# WHAT IS STILL MISSING TO ACHIEVE AN OPTIMUM CURRENCY AREA UNDER EU LAW?*

*Antonio Marcacci***

*Abstract*

The article normatively assesses the effectiveness of the European Union's post-crisis reforms in the banking field against the economic theory of the Optimum Currency Area, with the aim to ascertain whether the legal requisites claimed by this theory have been institutionally incorporated. First, the article lists the economic criteria that a currency area needs to fulfil in order to be optimal. Second, it explains the implications of such a theory for the institutional design of a currency area. Third, it tests such theoretical findings against the actual architecture established by the recent reforms. The findings show that the new institutional design has many deficiencies. In particular, the governance structure of the Single Supervisory Mechanism is weak because it is based mainly on soft-law measures and on coordination between the European Banking Authority and the European Central Bank. Due to constitutional constraints, the current institutional infrastructure does not include the necessary fully-fledged lender of last-resort and fiscal backstop. Finally, although it was legally feasible, the creation of a Single European Deposit Guarantee Scheme is still a legislative proposal of the European Commission.

* The author would like to thank his fellow EUI alumni Dr. Valentina Spiga and Dr. Antoine Acker for their valuable comments on the legal and institutional aspects of this article, and Dr. Alessandra Vannini for her precious advice on economic matters. All mistakes are the author's own.

** EUI PhD Alumnus, Banking & Financial Compliance Professional.

TABLE OF CONTENTS



## 1. Introduction

The 2011 Euroarea sovereign debt crisis was characterized by a scramble for home debt, with many European banks buying too much sovereign debt in order to support their home country's public institutions, thirsty of funds. Unfortunately, this behavior ended up causing significant problems. First, too much public debt negatively impacted the banks' own funds requirements. Second, too much effort on national financial markets seriously hampered the correct functioning of the single European financial services market, with the significant loss of business opportunity deriving from it. Third, given the *odd* relationship between commercial banks and sovereign debts – the so-called "vicious circle"[1] –, the transmission belt of the European Central Bank (ECB) monetary policy became unstable and pressed alongside national borders with the credit provision to real economy dimming alarmingly[2].

[1] D. Valiante, *Last Call for a Banking Union in the Euro Area* (2012).
[2] On the consequences of the crisis: European Commission, *Legislative package for banking supervision in the Eurozone – frequently asked questions - Why is a single*

The establishment of a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM) – politically emphasized as the "Banking Union" – is, undoubtedly, the main regulatory outcome of the 2011 Euroarea sovereign debt crisis. The

---

*supervisory mechanism necessary and when should it be in operational?* MEMO/13/780, 12/09/2013, at 1, http://europa.eu/rapid/press-release_MEMO-13-780_en.htm accessed 7 November 2015. As Valiante argues: "Instability of the banking system in the Eurozone is mainly caused by moral hazard and adverse selection problems. The moral hazard issue fosters liquidity ring-fencing in national boundaries (Draghi, 2012), while adverse selection impedes the restart of cross-border interbank activities for the risk aversion of northern Eurozone banks. This situation hampers the transmission channels of monetary policy, as liquidity injections by the ECB have not been able to restart a well-functioning interbank market." D. Valiante, *Last Call for a Banking Union in the Euro Area,* cit. at 1. Moreover, Sarcinelli highlights that many scholars argue how national regulators have been too lenient towards domestic banking institutions, thus worsening the crisis. M. Sarcinelli, *L'Unione Bancaria Europea e la stabilizzazione dell'Eurozona,* in 66 Moneta e Credito 24 (2013). Also: V. Constâncio, *Towards a European Banking Union*, Lecture held at the start of the academic year of the Duisenberg School of Finance, Amsterdam, (2012) 7 September 2012, available at https://www.ecb.europa.eu/press/key/date/2012/html/sp120907.en.html accessed 7 November 2015. On the nationalitation of trasmission belt of the ECB monetary policy, Merler and Wolf point out how: "Relying on national authorities can only lead to major differences and applications in different countries, thereby undermining financial integration and reinforcing the re-nationalisation of finance that has been seen in the last few years. This is not only sub-optimal, but also undermines monetary integration to the extent that the fragmentation of financial markets along national borders hinders the transmission of the single monetary policy." S. Merler & G. Wolff, *Financial Odyssey: How should the first steps of the banking union be implemented*, VoxEU.org, available at http://www.voxeu.org/article/first-steps-banking-union-implementation, accessed 11 December 2015.

Alongside these economic reasonings, Kaarlo Touri makes the case for a legal analysis of the crisis in that he argues how this is not only an economic or financial crisis but also a constitutional crisis since the Europeanized monetary policy and the ECB monetary programs have shaken the foundations of the so-called the "second layer of the EU economic constitution" (*i.e.*, the one dealing with macroeconomics – being the first layer the one focusing on the basic principles of microeconomics), shown a tendency towards monetary policy's politicization and, thus, raised legitimacy issues. In the words of prof. Touri: "The further away from a monetary policy directed by the price-stability objective the ECB ventures and the more active a role it adopts in fiscal rescue operations, the more the original justification for its present institutional status loses coverage." K. Touri, *The European Financial Crisis – Constitutional Aspects And Implications*, EUI Working Papers, Law 2012/28, 38 (2012).

New Institutional Architecture for the banking sector (NIA) was conceived to establish a legal "safety net"[3] meant to overcome the crisis. Ironically, the need for such a safety net had been long heralded, even if implicitly, by the Theory of an Optimum Currency Area – OCA. This article argues, normatively, that it is not clear whether the legal requisites claimed by the OCA theory have been incorporated through the recent reforms in the baking law field.

As a first step, the article starts by listing the economic criteria that a currency area needs to fulfil in order to be optimal according to the OCA theory. It then explains what are the implications of such theory for the public institutional design of a currency area. As a last step, the article tests such theoretical findings against the actual design of the SRM/SSM legislative package in order to verify whether it covers all the pillars of the OCA's safety net. Unfortunately, the findings are quite disappointing and the road leading to the institutionalization of an Optimum Currency Area under the EU law is still long.

## 2. The Theory of an Optimum Currency Area [i.e., what the Euroarea is supposed to be(come)]...

In 1953 Milton Friedman analyzed the so-called "asymmetric shocks"[4] which only hit one of the regions/member countries of a single currency area (SCA) and not the others, and

[3] The expression "safety net" is used, among others, by D. Gros & D. Schoenmaker, *European Deposit Insurance and Resolution in Banking Union,* 52 J. Comm. Mkt St. 9 (2014). Carmassi et al. argue in favor of a safety net for Europe, since the necessity to tame "moral hazard and excessive risk-taking requires a consistent set of regulatory incentives, based not only on common rules but also on integrated supranational powers in banking supervision, deposit insurance and crisis management, including resolution. The three functions are intimately interconnected, and only their joint management can eradicate the expectation of national bail-outs from the system and thus establish proper incentives against reckless risk-taking by banks in the internal market." J. Carmassi et al., *Banking Union: a federal model for the European Union with prompt corrective action*, Centre for European Policy Studies CEPS 282/2012, 1, (2012) available at http://www.ceps.eu/publications/banking-union-federal-model-european-union-prompt-corrective-action, accessed 7 November 2015.

[4] M. Friedman, *The Case for Flexible Exchange Rates*, in M. Friedman, *Essays in Positive Economics* (1953).

that, due to a fixed exchange, which cannot be rebalanced through a flexible exchange rate. Less than a decade later, in 1961 Robert Mundell theorized the OCA[5] for the first time by assuming that countries and/or regions with strong economic ties and high level of market integration would economically benefit by sharing the same currency.

Mundell held that an SCA achieves its optimality when asymmetric shocks can be overcome, and this "implies a single central bank (with note-issuing powers) and therefore a potentially elastic supply of interregional means of payments"[6]. What Mundell had in mind was a central bank able to jump in and contribute to fighting the distortions provoked by economic shocks through tools affecting the efficient allocation of capital. This assumption was enriched and pushed forward by several other economists in the following decades, such as McKinnon,[7] Kenen[8], Mongelli[9], Grubel[10], and Fleming[11].

As of today, it is possible to highlight the criteria[12] – developed over the decades as a shared vision[13] – which make the exchange rate tool of little help to solve economic shocks:

---

5 R.A. Mundell, *A Theory of Optimum Currency Areas,* 51 Am. Econ. Rev. 657 (1961).

6 Id., 658.

7 R.I. McKinnon, *Optimum Currency Areas,* 53 Am. Econ. Rev. 717 (1963), cited in M. Petreski, *Is the Euro Zone an Optimal Currency Area?* (2007) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986483, accessed 7 November 2015.

