THE THREE PILLARS OF THE EUROPEAN BANKING UNION: AN EVOLUTIONARY ROAD

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Abstract

The European Banking Union is the last institutional response to the financial crisis, enhancing integration and stability in the EU. Under an historical perspective, the paper explores the European unification process, from the Great Depression to the recent systemic turmoil. From an administrative law standpoint, each of the fundamental pillars of the EBU is examined: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the Deposit Guarantee Schemes (DGS). The outcome of this analysis is that the new architecture for banking supervision, resolution and financial backstop may be too complex to ensure the effective and consistent functioning of the single banking market.

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Introduction

The building up of the European Banking Union is a major step towards further integration and stability in the European Union.

After the financial crisis of 2008, the European integration process is now at a point of no return: it has to choose if to take the plunge into deep institutional, fiscal and political reforms, or if to come back.

This paper evaluates the three pillars the EBU is based on, from a legal and institutional viewpoint: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the Deposit Guarantee Schemes (DGS).

Our analysis starts with a summary of the EBU historical and economic background, then focuses on the legal basis, the structure, the administrative procedures and the essential issues related to each of the three pillars.

Concluding, we try to answer to a looming question: will it work?

1. The road towards the European Banking Union

If we consider the integration process in Europe, during the last sixty years, there are three main lessons we can learn: (i) financial crises are dramatic, but they can trigger innovation and structural reforms; (ii) cooperation is ineffective in addressing systemic crises; (iii) building the European Union represents a one-way path.

In this paragraph, we are going to discuss each of the above assumptions, providing some evidences to support them.

1.1. Systemic crises as chances for institutional reform

During the last century, the world has faced two systemic financial and economic crises: the one arousing from the New York Exchange crack, in 1929, and the most recent one, coming from the US sub-prime mortgage crisis. These crucial events share similar causes and comparable immediate effects: both of them ensued from the burst of a real estate and housing bubble, which adversely affected the US, and quickly spread panic worldwide. In both cases, skeptics about the soundness of the financial and banking markets resulted in "run on the bank", causing liquidity crises and massive defaults for several banks, exposed to a risk of contagion, due to their interconnection[1]. The following disruption in the flow of credit to businesses and consumers ("credit crunch") provoked a collapse in world trade, a receding final demand and a steep decline in investments.

Actually, the mentioned elements characterize both the Great Depression of the Thirties and the current global recession, but they differ as for the long-term solutions put in place to cope with them. Whilst the former had boosted Protectionism in economy and Nationalism in politics, doomed to blow up in the Second World War, the latter have launched a new season of financial regulation reforms, including the construction of the European Banking Union.

Moreover, the different reactions to the crises reflect a divergent State model, related to opposite notions of banking supervision.

In fact, from the first half of the Twentieth century, until the Seventies, the paradigm of State intervention, in response to the 1929 crisis, had been justifying public impingement and public financial aid in economic matters. Accordingly, the doctrine of "structural" banking supervision urged a strict government control over credit institutions, to be subdued to the needs of financial stability and monetary policy. As an example of this, in Italy, the Banking Law of 1936[2] defined the collection of savings from the public and the credit supply as "public-interest functions" (Art. 1), so that the National Central Bank (*Banca d'Italia*) was in charge with wide discretionary powers to determine the scope, the structure and the mission of the banking sector.

After the Second World War, the European Coal and Steel Community (ECSC), the European Economic Community (EEC)

[1] For instance, Lehman Brothers Holdings Inc., one of the biggest investment banks in the US, filed for Chapter 11, US Bankruptcy Code on September 15, 2008. Lehman Brothers' default become the conventional starting point of the financial crisis and, for the first time, it challenged the "too big to fail" doctrine.

[2] Royal decreto-legge of 12 March 1936, no. 375, converted by the Law of 7 March 1938, no. 141, and subsequent amendments and integrations.

and the European Atomic Energy Community (Euratom)[3] were founded to neutralize competition between European nations over natural resources and to create the European internal market. The idea that economic cooperation could prevent other bloody conflicts in Europe, paved the way to the integration progress driving to the European Union.

Progressively, between the Seventies and the Eighties, the former archetype of "Entrepreneurial State" decayed and was superseded by a new concept of State, devoted to neoliberalism and restrained from intruding in the functioning of the market[4]. The new "Regulatory State" only provided the framework rules, assuming a *laissez faire* approach towards the open market.

Also the banking structural supervision was translated into "prudential supervision", whose main goal is to create a level playing field among credit institutions, in order to monitor the risks they take in their free professional activity and contain moral hazard.

Prudential supervision is based upon two principles:

- mutual recognition, under which the products and services lawfully provided in one member States of the EU cannot be banned from another member State, even in the absence of harmonized national legislations;
- minimum harmonization, which guarantees that the EU Law outlines the basic principles in certain matters of interest for the Union, leaving the detailed rules at the State-level.

The switch from structural to prudential supervision was endorsed both by the EU, through Directives no. 77/780/EEC[5]

[3] The European Coal and Steel Community (ECSC) was an international organization, formally established by the Treaty of Paris (1951), which was signed by Belgium, France, West Germany, Italy, the Netherlands and Luxembourg. In 1957, the European Economic Community (EEC) and the European Atomic Energy Community (Euratom), were founded by the Treaties of Rome.

[4] The President of the US Ronald Reagan and the British Prime Minister Margaret Thatcher were convinced supporters of the neo-liberal State.

[5] Lately implemented in Italy with the Decree of the President of the Republic no. 350/1985.

and no. 89/646/EC[6], and by the international community, through the Basel Accords[7].

Thanks to this general favor for risk-management and competition, in 1993, the twelve member States of the European Community (Belgium, Italy, Luxembourg, France, Netherlands, Germany, Denmark, Ireland, United Kingdom, Greece, Portugal and Spain), signed the Maastricht Treaty, which led to the creation of the European Union (EU), the Economic and Monetary Union (EMU) and the single currency (euro)[8]. The Treaty also conferred to the European Central Bank (ECB), established in 1999, an exclusive competence to formulate and implement the monetary policy in the euro area.

Notwithstanding the progress made by the EMU in the last twenty years[9], the EU was caught unprepared to handle the 2008 financial crisis. On one hand, some countries swiftly recurred to Emergency Liquidity Assistance (ELA) and to other long-term interventions to bring back confidence in the financial sector[10].

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[6] Implemented in Italy with the legislative decree no. 481/1992.

[7] The Basel Committee on Banking Supervision (BCBS) is a committee formed in 1974 by central bankers from around the world, meeting in Basel, Switzerland. It published a set of minimum capital requirements and prudential rules for banks, through Basel Accords of 1988, 2004 and 2010 (named respectively, Basel I, II and III).

[8] The European Union established by the Maastricht Treaty (or Treaty on the European Union, TUE), had a three-pillar structure, made of the European Community (EC) pillar, the Common Foreign and Security Policy (CFSP) pillar, and the Justice and Home Affairs (JHA) pillar. While the first pillar was managed by supra-national institutions (the Commission, the European Parliament and the European Court of Justice), the other two pillars shared an intergovernmental nature.

[9] The Maastricht Treaty has been amended by the Amsterdam Treaty (1997), the Nice Treaty (2003) and the Lisbon Treaty (2009). The latter, in particular, abolished the pillar structure of the EU, heightened the role of the European Parliament in respect to other European Institutions and renamed the Treaties of the EU as "Treaty on the European Union" (TEU) and "Treaty on the Functioning of the European Union" (TFEU).

[10] For example, in England, after the failure of the "light touch supervision", exercised by the Financial Services Authority (Fsa) since 1998, prudential supervision was conferred to the Prudential Regulation authority (Pra), as a part of the Bank of England. For more detailed information, consult "The Bank of England, Prudential Regulation Authority - Our approach to insurance supervision", available at http://www.fsa.gov.uk/pubs/speeches/boe_pra.pdf.

Generally, the regulatory failure of the self-restrained State model renewed a policy of public intervention, in the form of the rescue State[11].

On the other hand, the EU lacked of effective measures to lessen the effects of the financial crisis and to hinder its involution into the sovereign debt crisis.

1.2. From coordination to centralization

The European response to the crisis consisted of the institutional reform of the EU's financial architecture. Particularly, the European System of Financial Supervision (ESFS) was established to coordinate the micro and macro-economic regulation at a center level. Micro-prudential supervision was entrusted to three new Agencies, called European Supervisory Authorities (ESAs)[12]: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) [13] . The European Systemic Risk Board (ESRB) [14] complemented the ESFS, exerting macro-prudential tasks, under the responsibility of the European Central Bank.

From the functioning of the ESFS we deduce that mere coordination is an helpless device when it comes to financial

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Another example of emergency measures to address the subprime mortgage crisis, is the United States Troubled Asset Relief Program (TARP), to purchase assets and equity from financial institutions in order to stabilize the U.S. financial system. Although Congress initially authorized $700 billion for TARP in October 2008, the expenditure was reduced to $475 billion by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). For more information, cf. http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx#, from the U.S. Department of the Treasury official website.

11 M. Clarich, *Manuale di Diritto Amministrativo* (2014).

12 The "de Larosière High Level Group" report on financial supervision first envisaged the institution of the ESFS and of the ESAs, in 2009. The report is available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

13 EBA, ESMA and EIOPA were respectively established by Regulations (EU) No. 1093, 1095 and 1094 of the European Parliament and of the Council of 24 November 2010. They replaced the existing three Committees of Supervisors.

14 The ESRB was created by Regulation (EU) No. 1092/2010.

crises. Hence, the ESAs can only promote cooperation among the national competent authorities and take not-legally-binding decisions, which are not enforceable, according to the "act or explain" approach. Additionally, the ESFS did not address the so-called "financial trilemma", which states that financial stability, financial market integration and national financial policies are incompatible[15]. Actually, the new system still anchored prudential supervision to the national level and to the principle of "home country control", under which a European financial institution is authorized and supervised by its home country competent authority. Consequently, a bank could offer cross-border services or establish a branch in another EU member State, without additional supervision from the host country competent authority [16], but there was fragmentation among national supervisory institutions and rules.

Since 2011, the ECB has put in place ordinary and extraordinary measures, within the limits of its mandate[17], to struggle with the sovereign debt crisis and save the euro.

[15] D. Schoenmaker, *Financial supervision: from national to European?*, Financial and monetary studies"(NIBE-SVV), (2003) and "*The financial trilemma*", Duisenberg School of Finance, Amsterdam & Finance Department, VU University Amsterdam, TI 11-019/DSF 7, available at www.papers.tinbergen.nl/11019.pd. For a legal view on the "financial trilemma", cfr. R.M. Lastra, *Legal foundations of international monetary stability* (2006), 302.

[16] D. Schoenmaker, *Central Banks and Financial Authorities in Europe: which prospects?*, in D. Masciandaro (ed.), *Handbook of Central Banking and Financial Authorities in Europe: New Architectures in the Supervision of Financial Markets* (2005), 409.

[17] The ECB has progressively reduced the interest rates in the Euro area and recurred to Long Term Refining Operations (LTROs) to restore the sound functioning of the monetary channel from the Central bank, through commercial banks, to the real economy. In addition to this, it realized Outright Monetary Transactions (OMTs), subject to a strict conditionality. For more information about the ECB's monetary policy against the crisis, cfr. "*Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London*", 26 July 2012, when he pledged to do "*whatever it takes to preserve the euro*", available at http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html; and "*Introductory statement to the press conference (with Q&A)*", Mario Draghi, President of the ECB, Vítor Constâncio, Vice-President of the ECB, Frankfurt am Main, 6 September 2012, available at http://www.ecb.europa.eu/press/pressconf/2012/html/is120906.en.html.

