the need for national legislation approving an EU regulation.
6 Draft act put forward by the parliamentary groups CDU/CSU and FDP, Bundestagsdrucksache 17/13470.

SSM's supervisory remit will only extend to credit institutions under EU definition and activities governed by EU law

supervisory remit will generally only extend to banks classified as a deposit-taking credit institution under EU law, ie an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. Consequently, national authorities will retain sole responsibility for supervising entities classified as credit institutions under national law but not under EU law. This will be of particular relevance for Germany, as the German Banking Act (*Gesetz über das Kreditwesen*) defines credit institutions much more broadly than EU legislation. Similarly, the proposed SSM legislation distinguishes between national and EU law in the specific business activities of a credit institution; the ECB will only be responsible for monitoring the application of EU law and national legislation which transposes EU directives or exercises the options for member states that are granted in EU regulations. Competence for monitoring compliance with regulatory requirements founded solely in autonomous national law will remain with the national supervisory authorities. In Germany this will apply, for example, to the Pfandbrief Act (*Pfandbriefgesetz*), the legal provisions on significant loans to managers and the sphere of central counterparties (CCPs) in securities and derivatives business (expressly mentioned in Article 1 (2)). However, the tasks conferred on the ECB essentially cover the entire spectrum of material rules relating to the prudential supervision of credit institutions, which have recently been additionally harmonised through the EU legislation implementing Basel III (CRR/CRD IV[7]).

Opt-in for EU countries outside EMU

As it is envisioned as an addition to EMU, the SSM's geographical scope will cover the entire euro area. EU member states outside the euro area are entitled to opt into the SSM. Article 7[8] provides for the possibility of establishing close cooperation between the ECB and the national supervisory authority of an EU member state seeking to join the SSM, rendering this country a "participating member state" (Article 2 (1)) – a term used frequently in the SSM Regulation to define the geographical scope of the SSM. This close cooperation can be terminated either by the member state or, if the country does not adequately implement the ECB's measures, by the ECB.

ECB also supersedes national supervisors as the "competent authority" in relations with non-SSM countries

Yet the SSM will also have implications for countries outside its supervisory remit. As the SSM Regulation designates the ECB as the "competent authority" for banking supervision, it will also perform the tasks of the "competent authority" in relations with non-SSM countries (see, for example, Article 4 (1) letter g and (2)). This will mainly affect participation in cross-border supervisory colleges.

Distribution of tasks between the ECB and national authorities within the SSM

Forming an SSM comprising the ECB and national supervisory authorities

Although the ECB will, in principle, be broadly responsible for supervising credit institutions in the SSM countries, it will not perform all of the tasks covered by the SSM Regulation directly itself. Instead, the SSM will be composed of the ECB and the national supervisory authorities and founded on the principles of cooperation and decentralisation. This network of existing institutions will have a similar structure to the Eurosystem (comprising the ECB and the national central banks of the euro-area countries). In terms of the institutions involved, there is a substantial overlap between the Eurosystem and the SSM: the national central banks in 11 of the 17 euro-area countries are also responsible for banking supervision.

National supervision of less significant institutions

The ECB will be exclusively responsible for all supervisory tasks listed in Article 4 (1) in relation to all credit institutions established in SSM member states – albeit within the framework of Article 6. This proviso means that the ECB

7 For an in-depth analysis of this issue, see Deutsche Bundesbank, Implementing Basel III in European and national law, Monthly Report, June 2013, pp 55-71.
8 In this and all subsequent cases in this Monthly Report article, the citation refers to the SSM Regulation unless stated otherwise. We refer to the reworded version of 1 July 2013, which is available on the Council's website (document number 9044/13).

will not perform all of these supervisory tasks for all banks itself; instead, the tasks will be divided between the ECB and the national supervisory authorities. As a result, only institutions classified as "significant" will be supervised by the ECB directly. For "less significant" institutions, by contrast, these tasks will fall under the remit of national authorities (Article 6 (6)). This will include responsibility for ensuring compliance with regulatory requirements. However, national supervisors will not be fully autonomous in this respect; the ECB will exercise oversight over the system as a whole and will be responsible for ensuring high-quality, harmonised supervision throughout the euro area by issuing regulations, guidelines or general instructions to national supervisory authorities.

Distinction between significant and less significant credit institutions

Institutions will be classified as significant or less significant according to pre-defined criteria regarding their size, economic importance and the importance of their cross-border activities. Specifically, an institution will be considered significant if any of the following conditions is met:

– the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
– it is a recipient of direct assistance from the EFSF or the ESM;
– it is one of the three most significant credit institutions established in an SSM member state.

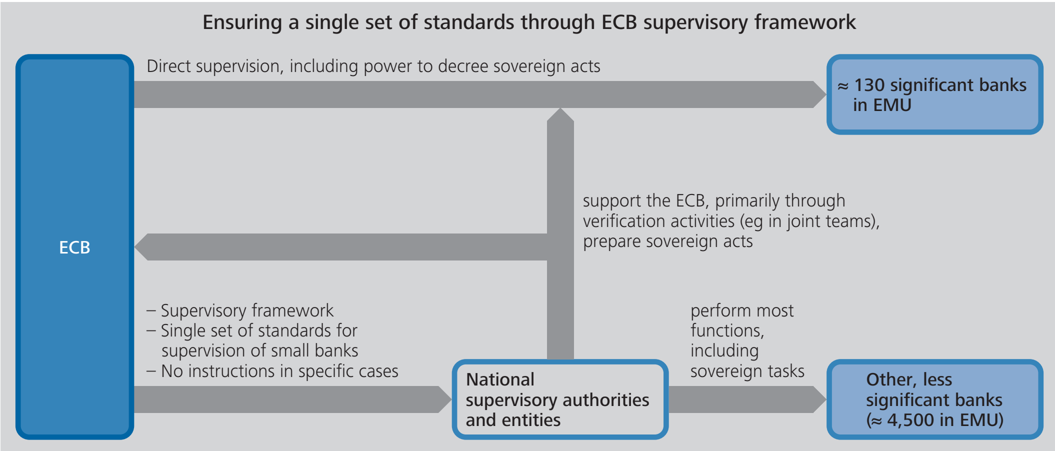
Only one of these criteria needs to be met for an institution to be classified as significant. The criteria will be applied at the highest level of consolidation within the SSM member states; consequently, if a group of credit institutions reaches the threshold at the consolidated level, its banking subsidiaries and branches will also be considered significant even if they do not exceed the significance threshold on their own.