8 P.B. Kenen, *The Optimum Currency Area: An Eclectic View,* 58 Am. Econ. Rev. 356 (1969), cited in M. Petreski, *Is the Euro Zone an Optimal Currency Area?* cit. at 7.

9 F.P. Mongelli, *"New" Views on the Optimum Currency Area Theory: What is EMU telling us?* ECB Working Paper Series - no 138/2002 available at http://repec.org/res2002/Mongelli.pdf, accessed 7 November 2015, (2002). Cited in M. Petreski, *Is the Euro Zone an Optimal Currency Area?* (2007), cit. at 7.

10 H.G. Grubel, *The Theory of Optimum Currency Areas,* 3 Can. J. Econ./Revue canadienne d'Economique 318 (1970), cited in M. Petreski, *Is the Euro Zone an Optimal Currency Area?* (2007), cit. at 7.

11 J.M. Fleming, *On Exchange Rate Unification*, 81 Econ. J. 467 (1971), cited in F.P. Mongelli, *"New" Views on the Optimum Currency Area Theory: What is EMU telling us?*, cit. at 9.

12 M. Petreski, *Is the Euro Zone an Optimal Currency Area?*, cit. at 7. For the history and development of the OCA theory, see: R. Horvath & L. Komarek, *Optimum Currency Area Theory: An Approach For Thinking About Monetary Integration*, Warwick Economic Research Papers - No 647/2002, (2002).

1. Full mobility of labor and other factors of production such as capital between a shock-hit country and a non-shock-hit country. This is because such factors ease the aftermath of a shock by pushing down unemployment (through the migration of unemployed people from a country to another) and increasing productivity (through, for instance, the relocation of a company's business process).

2. Price and wage flexibility within a currency area, because shocks turn into a decrease of prices and wages, and unemployment in one country and inflation in another one are avoided;

3. financial market integration and economic openness. The first criterion leads to a level-playing-field for all financial players and unhook capital mobility from currency exchange rates; whereas the second criterion is linked to the fact that international prices easily penetrate into a currency area making thus currency exchange rates useless;

4. production and consumption, because a highly diversified economy does not need currency exchange rates as production and consumption quite easily adjust to and overcome shocks;

5. convergence of inflation rates and trade, because when inflation rates of different countries converge, then the terms of trade also converge, leading to equilibrated current account transactions that do not need an exchange rate adjustment;

6. fiscal and political integration. This is because through a politically-based fiscal backstop, wealthier areas support shock-hit areas through fund conferrals[14].

---

[13] M. Petreski, *Is the Euro Zone an Optimal Currency Area?*, cit. at 7.

[14] In this regards, Tower and Willet have clearly stated that "a successful currency area needs a reasonable degree of compatibility in preferences towards growth, inflation and unemployment and significant ability by policy-makers in trading-off between objectives". E. Tower & T. D. Willett, *The theory of optimum currency areas and exchange-rate flexibility*, (1976), cited in Petreski, *Is the Euro Zone an Optimal Currency Area?*, cit. at 7.

### 3. ...and what it implies in legal and institutional terms: the safety net

The OCA criteria spelt out above imply the establishment of a "safety net"[15] meant to ensure financial stability in the long run. In synthetic institutional terms, such safety net involves an interplay of the following private and public law tools:

1. An administrative supervisory authority, usually the Central Bank, tasked with watching over banks' management.
2. A lender of last resort, usually the Central Bank in full control of its monetary policy, charged with lending financial institutions liquidity in order to avoid a systemic stand-off and "maintain financial stability"[16].
3. A fiscal backstop, which is, usually, the Government injecting monies (either/both direct taxpayers' money or/and borrowed fund) to recapitalize troubled banks.
4. A deposit insurance scheme[17], which is a tool employed to boost depositors' confidence in the financial system as a whole, reduce the risk of bank runs, and limit the

[15] See note 3.

[16] P. De Grauwe, *The European Central Bank: Lender of Last Resort in the Government Bond Markets?*, CESifo Working Paper Series No. 3569/2011, (2011) http://www.cesifo-group.de/portal/page/portal/DocBase_Content/WP/WP-CESifo_Working_Papers/wp-cesifo-2011/wp-cesifo-2011-09/cesifo1_wp3569.pdf, accessed 7 November 2015.

[17] D. Gros & D. Schoenmaker, *European Deposit Insurance and Resolution in Banking Union*, cit. at 3. Also mentioning M.H. Engineer, et al., *A positive analysis of deposit insurance provision: Regulatory competition among European Union countries,* 9 J. Financial Stability 530 (2013); and F. Allen, et al., *Cross-Border Banking in Europe: Implications for Financial Stability and Macroeconomic Policies,* (2011), available at http://www.voxeu.org/sites/default/files/file/cross-border_banking.pdf, accessed 7 November 2015, regarding the close relation between resolution and deposit guarantee schemes, even proposing a single fund covering both resolution and deposit insurance needs so as to avoid potential conflicts between two funds. On the fact that a Deposit Guarantee Scheme is a core component of the "financial safety net" is also highlighted by M. Gerhardt & K. Lannoo, *Options for reforming deposit protection schemes in the EU*, European Credit Research Institute - ECRI Policy Brief no 4 (2011), available at http://www.ceps.eu/publications/options-reforming-deposit-protection-schemes-eu, accessed 7 November 2015.

negative externalities generated by bank failures[18]. It can be either a private or a public law scheme, whether it is established and funded by the Government or by the industry. Hybrid solutions, such as fund based on private law, recognized by a public authority and funded by fees paid by the industry is, actually, very likely to occur[19].

5. A resolution fund and mechanism, intended to work hand-in-hand. The fund can be based either on public or private law, or even have a hybrid nature, such as, for instance, having a private law nature while being fuelled by the Government or by both the Government and the industry. However, despite the legal nature of the fund, the resolution authority implementing the resolution mechanism, thus enforcing resolution laws and managing the winding down or – when necessary – the resolution of troubled banks, is (usually) public and uses a mix of administrative law powers and private law instruments[20].

---

[18] European Commission, *Deposit Guarantee Schemes* (2015) available at http://ec.europa.eu/internal_market/bank/guarantee/, accessed 7 November 2015.

[19] The Italian, French, and Spanish Deposit Guarantee Funds share some significant similarities but also diverge in several aspects. The Italian "*Fondo Interbancario di Tutela dei Depositi*" is a private law consortium recognized by the Bank of Italy and funded by the member banks. See: *Fondo Interbancario di Tutela dei Depositi, Statuto e Regolamento* (2012). The French "*Fonds de garantie des dépôts*" was established as a private law legal person directly by the law in 1984 by art. Article 52-1 of Act n° 84-46 du 24 janvier 1984 and amended in 1999 by Article 65 of Act n°99-532 du 25 juin 1999. Fees are paid by the Fund's Members. The Spanish "*Fondo de Garantía de Depósitos de entidades de Crédito*" was originally established in 1977 by the Real Decreto 3048 of 1977 (and amended in 1980 by the Real Decreto 4 of 1980) as a public legal person enabled to conclude private law contracts and funded by the industry. The Real Decreto *2606 of 1996*, instead, simply provides that the fund is a legal person able to private law contracts, and the private law nature of Fund has been confirmed by the last amendment done by the Real Decreto-ley 16 of 2011.

[20] In Italy, for instance, on the basis of a proposal coming from the domestic Central Bank – Banca d'Italia – the Ministry of Economy and Finance appoints ad-hoc administrators tasked with running the trouble institution. The appointment of the ad-hoc administrators is an administrative law measure and can, under certain circumstances, be challenged before a Public Administrative Court, whereas the management of the firm is carried out with the usual private law tools. As regards resolution procedures, see: Title IV, Section I and II of the Italian Consolidated Banking Law (decreto legislativo 385/1993).