Nonetheless, it soon became urgent to redesign the European financial anatomy.

1.3. European integration: the way forward

The systemic crisis of 2008 led to the building of a European Banking Union (EBU) [18] based on three pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the Deposit Guarantee Schemes (DGS). In the next paragraphs, we are going to evaluate each of these elements from a legal and critical perspective.

Under a legal point of view, the EBU reflects a "concentric circle" pattern. In the inner circle, there are the legal acts establishing the first two components already entered into force (SSM [19] and SRM [20]), whereas the political momentum for the approval of the DGS is yet to come[21]. These components apply only to the member States of the euro area and to other member States whose currency is not the euro, but who decide to participate on a voluntary basis.

In the outer circle, we find the existing "single rulebook", applying to all the 28 EU member States and including an harmonized legal framework arranged by the EBA and formally approved by EU institutions: the Capital Requirements

[18] European Commission, "*A Roadmap Towards a Banking Union*" (COM (2012) 510).

[19] Council Regulation (EU) No. 1024/2103 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) entered into force on 3 November 2013. Together with the SSM Regulation, the EBA legal framework was changed by 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.

[20] 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).

[21] The current harmonized framework for deposit guarantee schemes, applying in all 28 EU member States, refers to Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on Deposit Guarantee Schemes [2014] OJ L173/149.

Regulation (CRR)[22], the Capital Requirements Directive IV (CRDIV)[23], the Bank Recovery and Resolution Directive (BRRD)[24] and the recasted Deposit Guarantee Schemes Directive[25].

The two circles differ for geographical scope and for their general approach: the single rulebook is based on harmonization and national discretion, and strictly complies with the Meroni Doctrine, while the EBU centralizes banking supervision and resolution at the European level, and introduced a "mellowed" vision of the delegation of powers[26].

Along with the EBU, the other three building blocks of the forthcoming EU are the Economic Union, the Fiscal Union and the Political Union[27]. From this context, we infer the third lesson about the EU's integration: it is a one-way path. There are at least two arguments supporting this conclusion: first, we cannot waste the political efforts made to get where we are; second, most observers, unlike dominant public opinion, believe that only a

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[22] 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).

[23] 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).

[24] 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 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).

[25] Directive 2014/49/EU.

[26] J. Pelkmans, M. Simoncini, *"Mellowing Meroni: How ESMA can help build the single market"*, CEPS Commentary, 18 February 2014.

[27] The future EU structure has been depicted by the report "*Towards a genuine Economic and Monetary Union*" (so called "Four President Report"), by Herman Van Rompuy, President of the European Council, in close collaboration with: José Manuel Barroso, President of the European Commission, Jean-Claude Juncker, President of the Eurogroup and Mario Draghi, President of the European Central Bank, 5 December 2012, available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf.

more perfect and integrated European Union could keep on playing a relevant role on a global scale[28].

2. Single Supervisory Mechanism

2.1. Legal basis, structure and objectives

The legal basis for the establishment of the SSM is Art. 127 (6) TFEU.

This enabling clause provides that "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings".

There are several advantages in using this legal basis to create the SSM:

1. it allows the centralization of supervision in the hands of an existing, independent European institution without amending the Treaties;

2. it complies with the "Meroni Doctrine", under which the delegation of powers is strictly limited to powers that the delegating authority itself received under the Treaty[29];

[28] M. Draghi, "*Europe's pursuit of 'a more perfect Union'*", lecture taken at *Harvard Kennedy School*, Cambridge (USA), 9 October 2013, available at the ECB official website.

[29] The Meroni doctrine is named after the landmark Meroni Case (Meroni&co. Industrie Metallurgiche Spa v High Authority of the European Coal and Steel Community, Case 9-56 of 13 June 1958) in which the European Court of Justice claimed the principle of institutional balance, preventing the delegation of highly discretionary powers to European Agencies so far, unlike in the US. For an analysis of the Meroni Doctrine, cfr. D. Gerardin, R. Munoz, N. Petit, *Regulation Through Agencies in the EU: A New Paradigm of European Governance* (2005), 219. However, a broad-minded interpretation of the Meroni doctrine was argued in the case United Kingdom v EU Parliament and EU Council of 22 January 2014 (C-270/12). According to this recent judgment of the ECJ, the ESMA (and other European Agencies and institutions) can exercise powers of intervention in extraordinary circumstances, with a certain degree of discretion, provided that they are limited by predetermined and objective criteria.

3. though it formally confines the EP to an advisory role, the latter was asked to express its consent, to enhance the democratic legitimation of the SSM.

It is noticeable that the SSM is not a new Authority, nor a decision making body, but a mechanism, in which the ECB and the national competent authorities (NCAs) cooperate exercising active administrative functions. Thus, the SSM does not have legal personality, as well as the European System of Financial Supervision (ESFS), and it appears as an integrated network of European and national authorities[30].

Its purview encompasses all the credit institutions established in the participating member States of the Euro-area and in member States whose currency is not the Euro, which have arranged a "close cooperation" with the SSM on a voluntary basis, according to Art. 7 of the SSM Regulation[31].

In fact, it would have been impossible for the ECB to control all the 6000 banks established in the participating member States. Besides, the full inclusiveness of the SSM derives from the possibility that even small credit institutions can cause systemic turmoil, due to the interplay of the financial sector in the EU[32]. Consequently, banking supervision within the SSM is not completely denationalized, but distributed into a complex scheme, unitary but functionally multi-layered[33].

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[30] The conferral of supervisory powers to a new authority would have been compelling a Treaty amendment and inconsistent with the Meroni Doctrine.

[31] Artt. 106-119 of the Regulation Framework discipline the establishment and the implementation of close cooperations.

[32] The Spanish *cajas* are an example of the "domino effect" rising from less significant banks and affecting the whole financial system. R. Goyal, P.K. Brooks *et al.* and an IMF Staff Team, *A Banking Union for the Euro Area, International Monetary Fund, European Department*, in collaboration with the Legal, Monetary and Capital Markets, and Research Departments, 13 February 2013, available at http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf. To this end, recital 16 of the SSM Regulation Recital 16 of the SSM Regulation specifies that "the safety and soundness of large credit institutions is essential to ensure the stability of the financial system. However, recent experience shows that smaller credit institutions can also pose a threat to financial stability. Therefore, the ECB should be able to exercise supervisory tasks in relation to all credit institutions authorized in, and branches established in, participating Member States".

[33] The composite structure of the SSM is the result of compromise between the complete centralization of the banking supervision and the risk of creating a

Thereby, the supervisory competences and day-to-day verifications are articulated into a double structure, with wide recourse to delegation of powers.

Accordingly, at the center of the SSM, the ECB shall overview the whole system and directly control the 130 most significant credit institutions, representing 85% of the banking sector. At the periphery, instead, the NCAs shall play an ancillary role towards the ECB, giving their assistance as for the day-to-day supervision of most significant banks. Additionally, the NCAs retain the direct and exclusive supervision of the less significant banks on a consolidated basis. If we were asked to draw a graphic picture of the SSM structure, it would be a wheel, with the ECB as the pivotal keystone and the NCAs at the perimeter. In such a machinery, the impulses rise from the center and are transmitted to the border through stokes, representing the bilateral flows of instructions, information and decisions between the ECB and the NCAs.

The efficient functioning of this mechanism could have been ensured by a better distribution of competences between the center level and the national level, than the one settled by the SSM Regulation. Actually, Art. 6 introduces a dynamic framework, based on the subjective index of banks' significance. The quantitative and alternative criteria assessing the significance of a supervised institution are: (i) its size[34]; (ii) its importance for the

two-tier system, which would have annul the benefits of integration. According to this, the Deutsche Bank (2012), claimed that "establishing a monitoring mechanism on two distinctive levels, in which ECB monitors only systemic banks and national authorities supervise the remaining banks, is not indicated as small local or regional banks may be too at the origin of systemic crises". T.C. Barbu, I.A. Botain, *Implications of the single supervisory mechanism on ECB's functions and on credit institutions' activity*, 580 Theoretical and Applied Economics 103-120 (2013), available at http://store.ectap.ro/articole/843.pdf.

[34] Particularly, "a credit institution or financial holding company or mixed financial holding company shall not be considered less significant, unless justified by particular circumstances to be specified in the methodology, if any of the following conditions is met:

(i) the total value of its assets exceeds EUR 30 billion;

(ii) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20 %, unless the total value of its assets is below EUR 5 billion;

(iii) following a notification by its national competent authority that it considers such an institution of significant relevance with regard to the domestic economy of the Union or of any participating Member State[35]; (iii) its cross-border activities [36] (art. 6 (4). In any case, credit institutions "for which public financial assistance has been requested or received directly from the EFSF or the ESM shall not be considered less significant" (Art. 6 (4), forth sub-paragraph)[37].

However, the SSM organizational and governance framework is highly asymmetrical, in favor of the ECB.

Specifically, the ECB's Governing and Executive Council are the ultimate decision-making bodies on prudential supervision. Thus, the ECB is the hub of the new system, which resembles a hierarchical structure, to the extent that NCAs act as agents or subsidiaries of the ECB and shall abide by ECB's decisions in matters falling under its exclusive competence. Despite both the ECB and the NCAs are subject to a "duty of cooperation in good faith, and an obligation to exchange information"[38], only the former is "responsible for the effective and consistent functioning of the SSM" (art. 6 (1) and "shall exercise oversight over the functioning of the system" (art. 6 (5) (c). This means that the ECB is in overall charge with the effective functioning of the whole system, and shall at any time take upon itself the supervision for one or more credit institutions, "when necessary to ensure consistent application of high supervisory standards" (Art. 6 (5) (b).

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economy, the ECB takes a decision confirming such significance following a comprehensive assessment by the ECB, including a balance-sheet assessment, of that credit institution" (Art. 6 (4), sub-paragraph 2).

[35] In fact, "the ECB shall carry out the tasks conferred on it by this Regulation in respect of the three most significant credit institutions in each of the participating Member States, unless justified by particular circumstances" (Art. 6 (4), last sub-paragraph).

[36] "The ECB may also, on its own initiative, consider an institution to be of significant relevance where it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities subject to the conditions laid down in the methodology" (Art. 6 (4), sub-paragraph 3).

[37] The procedures for the classification of a credit institution as significant or less significant, cfr. Artt. 39-72 of the Regulation Framework. On 4 September 2014, the ECB published "The list of significant supervised entities and the list of less significant institutions", pursuant to Art. 49 of the Regulation Framework.

[38] Art. 6 (1) of the SSM Regulation and Art. 21 of the Regulation Framework.

In relation to macro-prudential powers, the ECB may, if deemed necessary, replace NCAs and decide to apply higher requirements for capital buffers and more stringent measures aimed at addressing systemic or macroprudential risks (Art. 5 (2).

In addition to this, the ECB shall exert regulatory prerogatives, issuing regulations, guidelines, general and individual instructions to NCAs (Artt. 6 (5) (e) and 9 (1). On the other way round, a continuous flow of information shall come from the NCAs to the ECB, on the performance of the tasks carried out by them (Art. 6 (5) (e). Finally, the ECB can benefit from the NCAs' expertise, offices and resources[39].

Political manoeuvring was required to arrange the innovative and polycentric scheme of the SSM. In the end, thanks to pragmatic concessions, the SSM has been rapidly set out, to pursue the following overriding objectives:

1. breaking the vicious link (doom loop) between banks and the sovereign States;
2. overtaking the "home bias" problem, concerning "the tendency for supervisors to be more lenient with certain banks because they are embedded in their national perspective"[40], thus eliminating the regulatory capture;
3. creating a common level playing field for credit institutions in the EU, curbing the fragmentation of the banking sector along national borders.