The division of tasks between the ECB and the national supervisory authorities will be guided by this distinction between significant and less significant institutions. The ECB will perform the tasks listed in Article 4 (1) – which include sovereign powers – for significant credit institutions; in effect, these tasks will cover the entire spectrum of supervisory activities. In addition, the ECB will have comprehensive data collection and verification powers in accordance with Articles 10 to 13 (requests for information from legal or natural persons, general investigations, on-site inspections). However, this does not mean that national authorities will cease all of their supervisory activities for these institutions. Faced with the challenge of creating a functioning supervisory mechanism from scratch within the ECB, it is both reasonable and necessary to use the existing resources and expertise of national supervisors – which will also allow the SSM to draw on a pool of in-depth knowledge about the specific legal and actual circumstances in each of its member states. There are tentative plans to establish joint supervisory teams for each significant bank or banking group, composed of staff from the ECB and the national supervisory authorities who are in permanent contact with each other. This would enable national authorities to contribute, for example, to verification activities or data analysis concerning significant institutions even though the responsibility for issuing sovereign, supervisory measures will lie with the ECB.

Direct ECB supervision of significant institutions involving national authorities

The ECB will also be entitled, on its own initiative, to classify a specific institution involved in cross-border activities as significant even if it does not fulfil the significance criteria, thus drawing additional institutions into its direct supervisory remit. The ECB's powers under Articles 10 to 13 (requests for information, general investigations, on-site inspections) also apply to less significant institutions subject to national supervision (Article 6 (5) letter d). The chart on page 18 illustrates the distribution of tasks between the ECB and the national authorities within the SSM, while the box on pages 19 and 20 explains the interaction between the

Division of tasks between national and European level



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national and European levels when implementing and applying supervisory measures.

Most of the provisions in the SSM Regulation which assign the ECB powers over banks also explicitly extend their scope to all credit institutions in the SSM countries. Given the division of tasks envisaged in the regulation, however, the ECB will only exercise its powers over less significant banks if the applicable criteria in the regulation are fulfilled.

ECB not authorised to issue instructions concerning specific cases

Aside from its aforementioned general right to issue instructions, the ECB is not authorised to address instructions to national supervisory authorities concerning specific cases. However, it is unclear whether the regulation accords the ECB a general right of intervention which would also allow it – instead of the national authorities, which are actually responsible for such activities – to issue and implement measures for specific cases involving less significant institutions at any time. Article 6 (5) letter b specifies that the ECB may decide to exercise "all the relevant powers" over less significant banks itself where this is necessary to ensure a consistent application of high supervisory standards, which could be interpreted as a legal basis for such a right of intervention. Alternatively, "all the relevant powers" could also be understood to mean that, if the ECB chose to make use of this option, it would then have to exercise all powers over that institution itself in the future and would not be allowed to simply intervene on a case-by-case basis in the national authorities' ongoing supervisory work. This interpretation would render this provision no more than an additional option, alongside Article 6 (4) subparagraph 3 but subject to different conditions, allowing the ECB to take over full responsibility for supervising an institution that had previously fallen under the remit of the national authority. Nonetheless, this interpretation is of great significance in practice, where it is important to have clear lines of competence and responsibility for supervisory activities. This can only be ensured if the ECB is not permitted to issue specific instructions regarding less significant banks.

New licensing regime for credit institutions

ECB to issue and withdraw authorisation for all institutions

The above-described division of labour leaves aside the whole subject of issuing and withdrawing authorisations to conduct banking business, which is governed by a special regime. These powers are transferred to the ECB pursuant to Article 14, regardless of the significance of the institution.

Ways for the ECB to institute supervisory legal acts

In its new role as a supervisory authority, the ECB will have powers of administrative intervention. This move by European regulators into uncharted waters was forced by the absence of harmonised European administrative legislation. The ECB will essentially have a choice of three procedures: directly exercising its own powers, applying national legislation and instructing national authorities to institute supervisory legal acts.

The ECB will have numerous instruments directly at its disposal to fulfil and discharge its tasks. Article 16 (2), in particular, provides a comprehensive catalogue of powers:[1] the ECB may order an institution which it supervises directly to hold additional own funds for uncovered risk or to present a plan to restore compliance with supervisory requirements. It can, moreover, prescribe a specific provisioning policy or treatment of assets and require an institution to restrict or limit certain business activities or sell off activities that pose excessive risks to the soundness of the institution. The ECB can also restrict variable remuneration to a certain percentage of net revenues if this remuneration is incompatible with maintaining a sound capital base. Moreover, it can order an institution to reinvest net profits to strengthen its own funds and restrict or prohibit profit distribution altogether. In addition, the ECB can impose more frequent and additional reporting requirements and specific liquidity requirements. It can also remove managers who fail to comply with supervisory requirements.