**4. The New Institutional Architecture for the banking sector: the European safety net**

The OCA theory had long influenced the economic debate about the establishment and development of Europe's Economic and Monetary Union (EMU)[21]. However, even if pre-SSM/SRM Euroarea was an SCA, it was crystal clear that it did not meet all the OCA criteria[22]. Actually, not even half of them were met. The mandate of the European Central Bank (ECB) as a lender of last resort[23] was quite limited compared to that of the Bank of England

[21] J. Horvath, *Optimum currency area theory: A selective review*, BOFIT - Discussion Papers No. 15 Bank of Finland - Institute for Economies in Transition, 7 (2003), available at http://www.suomenpankki.fi/pdf/110655.pdf, accessed 7 November 2015. The author uses the words of Bofinger: "[the OCA theory] seems to be almost generally accepted as the main touchstone of the advantages of EMU and as the theoretical basis for all empirical tests in this area". P. Bofinger, *Is Europe an Optimum Currency Area?* (1994). See also: M. Buford Canzoneri & C. Ann Rogers, *Is the European Community an Optimal Currency Area? Optimal Taxation versus the Cost of Multiple Currencies,* 80 Am. Econ. Rev. 419 (1990); H. Snaith, *Narratives of Optimum Currency Area Theory and Eurozone Governance*, 3 New Political Econ. (2014); J. Jager & K.A. Hafner, *The Optimum Currency Area and the EMU: An Assessment in the Context of the Eurozone Crisis*, 5 Intereconomics 315 (2013); F.P. Mongelli, *What is European Economic and Monetary Union Telling us About the Properties of Optimum Currency Areas?,* 43 J. Comm. Mkt. St. 607 (2005); W. Schelkle, *The Optimum Currency Area Approach to European Monetary Integration: Framework of Debate or Dead End?,* South Bank European Paper 2/2001.

[22] According to Krugman, an "optimum currency area theory suggested two big things to look at – labor mobility and fiscal integration. And on both counts it was obvious that Europe fell far short of the U.S. example, with limited labor mobility and virtually no fiscal integration." P. Krugman, *Revenge of the Optimum Currency Area*, The New York Times (2012), available at http://krugman.blogs.nytimes.com/2012/06/24/revenge-of-the-optimum-currency-area/?_r=0, accessed 7 November 2015.

[23] As stated by Article 127.1 of the Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C 326/1: "The primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119."

or the Federal Reserve[24], and the "fiscal" and "political integration" were just missing. Perhaps, only economic openness was, for the time being, a concrete achievement.

In more concrete legal terms, the EMU was established without a single supervisory authority[25]. Monetary policy was practically the only tool the ECB was officially endowed with. As regards resolution procedures and deposit guarantee schemes[26],

---

[24] A very interesting analysis of the role of the ECB as a lender of last resort compared to that of the FED and the BoE is provided by: P. De Grauwe, *The European Central Bank: Lender of Last Resort in the Government Bond Markets?*, cit. at 16.

[25] Up to now prudential supervision was run by the Member States' banking Authorities and Central Banks, with the supervision of the payment system being split between some domestic authorities, namely the Central Banks of Germany, France, and Italy. [*Source*: Banca d'Italia, '*Sistema di pagamenti*' (bancaditalia.it 2014) https://www.bancaditalia.it/compiti/sispaga-mercati/sistemi-pagamenti/index.html, accessed 7 November 2015] and the ECB.

[26] On the importance of a Pan-European deposit guarantee mechanism: J. Carmassi et al., *Banking Union: a federal model for the European Union with prompt corrective action*, cit. at 3, 2; J. Pisani-Ferry, et al., *What Kind Of European Banking Union?* (Bruegel Policy Contribution - Issue 2012/12, 18 (2012), http://bruegel.org/2012/06/what-kind-of-european-banking-union/, accessed 7 November 2015. Moreover, as regards the close relationship between deposit insurance and resolution scheme, see: D. Schoenmaker, *Governance of International Banking: The Financial Trilemma*, 139 (2013); M.H. Engineer, et al., *A positive analysis of deposit insurance provision: Regulatory competition among European Union countries,* cit at. 17. In particular, Colliard highlights the importance of a Deposit Guarantee Scheme in a multi-States currency area: "A corollary is that common deposit insurance is useful precisely because part of the losses in this case will be borne by non-nationals". J.E. Colliard, *Monitoring the Supervisors: Optimal Regulatory Architecture in a Banking Union*, HEC Paris - Finance Department, 27 (2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2274164, accessed 7 November 2015. This is actually why a few Member States fiercely opposed the establishment of a single Deposit Guarantee Scheme. With different but complementary words, Gros & Schoenmaker: a deposit guarantee scheme can "make a material difference because it would provide an external loss absorption mechanism, which is independent of the solvency of the sovereign [*the sovereign debt*]. Such an external loss absorption mechanism is important, especially during a financial crisis, which usually goes hand in hand with a deep recession and thus large deficits and increasing public debt levels". D. Gros & D. Schoenmaker, *European Deposit Insurance and Resolution in Banking Union*, cit. at 3, 6. Ruding too backed Gros & Schoenmaker's argument by stating that a "deposit guarantee scheme and [a] bank resolution probably should be implemented simultaneously. They are separate arrangements, but in

the landscape was empty. And the same held true for the fiscal backstop[27]. Within this context, the new institutional architecture is a potential "game changer"[28] able to solve the problems lying in the flawed institutional design of the EMU[29].

From a normative point of view, the wider picture of the NIA is made up with two legislative packages, the SSM and the SRM. The first is the Single Supervisory Mechanism – SSM, based on Council Regulation 1024/2013[30] and Regulation 1022/2013[31]. Council Regulation 1024/2013 moves from the domestic to the European level the administrative prudential supervision over larger banks[32] established in countries whose currency is the Euro.

---

practice they must go hand-in-hand. Their institutional and financial governance may, to a certain extent, be integrated or coordinated." H.O. Ruding, *The Contents and Timing of a European Banking Union: Reflections on the differing views,* Centre for European Policy Studies CEPS - Essays ed. (2012), http://www.ceps.eu/publications/contents-and-timing-european-banking-union-reflections-differing-views, accessed 7 November 2015.

[27] In the words of Sarcinellli: "[a] banking union requires a fiscal backstop and this can be provided only by a sort of Euroarea's treasury endowed with tax resources and with the power to borrow" (*my own translation from Italian*). M. Sarcinelli, *L'Unione Bancaria Europea e la stabilizzazione dell'Eurozona,* cit. at 2, 37.

[28] Lannoo uses the expression "game changer" to define the potential impact of the Single Supervisory Mechanism. K. Lannoo, *The New Financial Regulatory Paradigm: A transatlantic perspective,* Centre for Economic Policy Research - CEPS Policy Briefs ed., 8 (2013) http://www.ceps.eu/publications/new-financial-regulatory-paradigm-transatlantic-perspective, accessed 7 November 2015.

[29] A. Enria, *The Single Market after the Banking Union*, speech at the AFME and EBF Banking Union in Europe Conference, 3 (2013), https://www.eba.europa.eu/-/speech-by-andrea-enria-at-the-afme-and-ebf-banking-union-in-europe-conference, accessed 7 November 2015. The Banking Union is a game changer because, on the hand, it centralises supervision in the hands of the ECB [on the importance of arranging the three functions together (banking stability, system of payments, and monetary policy), *see*: T. Padoa-Schioppa, *The euro and its central bank - Getting united after the union*, the MIT Press, 119 (2004); on the other hand, more holistically, it (partially) fills the current huge gap with the creation of a single resolution fund and a uniform resolution mechanism. In the words of Vítor Constâncio: "The deeper rationale is however the need to construct a Banking Union for ensuring a successful and well-functioning Monetary Union." V. Constâncio, *Towards a European Banking Union*, cit. at. 2.

[30] Council Regulation 1024/2013 OJ L 287/63, 29.10.2013.

[31] Regulation 1022/2013 OJ L 287/5, 29.10.2013.

[32] The remit covered by the supervision of the ECB is circumscribed to those institutions which are not considered as less-significant, such as those firms: *i*) whose assets' total value exceeds 30 billion €; *ii*) whose total assets' ratio over

To avoid the ECB being overwhelmed by the supervision activity, the Council Regulation splits responsibilities along three lines, that is:

a. between National Competent Authorities (NCAs) and the ECB. Unfortunately, there is no clear-cut division between the ECB and the NCAs but the responsibilities are, in actual law and in practice, very intertwined. For instance, the ECB is exclusively competent for authorizations (and withdrawal!) and for the vetting of shareholders as suitable for all Euroarea banks. In addition, the ECB has the ultimate responsibility for the functioning of the entire supervisory system, being able to take on direct supervision of non-significant banks hitherto under NCAs' purview;

b. between the ECB and the other European Authorities[33], in particular the European Banking Authority (EBA) – whose governance is reformed by Regulation 1022. The EBA is, indeed, in charge of drafting the single rulebook – e.g. the "glue that should keep together the Single Market"[34] – and adopting converging supervisory practices – the Single Supervisory Handbook – at EU level[35].

c. between NCAs as regards exchange of information concerning cross-border operations of banks based in the SSM.[36]

---

the GDP of the Euro participating Member State of establishment exceeds 20%, unless the total value of assets is below 5 billion €; *iii*) on the bases of a NCA's notification considering an institution of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such significance following a comprehensive assessment, including a balance-sheet assessment, of that credit institution. Art. 6 (4), Council Regulation 1024/2013.