2.2. ECB supervisory tasks and powers

The ECB will fully exercise the tasks conferred by the SSM Regulation by 4 November 2014, twelve months after the SSM Regulation enters into force (3 November 2013). During this transition period, the ECB has reached several implementation arrangements[41] and started a "comprehensive review", to check

[39] On this point, cf. recital (37), (67) and (79) of the SSM Regulation.

[40] Bundesbank, *Monthly Report*, July 2013, Vol 65, available at http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report/2013/2013_07_monthly_report.pdf?__blob=publicationFile.

[41] Memorandum of Understanding (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 (IIA) covering practical aspects of the exercise of democratic

the significant banks' balance sheet and eventually realize corrective action. This preparatory work should revamp transparency and confidence in the banking sector.

When the SSM will be fully operational, it will be exclusively responsible "to authorise credit institutions and to withdraw authorisations" (Art. 4 (1) (a)) and "to assess notifications of the acquisition and disposal of qualifying holdings" (Art. 4 (1) (c) in all credit institutions domiciled in the participating member States, regardless to their significance (Art. 6 (4).

Moreover, as far as more significant banks are concerned and within the framework of Art. 6, the ECB will exercise a list of prudential specific tasks:

1. "for credit institutions established in a participating Member State, which wish to establish a branch or provide cross-border services in a non participating Member State, to carry out the tasks which the competent authority of the home Member State shall have under the relevant Union law" (Art. 4 (1) (b);

2. to ensure compliance with the acts referred to prudential requirements on credit institutions[42] and to robust governance arrangements[43] (Art. 4 (1) (d) (e);

3. "to carry out supervisory reviews, including where appropriate in coordination with EBA, stress tests and their possible publication"[44] (Art. 4 (1) (f);

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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.

[42] "in the areas of own funds requirements, securitisation, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on those matters" (Art. 4 (1) (d).

[43] "including the fit and proper requirements for the persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices and effective internal capital adequacy assessment processes, including Internal Ratings Based models" (Art. 4 (1) (e).

4. to carry out consolidated supervision over credit institutions' parents established in one of the participating Member States, and to participate in supplementary supervision of financial conglomerates (Art. 4 (1) (g) (h);

5. to carry out supervisory tasks in relation to recovery plans, and early intervention (Art. 4 (1) (i);

6. to carry out the tasks for which the national competent authorities are competent in accordance with relevant Union law, for credit institutions established in a non-participating Member State, which establish a branch or provide cross-border services in a participating Member State (Art. 4 (2);

7. to make use of the powers referred to in Articles 10 to 13, which entail investigatory powers (Artt. 10, 11) and on-site inspections (Artt. 12, 13)[45].

According to recital 28 and Art. 1 of the SSM Regulation, supervisory tasks not conferred on the ECB should remain with the national authorities. These include the following residual powers:

a) "to receive notifications from credit institutions in relation to the right of establishment and the free provision of services";

b) "to supervise bodies which are not covered by the definition of credit institutions under Union law but which are supervised as credit institutions under national law", including insurance undertakings[46];

c) "to supervise credit institutions from third countries establishing a branch or providing cross-border services in the Union";

d) "to supervise payments services";

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[44] "In order to determine whether the arrangements, strategies, processes and mechanisms put in place by credit institutions and the own funds held by these institutions ensure a sound management and coverage of their risks, and on the basis of that supervisory review to impose on credit institutions specific additional own funds requirements, specific publication requirements, specific liquidity requirements and other measures, where specifically made available to competent authorities by relevant Union law" (Art. 4 (1) (f).

[45] Cfr. Artt. 138-146 for a description of the procedural aspects of the ECB specific powers.

[46] Supervision of insurance undertakings is expressly excluded from the specific tasks which can be conferred on the ECB, by art. 127 (6) TFUE.

e) "to carry out day-to-day verifications of credit institutions";

f) "to carry out the function of competent authorities over credit institutions in relation to markets in financial instruments, the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and consumer protection" (recital 28);

g) to intervene in case the supervised institutions breach non-harmonised national laws.

2.3. Administrative procedures

The authorization, the supervisory decisions and the sanctioning procedures are examples of the complexities in the interface between the ECB and the NCAs.

To start with the authorization procedure[47], as already said, it falls under the exclusive competence of the ECB for all the credit institutions established in the participating member States, regardless to their significance. According to this, the EU Legislator aims at utterly unify the structural supervision, by centralizing the definition of the banking market dimensions, density and borders[48].

Art. 14 of the SSM Regulation depicts a two-fold procedure: at the first, national stage the NCAs shall evaluate if the application for an authorisation complies with the requirements set out in relevant national law[49] (Art. 14 (1). In the case of a positive result, the NCAs shall take a draft decision "to propose to the ECB to grant the authorization" (Art. 14 (2)). Under other conditions, the national competent authority shall reject the application for authorisation.

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[47] For a detailed explanation of the authorization procedure and of its withdrawal, cfr. Artt. 73-84 of the Regulation Framework.

[48] Cfr. recital 20 and 22 of the SSM Regulation.

[49] In Italy, for example, *Banca d'Italia* shall verify if the conditions set out in the *Testo Unico Bancario* and, more generally, in law no. 241/1990 are met. The Italian National Central Bank shall give advance notice of the eventual rejection, according to art. 10-*bis*, l. no. 241/1990, and the addressee could ask the Interdepartmental Committee for Credit and Savings (*Comitato Interministeriale peril Credito ed il Risparmio*, CICR) for a review of the denial (Art. 9, TUB).

At the second, European step, the ECB shall determine the compliance of the draft decision with the relevant Union Law. The draft decision shall be deemed to be adopted by the ECB according to a silent endorsement mechanism. Therefore, the ECB shall state a justified objection in writing within a maximum period of ten working days, only where the conditions for authorisation set out in relevant Union law are not met (Art. 14 (3). Otherwise, the final decision taken shall be notified by the national competent authority to the applicant for authorization (Art. 14 (4)). Both the approval or the rejection of the application for authorization can be appealed towards the Court of Justice of the EU[50] or the Administrative Board of Review. In any case, the final decision will be imputed to the ECB.

The authorization procedure is a fine illustration of the co-administration model introduced by the SSM[51]. The downside of this innovation is that it makes the authorization process more complicated than it was under the "home country control" principle.

Turning to supervisory decisions, the framework within which the ECB may perform its supervisory tasks, is set by Art. 4 (3) of the SSM Regulation. Pursuant to the latter, "the ECB shall apply all relevant Union law, and where this Union law is composed of Directives, the national legislation transposing those Directives. Where the relevant Union law is composed of Regulations and where currently those Regulations explicitly grant options for Member States, the ECB shall apply also the national legislation exercising those options" (Art. 4 (3)[52].

Consequently, the ECB guidelines, recommendations and decisions must be subject to and in compliance with the relevant

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[50] Recital 60 of the SSM Regulation states that "pursuant to Article 263 TFEU, the CJEU is to review the legality of acts of, *inter alia*, the ECB, other than recommendations and opinions, intended to produce legal effects vis-à-vis third parties".

[51] Cfr. M. Clarich, *I poteri di vigilanza della Banca centrale europea*, Report at the XX Italian-Spanish Congress of Administrative Law Professors, concerning *I servizi pubblici economici tra mercato e regolazione*, Rome, 27 February -1 March 2014. The creation of supervisory teams of national competent authorities taking supervisory actions and involving staff from national competent authorities of other participating Member States, is another example of the new co-administration European scheme (Art. 31 (2) of the SSM Regulation).

[52] Cfr. recital 34 of the SSM Regulation.

Union law (basically CRR and CRDIV) and in particular with binding regulatory and implementing technical standards developed by EBA and adopted by the Commission in accordance with Artt. 10-16 of Regulation (EU) No 1093/2010 and to the "supervisory handbook" developed by EBA in accordance with that Regulation.

Thereby, it is the first time that an European Agency is empowered to directly apply binding national laws to carry out the tasks conferred within its mandate. We highlight that national laws transposing directives or options granted in regulations belong to diverging legal frameworks and different national supervisory policies, so that the ECB may ask for the assistance of the NCAs to recognize and interpret them[53]. Further, if the national laws were not in line with the wording or the aim of the CRR or the CRDIV, the ECB could apply them in conformity with the EU legislation, in accordance with the principle of the primacy of EU law (recital 34 of the SSM Regulation).

National laws not transposing EU legislation on banking are the only limit to the remit of the ECB. Under the circumstances that national laws confer on NCAs certain powers which are currently not required by Union law, the ECB is only allowed to require NCAs "by way of instructions […] to make use of their powers, under and in accordance with the conditions set out in national law" in case the SSM Regulation "does not confer such powers on the ECB" (Art. 9 (1), sub-paragraph 3)[54].

Obviously, the ECB (and the NCAs) must adhere to EU law fundamental rights and general principle, such as:

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[53] Cfr. H. Schneider, *Inconsistencies and unsolved problems in the European Banking Union*, 12 Europaische Zeitschrift fur Wirtschaftsrecht (2013). Cfr. also Art. 90 of the SSM Regulation Framework: "An NCA shall assist the ECB in the performance of its tasks under the conditions set out in the SSM Regulation and […] in particular, perform all the following activities: (a) submit draft decisions to the ECB in respect of significant supervised entities established in its participating Member State; (b) assist the ECB in preparing and implementing any acts relating to the exercise of the tasks conferred on the ECB by the SSM Regulation, including assisting in verification activities and the day-to-day assessment of the situation of a significant supervised entity; (c) assist the ECB in enforcing its decisions. When assisting the ECB, an NCA shall follow the ECB's instructions in relation to significant supervised entities".

[54] Cfr. recital 35 of the SSM Regulation.

- the duty to adopt the final supervisory decision, at the end of the proceeding, within a reasonable time frame, in the light of the principle of sound administration and in order to preserve the right of defence[55];
- the obligation to state the reasons on which the supervisory decisions are based, (Art. 22 (2) of the SSM Regulation), functional to judicial control called for under Article 263 of the TFEU[56];
- the right to express one's view, recognized by Art. 41 (2) of the Charter on Fundamental Rights of the EU and by Art. 22 of the SSM Regulation[57]. In turn, this right is declined in: (i) the right to be informed in timely fashion about the investigation and about the allegation; (ii) the right to have access to the files[58], as a procedural safeguard deemed to protect the right of defence[59], to

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[55] Cfr. ECJ, Case Guérin Automobiles, C-282/95, § 37: "the Commission's definitive decision must, in accordance with the principles of good administration, be adopted within a reasonable time after it has received the complainant's observations". Cfr. also ECJ, Case C-105/04, Nederlandse Federatieve Vereniging voor de Groothandel op Elektrotechnisch Gebied, § 49: "the excessive duration of the first phase of the administrative procedure may have an effect on the future ability of the undertakings concerned to defend themselves, in particular by reducing the effectiveness of the rights of the defence in the second phase of the procedure" (R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, 74 Quaderni di Ricerca Giuridica della Consulenza Legale 52 (2013).

[56] R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit., 55.

[57] Art. 22 (2), second sub-paragraph of the SSM Regulation provides an exceptional restriction to this fundamental right, as it can be suspended *"if urgent action is needed in order to prevent significant damage to the financial system. In such a case, the ECB may adopt a provisional decision and shall give the persons concerned the opportunity to be heard as soon as possible after taking its decision"* (R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit., 56).