The provisions established in Article 4 (3) of the SSM Regulation are very unusual in European law. What is new is that, in order to circumvent the issue of directives not being directly applicable in the member states, a European body will be required to implement national law – ie, national legislation transposing EU directives. The application of national legislation by the ECB is likely to cause considerable practical problems since EU directives, despite all efforts at harmonisation, often allow member states options and scope to take account of national peculiarities, which the ECB would then likewise have to observe. In order to make effective use of this possibility, the ECB would therefore need to be familiar with a large number of national legal systems, including the relevant administrative legislation. Moreover, appeals against supervisory measures taken by the ECB could only be submitted to the European Court of Justice, which would have to examine the legality of a measure not just under European law but also – against its usual practice – under national law. Admittedly, these problems are likely to come up in everyday practice only where this involves supervisory measures not included in the extensive catalogue of powers envisaged in

1 The scope of these powers, especially the question of whether they are limited to significant institutions supervised directly by the ECB or are applicable to all credit institutions, is not entirely clear. The former interpretation is supported by the chain of references from Article 16 (1) to Article 4 (1) and from there to the framework pursuant to Article 6, which is currently being developed with this interpretation in mind. This understanding of the ECB's powers is consistent with the principle in the SSM Regulation of distinguishing between significant and less significant institutions with regard to the scope of the ECB's activities. On the other hand, Article 16 (1) states that the measures listed therein can be directed at "any credit institution". As a result, the possibility of these powers being applied to all banks in future practice cannot be ruled out entirely even though this is not the intention underlying the work at present. This would upgrade the ECB's role to the substantial detriment of national authorities.

the CRR and the SSM Regulation that are directly applicable under European law.

In some cases, the ECB will also be given the power to issue instructions to national supervisory authorities. With respect to significant financial institutions, which will be supervised directly by the ECB, the SSM Regulation invests the ECB with a right to issue instructions. Unlike in the case of less significant banks, the wording of the regulation does not restrict this entitlement to general matters, and it therefore also includes the right to issue specific instructions (third subparagraph of Article 9 (1)). Although the ECB has direct powers over those banks which it supervises directly, the right to issue specific instructions gives the ECB the additional option of a two-stage supervisory procedure: the ECB issues instructions to national supervisors under European law and, in order to comply with these instructions, national authorities impose measures on credit institutions under national law.

The application and implementation of supervisory legislation will not be restricted to the imposition of a supervisory measure, ie a supervisory legal act (under German administrative law, which is applicable to BaFin, this usually takes the form of an administrative act pursuant to section 35 of the Act on Administrative Procedures *(Verwaltungsverfahrensgesetz),* whereas under European law – as applied by the ECB – it will be a decision under Article 288 (4) of the Treaty on the Functioning of the European Union (TFEU)). Compliance with an adopted supervisory legal act must be enforced, where necessary, through legal channels. In addition, the SSM Regulation empowers the ECB to impose sanctions for non-compliance: under Article 18, it may punish breaches by imposing administrative penalties of up to twice the amount of profits enabled by the breach or up to 10% of the total annual turnover. Alternatively, it may instruct national authorities to open penalty proceedings pursuant to national law – in Germany, this would mean, in particular, the laws governing administrative offences *(Ordnungswidrigkeiten)*. National supervisors can impose sanctions not only on a credit institution itself as a legal person but also on any natural persons responsible for the breaches. However, should enforcement measures turn out to be necessary because other methods have failed to ensure compliance with legal requirements, the ECB will inevitably have to enlist the assistance of national supervisors and, where necessary, other national authorities; the European institutions do not have their own fully developed set of enforcement mechanisms. In that vein, Article 12 (5) of the SSM Regulation explicitly requires national authorities to assist the ECB by imposing enforcement measures pursuant to national law with regard to on-site inspections.

Applications for authorisation to conduct banking business must be made to the national competent authority, which then assesses compliance with national legislation and, if the outcome is positive, submits a draft decision to the ECB within a nationally defined timeframe as to whether or not to grant authorisation. A "no objection" approach applies: the decision to grant authorisation is deemed adopted unless the ECB objects to the proposal of the national authority. Nonetheless, the issue of authorisation is considered an ECB act.

The draft regulation contains two ways of revoking authorisation. The ECB may withdraw authorisation on its own initiative; in this case, it must consult the national authority. Alternatively, the national competent authority may make a proposal to have authorisation revoked. Even then, however, the final decision on whether or not to withdraw the authorisation rests with the ECB.

Member states retain deferring veto against withdrawal of authorisation as long as they remain competent to resolve credit institutions

For the transitional period until a harmonised European bank recovery and resolution regime enters into force, a special rule will apply (Article 14 (6)): as long as responsibility for bank resolution remains at the national level, the national authority may invoke a deferring veto against the ECB's plan to withdraw a bank's authorisation in cases where this would jeopardise financial stability. This is intended to win time in which to take measures to protect financial stability (which may include bank resolution). The length of the deferral is not laid down in the regulation itself, but is agreed between the ECB and the national authority.

Institutional provisions

Need for strict separation of banking supervision and monetary policy

One of the greatest challenges for the SSM is integrating the ECB's new supervisory powers into its existing governance structure. Regulators recognised the danger of mutually exclusive goals and conflicts of interest between banking supervision and monetary policy. A central bank with supervisory responsibility could, for instance, be tempted to provide liquidity in response to the problems of the banks it supervises. This would, however, conflict with the objective of price stability. Based on such considerations, the SSM Regulation (recitals 65 and 73 and Article 25, for instance) stresses the need for a full and strict separation of the two policy areas.

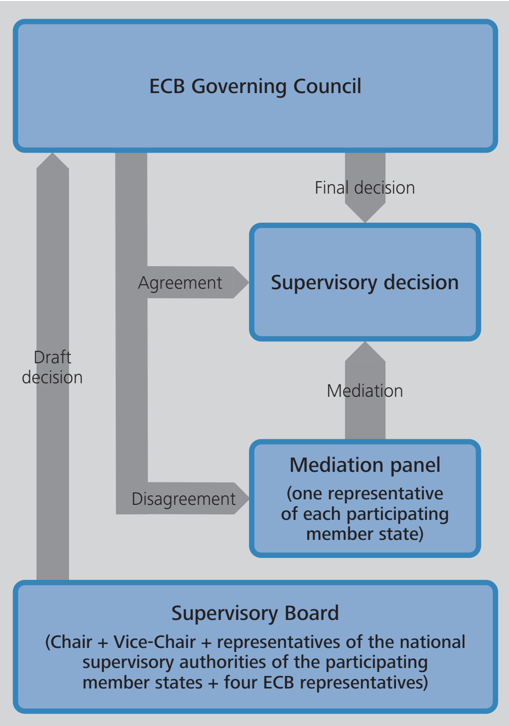
Chinese walls at operational level

To this end, the units that are responsible for the two policy areas are to be separated by Chinese walls within the ECB. ECB staff entrusted with supervisory tasks may not exercise any monetary policy functions and must be organised in separate reporting lines and chains of command.