[33] In this context, Article 3 of Regulation 1024/2013 clearly states that the "ECB shall cooperate closely with EBA, ESMA, EIOPA, and the European Systemic Risk Board (ESRB), and the other authorities which form part of the ESFS", namely the European System of Financial Supervision.

[34] A. Enria, *The Single Market after the Banking Union,* cit. at. 29, 4.

[35] J. Carmassi et al., *Banking Union: a federal model for the European Union with prompt corrective action,* cit. at. 3, 5.

[36] And, when necessary, even a cooperation with the national judicial authorities. On this point, see: F. Lafarge, *Les autorités européennes de surveillance, la régulation financière et l'union bancaire européennes* (2013).

Cooperation is the key element of the new European system of banking supervision. Notably, Art. 3(1) and (6) of Council Regulation 1024 identifies quite a common soft-law tool such as "memoranda of understanding" as *the* tool to be employed by the ECB when cooperating with other EU and/or national authorities. From a governance perspective, the Supervisory Board (SB) – made up of a Chair[37] and Vice Chair[38], four representatives of the ECB[39], and one representative of the each NCA coming from an SSM-participating MS[40] – is informally responsible for the overall correct functioning of the SSM. However, due to the fact that the SB was not created by the Treaty, the ultimate responsibility lies with the Governing Council which must approve any supervisory decision through the non-objection procedure[41].

The other legislative package is the Single Resolution Mechanism – SRM, based on Regulation 806/2014[42]. Such Regulation provides that the banks subject to the SSM are also subject to the SRM, the European procedure to orderly wind down or resolve troubled banks. The SRM is run by the Single Resolution Board (SRB), a new EU agency, whereas traditional National Resolution Authorities (NRAs) are now asked to assist and coordinate with the Resolution Board. Regulation 806/2014 also establishes the European Single Resolution Fund (SRF) with the aim of financing troubled banks[43]. Significantly, NRAs are still responsible for handling non-SSM banks' resolution procedures, unless the SRF is asked for help: In this case the SRB is the resolution authority.

---

[37] The Chair is an external candidate.

[38] The Vice Chair is a member of the ECB executive board.

[39] The four representatives are appointed by the ECB Governing Council.

[40] Art. 26 (1), Council Regulation 1024/2013.

[41] Article 26(8) of Regulation 1024/2013.

[42] Regulation 806/2014/EU, OJ L 225/1, 30.7.2014.

[43] The SRF is run by the SRB. Very importantly, the SRF is not part of the EU budget, but it is fed by fees paid by banks and collected at national level. At least for the first eight years, it will be made up of national compartments that will be gradually merging. Over this transitional period, mutualisation of the resolution burden between national compartments will be gradually increasing: 60% during the first two years and then 6.7% for each of the remaining six years. Should a bank fails over this transitional period, what would remain uncovered would be funded by national authorities (where the failed institution has its legal headquarters). Importantly, temporary lending among national compartments are also allowed. Regulation 806/2014.

The Regulation introduces a single regulatory framework for the recovery and resolution of banks through certain tools such as the *bail-in* (Article 27). Significantly, for those EU Member States not joining the SSM/SRM, another piece of legislation introduces a harmonized framework for the recovery and resolution of credit institutions and investment firms, the so-called Bank Recovery and Resolution Directive (BRRD),[44] whose content substantially reproduces that of the SRM Regulation in terms of legal tools that national resolution authorities can use.

Notably, the Single Resolution Mechanism was indispensable for Europe to complete an integrated financial framework, for three main reasons: the establishment a fair and swift decision-making process; the reduction of resolution costs and break down the bank-sovereign nexus; and the completion of the Single Supervisory Mechanism by making sure that banks on the edge of default are being restructured or even closed down rapidly if needed.[45] The two pieces of legislation were, thus, conceived to be working hand-in-hand.

## 5. Testing the OCA Theory over the European safety net: what is missing? what is unlikely to work?

### 5.1. A supervisory authority based on coordination

The ECB-NCAs cooperation mechanism[46] sounds smooth, at least on paper. If the ECB is accountable for the "effective and consistent functioning of the SSM"[47], in any case both the ECB and the NCAs are "subject to a duty of cooperation in good faith, and an obligation to exchange information".[48] Domestic authorities are clearly and explicitly asked to provide the ECB "with all information necessary for the purposes of carrying out the tasks conferred on the ECB by this Regulation",[49] giving the idea that cooperation is strongly based on exchange of information. Importantly, if NCAs are to assist the ECB in the preparation and

[44] Directive 2014/59/EU, OJ L 173/190, 12.6.2014.
[45] As rightly claimed by Mr. Van Rompuy. H. Van Rompuy, *Towards A Genuine Economic And Monetary Union,* 7 (2012).
[46] Art. 6, Council Regulation 1024/2013.
[47] Art. 6 (1), Council Regulation 1024/2013.
[48] Art. 6 (2), Council Regulation 1024/2013.
[49] Art. 6 (2), Council Regulation 1024/2013.

implementation of any acts relating to the ECB's supervisory tasks, the ECB is asked to coordinate and summarize traditional national supervision cultures and practices[50].

So far, so good. However, the ECB-EBA relationship raises some doubts. Due to Treaties constraints, the EBA could not be charged with supervisory tasks. Council Regulation 1024/2013[51] is, indeed, based on Art.127(6) TFEU, which reads as follows:

> "The Council [...] may [...] confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions [...]."

The result is that, on the one hand, the European Central Bank carries out supervisory tasks through the Single Supervisory Mechanism; but, on the other hand, as mentioned above, the European Banking Authority is still entrusted with the task of drafting and issuing the rules of the European single rulebook[52] for the entire EU[53] (which is, actually, its most daunting challenge!) [54].

---

[50] When a person opposes an inspection carried out by the ECB, the national authority must, when its power is not sufficient, must request the indispensable assistance of other national authorities [Art. 12 (5), Council Regulation 1024/2013], thus making the administrative cooperation system even more complex.

[51] Council Regulation 1024/2013 OJ L 287/63, 29.10.2013.

[52] As the official website states: "The term Single Rulebook was coined in 2009 by the European Council in order to refer to the aim of a unified regulatory framework for the EU financial sector that would complete the single market in financial services". The European Banking Authority, "The Single Rulebook", http://www.eba.europa.eu/regulation-and-policy/single-rulebook accessed 7 November 2015.

[53] J. Carmassi et al., *Banking Union: a federal model for the European Union with prompt corrective action*, cit. at 3, 5.

[54] A. Enria, *The Single Market after the Banking Union,* cit. at 29, 12. The conundrum is made even more puzzling by the hierarchical relationship between the Single Supervisory Handbook and its domestic counterparties and the relationship between the Single Supervisory Handbook and the supervisory activity of the SSM. In the words of Enria: "the legislative mandate refers to the single handbook as a collection of good practices competent authorities can refer to. Hence, we will have the handbook, but also the SSM manual and national manuals in Member States not participating in the SSM". A. Enria, *The*

Given the increasing convergence at European level of banking and financial regulation – which is likely to be boosted by the early 2014 landmark Short Selling Case[55] in which the ECJ gave a specific interpretation of the *Meroni* doctrine[56] and provided the EU regulatory agencies with a broader leeway – the role of the EBA's rulebook is meant to become more and more pervasive. For this very reason, Regulation 1022/2013[57] amended EBA's governance to rebalance the lopsided power equilibrium

*Single Market after the Banking Union,* cit. at 29,8. On this point also M. Sarcinelli, *L'Unione Bancaria Europea e la stabilizzazione dell'Eurozona*, cit. at 2, 29.

[55] United Kingdom v Council and Parliament (ESMA's powers on Short Selling).