[58] In the Solvay (CFI, T-30/91, § 59) and ICI (CFI, T-36 and 37/91, §§ 69 and 49 respectively) cases the Court of Justice of the EU argued that "the purpose of providing access to the file in competition cases is to enable the addressees of statements of objections to examine evidence in the Commission's file so that they are in a position effectively to express their views on the conclusion reached by the Commission in its statement of objections on the basis of that evidence" (R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit., 57).

[59] The right of access to files under Article 41(2) (b) of the Charter as a component of the right of defence, is related to a specific administrative

be balanced with the necessity of confidentiality; (iii) the right to be heard, which can be made redundant in the field of prudential supervision, where the subjects concerned are professional on the market and express their view in writing form[60].

The Governing Council is the major decision-making body of the ECB, as for monetary policy and prudential supervision. In order to separate these two functions, Art. 26 of the SSM Regulation sets up another internal body, the Supervisory Board, composed of its Chair and Vice Chair, four representatives of the ECB and one representative of the national competent authority in each participating Member State (Art. 26 (1))[61]. All members of the Supervisory Board shall act in the interest of the Union as a whole, and it is specified that "the four representatives of the ECB appointed by the Governing Council shall not perform duties directly related to the monetary function of the ECB" (Art. 26 (5).

Draft decisions of the Supervisory Board shall be taken by a simple majority of its members (one member-one vote), but the final supervisory decisions are deemed to be adopted by the Governing Council, pursuant to a non-objection procedure. Hence, the Supervisory Board shall transmit the draft decision at the same time to the Governing Council and to NCAs of the

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proceeding, liable to culminate in a measure adversely affecting its addressee. On the contrary, the general interest of any citizen of the Union to access to documents is functional to the principle of transparency of Union's institutions and bodies. Cfr. R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit., 58.

[60] R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit., 50-60. The guarantees stated in Art. 22 of the SSM Regulation only apply to micro-prudential supervisory decisions, as the provision does not refer to Art. 5, concerning macro-prudential supervision. Nevertheless, the latter proceedings are submitted to the general principles provided by Art. 41 (2) of the Charter. Cfr. R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit. For an insight of the procedures applying to these rights, cfr. Artt. 31-33 of the Regulation Framework.

[61] Currently, the Supervisory Board is formed by: Danièle Nouy, Chair (appointed for a non-renewable term of five years); Sabine Lautenschläger, Vice-Chair (chosen from among the members of the ECB's Executive Board); ECB representatives: Sirkka Hämäläinen, Julie Dickson, Ignazio Angeloni; one representative of each participating Member State (where the competent authority is not a national central bank (NCB), the members of the Supervisory Board may decide to bring a representative from their respective NCB).

member States concerned. The Governing Council may raise a written, motivated objection to a draft decision within a maximum period of ten working days, which is reduced to 48 hours "in emergency situations" (Art. 26 (8)). If any objection is opposed, the decision is deemed to be adopted[62].

To conclude with the sanctioning procedures[63], Art. 18 of the SSM Regulation alleges three hypotheses, in which ECB and NCAs can impose "effective, proportionate and dissuasive"[64] administrative penalties to supervised entities, for the purpose of carrying out the tasks conferred on it by the SSM Regulation[65]:

A) the ECB may apply pecuniary penalties to legal persons breaching "a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties shall be made available to competent authorities under the relevant Union law"[66] (Art. 18 (1). Here, the directly applicable Union law coincides with the CRR and Artt. 67 and 70 of the CRDIV, in relation to quantitative criteria[67];

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[62] To support the meetings of the Supervisory Board, it shall establish a Steering Committee from among its members, charged with preparatory tasks (Art. 26 (10). The Supervisory Board set out its Rules of Procedure, which entered into force on 1 April 2014 (Art. 26 (12).

[63] For a deep examination of the supervisory and sanctioning proceedings, cfr. R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit. Cfr. also Artt. 120-137 of the Regulation Framework.

[64] Art. 18 (3), SSM Regulation.

[65] For a deeper examination of this three-level sanctioning system, cfr. M. Clarich, *Le sanzioni amministrative bancarie nel meccanismo di vigilanza unico*, in *Sistema creditizio e finanziario: problemi e prospettive* (2014).

[66] The maximum amount of the pecuniary penalties which can be imposed is "of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined, or up to 10% of the total annual turnover, as defined in relevant Union law, of a legal person in the preceding business year or such other pecuniary penalties as may be provided for in relevant Union law" (Art. 18 (1).

[67] Two different interpretations have been suggested in relation to this provision. According to an objective interpretation, as Art. 18 (1) does not refer to the framework set out by Artt. 4 and 6 of the SSM Regulation, it implies that the ECB has an exclusive competence to impose sanctions in case the relevant Union law is breached, regardless to the significance of the institutions committing the violations. This exegesis is based on the nature both of the rule violated (directly applicable Union law) and of the addressee of the penalties (legal persons) seems more in line with the text and the aim of Article 18 (R.

D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, cit.), but it is not satisfactory to the extent that it rises an asymmetry between supervisory and sanctioning powers. For example, if a non-significant bank, directly controlled by *Banca d'Italia*, breached the CRR, it could be sanctioned by the ECB, but there would be the risk that the ECB itself would not be able to assess the violations committed. However, reports of breaches may be submitted to the ECB by "any person, in good faith […] if that person has reasonable grounds for believing that the report will show breaches of the legal acts referred to in Article 4(3) of the SSM Regulation by credit institutions", according to Art. 36 of the Regulation Framework.
On the other hand, under a second, subjective point of view, based on the nature of the bank involved, the distribution of competences in relation to the dimensions of the supervised institutions (Artt. 4 and 6 of the SSM Regulation) would also apply to the sanctioning procedures. As a consequence, the ECB shall impose penalties to more significant banks, while NCAs shall remain competent as for less significant ones. This vision guarantees a full symmetry between supervision and sanctioning prerogatives, but it could bring coordination problems in case a significant credit institution would breach "a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties shall be made available to competent authorities under the relevant Union law" (Art. 18 (1). Mancini criticizes the reading of Article 18 in connection with Article 6 of the SSM Regulation (cfr. M. Mancini, *Dalla vigilanza nazionale armonizzata alla Banking Union*, 73 Quaderni di Ricerca Giuridica della Banca d'Italia 29-30 (2013). In fact, neither the SSM Regulation nor the Regulation Framework clarify what would happen if both the ECB and the NCA began a sanctioning procedure with respect to the same violation. In the opinion of Loosveld, "If an institution supervised by the ECB breaches, intentionally or negligently, a requirement under directly applicable EU law for which administrative sanctions are made available, then the ECB will, according to the proposed SSM Regulation, have the right to start a sanctioning procedure and impose administrative pecuniary sanctions. The same right will exist in case of breaches of regulations or decisions adopted by the ECB in the exercise of its supervisory tasks. In other cases - particularly breaches of national legislation that transposes EU directives - the ECB will only have the possibility to require the national supervisory authorities to open a sanctioning procedure with a view to taking action in order to ensure that appropriate sanctions are imposed by the national authorities. Such action by the national authorities instead of by the ECB will also be necessary when administrative sanctions or measures need to be imposed on natural persons, such as members of the management of credit institutions supervised by the ECB, or other individuals who under relevant national legislation are responsible for regulatory breaches. The reason is that, as is currently envisaged, the ECB will only be empowered to impose sanctions on legal persons and not on individuals" (S. Loosveld, *The ECB's Investigatory and Sanctioning Powers under the Future Single Supervisory Mechanism*, in Journal of International banking Law and Regulation 423 (2013).

B) with regard to significant supervised entities, the NCAs, "only at the request of the ECB" (Art. 134 (1), Regulation Framework), may open proceedings to impose appropriate penalties in cases not covered by the above Article 18 (1) of the SSM Regulation (Art. 18 (5)), which includes: (a) non-pecuniary penalties in the event of a breach of directly applicable Union law by legal or natural persons, as well as any pecuniary penalties in the event of a breach of directly applicable Union law by natural persons; (b) any pecuniary or non-pecuniary penalties in the event of a breach by legal or natural persons of any national law transposing relevant Union directives; (c) any pecuniary or non-pecuniary penalties to be imposed in accordance with relevant national legislation which confers specific powers on the NCAs in euro area Member States which are currently not required by the relevant Union law (Art. 134 (1), Regulation Framework). As a consequence, albeit "an NCA may ask the ECB to request it to open proceedings" in the mentioned cases (Art. 134 (2)), Regulation Framework), it is clear that the ECB holds high discretion in deciding if and when to take the initiative in this field. Though an NCA shall abide to the request of the ECB to open the penalty procedure and shall notify of its completion, the NCA preserve a margin of discretion regarding the final decision to impose a penalty or not (Art. 134 (3), Regulation Framework);

C) the ECB may impose sanctions in accordance with Regulation (EC) No. 2532/98, in case of a breach of ECB regulations or decisions (Art. 18 (7) and recital 36). Such sanctioning power can be exerted towards all credit institutions, regardless to their significance (Art. 122, Regulation Framework)[68].

The Regulation Framework provides for procedural rules for the imposition of administrative penalties, "to take into account recent developments in Union legislation in the field of sanctions and the European Court of Human Rights case-law regarding the principle of separation between an investigation and the decision-taking phase" (recital 6). Specifically, Art. 123

[68] "In the event of a continuing breach of a regulation or supervisory decision of the ECB, the ECB may impose a periodic penalty payment [for a period no longer than six months] with a view to compelling the persons concerned to comply with the regulation or supervisory decision" (Art. 129, Regulation Framework).

determines the establishment, within the ECB, of an internal independent investigating unit, composed of investigating officers who have not been involved, for the previous two years, in the direct or indirect supervision or authorisation of the relevant supervised entity. Moreover, "the investigating officers shall perform their investigative functions independently of the Supervisory Board and Governing Council and shall not take part in the deliberations of the Supervisory Board and Governing Council" (Art. 123 (3).

At the end of the investigation procedure, the investigating unit submits a proposal for a complete draft decision to the Supervisory Board, "determining that the supervised entity concerned has committed a breach and specifying the administrative penalty to be imposed" (Art. 127 (1). At this point, the Supervisory Board, on the basis of a complete file, may agree with the proposal or not. In the first case, it shall adopt the complete draft decision proposed by the investigating unit regarding the breach or breaches it agrees have taken place (127 (4). Otherwise, it may adopt a complete draft decision closing the case (127 (5)[69].

In relation to procedural rights, a "complete draft decisions adopted by the Supervisory Board and to be proposed to the Governing Council shall be based only on facts and objections on which the supervised entity has had the opportunity to comment" (127 (9)). To that end, Art. 126 of the Regulation Framework prescribes the right of the supervised entity concerned to make submissions in writing and to access the files. The investigating unit may also invite the supervised entity to an oral hearing (126 (3).

[69] There is also room for other solutions: "if the Supervisory Board, on the basis of a complete file, agrees with the determination in the proposal for a complete draft decision of the investigating unit that the supervised entity concerned has committed a breach, but disagrees with the proposed recommendation concerning administrative penalties, it shall adopt the complete draft decision, specifying the administrative penalty it considers appropriate" (127 (6). Finally, "if the Supervisory Board, on the basis of a complete file, does not agree with the proposal of the investigating unit, but concludes that a different breach has been committed by a supervised entity, or that there is a different factual basis for the proposal of the investigating entity, it shall inform the supervised entity concerned in writing of its findings and of the objections raised against the supervised entity concerned" (127 (7).

2.4. Critique on the SSM

The SSM structure and functioning prompt many lines of inquiry.

First and foremost, the centralization of supervision in the hands of the ECB hides the disruption of tasks and powers to a multitude of different bodies, namely the Governing Council and the Supervisory Board of the ECB, the EBA, the NCAs.