Supervisory Board draws up draft decisions for the Governing Council

The SSM centres around a newly established Supervisory Board which is to "fully" undertake the planning and execution of the supervisory tasks conferred on the ECB. This includes preparing supervisory legal acts, which are submitted to the Governing Council of the ECB for approval (Article 26). This body has a full-time Chair and a Vice-Chair, who are appointed by the Council of the EU (member states not participating in the SSM have no voting rights) following a proposal by the ECB and with the agreement of the European Parliament; the Chair is chosen in an open selection procedure from the ranks of external candidates (ie not from among the members of the ECB Governing Council) with recognised expertise in banking and financial matters, while the Vice-Chair must be chosen from among the members of the ECB's Executive Board. In addition, there will be four ECB representatives appointed by the ECB's Governing Council and one representative from each of the national supervisory authorities of the participating member states. The Supervisory Board takes decisions on the basis of a simple majority of its members or, where directly applicable regulations are to be issued (the ECB has the authority to institute such legislation), with a weighted voting in line with the voting rules for a qualified majority on

Outline of the decision-making structures under the supervisory mechanism



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the Council of the EU.[9] For states where the authority competent to issue supervisory legal acts is not the national central bank but a separate supervisory authority – as is the case in Germany – the SSM Regulation provides the option of dispatching representatives of both institutions to the Supervisory Board, who are then considered as one member for voting purposes and thus exercise a joint voting right.[10] This allows the time-tested division of labour between the Federal Financial Supervisory Authority (BaFin) and the Bundesbank to be maintained at the European level and both institutions' specific expertise to be incorporated into the process.

Steering Committee helps prepare decisions

Pursuant to Article 26 (10), a Steering Committee is set up from among the members of the Supervisory Board. This committee, which has no decision-making powers of its own, prepares Supervisory Board decisions. It is headed by the Chair of the Supervisory Board and comprises up to ten members, of which no more than seven shall be representatives of the national competent authorities. The representatives of the national supervisory authorities are to rotate in an as yet unspecified process.

Mediation Panel to settle disagreements between Governing Council and Supervisory Board

The mediation panel described in Article 25 (5) is another instrument intended to ensure the separation of monetary policy and supervision. It will be made up of one member per participating member state, with the member state free to dispatch its central bank governor – who is a member of the ECB Governing Council – or its representative on the Supervisory Board to the Mediation Panel.

The Mediation Panel is being set up to resolve the following dilemma. Although the two policy areas need to be separated all the way up to the decision-making level in order to avoid conflicting objectives between supervision and monetary policy, at the same time the applicable European primary law does not allow for such an institutional separation: according to the ESCB Statute, which ranks as primary law, the ECB Governing Council is the ECB's supreme decision-making body, and there is no provision for a differentiation between policy areas. The SSM Regulation, as an element of secondary law, cannot override the fact, stipulated in the statute, that final responsibility rests with the ECB Governing Council. The Supervisory Board cannot therefore be equipped with its own decision-making powers in the place of the ECB Governing Council. Another problem associated with the ECB Governing Council having the final say is that only

9 Following the accession of Croatia on 1 July 2013, Germany controls 29 of 352 votes in the Council, which gives it a weight of roughly 8.2%. Its weight in the ECB's Supervisory Board is different, as states not participating in the SSM are not represented and the four ECB representatives receive voting rights equal to the median vote of the other members and the relative percentage of votes controlled by member states' representatives is correspondingly lower (Article 26 (7) sentence 2).
10 Article 26 (1) second subparagraph of the SSM Regulation. This rule differs from the corresponding passage of the EBA Regulation (Article 40 (4) and (5)), which states that the supervisory authority has the right to vote on the Board of Supervisors, as the EBA's highest decision-making body, while the central bank may participate in meetings but has no voting rights.

member states who have adopted the euro have voting rights there under the applicable treaties. If the Governing Council were to perform supervisory tasks itself, non-euro states would therefore not be able to opt in and participate in the SSM on an equal footing.

In order to defuse this dilemma, a "no objection" procedure was developed for decision-making processes in the SSM. The Supervisory Board draws up draft decisions, which it submits to the Governing Council for approval. Provided the latter raises no objections within a period to be defined later, the draft is considered to have been accepted; in other words, silence from the Governing Council is interpreted as approval. This procedure is an attempt at a compromise between the Governing Council's ultimate decision-making powers, on the one hand, and the need to transfer supervisory issues to a separate body outside of the Governing Council with other voting rules, on the other hand. If the Governing Council raises objections to a draft decision put forward by the Supervisory Board, the member states in question can apply to the Mediation Panel to settle the difference of opinion. The panel's decisions are taken by simple majority. The wording of the SSM Regulation does not explicitly rule out the interpretation that the Mediation Panel ultimately overrides the Governing Council; that would, however, not be compatible with higher-ranking EU law. The ECB Governing Council has the final say, as outlined above, and cannot, therefore, be bound by the Mediation Panel.

Administrative Board of Review

Another new body that is to be created by the SSM Regulation (Article 24) is an Administrative Board of Review. This is because the ECB, as a sovereign supervisor, will be granted the authority to impose measures that directly interfere with the rights of private entities – primarily banks, to whom supervisory acts are addressed. This raises the issue of legal protection. A five-strong board of external individuals, ie not staff of the ECB or national supervisory authorities, will be created; any natural or legal person may request that this panel review a supervisory decision by the ECB. The conditions under which this application is admissible (the act must be of direct and individual concern to the applicant) are modelled on those for legal challenges before the European Court of Justice (ECJ), and the existence of this Board of Review does not preclude the option of applying to the ECJ for legal protection. The benchmark for this new remedy encompasses procedural issues as well as material legality.