[56] In the Meroni case, the ECJ stated four important principles: first, coherently with the idea that *nemo plus iuris transferre potest quam ipse habet,* the ECJ excluded the possibility for a delegating authority to delegate on other bodies powers different from those already possessed by the delegator under the Treaty, S. Griller & A. Orator *Everything under control? The "way forward" for European agencies in the footsteps of the Meroni doctrine,* 35 Eur. L. Rev. 10 (2010). Second, a delegation of powers cannot be presumed, but the delegating authority must make an express delegation [*Ibid*, at 10]. Third, a delegation of "discretionary powers" is unlawful because it can "make possible the execution of actual economic policy" [Case 9/56, Meroni & Co Industrie Metallurgiche SpA vs High Authority of the European Coal and Steel Community (Meroni I),[1957] ECR 133] thus replacing "the choices of the delegator by the choices of the delegate"[Ibid], and causing "an actual transfer of responsibility" [Ibid]. Finally, a delegation of "discretionary powers" is unlawful because it would jeopardize the balance of powers between the European institutions, X.A. Yataganas, *Delegation of Regulatory Authority in the European Union – The Relevance of the American Model*, (2001). http://www.jeanmonnetprogram.org/archive/papers/01/010301.html, accessed 7 November 2015. Since then, ECJ case law has not authorized the creation of European agencies endowed with "discretionary power to translate broad legislation guidelines into concrete instruments". D. Geradin & N. Petit, *The Development of Agencies at EU and National Levels: Conceptual Analysis and Proposals for Reform*, (2004), available at http://jeanmonnetprogram.org/archive/papers/04/040101.pdf, accessed 7 November 2015. This approach has, for 50 years, been "a constitutional limit to delegation", P. Craig, *EU Administrative Law*, 161 (2006), and it has substantially impeded the establishment of regulatory agencies [for the debate on European regulatory agencies, see: G. Majone, *Delegation of Regulatory Powers in a Mixed Polity,* 8 Eur. L. J. 319 (2002), with functions and powers like those belonging to US federal regulatory agencies, such as the SEC [For the categorization of EU agencies, see: S. Griller & A. Orator *Everything under control? The "way forward" for European agencies in the footsteps of the Meroni doctrine,* cit. at 56.

[57] OJ L 287/5, 29.10.2013.

between Euroarea Member States (MSs) – now far more unified under the SSM – and non-Euroarea MSs, in particular the UK. Possible hurdles may stem not only from potential rifts between SSM-MSs and non-SSM-MSs[58], but, in particular, from the fact that, on the one hand, the ECB supervision covers only Euroarea MSs; on the other hand, the EBA rulebook covers the entire Union's banking system. This fragmentation may obstacle the harmonization process[59].

Leaving aside the more technical issues linked to the new EBA's voting system and governance procedures[60], what matters more is the doubts stemming from the not-so-easy coordination between a supervisor without regulatory powers and a regulator without supervisory powers. If joint within the same body, supervision and regulation can turn into a very strong combination[61]. In this regard, the US Federal Reserve Board can be taken as a yardstick since it is vested with both regulatory and supervisory powers[62], something that is still missing in Europe.

Concerning the coordination between NCAs, this was already "regulated" by Article 116 of Capital Requirement Directive IV which provides that the consolidating supervisor must establish colleges of supervisors with the aim to facilitate the exercise of supervisory tasks of a bank involved in cross-border businesses[63]. Not surprisingly, the EBA is asked to "contribute to promoting and monitoring the efficient, effective and consistent functioning of colleges of supervisors"[64].

---

58 A. Enria, *The Single Market after the Banking Union,* cit. at 29, 3.

59 See: L. C. & G. F., *Il governo della vigilanza nell'Unione bancaria europea*, 12 Bancaria, 28 (2013).

60 System and procedures that increase "the complexity of an already burdensome decision-making process". A. Enria, *The Single Market after the Banking Union,* cit. at 29, 12.

61 About the role of enforcement in financial markets, see: J. C. Coffee Jr., *Law and the Market: The Impact of Enforcement*, (2007) https://www.law.upenn.edu/journals/lawreview/articles/volume156/issue2/Coffee156U.Pa.L.Rev.229%282007%29.pdf, accessed 7 November 2015.

62 On the enforcement actions of the FED: http://www.federalreserve.gov/newsevents/press/enforcement/2015enforcement.htm.

63 For banks coming from MSs joining the BU, the competent authority is the ECB.

64 Article 116 (1), Directive 2013/36/EU, OJ L 176/338, 27.6.2013.

In the same vein, the BRRD as well pays attention on the coordination mechanism[65] between authorities charged with resolving banks with cross-border activities[66], and it provides the establishment of resolution colleges alongside the supervisory colleges[67]. Within the SRM framework, Recital 91 of the SRM Regulation clarifies that since the SRM Board replaces the local resolution authorities of the Member States joining the SSM/SRM in their resolution decisions, then the Board also replaces the very same authorities in terms of the cooperation with non-participating Member States, including in the resolution colleges regulated by the BRRD.

This institutional framework is not convincing. Loyal cooperation between different levels of power is welcome and very often necessary. Subsidiarity is a basic principle of the EU[68]. Cooperation is a necessity due to the number – more than 6000[69] – of the banking institutions subject[70] to the new centralized supervision. However, the complexity of this multi-layered

[65] As specified by Babis: "The EU Recovery and Resolution Directive makes provisions for group recovery plans, intra-group financial assistance and coordinated early intervention measures for groups" V. Babis, *European Bank Recovery and Resolution Directive: Recovery Proceedings for Cross-Border Banking Groups,* (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346310, accessed 7 November 2015.

[66] Recital 42 clearly states that "any resolution action should take into account the potential impact of the resolution in all the Member States where the institution or the group operates".

[67] These resolution colleges must include not only domestic resolution authorities but also competent ministries, central banks, the EBA and, when necessary, authorities overseeing national deposit guarantee schemes. As it is the case for supervisory colleges in term prudential supervision, resolution colleges are designed to provide a forum for the exchange of information and the coordination of resolution actions.

[68] On the subsidiarity principle, see: P. Craig & G. de Búrca, *EU Law: Text, Cases, and Materials*, 5th Ed., 95 (2011).

[69] As reported by R. Goyal, et al., *A Banking Union for the Euro Area*, IMF Staff Discussion Note, 14, (2013), available at https://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf, accessed 7 November 2015.

[70] The EBC is the supervisor of all Euroarea banks for authorization and shareholder vetting. In addition, the EBC runs the generic SSM oversight on more than 120 significant banking groups (with many more banks in them), with the support of the NCAs.

structure based on cooperation raises doubts[71] about how far it is meant to effectively work[72], at least in the short run, and whether it concretely overcomes the previous fragmentation[73].

Such a complex system, characterized by the inconvenience of having too many governance layers[74], is, instead, very likely to take quite a long span of time before greasing the wheels and smoothly working, so that it might result in potential credibility risks which would minimize the stability efforts justifying the building of the NIA[75]. And alongside the time needed to put the entire machine into work, potential problems arising from information asymmetries between the ECB and the NCAs – and the related agencies costs – should not be ignored[76].

This is complicated further by the use of a soft-law tool like the Memoranda of Understanding envisaged by Article 3 Reg. 1024/2013 in such an economically sensitive area, as it would add institutional uncertainty and, thus, have a negative impact on the final goal, the achievement of an OCA (in particular given the already-experienced Eurozone governance uncertainty, which proved to be extraordinary weak during the sovereign crisis).

Generally speaking, soft law measures are defined as those "rules of conduct which, in principle, have no legally binding

---

[71] In the words of Enria, A. Enria, *The Single Market after the Banking Union,* cit. at 29, 12: "the institutional set-up for banking, supervision and resolution is becoming increasingly European, but not necessarily less complex".

[72] The Framework Regulation 468/2014, OJ L 141/1 (ECB/2014/17) adopted by the ECB pursuant to Article 6(7) of Council Regulation 1024/2013 deals with the procedures governing the cooperation between the ECB and NCAs as regards the supervision of significant credit institutions and the supervision of less significant credit institutions.

[73] On the uncompleted centralization brought about the SSM and the stability of the EU financial system: L. Chiarella & G. Ferrarini, *Il governo della vigilanza nell'Unione bancaria europea,* 12 Bancaria 28 (2013).

[74] E. Ferran & V. S.G. Babis, *The European Single Supervisory Mechanism*, University of Cambridge Faculty of Law Research Paper No. 10/2013, 14 (2013) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2224538, accessed 7 November 2015.