More precisely, the cooperation between the ECB and the NCAs is much reliant on the quality of information flows and the willingness of local supervisors to play their ancillary role towards the ECB. Therefore, the ECB could not exercise prevention or early intervention measures in case less significant banks are in trouble and the NCA does not decisively intervene[70]. Additionally, the ECB depends on NCAs for enforcement in countries where the single rulebook is not fully implemented, according to the sanctioning procedures set out by Art. 18 of the SSM Regulation[71]. These elements, together with divergent national rules and administrative traditions, may hamper the effectiveness and the timing of the ECB action.

As far as regulation is concerned, in spite of the EBA's permanence as European principal Regulator for the banking sector, the ECB "shall contribute in any participating role to the development of draft regulatory technical standards or implementing technical standards by EBA in accordance with Regulation (EU) No 1093/2010 or shall draw the attention of EBA to a potential need to submit to the Commission draft standards amending existing regulatory or implementing technical standards" (Art. 4 (3), last sub-paragraph). Consequently, the ECB is subject to the technical standards implemented by the EBA, like any other NCAs. At the same time, the ECB can give its own contribution to the drafting and the implementation of them. Moreover, as already explained, it shall act as a regulator itself, with respect to NCAs. Whereas ECB and EBA regulatory powers differ in relation to geographical scope, addressees and

[70] E. Ferran, *European Banking Union: imperfect, but it can work*, Paper no. 30/2014, Legal Studies Research Paper Series, University of Cambridge, Faculty of Law, April 2014.

[71] E. Ferran, *European Banking Union: imperfect, but it can work*, cit. at 70, 9.

enforceability[72], there is still room for overlaps and conflicts between them.

The potential sluggishness of the decision-making process in supervisory matters is also striking if we look at the ECB governance structure, which comprises a number of separate subjects: the Supervisory Board supported by a steering committee, the Governing Council with the right to object to supervisory decisions from the Board, and a mediation panel[73].

Especially in the field of banking supervision, this lack of effectiveness in the decision procedure may be a death-blow in the event of "hard cases", such as the withdrawal of authorization of a big bank with intense cross-border activities, or the interference in the corporate governance of a credit institution, or the imposition of heavy pecuniary penalties.

To draw a conclusion on this point, we embrace the idea that it is too simplistic to condemn the SSM on the ground that it is too complicated[74]. However, from a comparative perspective, the European supervisory system may disentangle its polycentric and multi-layered nature, taking inspiration from other federal system, such as the US Federal Reserve[75].

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[72] The EBA single rulebook and single handbook apply to all the credit and financial institutions of the 28 EU member States, while the ECB regulations, directives and instructions only apply to the supervised credit institutions of participating member States. Moreover, the former are not legally binding, whilst the latter are binding and enforceable.

[73] Art. 25 (5) of the SSM Regulation determines that "with a view to ensuring separation between monetary policy and supervisory tasks, the ECB shall create a mediation panel. This panel shall resolve differences of views expressed by the competent authorities of participating Member States concerned regarding an objection of the Governing Council to a draft decision by the Supervisory Board. This panel shall include one member per participating Member State, chosen by each Member State among the members of the Governing Council and the Supervisory Board, and shall decide by simple majority, with each member having one vote. The ECB shall adopt and make public a regulation setting up such mediation panel and its rules of procedure".

[74] E. Ferran, *European Banking Union: imperfect, but it can work*, cit. at 70, 9.

[75] Indeed, it is contentious if the SSM would win a comparative scrutiny on the clarity of its basic design, in opposition to the Federal Reserve, unlike some authors affirm (E. Ferran, *European Banking Union: imperfect, but it can work*, cit. at 70, 9).

Still, only empirical evidence will strengthen or shun the qualms about the SSM efficiency in lessening the disbelief towards the European banking sector.

Secondly, the conferral of supervisory tasks to the ECB has reignited the simmering dispute between the ones who promote the combination of monetary and supervisory functions within the same Authority, and the ones opposing to this solution[76].

On one hand, the foremost arguments in favor of the convergence of the two functions are:

a. more efficient and persuasive decisions related to central banking, on the ground of a better consciousness of the features and risks affecting the financial market (SMITS[77], ELLIOTT[78]);

b. liability of "Chinese walls" to realize a functional separation between the two functions[79];

c. close connection of both supervision and monetary policy with the payment systems oversight[80];

d. informative and professional synergies between the expertise in charge with the monetary policy and the one responsible for supervision[81];

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[76] Fourteen of the seventeen national central banks in the euro area have a role in supervision, such as *Banca d'Italia* or *Banco de Espana*. Differently, other countries have instituted two separate Authorities, each responsible for one and only function, like the *Bundesbank* and the *Bafin* in Germany. However, after the financial crisis, the Bank of England has assumed supervisory responsibilities previously assigned to the Financial Services Authority. In the US, the role of the Fed in financial supervision has been recently strengthened. In the opinion of Mario Draghi, ECB President, "this all suggests that the relationship between monetary policy and financial supervision is particularly important in times of crisis. It is not by chance that historically the first central banks were supervisors of commercial banks. The ECB will establish clear guiding principles and internal operating practices to ensure effective separation of monetary policy and financial supervision". For a detailed elaboration of Draghi's faith in the tools for separation, cfr. his *Introductory statement at the hearing of the Committee on Economic and Monetary Affairs of the European Parliament*, Brussels, 17 December 2012.

[77] R. Smits, *The European Central Bank: Institutional aspects* (1997), 324.

[78] D.J. Elliott, *Key issues on European Banking Union. Trade-offs and some recommendations*, Global Economy and Development working paper 52, November 2012, available at www.brookings.edu.

[79] R. Smits, *The European Central Bank: Institutional aspects*, cit. at 77, 325.

[80] R. Smits, *The European Central Bank: Institutional aspects*, cit. at 77, 326.

[81] C. Brescia Morra, *Il diritto delle banche* (2012), 103.

e. empirical evidence: it has been observed that the 104 biggest failures in the history of financial markets were experienced in countries whose NCB was not empowered to exercise supervisory tasks[82].

On the other hand, the following points buttress the separation theory:

a) traditionally, prudential supervision did not embody the core function in central banking, because financial stability was not as much at stake as it is nowadays[83];

b) bureaucracy effect: the organs responsible for monetary policy may overflow into supervisory matters, and vice versa, causing a *détournement de pouvoir*[84];

c) the implication of a Central Bank on banks' failures may adversely affect its reputation and independence, undermining its prestige as for monetary and economic policy-maker[85];

d) conflict of interest: for example, the ECB could be prone to decrease its interest rate for refinancing operations[86] to advantage credit institutions struggling with unsound balances, regardless for monetary policy needs.

All in all, the advantages of combination outnumber the disadvantages, though the ECB shall do its utmost to avoid conflict of interest.

Against this background, the SSM Regulation enacts a functional separation between monetary policy and prudential

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[82] C. Goodhart, D. Schoenmaker, *Should the functions of monetary policy and banking supervision be separated?*, 47 Oxford Economic Papers 539-560 (1995).

[83] C. Goodhart, *The organizational structure of banking supervision*, Financial Stability Institute Bank for International Settlements, Basel, Switzerland, FSI Occasional Papers, No. 1 – November 2000-10-25, available at http://www.bis.org/fsi/fsipapers01.pdf.

[84] D.J. Elliott, *Key issues on European Banking Union. Trade-offs and some recommendations*, cit. at 78

[85] R. Smits, *The European Central Bank: Institutional aspects*, cit. at 77, 325-6.

[86] The interest rate for refinancing operations is also known as "refi" and it represents the price that banks pay to borrow funds from the European Central Bank. This 'purchase price' is an important factor for banks when setting the interest rates that they charge when they lend money. By raising or lowering interest rates the ECB can exercise indirect influence over the interest levels that the banks apply to interbank transactions, business loans, consumer loans, mortgages and savings accounts, amongst other things. Cfr. ww.global-rates.com.

supervision. Pursuant to Art. 25 (3), the ECB shall carry out the tasks conferred on it by the SSM Regulation "without prejudice to and separately from its tasks relating to monetary policy and any other tasks. The tasks conferred on the ECB by this Regulation shall neither interfere with, nor be determined by, its tasks relating to monetary policy. The tasks conferred on the ECB by this Regulation shall moreover not interfere with its tasks in relation to the ESRB or any other tasks. The ECB shall report to the European Parliament and to the Council as to how it has complied with this provision" (Art. 25 (3).

Moreover, "with a view to ensuring separation between monetary policy and supervisory tasks, the ECB shall create a mediation panel" (Art. 25 (5). The mediation panel aims at resolving "differences of views expressed by the competent authorities of participating Member States concerned regarding an objection of the Governing Council to a draft decision by the Supervisory Board. This panel shall include one member per participating Member State, chosen by each Member State among the members of the Governing Council and the Supervisory Board" (Art. 25 (5).

Of course, the Governing Council and the Supervisory Board have different conformations: the former consists of the six members of the Executive Board, plus the governors of the national central banks of the 18 euro area countries, while the latter is composed by Chair and Vice Chair, four representatives of the ECB and one representative of the national competent authority in each participating Member State. As both of them are engaged in the decision-making process for prudential supervision, disagreements may emerge.

Once a notice requesting mediation is received by the Mediation Panel, it shall appoint among these members a Case Committee devoted to prepare a draft opinion to be submitted to the Supervisory Board and the Governing Council within 20 working days from receipt of the request, or within a shorter period in urgent cases.

The separation pledge between monetary and supervisory functions leaves the SSM open to skepticism, for three primary reasons:

1) the draft opinion taken by the Mediation Panel through its Case Committee is not legally binding on the Supervisory Board and the Governing Council;

2) the mediation procedure is far from being streamlined, so that an impasse related to a supervisory decision could not be unraveled without a considerable waste of time, especially under pressing circumstances;

3) the Governing Council is the ultimate decision-making body as for monetary policy, as for prudential supervision and, of course, the building up of "Chinese walls" among its members is not viable.

Finally, the need to strike a new balance between the ECB Independence and Accountability is another troubling issue.

Central banking Independence is a mainstream especially in countries that unquestionably trust in Independent Authorities to pursue public interests.

The SSM Regulation determines that "when carrying out the tasks conferred on it by this Regulation, the ECB and the national competent authorities acting within the SSM shall act independently. The members of the Supervisory Board and the steering committee shall act independently and objectively in the interest of the Union as a whole and shall neither seek nor take instructions from the institutions or bodies of the Union, from any government of a Member State or from any other public or private body" (Art. 19 (1). In order to ensure its Independence and to avoid conflict of interests, the ECB's Governing Council is to establish and publish a Code of Conduct for the ECB staff and management involved in banking supervision, as part of a general review of the Ethics Framework that applies to all ECB staff[87].

The ECB Independence in Supervisory matters is counterbalanced by its Accountability towards the European Parliament and the national parliaments. More in detail, Artt. 20-21 of the SSM Regulation, Art. 13 of the Rules of Procedure and the Inter Institutional Agreement between the ECB and the EP[88]

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[87] Art. 19 (3) of the SSM Regulation. Cfr. also SSM Quarterly Report - Progress in the operational implementation of the Single Supervisory Mechanism Regulation", August 2014, available at http://www.ecb.europa.eu/pub/pdf/other/ssmqr20143en.pdf.