Elaboration on the requirements set out in the SSM Regulation

Exact procedures in day-to-day practice still need to be specified in greater detail …

The operational work to prepare the SSM is in full swing. Since the summer of last year, representatives of the ECB and the national supervisory authorities have, in various committees and working groups, been jointly developing the structure and processes of the SSM, which are essentially to be specified in an ECB framework regulation. A central aspect of this work is resolving how to organise daily supervision within the SSM. The SSM Regulation only sets out a rough framework: joint supervisory teams headed by the ECB are to be responsible for operational supervision of those banks that fall under the direct oversight of the ECB. Staff of the ECB and the national supervisory authorities will cooperate within these supervisory teams and undertake ongoing supervision of the significant institutions within the SSM. Supervision of less significant banks will be exercised by the national supervisory authorities based on the general supervisory guidelines and general instructions of the ECB.

… and will need to meet certain requirements

When drawing up the details of this supervisory model, care must be taken to ensure that there is a distinct division of responsibilities between the ECB and the national supervisory authorities, and that clear processes for cooperation are defined. Procedural reasons alone make this crucial, as does the need to ensure the necessary legal certainty for the SSM's supervisory actions. From a practical viewpoint, a duplication of work has to be avoided as do supervisory gaps. Moreover, the SSM's governing principle as a decentralised and cooperative supervisory system should be reflected in an appropriate involvement of the national supervisory authorities. The SSM is reliant on the experience and expertise these authorities have gathered over many decades. At the same time, it is hoped that the SSM's international outlook will prevent national considerations from playing an inappropriate role in assessments.

Accountability and budget

ECB will be independent in banking supervision, but must be accountable

European primary law gives the ECB far-reaching independence in fulfilling its tasks, without differentiating by the nature of the activity in question – monetary policy or banking supervision. However, institutional independence in the sense of freedom from external instructions has to go hand in hand with accountability to the public in order to lend democratic legitimacy to the actions that the central bank takes in fulfilling its tasks, which includes supervision.[11] On top of the ECB's accountability in terms of its tasks within the ESCB and the Eurosystem, which is laid out in primary legislation, the SSM Regulation explicitly states that it must hold itself to account to the European Parliament and the Council of the EU in relation to its supervisory tasks.

Annual reports

The ECB is to fulfil this duty primarily by presenting a report on its prudential supervisory activities once a year, which will be sent to the above-mentioned institutions as well as the European Commission, the Eurogroup and the national parliaments of the participating member states.

European Parliament's rights to question ECB and summon it to its hearings

In addition, the European Parliament has the right to summon the Chair of the Supervisory Board to hearings of the competent parliamentary committees; the Parliament and the Eurogroup may, moreover, send the ECB written questions on its supervisory activities, which the ECB is obliged to answer. Where information is confidential, the European Parliament can demand that the Chair of the Supervisory Board of the ECB hold confidential oral discussions "behind closed doors" with the chair of the competent parliamentary committee.

Also accountable to parliaments of the member states

National parliaments, too, can submit written questions to the ECB on its supervisory activities or invite members of the Supervisory Board to an exchange of views. The ECB is not, however, obliged to comply with their requests – unlike those of the European Parliament. This is without prejudice to the accountability of national supervisory authorities to their parliaments in accordance with national law.[12]

Separate budget funded with supervisory fees

Supervisory activities will not be financed out of the ECB's general budget, which would, through the ECB's profit distribution mechanism, take place at the expense of its shareholders, ie the national central banks, and thus ultimately the member states' budgets. Instead, the ECB will collect supervisory fees from the relevant credit institutions based on their significance and their risk profile according to the cost recovery principle. The national supervisory authorities retain their right to levy national fees to fund their respective activities. Spending on banking supervision will be shown separately in the ECB's budget.

Relationship with the European Banking Authority (EBA)

Changes to EBA Regulation not just superficial

The establishment of the SSM necessitated modifications to the regulation that set up the EBA. Whereas the Commission draft of September 2012 had largely been limited to mere

11 On the relationship between central bank independence and accountability see: European Central Bank (2008), Monthly Bulletin, 10th anniversary of the ECB, pp 22-24, and Safeguarding stability, Deutsche Bundesbank brochure (2012), p 12.
12 Article 21 (4) of the Regulation.

editorial adjustments to the wording, the political compromise agreed upon goes further and specifies that substantial changes are also to be made to the powers and decision-making processes of the EBA.

EBA powers to be extended to allow it to approach credit institutions directly

The powers of the EBA vis-à-vis credit institutions in stress tests are, for instance, to be expanded. While the EBA has, to date, usually received the data necessary for stress tests from the competent supervisory authorities, it can now collect them directly from the institutions. Outside of stress tests, too, the EBA can now gather information directly from credit institutions, and even from unregulated units within a financial group or a conglomerate, where the information provided by the competent supervisory authorities is insufficient. Moreover, the EBA is now explicitly given the responsibility of developing a supervisory manual which is to provide a guideline for day-to-day supervisory practice – both at the ECB and national authorities.

Introduction of double majority for EBA decisions

Noteworthy changes have been made to the EBA's internal decision-making processes as well. National authorities will continue to be voting members in the top EBA decision-making body, the Board of Supervisors. The same applies to states participating in the SSM; in other words, the ECB is still only represented by one non-voting member and does not bundle the voting rights of the SSM states. There will, however, be adjustments to the voting modalities: while a qualified majority in the sense of the voting rules in the European Council has to date been sufficient to take decisions on the most important issues – binding technical standards, budgetary matters and the temporary ban on certain financial activities – a simple majority of those EU member states participating in SSM and another simple majority of those not participating will, in future, also be required to agree. This concept is referred to as double majority.