[75] In the words of an IMF Staff Discussion Note: "the challenge of developing the requisite competence at the ECB and building credibility in supervision should not be underestimated", R. Goyal, et al., *A Banking Union for the Euro Area* cit. at. 69, 14.

[76] On this point, see: L. Chiarella & G. Ferrarini, *Il governo della vigilanza nell'Unione bancaria europea,* cit. at. 73.

force but which nevertheless may have practical effects"[77]. This kind of measures are very hard to classify by using traditional legal categories (contract law, administrative law, and so on and so forth). In particular, the memoranda of understanding do not undoubtedly fall into any well-defined legal category since, on the one hand, they are used as non-binding regulatory tools provided by the EU law; but, on the other hand, they can be considered neither as EU administrative law, nor as international public law.

However, leaving aside the more legalist categorization issue, it is anyhow possible to place the memoranda of understanding provided by Art. 3(1) and (6) across two subcategories of EU soft-law tools: commitments about the conduct of institutions and model law-making[78]. If the former concerns those agreements used to organize the intra-EU institutional relations; the latter is far more controversial and it concerns those areas of the EU law where harmonizing measures cannot take the form of hard-law tools – such as Regulations, Directives, and Decisions –, and guidelines and recommendations set out best practices for Member States' authorities.

The crucial point with the memoranda of understanding provided by Art. 3 (1) and (6) is that, on the one hand, they look as if they were intra-institutional agreements produced by a multi-layered organization like the EU and aimed at easing the exchange of information flow; but, on the other hand, they are the king tool through which a European cooperation system designed for "an adequate level of regulation and supervision"[79] is based, thus hinting at the option that not only intra-institutional relations but also proper regulatory areas are covered by them. Therefore, even if highly flexible soft-law tools can be a useful resource when wisely employed in the governance of a broad common currency area, for the time being, fears for the institutional uncertainty seem to dwarf the hopes for efficiency through flexible rules.

---

[77] Soft law measures are those "rules of conduct which, in principle, have no legally binding force but which nevertheless may have practical effects". F. Snyder, *Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques*, 56 Modern L. Rev. 35 (1993).
[78] Categorization reported by D. Chalmers, et al., *European Union Law: Cases and Materials,* 102 (2010).
[79] Art. 3 (1), Council Regulation 1024/2013.

Finally, the fact that the Supervisory Board is made up of members coming from the National Competent Authorities may not result in a concrete and firm centralization of supervisory powers on the hands of the SSM[80]. This is due to the fact that the most influent Central Banks (i.e., those Central Banks coming from the economically strongest Member States) may be successful in eroding the SSM's supervisory powers (in particular over local, formerly public banks) with the effect of watering down the financial stabilization aim pursued by the supervisory centralization. Consequently, the SSM runs the risk to turn into a lame duck[81], characterized by a certain degree of uncertainty.

To conclude, the more uncertain the supervisory and legal framework at EU level, the more the ECB is likely to rely on the necessary loyal cooperation of national authorities[82], thus making things more complicated. Unfortunately, this quite complex system of cooperation does not meet an OCA's institutional demands, which theoretically require a strong centralization of supervision and resolution powers with clear-cut institutional responsibilities.

### 5.2. The absence of a lender of last resort and a fiscal backstop

A central bank empowered to act as the lender of last resort for its polity's Treasury through the purchase of sovereign bonds in the primary market can strongly contribute to stabilizing intra-SCA financial imbalances and preventing members of an SCA "from being pushed into bad equilibria by self-fulfilling fears of liquidity crises in a monetary union"[83]. However, this is not the

[80] In the words of Troeger: "the ECB-led supervision [is] essentially a common activity of Member States". T. Troeger, *The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?* SAFE Working Paper No. 27, 24, (2013) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2311353, accessed 7 November 2015.

[81] L. Chiarella & G. Ferrarini, *Il governo della vigilanza nell'Unione bancaria europea*, cit. at. 73, 10.

[82] E. Ferran & V. S.G. Babis, *The European Single Supervisory Mechanism*, cit. at. 74, 30.

[83] P. De Grauwe, *The European Central Bank: Lender of Last Resort in the Government Bond Markets?,* CESifo Working Paper Series No. 3569 (2011).

case for the ECB[84], and even if the Emergency Liquidity Assistance (ELA)[85] program is carried out under supervision of the ECB, it is still decentralized through national borders due to the fact that the central bank credit to Euroarea banking institutions is exceptionally granted by the National Central Banks and not by the ECB. Unfortunately, the recent reforms not even touch upon the subject.

Nevertheless, it would be unfair to blame the reform package for this. Alike the *constitutional* constrains prohibiting the conferral of supervisory powers on the EBA's shoulders, other constrains did not permit to modify the existing scenario and turn the ECB into a fully-fledged Central Bank empowered to purchase sovereign bonds in the primary market (interpretation confirmed by the ECB in the recent *Gauweiler* case[86]). Article 127.1 of Treaty on the Functioning of the European Union (TFEU) clearly reads:

> "The primary objective of the European System of Central Banks[87] […] shall be to maintain price

[84] In the very recent *Gauweiler* case the ECJ held that the ECB can purchase sovereign bonds if "*a minimum period is observed between the issue of a security on the primary market and its purchase on the secondary market*". Case 62/14, Peter Gauweiler and Others vs Deutscher Bundestag (2015).

[85] European Central Bank, ELA Procedures. Available at: https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf?e716d1d560392b10142724f50c6bf66a, accessed 7 November 2015.

[86] Case 62/14, Peter Gauweiler and Others *vs*. Deutscher Bundestag, [2015]. The Court was asked to determine whether the ECB's financing program (so-called "Outright Monetary Transactions"): (*i*) was a tool of economic policy (which would go beyond the powers granted by the Treaty) or, instead, a tool of monetary policy (which is, instead, legitimate); (*ii*) was compatible with the ban of monetary financing of Member States. The ECJ recognized the lawfulness of the ECB financing program thus grating the ECB the necessary powers to efficiently deploy its monetary policy. Furthermore, while reaffirming the prohibition to buy sovereign bonds directly from a Member State, the ECJ stated that the ECB financing program does not break such prohibition since the ECB's purchase takes place after "a minimum period is observed between the issue of a security on the primary market and its purchase on the secondary market". Case 62/14, Peter Gauweiler and Others *vs*. Deutscher Bundestag, (2015) 9.

[87] The European System of Central Banks comprises the ECB and the national central banks of all EU Member States, both Member and non-Members of the Eurozone. This is not to be confused with the Eurosystem, which comprises the ECB and the national central banks of those countries that have adopted the

> stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union […]. The ESCB shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources, […].”

As regard the fiscal backstop, the establishment of a European Federal Treasury would itself require a Treaty reform, which represents an even greater leap forward involving a sound political footing. Unfortunately, even if the NIA is the most far-reaching step of federalization in many years, it is “just” a bespoke legislative product devised to solve specific urgent matters in Europe. And yet, when this is read through the lenses of OCA theory, the assessment cannot but be negative.

### 5.3. The absence of a single deposit guarantee scheme

The absence of a *federal* centralized deposit guarantee scheme raises serious questions about the entire project. A deposit guarantee scheme insures all deposits held by banks within a certain jurisdiction (which should correspond to a single integrated market). Under the same scheme, all depositors are treated equally and all deposits are considered holding the very same currency[88], which is particularly important in the still fragmented European retail banking market[89].

From a legal point of view, the establishment of a centralized deposit guarantee scheme was feasible. Article 1 of the

---

Euro. The ESCB and the Eurosystem will co-exist so long as there are EU MSs not adopting the Euro. See: European Central Bank, *ECB, ESCB and the Eurosystem* (2014), available at http://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html, accessed 7 November 2015.

[88] J. Carmassi et al., *Banking Union: a federal model for the European Union with prompt corrective action*, cit. at 3, 2, correctly point out a “deposit insurance must be centralized to provide not only equal incentives to bank shareholders and managers with ex-ante funding and risk-based fees throughout the internal market, but also full risk pooling and an adequately funded insurance fund across the banking system at EU level, so as to be able to cushion large shocks affecting one of the largest cross-border banks”.

[89] On the fragmentation of banking and credit markets in Europe, see: Vincent Bignon, et al., *Currency Union with and without Banking Union*, Banque de France - Working paper no 450 (2013).