[88] The final version of the IIA was signed on November 2013 and it is available at

provide a toolkit enhancing the democratic legitimation of the EU, at least in the banking sector[89]:

- Annual Report, which the ECB shall submit to the EP, the Council, the Commission, the euro Group, and the national parliaments pertaining to the execution of its supervisory tasks;
- Ordinary public hearings, additional *ad hoc* exchanges of view and confidential meetings of the Chair of the Supervisory Board, before the euro Group or the competent committees of the EP or the national parliaments;
- Responding to questions put to the ECB by the EP or by national parliaments;
- Access to information, through a comprehensive and meaningful record of the proceedings of the Supervisory Board that enables the EP to understand the discussions, including an annotated list of decisions;
- Participation of the EP in the selection procedures for the Chair of the Supervisory Board.

To sum up, our interim examination of the legal and institutional features of the SSM is to be validated or contradicted by the SSM pragmatic impact into banking supervision. It is worth noting that ts functioning and effectiveness will not be satisfactory until the other two pillars of the EBU would be in place. Thus, in the next paragraphs, we disclose the latest implementations of the Single Resolution Mechanism and of the Deposit Guarantee Schemes.

3. Single Resolution Mechanism

3.1. Legal basis, structure and objectives

The second pillar of the EBU is the Single Resolution Mechanism (SRM), established with the Regulation (EU) No. 806/2014 of 15 July 2014 of the European Parliament and of the Council[90]. The SRM Regulation's subject matter consists of

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http://www.europarl.europa.eu/document/activities/cont/201311/20131107ATT74064/20131107ATT74064EN.pdf.

[89] The lack of democratic legitimation is a long-lasting concern about EU Institutions and bodies.

[90] The SRM Regulation shall be entirely applicable from 1 January 2016, with the exceptions set out in Art. 99.

uniform rules and procedure for the resolution of the credit institutions established in a participating member State[91], applied by the Single Resolution Board (hereafter "SRB" or "the Board"), together with the Council, the Commission and the national resolution authorities (NRAs) within the framework of the SRM and thanks to the support of a Single Resolution Fund (hereafter "SRF" or "the Fund").

The legal basis for the SRM is Art. 114 TFEU, which provides for the adoption of "the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market" (Art. 114 (1) TFEU). The internal market objective is satisfied in the case of the SRM, because it necessarily complements the SSM and represents an irrevocable building block of the EBU, which do aims at ensuring the neat functioning of the single market in the banking sector[92]. Furthermore, the financial crisis showed that fragmented, consensus-based decision-making in the restructuring of failing banks should be replaced by a unified, smooth apparatus, able to take momentous decisions in stressful situations. The harmonization provision of Art. 114 TFEU was the only way to realize such an ambitious centralization, within a short span and, more importantly, without any Treaty change.

Like the SSM, the SRM is a mechanism, whose multiparty structure calls to mind some colorful, multifaceted, gothic glass window. Yet, the SRM is a headless and meandering decision-making apparatus, in which the Board works as the metallic framework, joining and coordinating all the other components. In fact, the Board is a Union agency with legal personality[93] (unlike

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[91] The SRM scope of application is linked to the one of the SSM, as the former extends only to banks and financial institutions established in participating member States and subject to the supervision of the ECB and the NCAs within the SSM Framework (Art. 4 (1) and recitals 15, 17 of the SRM Regulation).

[92] Recital 11 of the SRM Regulation clearly states that "supervision and resolution are two complementary aspects of the establishment of the internal market for financial services whose application at the same level is regarded as mutually dependent". Recital 12 of the SRM Regulation also makes plain the overriding importance of effective resolution decisions for the internal market.

[93] Art. 42 of the SRM Regulation.

the SRM), but the Meroni doctrine[94] and Art. 291 TFEU[95] inhibit its entrustment with ultimate decision-making powers.

Consequently, the resolution is a play casting a throng of actors:

- the Supervisors (ECB and NCAs), which trigger the resolution procedure exercising their initiative power;
- the Politics (Commission and Council), holding a monopoly over the ultimate decisions;
- the Board, who is responsible for the effective and consistent functioning of the SRM[96] and it is the owner of the Fund, which shall be used "only for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers" (Art. 67 (2);
- the National Resolution Authorities (NRAs), which perform resolution tasks in relation to less significant entities[97], according to the division of tasks settled by Art. 6 of the SSM Regulation.

All these subjects shall act under an intricate resolution procedure, aimed at minimizing the costs of a failing entity borne by the taxpayers (public expenditures)[98]; snitching up the segmentation of national rules for the bail-outs processes; preempting banks' crises and defaults and resolving systemic entities without jeopardising financial stability[99].

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[94] As already said, the ESMA case (United Kingdom v EU Parliament and EU Council of 22 January 2014 - C-270/12) "mellowed Meroni" (J. Pelkmans, M. Simoncini, *Mellowing Meroni: How ESMA can help build the single market*, CEPS Commentary, 18 February 2014), as it loosed the limits within which the conferral of discretion on a EU agency is allowed. Cfr. E. Ferran, *European Banking Union: imperfect, but it can work*, 30 Legal Studies Research Paper Series - University of Cambridge 21 (2014).

[95] Art. 291 (2) determines that "where uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission, or, in duly justified specific cases and in the cases provided for in Articles 24 and 26 of the Treaty on European Union, on the Council".

[96] Art. 7 (1) of the SRM Regulation.

[97] Art. 7 (3) of the SRM Regulation.

[98] *Cf.* recital 73 of the SRM Regulation.

[99] The objectives of the SRM are enucleated by Art. 14 (2) of the SRM Regulation, as follows: "(a) to ensure the continuity of critical functions; (b) to avoid significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures, and by maintaining

Accordingly, the SRM discipline marks an unprecedented shift from the moral hazard immanent to bail-outs financed by State aid and the new consciousness that banks' imbalances should be puzzled out by the banking sector itself.

3.2. The resolution procedure

The guiding principle when taking the resolution decisions under the SRM Regulation is the minimisation of the cost of resolution and the avoidance of destruction of value. The SRM Regulation articulates a threefold procedure, made up by:

1. early intervention and preparation (Art. 13): the ECB and the NCAs shall inform the Board of any early intervention measure adopted towards a supervised entity [100], so that the latter may prepare for the resolution of the institution or group concerned;
2. drafting and adoption of the resolution scheme, which is the core of the whole procedure (art. 18);
3. implementation of the resolution decision by national resolution authorities (Art. 29).

The resolution procedure set out in Art. 18 is the salient part of the SRM and it comprises a number of different stages and subjects, as follows.

First, the ECB alerts without delay the Commission and the Board if a supervised entity (a significant bank or a cross-border group) is failing or is likely to fail[101] ("failure condition", Art. 18

market discipline; (c) to protect public funds by minimising reliance on extraordinary public financial support; (d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; (e) to protect client funds and client assets".

[100] Pursuant to Art. 16 of the SSM Regulation, Artt. 27-29 of the BRRD or Art. 104 of the Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (Art. 13 (1) of the SRM Regulation).

[101] According to Art. 18 (4) of the SRM Regulation, the failure condition is met in one or more of the following alternative circumstances: "(a) the entity infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the ECB, including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; (b) the assets of the entity are, or there are objective elements

(1) a). Though the chance for the Board to act on its own initiative is envisaged, the details of its initiative power are not pinpointed, so that the ECB seems the only institution empowered to pull the trigger of the resolution procedure. After all, given the complementarity and the consequentiality between supervision and resolution, the central Supervisor is in the best position to ascertain if the "failure condition" is met and if to prompt a resolution or not.

Second, the SRB in its executive session[102] makes a negative prognosis about the viability of other alternative private sector rescue measures to prevent the failure within a reasonable timeframe ("prevention condition", Art. 18 (1) b))[103]. Further, the Board determines that a resolution action meets the "public interest condition", that is if the action is "necessary for the achievement of, and is proportionate to one or more of the resolution objectives referred to in Article 14 and winding up of

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to support a determination that the assets of the entity will, in the near future, be less than its liabilities; 30.7.2014 L 225/41 Official Journal of the European Union EN; (c) the entity is, or there are objective elements to support a determination that the entity will, in the near future, be unable to pay its debts or other liabilities as they fall due; (d) extraordinary public financial support is required except where, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, that extraordinary public financial support takes any of the following forms: (i) a State guarantee to back liquidity facilities provided by central banks in accordance with the central banks' conditions; (ii) a State guarantee of newly issued liabilities; or (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the entity, where neither the circumstances referred to in points (a), (b) and (c) of this paragraph nor the circumstances referred to in Article 21(1) are present at the time the public support is granted".

[102] The Board has two compositions: on one hand, its executive session is composed of the Chair and four full-time members (Artt. 53 (1) and 43); it shall meet as often as necessary and it takes specific decisions related to an individual bank or a banking group (not exceeding a 5 billion euros threshold), preferably reaching a joint agreement by consensus or, if this is not possible within a determined deadline, deliberating by simple majority (Art. 55 (1); on the other hand, its plenary session, taking general decisions, includes the members of the executive session, plus a member appointed by each participating member State, representing their NRAs (Artt. 49 and 43).

[103] In making the assessment on the "prevention condition", the SRB shall have regard to "timing and other relevant circumstances" (Art. 18 (1) b). Where applicable, the national resolution authorities in close cooperation with the ECB can also assess if this condition is met or not (Art. 18 (1), forth sub-paragraph).

the entity under normal insolvency proceedings would not meet those resolution objectives to the same extent" (Art. 18 (5)[104].

Third, if the three conditions laid down are met ("failure condition", "prevention condition" and "public interest condition"), the Board drafts and adopt a resolution scheme, which, according to Art. 18 (6), shall:

(a) place the entity under resolution;

(b) determine the application of the resolution tools, which are: the sale of business tool (Art. 24)[105]; the bridge institution tool (Art. 25)[106]; the asset separation tool (Art. 26)[107]; the bail-in tool, as illustrated in the next paragraph (Art. 27);

(c) ascertain the use of State aid or of the Fund to support the resolution action, in accordance with a Commission positive or conditional decision concerning the compatibility of such aid with the internal market (Art. 19).

Forth, "the resolution scheme shall enter into force into only if no objection has been expressed by the Council or by the Commission within a period of 24 hours after its transmission by the Board" (Art. 18 (7), fifth subparagraph). Hence, the Politics retain the ultimate decision-making power with a discretionary room for manouvre, through a non-objection mechanism. To be more specific, the Commission is responsible for the endorsement or the objection of the resolution scheme, whereas the Council intervention may be proposed by the Commission only under certain, restricted circumstances[108], related to the fulfillment of the

[104] If the "public interest condition" referred to in Art. 18 (5) is not fulfilled, "the relevant entity should be wound up in an orderly manner in accordance with the applicable national law" (Art. 18 (8).

[105] "Within the resolution scheme, the sale of business tool shall consist of the transfer to a purchaser that is not a bridge institution of the following: (a) instruments of ownership issued by an institution under resolution; or (b) all or any assets, rights or liabilities of an institution under resolution" (Art. 24 (1).

[106] "Within the resolution scheme, the bridge institution tool shall consist of the transfer to a bridge institution of any of the following: (a) instruments of ownership issued by one or more institutions under resolution; (b) all or any assets, rights or liabilities of one or more institutions under resolution" (Art. 25 (1).

[107] "Within the resolution scheme, the asset separation tool shall consist of the transfer of assets, rights or liabilities of an institution under resolution or a bridge institution to one or more asset management vehicles" (Art. 26 (1).

[108] According to Art. 18 (7), third and fourth sub-paragraphs, "within 12 hours from the transmission of the resolution scheme by the Board, the Commission

"public interest" condition or a material modification of the amount of the Fund. Anyway, the resolution procedure shall last no more than 32 hours, given that "the Board shall, within eight hours modify the resolution scheme in accordance with the reasons expressed" by the Commission or the Council in their objections (Art. 18 (7), seventh sub-paragraph).