Assessment of the consensus reached

Fundamental assessment of the SSM as part of the comprehensive project of banking union

SSM fundamentally welcome …

Establishing a Single Supervisory Mechanism as part of a banking union marks a turning point in Europe's financial market architecture. Although a number of questions remain unanswered, and notwithstanding some criticism of details, it represents a decisive step towards strengthening financial stability and the institutional framework of monetary union: given the close financial ties among European credit institutions and the cross-border effects of banking crises, it makes sense increasingly to exercise banking supervision at a cross-border level. Such a mechanism, operating on the basis of more comprehensive information and with the benefit of cross-border comparisons, will enable risks which threaten, or emanate from, the banking system to be identified more easily and at an earlier stage. It will remove the incentive to be lenient with banks out of national considerations, which also creates risks for other member states. However, a binding single supervisory mechanism for all EU member states would be desirable with a view to achieving a truly European regime of prudential supervision which encompasses the entire single market and under which European legislators adopt supervisory legal acts for banks.

… but not sufficient on its own

A consistent institutional framework needs to be in place to prevent future problems. The SSM, which should – and, following the agreements in the European Council of June 2012, will – represent an important precondition for a potential communitisation of risk via the direct recapitalisation of banks by the ESM, is not sufficient on its own, however. To ensure that investors first and foremost bear the risk of their investment decisions (bail-in), work is ongoing on a material harmonisation of the national resolution regimes of all EU member states in the form of the Bank Recovery and Resolution Directive (BRRD). In addition, the SSM needs a European counterpart for restructuring and resolution. The SSM needs to be expanded to include a restructuring and resolution mechanism, as liability and control will otherwise diverge. The European Commission's draft regulation on establishing a Single Resolution Mechanism (SRM) was presented in July 2013.

Legacy debts must be identified and dealt with nationally before the transfer of supervisory powers

The transition to the SSM and the SRM raises issues regarding intertemporal and cross-border burden-sharing if, for example, banks' balance sheets already contain impaired assets which will require future write-downs. These risks, which can vary widely from country to country, arose on the watch of national supervisors although they may materialise only after the launch of the SSM. Communitising the fiscal liability for these legacy assets would therefore be a form of redistribution. The political decision to give the ESM the power to directly recapitalise banks once the SSM has been established also adds to the scale of this problem.

Before supervisory powers are transferred to the ECB, these legacy assets should therefore be identified and then eliminated or secured through a comprehensive balance sheet review for at least the significant institutions, or better still, all institutions. This is the only way to ensure that even if these risks materialise after the SSM has been established, their consequences are borne by the member states under whose watch they arose. The fact that the SSM Regulation envisages this type of balance sheet review is therefore to be welcomed. Possible approaches are currently being developed. Because the planning and implementation of this project is highly complex and involves a large workload, it poses a major challenge to the ECB and the national supervisory authorities. Impartial third parties (eg external auditors) should play a significant role in the assessment.

In addition to the single supervisory mechanism and an effective restructuring and resolution mechanism, regulatory measures should also be taken in the medium term to prevent banks from taking on excessive risk through the financing of governments. These include own fund requirements for government bonds in accordance with the risks involved and a ceiling on lending to governments. This may also help to loosen the ties between public finances and bank balance sheets which proved so harmful during the crisis.

Communitisation of liability should be accompanied by expansion of fiscal and economic controls at European level

In the longer term, particular attention should be paid to the fact that the growing communitisation of liability risks requires considerable progress in integrating fiscal and economic policy and the establishment of effective powers of control and intervention at the European level; otherwise, liability and control would be at odds with one another, creating a worrying incentive effect (moral hazard).

Evaluation of the institutional structure of the SSM itself

Differentiation between banks in the draft regulation is a welcome development, as is …

The draft regulation contains a number of useful provisions in terms of the institutional structure of the SSM. In particular, the intended differentiation between significant and less significant institutions and the subsequent division of tasks between the ECB and national supervisory authorities is to be welcomed. Although the threshold of €30 billion in assets for classifying institutions as significant is somewhat low from Germany's point of view, it is likely to have been difficult to reconcile the needs of the larger and smaller member states in this regard.

… the division of macroprudential powers

The fact that the draft regulation keeps macroprudential policymaking at national level since the macroeconomic costs of a systemic crisis are likewise incurred at national level also deserves support. However, the ECB is empowered to tighten up national macroprudential policy. In view of the increasing communitisation of risks in the euro area, it seems appropriate for a European institution to be able to intervene in macroprudential matters.

Tying the SSM in with macroprudential oversight

At the European level, macroprudential oversight is conducted by the European Systemic Risk Board (ESRB). However, given that the various national financial systems in Europe are continuing to evolve in very different directions, it is important for national authorities, too, to be able to respond appropriately to threats to the stability of their financial system by deploying suitable systemic instruments. The use and dosage of the appropriate instruments are recommended by the macroprudential authorities or bodies responsible at national level. This task is performed in Germany by the Financial Stability Commission (*Ausschuss für Finanzstabilität,* hereinafter AFS), on which BaFin, the Bundesbank and the Federal Ministry of Finance are represented. With the introduction of the SSM, the ECB, too, will receive some macroprudential powers over the institutions in SSM member states. However, as a general rule, the tasks and powers of the ESRB and the national macroprudential authorities will remain the same as before; the latter, in particular, will retain the option of deploying macroprudential instruments, such as capital buffers, at the national level. The ECB, with its systemic role, will join the existing institutional framework for macroprudential oversight as an additional entity which – unlike the ESRB and AFS – has not only non-binding but also binding instruments in its toolkit. In general, the individual entities' responsibilities can be outlined as follows. The ESRB will be responsible for macroprudential oversight over the entire financial system (eg banks, insurers and financial market infrastructures) in the EU member states. The ECB will supervise banking systems in the SSM member states, and will also be given the individual macroprudential powers set forth in Article 5 of the SSM Regulation. Under the European banking legislation known as CRR/CRD IV, the ECB will accordingly be able to tighten macroprudential measures, such as capital buffers, imposed by national authorities in their sovereign territory. The ECB will therefore have to be notified of such measures in advance. National authorities with systemic mandates will continue to be in charge of macroprudential oversight in their respective country. The use of instruments at national level has to be coordinated with the ESRB if a significant cross-border impact is expected. This is a key "safety catch" to forestall the misuse of national discretion. Coordination between the ECB and the national macroprudential authority (of an SSM member state) will additionally be necessary if there are plans to use an instrument which could, in theory, be used by both entities. Coordination between the national authority and the ESRB will generally occur prior to coordination with the ECB. The ECB's powers with respect to coordinating the use of macroprudential instruments are without prejudice to the ESRB's mandate.