SRM Regulation establishes the Single Resolution Fund in order to support the effectiveness of SRM and leaves certain technical (but politically hot) aspects of the functioning of the Fund to an agreement among the SRM-participating MSs. The SRM Regulation is based on Article 114 of the TFEU on the measures for the approximation of MSs' rules, which implies that institutional bodies backed by it are established with the aim to "improve the conditions for the establishment and functioning of the internal market"[90]. The very same choice could have been made for a centralized deposit guarantee scheme[91], but, due to a substantial lack of political consensus[92], it was made for far less demanding recast Directive[93] of the 1994 Directive on national Deposit Guarantee Schemes[94].

Unfortunately, when compared to the United States, the EU still looks far behind. In the US, the Banking Act[95] established in 1933 the Federal Deposit Insurance Corporation (FDIC)[96], a government corporation which still serves as a guarantee for deposits held by US banks, up to $250000[97] per depositor per bank[98]. Regrettably, nothing like this currently exists in Europe[99].

---

[90] Case C-217/04, *United Kingdom vs. European Commission and Council*,[2006] ECR I-3771., para.42.

[91] On this point: A. Pagliacci, *The Three Pillars Of The European Banking Union: An Evolutionary Road*, 2 IJPL, 304 (2014).

[92] Reuters, *Germany says it remains opposed to EU deposit guarantee scheme*, 9 December 2015. Available at http://www.reuters.com/article/eu-summit-deposits-germany-idUSB4N0ZH00Z20151209#34qAXX4C9PXFwyIo.97

[93] Directive 2014/49/EU, OJ L 173/149, 12.6.2014.

[94] Directive 94/19/EC, OJ L 135/05, 31.05.1994.

[95] Banking Act (Glass–Steagall Act) Pub.L. 73-66, 48 Stat. 162 (1933).

[96] Interesting comparative analyses between the US and the EU are carried out by: K. Lannoo, *The New Financial Regulatory Paradigm: A transatlantic perspective*, cit. at. 28; M. Gerhardt & K. Lannoo, *Options for reforming deposit protection schemes in the EU,* cit. at. 17; J.N. Gordon & W.G. Ringe, *Banking Union Resolution Without Deposit Guarantee: A Transatlantic Perspective on What it Would Take,* Columbia Law and Economics Working Paper No. 465, (2013) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2361347, accessed 7 November 2015.

[97] The ceiling was $2,500 in 1934 but has been progressively increased over the time.

[98] In 1991, in the aftermath of the so-called Savings and Loans crisis, the Congress promulgated the Federal Deposit Insurance Corporation Improvement Act (FDICIA) [*Federal Deposit Insurance Corporation Improvement Act Pub.L. No. 102-242,105, Stat. 2236 (1991)*] which strengthened the leeway of

The combination of a single deposit guarantee scheme and a single resolution fund would put all European banks under the same umbrella thus making the entire financial system more stable[100]. The benefit, then, would be maximized by the new unified supervision that could guarantee a uniformed application of the same rules throughout the Union. And yet, even if it was legally feasible and several scholars[101] argue in favor of the

---

the FDIC in protecting bank depositors by granting it access to funds provided directly by the Treasury. The "savings and Loans crisis" is a label indicating the failure of about 25% of the US thrifts institutions spanning over the '80s and '90s. See: M. E. Lowy, *High Rollers: Inside the Savings and Loan Debacle* (1991); L.J. White, *The S&L debacle: public policy lessons for bank and thrift regulation* (1992).

[99] Gros & Schoenmaker argues that "Recognising the interconnectedness, the functions of resolution and deposit insurance should be combined in Europe, as is done in the US.". D. Gros & D. Schoenmaker, *European Deposit Insurance and Resolution in Banking Union*, cit. at 3, 11.

[100] *Ibidem,* 2.

[101] *Ibidem*; J.E. Colliard, *Monitoring the Supervisors: Optimal Regulatory Architecture in a Banking Union*, cit. at. 26. Paul Krugman states that a "Europe-wide backing of banks" is needed, with this implying "both some kind of federalized deposit insurance and a willingness to do TARP-type rescues at a European level – that is, if, say, a Spanish bank is in trouble in a way that threatens systemic stability, there should be an injection of capital in return for equity stakes by all European governments, rather than a loan to the Spanish government for the purpose of providing the capital injection. The point is that the bank rescues have to be severed from the question of sovereign solvency." P. Krugman, *Revenge of the Optimum Currency Area*, cit. at. 22.

Interestingly, Buch et al. highlight the perils of the establishment of a Deposit Guarantee Scheme without certain preconditions which would, instead, avoid moral hazard: "central powers covering supervision, restructuring and resolution of banks are the preconditions for the introduction of European deposit insurance. These preconditions will not be in place for the foreseeable future. The introduction of pan-European deposit insurance would mutualize risks without, at the same time, establishing sufficient central surveillance mechanisms." C. Buch, T. Körner & B. Weigert, *Towards Deeper Financial Integration in Europe: What the Banking Union Can Contribute,* Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Working Paper No. 2/2013, 33 (2013) available at http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/publikationen/arbeitspapier_02_2013.pdf, accessed 7 November 2015. On the relationship between market discipline and the functioning of Deposit Guarantee Schemes, *see*: E. Vasileiou, *The new "Bail-in" regime and the need for stronger market discipline. What we can learn from the Greek case?* 3 Intn'l J. Finance & Banking St. (2014). Finally, Mayer argues that "no industry or state deposit insurance scheme is required. A simple 100% reserve requirement is sufficient", T. Mayer, *A Copernican turn in* necessity to construct a truly federal deposit guarantee scheme which would simply come to terms with the fact that Europe is already a wholesale financial market, the NIA is not equipped with it. If viewed through the lenses of the OCA theory, the absence of a single deposit guarantee scheme is an unforgivable missed chance.

Being aware of the necessary of a *federal* deposit guarantee scheme, the European Commission has very recently submitted a proposal for a Regulation[102] establishing a European Deposit Insurance Scheme (EDIS). According to the Proposal, the EDIS will cover banks subject to the SSM/SRM, be built on the existing national deposit guarantee schemes, and gradually introduced through the following three steps:

> 1) Until 2020, the re-insurance phase: where a national DGS would be able access the EDIS should its own funds dry out;
>
> 2) in the years 2020-2023, the co-insurance phase: the EDIS would be turning into a progressively mutualized system. In the phase, the EDIS would contribute to sharing the costs of the depositors' reimbursement, starting with quite a low quote (20%), to be increased on a yearly basis;
>
> 3) as of 2024, the full insurance: the EDIS would be fully insuring national DGSs, with the latter becoming integrated parts of the EDIS itself. The EDIS would be operating through a European Deposit Insurance Fund run by the Single Resolution Board[103].

---

*Banking Union urgently needed,* CEPS Policy Briefs Centre for Economic Policy Research, (2013) available at http://www.ceps.eu/publications/copernican-turn-banking-union-urgently-needed, accessed 7 November 2015. Even if this proposal may be economically feasible, it would not be so in legal terms as it implies a strong involvement of the ECB which may exceed its mandate.

102 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, Strasbourg, 24.11.2015, COM(2015) 586 final, at: http://ec.europa.eu/finance/general-policy/docs/banking-union/european-deposit-insurance-scheme/151124-proposal_en.pdf

103 *Supra*. See also: European Commission, *Fact Sheet - A European Deposit Insurance Scheme (EDIS) – Frequently Asked Questions*, Strasbourg, 24 November 2015. Available at: http://europa.eu/rapid/press-release_MEMO-15-6153_en.htm

The aim of the Commission is to create "a more European system, disconnected from the sovereign, so that financial stability is enhanced and citizens can be certain that the safety of their deposits does not depend on their geographical location"[104]. However, despite the very good intentions of the Commission, the necessary political consensus still seems to be lacking[105] and it is too early to predict which steps the European executive will take to overcome the current deadlock.

**5.4. The anti-moral hazard bail-in mechanism and the discretionary powers of resolution authorities**

Resolution mechanisms and, above all, the philosophy underpinning the new bail-in regulatory framework profoundly penetrate civil law traditions of the MSs. So far, bankruptcy procedures – and the public authorities entrusted with the powers to apply them – have always been national and are based on the idea that banks cannot default like other businesses do, and either the Government or the national Central Bank were asked to jump in and bail troubled banks out.