Finally, once a resolution scheme has been approved, the NRAs are in charge with its execution, under the surveillance and in compliance with the instructions addressed by the Board (Art. 18 (9). Therefore, within the SRM, the NRAs execute a double function: they not only implement the decision adopted by the Board towards the most significant entities, but also perform and are responsible for the resolution of domestic and less significant banks. However, the SRB is empowered to intrude into both of these two fields of action. Actually, during the implementation phase, the SRB can directly exercise executive, investigatory[109] and sanctioning powers[110] in relation to the entities concerned, under certain circumstances. For instance, should a NRA not apply or properly comply with a resolution decision, the SRB may itself address specific orders to an institution under resolution[111]. Moreover, the Board may extend its resolution authority towards domestic and non-significant banks by its own initiative "where necessary to ensure the consistent application of high resolution

may propose to the Council: (a) to object to the resolution scheme on the ground that the resolution scheme adopted by the Board does not fulfill the criterion of public interest referred to in paragraph 1(c); (b) to approve or object to a material modification of the amount of the Fund provided for in the resolution scheme of the Board. For the purposes of the third subparagraph, the Council shall act by simple majority".

[109] For the purpose of performing its tasks under the SRM Regulation, the Board may exercise a number of investigatory powers, from the request for information, to on-site inspections, (Artt. 34-37).

[110] The Board's sanctioning powers towards an entity who has intentionally or negligently committed an infringement within the resolution procedure, consists of the imposition of fines or periodic penalty payment (Artt. 38-41).

[111] These orders may include: "(a) in the event of action pursuant to Article 18, to transfer to another person specified rights, assets or liabilities of an institution under resolution; (b) in the event of action pursuant to Article 18, to require the conversion of any debt instruments which contain a contractual term for conversion in the circumstances provided for in Article 21; (c) to adopt any other necessary action to comply with the decision in question" (Art. 29 (2).

standards" (Art. 7 (4), or pursuant to an option taken by the NRAs (Art. 7 (5).

Anyway, "in the resolution planning, early intervention and resolution phases", all the authorities involved (the Board, the Council, the Commission, the ECB and the NRAs) are prone to an obligation to cooperate within the SRM (Artt. 30-33).

3.3. The bail-in tool

Among the resolution tools available to the SRB, we will to focus on the bail-in tool.

According to Art. 3, SRM Regulation, the "bail-in tool means the mechanism for effecting the exercise of the write-down and conversion powers in relation to liabilities of an institution under resolution".

In other words, the bail-in tool ensures that "shareholders and creditors of a failing entity suffer appropriate losses and bear an appropriate part of the costs arising from the failure of the entity", giving shareholders and creditors of entities a stronger incentive to monitor the health of an entity during normal circumstances[112].

The bail-in tool may be applied for both the recapitalisation of an entity to the extent sufficient to restore its ability to carry out the activities for which it is authorised[113] and the transformation of the claims of its creditors, through equity swaps, write-down or conversion of liabilities[114].

The selection of the liabilities that are eligible for the bail-in, as well as the decision concerning the likeliness of the failure of a bank in the near future, are samples of the discretionary powers inevitably involved in the bail-in decision-making process. Unfortunately, discretion is enemy to the certainty and

112 Recital 73 of the SRM Regulation.

113 This form of bail-in is subject to the existence of "a reasonable prospect that the application of that tool, together with other relevant measures […] will, in addition to achieving relevant resolution objectives, restore the entity in question to financial soundness and long-term viability" (Art. 27 (2), SRM Regulation).

114 Covered deposits; secured, collateralized or guaranteed liabilities; inter-bank liabilities with an original maturity of less than seven days; liabilities to an employee and other compulsory liabilities enumerated by Art. 27 (3), SRM Regulation shall not be subject to such write-down or conversion.

objectiveness required to restore the market faith and the soundness of the banking sector.

It follows that a uniform set of *ex ante* rules may define the exact order in which the liabilities of a failing bank should be written down, according to the principle that "losses should be borne first by shareholders and next, in general, by creditors of the institution under resolution in order of preference" (Art. 27 (12), SRM Regulation)[115]. Accordingly, shareholders and bondholders will bear the losses first and then it will be the turn of unsecured creditors, following a pre-determined order ("pecking order")[116]. After the latter, at the bottom of the bail-in hierarchy, there are deposits of individual persons and of small and medium size enterprises above €100.000, which benefit from a "depositor preference". Deposits below €100.000 will never be touched, as they are covered by the national deposit guarantee schemes[117].

The minimum bail-in threshold is equal to 8% of the total assets, including own funds, of the institution under resolution, measured at the time of resolution action (Art. 27 (6), SRM Regulation). If the indicated threshold is insufficient to cover all the losses and restore the net asset value of the institution, a contribution from the Resolution Fund may be granted to the institution under resolution, up to a maximum of 5% of the bank's total liabilities.

3.4. Interim reflections on the SRM

Albeit the SRM will be fully operational only by 1 January 2016, it is possible to scrutinize its provisional pros and cons.

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[115] Other limits to discretion within the bail-in process are the prohibition to discriminate "against entities, deposit holders, investors or other creditors established in the Union on grounds of their nationality or place of business" (Art. 6, SRM Regulation) and the 'no creditor worse off' principle referred to in Art. 15(1)(g), for which "no creditor shall incur greater losses than would have been incurred if an entity referred to in Article 2 had been wound up under normal insolvency proceedings". Cfr. E. Barucci, M. Messori, *Limits of the bail-in process*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union* (2014).

[116] E. Barucci, M. Messori, *Limits of the bail-in process*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit. at 115.

[117] Cfr. G. Pennisi, *Muddling through, on-the-brink: the Single Resolution Mechanism*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit. at 115.

The first benefit of the SRM is its legal framework, which represents the positive accomplishment of delicate negotiations among the European countries. Yet, the SRM is ruled by two legal texts:

- the SRM Regulation, binding and directly applicable in all 28 EU member States, adopted through the ordinary legislative procedure laid down by Art. 114 TFEU[118], which established the Fund, the way it shall be financed and used and the obligation of member States to collect contributions at national level;
- the Intergovernmental Agreement (IGA)[119], subject to unanimous ratification, approval or acceptance by its signatories and only binding for the Contracting Parties. The IGA deals with the transfer of the contributions from the State-level to the central level, where they shall be initially divided into different compartments which will be progressively merged, pursuant to a gradual mutualization[120] (Artt. 60, 70, 76, 77 of the SRM Regulation).

The recourse to this two-face legal basis for the SRM and the SRF was hailed in a "spirit of realism"[121], as it allowed the

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[118] Proposal by the Commission and decision by the co-legislators (EP and Council, by qualified majority).

[119] Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund (signed on 21 May 2014).

[120] Indeed, the use of the resources, accumulated through ex ante contributions by the contracting Parties, during the transitional period, shall be made in the following manner:
"- during the first and second year of the transitional period, recourse shall be had to the 40 % and 60 % respectively of the financial means available within the said compartments;
- during the subsequent years of the transition period, the availability of the financial means in the said compartments shall increase annually by 6 ⅔ percentage points. The referred increase per year of the availability of the financial means in all the national compartments of the Contracting Parties shall be spread evenly per quarter" (Art. 5 (1), lett. a) of the IGA).

[121] The Council, on February 2014, recognized that "accepting a limited IGA out of a spirit of realism would be a big concession for the Parliament. The Council should for its part fully recognise the role of the Parliament as colegislator. Once this principle is fixed, the objective should now be, over the coming weeks, to reach in substance the elements of an ambitious and acceptable compromise". Cfr. the full interinstitutional file available at http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%205945%202014%20INIT. Because the IGA is open to all member States

Council to overcome the political deadlock for the establishment of the SRF, deriving from the intransigent German aversion to a Fund pegged to Art. 114 TFEU[122].

The Fund will ensure the availability of medium-term funding to enable a bank to continue operating while it is being restructured. Its target level amounts to €55 billion[123], to be reached over eight years (originally ten), starting in 2016. The progressive mutualization of the Fund could be considered a downside, as it impedes the clean break between banks and the Sovereign, so that it is just a buffer solution to the "home bias" issue.

Another strength of the SRF is that it will be financed both by *ex ante* and *ex post* contributions, coming from the healthy part of the private banking sector (depositors and shareholders), and not from the Governments (taxpayers)[124].

On one hand, the *ex ante* contribution is the amount of money raised at least annually by an individual institution. It is based on two components: a flat contribution, that is pro-rata based on the amount of an institution's liabilities excluding own funds and covered deposits and a risk-adjusted contribution,

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participating in the SSM or in the SRM, the United Kingdom and Sweden have decided not to sign it for the moment, but they can choose to do so anytime in the future.

[122] R.J. Herring, *The Danger of Building a Banking Union on a One-Legged Stool*, in F. Allen, E. Carletti, J. Gray (eds.), *Political, Fiscal and Banking Union in the Eurozone?* (2013), 9-28, e-book available at www.eui.eu/Personal/Carletti. The main issue about the use of Art. 114 TFEU for the establishment of the Fund concerns the fact that it does not empower the EU to impose compulsory contributions on the private banking sector, nor on member States. Beyond this hidebound stickiness to the Treaties, some member States, such as Germany and France, were highly sensible to the implications of *pro rata* contributions and funding mutualization.

[123] The target funding level of the Fund equals "at least 1% of the amount of covered deposits of all credit institutions authorised in all of the participating Member States" (Art. 69 (1).

[124] Pursuant to Art. 70 (1) of the SRM Regulation, "the individual contribution of each institution shall be raised at least annually and shall be calculated pro-rata to the amount of its liabilities (excluding own funds) less covered deposits, with respect to the aggregate liabilities (excluding own funds) less covered deposits, of all of the institutions authorised in the territories of all of the participating Member States".

which may vary in relation to the risk profile of the bank's net total liabilities (Art. 70 (2), SRM Regulation)[125].

On the other hand, *ex post* contributions not exceeding three times the annual amount of *ex ante* contributions, shall be raised in extraordinary circumstances, in order to cover the additional amounts of losses not absorbed through the bailing-in (Art. 71, SRM Regulation).

If both the *ex ante* and the *ex post* contributions are not immediately accessible or do not cover the resolution expenses, the Board may contract for the Fund "borrowings or other forms of support from those institutions, financial institutions or other third parties, which offer better financial terms at the most appropriate time so as to optimise the cost of funding and preserve its reputation" (Art. 73 (1), SRM Regulation).

Though the funding mechanism of the SRF is far from a complete burden-sharing in the EU financial market, it helps ensuring predictable and nimble winding-up of failing banks, with minimum recourse to public money[126], so that massive public bail-out of banks will be outmoded. This point is of vital importance to restore confidence in Europe's financial sector. The only negative aspect hidden by the *ex ante* funding mechanism, is that it is going to take eight years before the Fund will be fulfilled and wholly mutualized: a blink of an eye if compared to the length and the lumps of the EU integration history, but ages in case another failure occurs.

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[125] Cfr. E. Barucci, M. Messori, *The need for a true back-stop*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit. at 115.

[126] "Where the available financial means are not sufficient to cover the losses, costs or other expenses incurred by the use of the Fund in resolution actions, extraordinary *ex-post* contributions from the institutions authorised in the territories of participating Member States shall be raised, in order to cover the additional amounts" (Art. 71 (1) of the SRM Regulation). In the event the neither the ex ante nor the ex post contributions are not immediately accessible or do not cover the expenses incurred by the use of the Fund in relation to resolution actions, "the Board may contract for the Fund borrowings or other forms of support from those institutions, financial institutions or other third parties, which offer better financial terms at the most appropriate time so as to optimise the cost of funding and preserve its reputation" (Art. 73 (1). Finally, if neither the alternative funding means referred to Art. 73 are immediately accessible in a reasonable time, "the Board shall decide to make a request to voluntarily borrow for the Fund from resolution financing arrangements within non-participating Member States" (Art. 72 (1).