Mixed supervisory teams are a good compromise between preventing gaps and duplicating work

The concept of joint supervisory teams, which is not included in the regulation itself, but emerged during the preparations for the supervisory framework, fundamentally fulfils the requirements outlined above for an effective division of tasks. The ECB has the final say on supervisory decisions affecting significant banks. Through their involvement in the supervisory teams, the national supervisory authorities receive information that allows them to participate in decisions on the level of the Governing Council of the ECB and the Supervisory Board. In turn, the ECB needs to receive information about the supervision of less significant institutions so that it can fulfil its overall supervisory responsibility. However, this must be without prejudice to the clear division of tasks pursuant to the SSM Regulation, under which the majority of supervisory decision-making powers lie with the national supervisory authorities. Giving the ECB the right to issue specific instructions to national supervisory authorities, for example, would not be in line with this principle. In any case, it must be ensured that the national supervisors can contribute their expertise and knowledge regarding certain markets and institutions, national and regional developments in the economy or individual sectors of the economy, and, not least, their national legal systems and administrative practices.

Article 127 (6) of the Treaty on the Functioning of the European Union (TFEU) as legal basis for SSM

The heads of state or government have decided to transfer extensive prudential supervisory functions to the ECB on the basis of Article 127 (6) of the Treaty on the Functioning of the European Union (TFEU).

Prevailing primary law does not allow sufficient separation of banking supervision and monetary policy at the level of the decision-making bodies

It is not possible to separate monetary policy and banking supervision without amending the ECB's institutional framework as enshrined in primary law. Although measures such as the establishment of the Supervisory Board and the mediation panel are aimed at separating these tasks, under the applicable treaties, the ECB Governing Council has the last word on banking supervisory decisions as a matter of principle. The fact that the Governing Council can only accept or reject decision-making proposals from the Supervisory Board, but has no input into these proposals, does not contribute to good governance either. If the Governing Council is to bear responsibility for supervisory decisions, it has to be in a position to shape the measures being taken. The only arrangement in place at the level of the decision-making bodies to separate monetary policy from supervision is therefore the organisational principle according to which the Governing Council has to make banking supervisory and monetary policy decisions at different meetings (Article 25 (4)). However, this separation is not strict enough to prevent conflicts of goals.

Non-euro-area countries not able to participate on an equal footing

Finally, and in particular because the Governing Council bears ultimate responsibility, the prevailing institutional framework leaves no room for non-euro-area member states to participate on an equal footing. Although the SSM Regulation grants these countries voting rights in the Supervisory Board and the mediation panel, primary law does not permit them to receive voting rights in the Governing Council, which is the body with ultimate responsibility. This reduces the incentive for the voluntary opt-in which would be needed for broader participation in the SSM.

Current compromise is a good start to European banking supervision

As a consequence, it would appear to make sense to amend EU primary law if banking supervision is to be fully Europeanised. The compromise reached, to base the SSM on article 127 (6) of the Treaty on the Functioning of the European Union, allows banking supervision at European level to be introduced swiftly on the basis of an existing legal framework. However, this legal basis has a number of disadvantages. Policymakers should therefore not leave the situation regarding the SSM as it is, but should amend the European treaties promptly to create a sound legal basis for European prudential supervision. This can be done either by reforming the institutional framework of the ECB or by enshrining a separate European banking supervisory authority in primary law. In any case, it must be ensured that the central bank's primary mandate of preserving the independence of monetary policy and thus ensuring price stability is not jeopardised.

In addition to the SSM, a change to primary law should focus on the Single Resolution Mechanism (SRM), which is a necessary complement to the SSM. Here, too, it is very doubtful whether the current treaties provide a sufficiently sound and institutionally consistent legal basis. Work should begin on making the necessary amendments to the treaties.

Evaluation of the relationship between the SSM and the EBA

Clear division of responsibilities between the EBA and the SSM

The EBA can play an important cohesive role within the EU by coordinating activities between the member states participating in the SSM (the "ins") and those not participating (the "outs"). It should be noted, though, that the political compromise also shifts the focus of the work performed by the EBA. While its work previously focused on regulatory issues, especially the development of binding technical standards, its powers now extend to operational supervisory activities. However, it should be assumed that, in practice, the ECB will ensure supervisory consistency in the area of the SSM and the task of the EBA will therefore be to focus on ensuring that supervision is consistent between those member states participating in the SSM and the other EU member states. To avoid unnecessary duplication of work and friction between two different European authorities, an effort should be made to create a clear division of tasks and responsibilities between the ECB and the EBA.

EBA's power to address binding decisions to the ECB increases risk of crossover of responsibilities

The proposed changes to the EBA regulation do not preclude the risk of a crossover between the responsibilities of the EBA and the ECB. The EBA already has the authority to issue binding instructions to the competent authorities in certain cases.[13] If its decision is disregarded, it can order the relevant credit institution to take the necessary measure directly, effectively bypassing the national supervisory authority. Whereas the original Commission draft of September 2012 reduced the EBA's powers over the ECB as a competent supervisory authority to a simple "comply or explain" procedure, the current compromise now gives the EBA the power to impose binding decisions on the ECB. This approach prevents the ECB from being treated differently to the national supervisory authorities, especially those of the non-participating countries. However, it must not lead to the EBA becoming involved in the ECB's day-to-day work.

Double majority in the EBA is a political compromise with no objective reason

The newly introduced double majority voting system in the Board of Supervisors may potentially complicate or delay decision-making processes in the EBA and lead to the increasing formation of two factions: between "ins" and "outs". Because the non-participating states are smaller in number, population and economic weight than the participating states, this procedure favours the "outs". It is doubtful whether this unequal treatment of different categories of member states is compatible with fundamental democratic principles. Furthermore, it creates incentives not to participate in the SSM, thus contradicting the declared policy objective of achieving as broad a base of participating countries as possible. In light of this, the double majority rule is most likely a political concession to individual member states to achieve the unanimity in the Council needed in order to adopt the SSM Regulation.