The introduction of the bail-in philosophy is a U-turn in bankruptcy law, not only for continental Europe, but also for the UK. It grants a public authority the power to write-down and/or convert liabilities of a bank under resolution in order to avoid using public funds. The bail-in concretizes the anti-moral hazard principle that the stabilization of the financial system must be borne by the financial industry itself[106]. In more details, the SRM bail-in redefines the classification of creditor claims, thus replacing national legal traditions on the order of preferred creditors and

---

104 European Commission, "On steps towards Completing Economic and Monetary Union", COM(2015) 600 final, Brussels, 21.10.2015, http://ec.europa.eu/priorities/economic-monetary-union/docs/single-market-strategy/communication-emu-steps_en.pdf, accessed 7 November 2015.

105 Reuters, 'Germany blocks small progress on banking union at EU summit', 15 December 2016. At: http://www.reuters.com/article/us-eu-banks-regulations-idUSKBN1442Z8

106 In the words of Huertas and Nieto: "To end moral hazard and "too big to fail", investors, not taxpayers, should bear the loss associated with bank failures." T. Huertas & M.J. Nieto, *A game changer: The EU banking recovery and resolution directive*, (2013) available at http://www.voxeu.org/article/banking-recovery-and-resolution-directive, accessed 7 November 2015.

reforming the *pari passu* treatment of creditors[107]. In so doing, it adopts a "carve-out"[108] approach and puts deposits held by natural persons and small-medium enterprises on a higher priority ranking vis-à-vis the claims deriving from ordinary unsecured and non-preferred titles as identified under national laws regulating standard insolvency procedures.

Importantly, national resolution authorities enjoy a certain leeway about granting further exclusions to investors' claims. The SRM Regulation makes these exclusions possible either when the application of the bail-in tool would generate destruction in value so that financial loses borne by other creditors are higher than if these claims were not excluded from the bail-in procedure; or when it is strictly necessary to achieve the continuity of important functions and core business lines (Article 44). It goes without saying that the assessment, evaluation, and exclusion of assets and liabilities is a delicate – but necessary – activity.

Two problems arise here. First, at least in the short run, uncertainty about the *bail-inable* liabilities may (irrationally?) affect institutional investors' asset allocation. Second, the local public authorities' assessment of the *bail-inable* liabilities would eventually replace market evaluations of financial instruments. And the fact that the authorities' assessment can be subject to judicial review (but only if the entire resolution measure is challenged), increases uncertainty due to slow judicial procedures.

EU law grants extensive discretionary powers in areas of an economic nature and in complex issues as the ECJ has recently confirmed in the *Gauweiler* case[109]. However, alongside the EU law realm, the bail-in tool instinctively reminds us of the limit to discretionary powers administrative authorities are usually entitled to exercise under the Continental European administrative law traditions. Traditionally speaking, public administration discretion can be defined as "a comparative weighting analysis of several secondary interests vis-à-vis a

[107] On this point, T. Huertas & M.J. Nieto, *A game changer: The EU banking recovery and resolution directive,* cit. at. 106.
[108] So defined by T. Huertas & M.J. Nieto, *A game changer: The EU banking recovery and resolution directive,* cit. at. 106
[109] With the *Gauweiler* case the ECJ has endorsed a substantial strengthening of the ECB's leeway. For details on the *Gauweiler* case: note 86.

primary one"[110]. In this case the primary interest would be the stability of the EU financial system which can ultimately be granted only by the activity of a public administrative body.

Indeed, after the comparative evaluation of the primary interest – financial stability – against the secondary ones – personal economic rights –, the latter are necessarily shrunken and torn, even when they are formally protected by the Article 16 of Charter of Fundamental Rights of the European Union which clearly states that the "freedom to conduct a business in accordance with Union law and national laws and practices is recognized"[111]. Within this framework, the stability of the financial system is not just a mere collective economic interest but it is *the* common good sheltered behind a public administrative power and justifying limitations to the personal freedom of conduct of business.

To conclude, it can be said that the bail-in was indispensable to avoid lavishing tax-payers' money on poor-managed banks and to concretize the anti-moral hazard principle that the costs of the stabilization of a financial system's distortions must be paid by the industry itself. Making the industry responsible for its own mistakes at EU level may reduce the risk of financial shocks within a currency area and avoid the related distortions, thus endogenously[112] easing the OCA-building phase. However, the fact that local resolution authorities enjoy quite broad discretionary powers may, instead, spawn fragmentations, at least in market expectations.

### 5.5. The anti-fragmentation role of the European Court of Justice

Courts have always played a prominent role in bankruptcy procedures. They have always worked hand-in-hand with resolution administrative bodies, which are involved with the justification of the necessity to "rescue" troubled banks – given the extremely delicate business carried out by credit institutions – and

[110] M.S. Giannini, *Diritto Amministrativo, vol. II*, 47 (1993). (Author's translation).
[111] OJ C 364, 18.12.2000.
[112] On the endogeneity of OCA, see: Jeffrey A. Frankel & A.K. Rose, *The Endogenity of the Optimum Currency Area Criteria*, NBER Working Paper No. 5700, (1996) http://www.nber.org/papers/w5700.pdf accessed 7 November 2015.

the need to avoid spill-over effects that bank failures very often generate.

So far, national courts have always judged the administrative measures produced by domestic resolution authorities. As of tomorrow, courts will substantially review the content of the decisions made by the Single Resolution Board, even if formally still conveyed by the traditional national administrative measures implementing those decisions. This is very likely to impact on the methods conventionally taken by domestic courts, not only due to the new bail-in tool, but also due to the looming (but slow) harmonization of the "bankruptcy culture" in Europe (an inevitable result of the centralization of the banking resolution procedures).

What is very important is that, in order to avoid national fragmentation, a certain leeway has been granted to the Court of Justice of the European Union (ECJ). First and foremost, Article 37 of the Resolution Regulation establishes that the lawfulness of the Resolution Board's decisions to conduct all necessary on-site inspections[113] are subject to review only by the EJC. In addition, Article 87 of the SRM Regulation also specifies how the ECJ is *the* court endowed with the jurisdiction to give judgment on the liability of the Board. Finally, coherently with Article 267 of the Treaty on the Functioning of the European Union, Recital 120 states that the ECJ is competent to give preliminary rulings upon request of national courts about the validity and interpretation of acts of the institutions, bodies or agencies of the Union.

The ECJ, which has always played a key role in building up the EU legal system[114], has been left with the last word with regard to the liability of the Board and on the lawfulness of its (very intrusive!) decisions with the aim to avoid centrifugal interpretations of the Board's decisions and shield the Board itself from locally-based interests likely to severely hinder the execution of its duties. This was a necessary step if a more uniformed landscape at European level was intended to be created, and against the backdrop of the OCA theory, this is clearly a very positive point.

---

113 Article 36.

114 As regard the ECJ's judicial review in details, see: D. Chalmers, G. Davies & G. Monti, *European Union Law: Cases and Materials,* 396 (2010).

**6. Conclusions**

This article has tested the OCA theory against the new institutional architecture established at EU level in the banking law field and the results are shown in the table below:

| LEGAL POINTS… | …READ THROUGH THE LENSES OF THE OCA THEORY |
|---|---|
| A single supervisory authority very much based on coordination and soft law | Negative in the short run |
| The absence of a fully-fledged lender of last resort and a fiscal backstop | Very Negative |
| The absence of a single deposit guarantee scheme in the original design of the reform package | Very Negative<br>Moreover, the recent Commission's Proposal seems to lack the necessary political endorsement |
| The anti-moral hazard bail-in mechanism and the discretionary powers of resolution authorities | Potentially Positive |
| The anti-fragmentation role of the European Court of Justice | Very Positive |

The post-crisis legislative reforms should be welcome as a very sophisticated arrangement based on an interplay of private and public laws through which the macro-prudential level – i.e., systemic financial stability – and the micro-prudential level – i.e., financial stability of single firms – holistically merge into one big picture. However, it is not possible to ignore the clear deficiencies.

If the absence of a fully-fledged lender of last resort and a fiscal backstop is justified by *constitutional* constrains, the absence of a single deposit guarantee scheme is clearly a missed chance. Unfortunately, the recent proposal put forward by the

Commission does not seem to be backed by the necessary political consensus. Furthermore, the byzantine governance of the SSM heavily based on cooperation and soft-law measures does not help at all. Potentially positive elements such as the anti-moral hazard bail-in mechanism and the anti-fragmentation role of the ECJ do not compensate for the missing parts.

To conclude, recent reforms do not establish under the EU law the institutional "safety net" that is considered necessary by OCA theory. Even if the new architecture does not look like a creaking edifice, it does not automatically create the necessary legal level-playing field where capital can move efficiently by readjusting internal distortions and imbalances among the MSs, thus effectively promoting an ever closer union.