The downsides deriving from the SRF discipline are that its amount seems to be too limited and its functioning too complex to represent an efficient back-stop against systemic shocks.

In the end, the crucial advantage brought by the SRM, in respect to ordinary insolvency procedures, consists on its supposed streamlined, efficient, hasty decision-making proceeding, which may lead to the adoption of a resolution scheme within a week-end, after the closure of the US markets and before their opening in Asia. Nonetheless, it is axiomatic that the multi-step, overcrowded, thorny resolution route may not yield the expected results.

When the restructure or the resolution of big credit institutions comes to mind, a credible and independent decision-making body would be strongly preferred in place of a coordinated apparatus like the SRM, as to avoid overlapping competences, vetoing powers, policy disagreements and national bias. In addition, efficient resolution calls for fast-track action, but the convoluted resolution procedure catered by the SRM Regulation is inconsistent with the agile functioning of the SRM.

The new regulatory setting could enhance its efficiency by reducing the ample discretionary margins related to the bail-in process or the resolution actions. For example, a rigid set of pre-determined rules should guide: the distinction between eligible or excluded liabilities in the bail-in process; the definition of the exact order for the writing-down or the conversion of the single unsecured claims of creditors; the objections eventually raised by the Council against the Board's resolution decision, with respect to the existence of the "public interest condition" and to the amount of the Fund to use[127].

To sum up, from a preliminary survey of the SRM we suppose that its authors would have placed a deterrent against moral hazard and a prompt underpinning to the SSM, rather than a ready-to-use shield against huge banking woes[128].

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[127] E. Barucci, M. Messori, *Limits of the bail-in process*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit. at 115.

[128] Other issues connected to the SRM are the administrative and judicial review of the resolution decisions, the independence and accountability of the SRB, the relationship between the latter and the ECB or the EBA, the participation of member States whose currency is not the euro, the double role of the Commission between its supervision upon the internal market/State aid

4. Deposit Guarantee Schemes

Deposit Guarantee Schemes (DGS) are the third and last pillar of the EBU. Unlike the SSM and the SRM, the DGS are not centralized at the European level, but still fragmented at the national level. On 15 April 2014, the EP approved the SRM Regulation, the BRRD and Directive 2014/49/EU[129], which recasted the harmonization of national deposit guarantee schemes.

From a broader point of view, a system of deposit insurance carries out two essential functions:

1) under a micro-prudential approach, it grants payout of little depositors, under a certain threshold (currently fixed at 100.000 € per depositor per bank), against individual banking defaults, which is deemed to avoid "deposit runs" and panic;

2) under a macro-prudential perspective, it avoids that the contagion from a bank failure infects the entire market, assuming systemic proportions, which requires financial support to transfer assets and other liabilities of a distressed bank to other sound banks[130]

In the SRM Regulation, the SRF accomplishes the second objective within the resolution scheme, while the first one is managed by national DGS.

Generally speaking, the factors influencing the success of the DGS are: wide attendance from the financial institutions; satisfactory coverage; timing and effective reimburses[131]. One

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rescues and its resolution new tasks. Each of these themes allows for further elaboration, which cannot be exposed in this work.

[129] Previously, the deposit guarantee schemes were considered as one of the clue elements to fulfill the single market, by Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994, lately amended by Directive 2009/14/EC.

[130] C. Brescia Morra, *Il diritto delle banche* (2012), 231-232.

[131] "Currently, depositors must be able to access their funds within 20 working days after a bank failure (or, more precisely, after the determination by the competent authority or a judge that deposits are unavailable). Repayment deadlines will be gradually reduced from 20 working days to 7 working days.[…] The measures stipulated in the Directive ensure that this faster pay-out will be achieved in practice. DGS will be informed at an early stage by supervisory authorities if a bank failure becomes likely. The DGS will have prompt access to information on deposits at any time. Banks will be required to tag eligible deposits, provide single customer views, and maintain their records up to date. The verification of claims is to be simplified by abandoning time-consuming set-off procedures. If a bank fails, no application from depositors

side-effect could be that the transfer of credit risk from the subject insured to the insurer may encourage moral hazard, but it can be limited by severe regulation[132].

Focusing on Europe, the DGS fragmentation risks to weaken their effectiveness because of their use of national, non-pooled resources and because the lack of coordination between the SRB and the States may slack the repayments, arousing uncertainty in the market[133].

Additionally, other weaknesses of the DGS are the following:

1- financial institutions deposits and interbank loans are covered, on the assumption that they are professional market actors who would have easy access to other sources of financing;

2- as a consequence of the latter point, EBU should clearly regulate the Emergency Liquidity Assistance (ELA). Usually is for National Central Banks to pledge the ELA, also known as Lender of Last Resort (LOLR)[134], which is the financial support to illiquid but solvent banks who finds it hard to get credit from the market, due to a misreading of their soundness and to the economic conjuncture. In an integrated Banking Union, this function shall be discharged by the ECB for credit institution supervised within the SSM, but political pressures have restrained this hypothesis, so far;

3- the coordination between SRB and DGS within the Resolution framework (SRM Regulation and BRRD) may produce transaction costs. In details, Art. 79 of the SRM Regulation describes the use of DGS within the SRM. With regard to a

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will be needed: the scheme will pay on its own initiative. As confirmed by the best practices in the world, rapid payout is feasible. In the United States, depositors are – even if under very different preconditions – usually paid out within a few days. A few years before the adoption of this Directive, the UK authorities also took measures to ensure a payout delay of one week". Cfr. MEMO 14-296 of the European Commission.

[132] C. Brescia Morra, *Il diritto delle banche*, cit., 231-232.

[133] C. Brescia Morra, *The relationship between the Single Resolution Fund and the National Deposit Guarantee Schemes*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit.

[134] British economist Walter Bagehot (Lombard Street, 1873) was the first who conceptualized the LOLR, including among the central banking functions, that of "lend freely to temporarily illiquid but solvent banks, at a penalty rate and on good securities".

resolution action taken by the Board, depositors shall continue to have access to their deposits, so that the deposit guarantee scheme to which the institution is affiliated shall be liable for the amounts determined by the Board, according to prior consultation with the concerned designated authority and "taking fully into account the urgency of the matter" (Art. 79 (3);

4- the SRF, as well as the resources gained from both the private sector and the national funding capacity may not be enough to rescue an ailing bank in the event of a systemic crisis[135].

That being said, if the DGS had been the first element of the EBU to be built up, a decisive step towards a true single banking market would have been made, to the extent that differences in depositing money in any bank established in any participating member States would have been shed. Ultimately, time has not yet come for a pan-EU DGS, but it is crucial to gather political consensus in the future to realize the last EBU building block.

5. Conclusions

The EBU is a creature in its early stage: albeit two out of three of its constitutive elements have been formally established, they will become fully operational only in the near future, and it will take years to collect the financial resources required to improve the EU resilience against financial crises.

Nonetheless, the cultural change stemming from the EBU is already tangible: the "too big to fail" doctrine has been dismantled; a culture of early intervention and prevention is blooming; the EU member States started perceiving that integration is better than fragmentation and mere coordination to face financial tensions.

Consequently, the EBU tried to transpose the above principles into a new European financial architecture, in which harmonization would be replaced by true unification and a single banking market would be finally realized.

In these regards, one could assume that "unification" and "centralization" are synonyms for "simplification". Unfortunately,

[135] C. Brescia Morra, *The relationship between the Single Resolution Fund and the National Deposit Guarantee Schemes*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit. at 115.

this is not the case. As this article has made plain, the efficiency issue is the crux of both the SSM and the SRM and, evidently, of the EBU. The "hub and spokes"[136] structure of the SSM and the "multifaceted glass window" design of the SRM are not seamless mechanisms. The crisis has proven the lack of a strong and unique decision-center to be one of the most dangerous deficiencies affecting the EU. That is why we believe that the EU should have taken the plunge into institutional reforms demonstrating a more courageous and far-reaching attitude.

Apart from this matter for regret, it is worth to underline that the progress attained in the last two years concerning the EBU could not have been imagined before the crisis. In order to exploit the favorable political momentum, the dispositions of the Treaties have been stretched out as far as possible.

At this stage, the margin for further manouvre within the existing legal framework is almost over. Thus, it is to be hoped that the next Treaties overhaul would redraw up the remit of every banking Authority, in order to obtain: a single Central Bank, with monetary function and LOLR power (ECB); a single Regulator, entrusted with supervisory prerogatives (EBA); and a new single Resolution Authority, in charge with decisive, sleek decision-making powers. After all, a clear-cut distribution of competences is the key element to avoid uncertainty in financial matters, as other multi-layered federal systems, like the US[137], have already understood.

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[136]E. Ferran, *European Banking Union: imperfect, but it can work*, 30 Legal Studies Research Paper Series - University of Cambridge 9 (2014).

[137] In the US, the Federal Reserve is the central bank with a unique structure, which includes two levels of regulation and supervision: a federal government agency, the Board of Governors, in Washington, D.C., and 12 regional Reserve Banks (Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, San Francisco) (cf. the Federal Reserve System website, http://www.federalreserveonline.org/). The Fed has no legal personality and its regional banks or departments may perform a range of functions. In some cases they act independently from the Federal Government (e.g. in the implementation of monetary policy), while in other circumstances they can act as Treasury Agents, subject to Governmental control (e.g. in the conduction of foreign exchange operations). This dual configuration inspired the Bundesbank structure and, later on, the ESCB. By the way, T.C. Barbu, I.A. Boitan, *Implications of the single supervisory mechanism on ECB's functions and on credit institutions' activity*, 580 Theoretical and Applied Economics 103-120 (2013), available at http://store.ectap.ro/articole/843.pdf)

In other words, the EU shall abandon the "falling forward method"[138], consisting of time-consuming, troubled negotiations and segmental adjustments, which we have been using to for the last twenty-five years. Instead, an overall revision of the Treaties is compelling to update the European financial architecture, under the auspices of a more perfect Union[139].

In conclusion, the EU could decide to grow-up and assume a proactive, scheduled, long-reaching approach in defining where to head for in the next decades.

report that a 2005 research by the American Bankers Association reveals that a major part of banks were subject to State control (70%), the bunk of which (80%) were of less significant credit institutions, representing a business model more compliant with State-level supervision. Despite that, recently this trend became favorable to the federal-level, because it is more sustainable, flexible and competitive, especially given that transnational M&A have been improving a lot. Against this background, the Federal Reserve Chairman Alan Greenspan (1995) observed that: "a single regulator, charged with responsibility for safety and soundness, is likely to have a tendency to suppress risk taking. A system of multiple supervisors and regulators create checks on this propensity." Definitely, a two-tier supervision is not redundant, but it embodies the best strategy to ensure stability and financial innovation in a banking system comprising 7.188 banks and 6.961 credit cooperatives (data from the Federal Deposit Insurance Corporation (FDIC, National credit Union Administration, 2012).

[138] Cfr. G. Pennisi, *Muddling through, on-the-brink. The Single Resolution Mechanism*, in E. Barucci, M. Messori (eds.), *Towards The European Banking Union*, cit.

[139] About this theme, cfr. M. Draghi, *Europe's pursuit of 'a more perfect Union'*, lecture taken at Harvard Kennedy School, Cambridge (USA), 9 October 2013, available at the ECB official website.