Further action needed and timetable before SSM is up and running

The ECB will take on its new SSM tasks 12 months after the SSM Regulation comes into effect. The ECB is therefore expected – subject

13 These are the monitoring of compliance with EU law by the competent supervisory authorities (Article 17 of the EBA Regulation), crisis management (Article 18 of the EBA Regulation) and the binding settlement of disagreements in the event of differences of opinion amongst several competent supervisory authorities (Article 19 of the EBA Regulation).

to the adoption of the regulation, which is still pending – to assume its powers in autumn 2014. However, this date may be postponed depending on the progress made with the preparatory work and/or at the request of the ECB.

Regulation expected to come into force in summer 2013

The entry into force of the SSM regulation, which marks the beginning of this transitional period, follows standard practice in European law. As such, the package must be formally adopted by the responsible bodies (only the Council in the case of the SSM Regulation, and both the Council and the European Parliament in the case of the EBA Regulation). The act will then be published in the Official Journal and the regulation will come into force five days later. This formal adoption has not yet taken place, but the date of the final vote in the European Parliament – which is scheduled for 10 September 2013 – gives an indication of when it is likely to happen.

ECB to obtain limited competencies even before end of transitional period

At the unanimous request of the ESM, the ECB may already take over the supervision of individual banks during the transitional period. This should also allow the short-term recapitalisation of banks through the ESM, if necessary. In June 2013, the Eurogroup decided that it should be possible to directly recapitalise banks through a subsidiary of the ESM as soon as a consensus is reached on the Bank Recovery and Resolution Directive (BRRD) and the new Deposit Guarantee Schemes Directive, under which shareholders and creditors are to make a sufficient contribution to sharing the burden. Moreover, the ECB can also already perform supervisory tasks for individual institutions, such as requesting information, for example, but is not permitted to adopt any supervisory decisions. In addition, the ECB must establish the organisational framework for its supervisory activities during this period. This includes institutionalising SSM committees such as the Supervisory Board and the mediation panel, recruiting staff and setting up IT and reporting systems. The aforementioned balance sheet evaluation is also supposed to take place during this period.

Framework sets out definitions and cooperation in detail

A number of questions about the cooperation arrangements between the ECB and the national supervisory authorities remain unanswered in the SSM Regulation. The supervisory framework provided for by article 6 (7), in which the ECB will set out details of the methods used to define significant and less significant banks and the specific cooperation arrangements between the ECB and national supervisory authorities, is therefore important. This framework will contain, for instance, detailed explanations of the methods used to define significant institutions, the basic organisational and operational structure and decision-making mechanisms in the SSM, and will codify them in a binding manner. It will therefore be the key document in terms of cooperation on the SSM and is to be published within six months after the regulation has entered into force.

SSM requires a single rulebook

In addition to these internal preparations, the broader context in which the SSM operates needs to be developed further. Banking supervisors can only ensure compliance with rules that have been imposed through banking supervisory legislation. Further progress should be made on the single rulebook, a set of harmonised rules for the supervision of financial institutions throughout the EU, in order to harmonise areas of legislation. The aforementioned CRR/CRD IV package is the most prominent example of this. However, the single rulebook goes much further and also includes delegated legislation such as the Binding Technical Standards developed by the EBA.[14]

Work on BRRD about to end; work on SRM about to begin

The SSM is only one of several components in the banking union project as a whole; the other components should be implemented promptly to avoid perpetuating the divide between liability and control. Responsibility for the resolution of a distressed bank should be located at the same level as control over supervisory actions. The fact that banking resolution

14 For more on this issue, see eg Deutsche Bundesbank, Monthly Report, September 2011, pp 89-93.

regimes, which were previously regulated at national level, will shortly be harmonised by the BRRD is therefore to be encouraged, although the transitional period before the harmonised resolution tools come into force seems rather long.[15] Furthermore, on 10 July 2013, the European Commission presented a draft regulation for the establishment of a Single Resolution Mechanism (SRM) with a European bank resolution fund. This will now go through the legislative procedure at European level, initially in the form of negotiations in Council working groups and the responsible committee of the European Parliament.

DGS is not currently a priority

From time to time, there are calls for an additional banking union component in the form of a common European deposit guarantee scheme (DGS). Although deposits must be protected effectively, a European DGS would be neither useful nor necessary in order to stabilise the monetary union in its current form. For many years, EU member states' DGSs have been harmonised through legal acts[16] which strike a balance between ensuring that a minimum standard is provided, on the one hand, and that the specific features of national banking systems are taken into account, on the other. In this respect, the Deposit Guarantee Schemes Directive is currently being amended to ensure that the rules on financing guarantee funds are also placed on a common basis for the first time. By contrast, Europeanisation that extended beyond harmonising deposit scheme legislation, such as the introduction of a single DGS fund, would have a redistributive effect which would require substantial fiscal and economic policy intervention and control rights at European level (a fiscal union), requiring member states to surrender sovereignty. It is doubtful whether the political will to achieve this currently exists. For the time being, the areas of supervision and resolution should therefore be given priority over a European deposit guarantee scheme, although the aim of improving the Deposit Guarantee Schemes Directive should be pursued further. Implemented correctly, the SSM and the SRM could help to stabilise the financial markets and thus reduce the likelihood of compensation events for depositors.

Unrealistic expectations of the banking union should be avoided

Despite the importance of establishing and implementing the banking union quickly, and given the need for an effective SSM, overinflated or unrealistic expectations of the project should be avoided. A banking union cannot undo the past failures and mistakes which caused the present crisis. However, it may be a valuable tool for reducing the likelihood of future financial crises and increasing the resilience of the European financial market to shocks.

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15 The general approach taken by the Council in June 2013 envisages a transitional period of four years for the bail-in instrument.
16 These include Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994.