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Single Supervision and the Governance of Banking Markets

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Abstract

In this paper, I try to assess the likely impact of the Single Supervisory Mechanism (SSM) on Eurozone banking markets. I start by analysing the predictions made by economists and policy makers with regard to the deeper integration of financial markets which may derive from the Banking Union. I then try to identify the regulatory weaknesses that may throw uncertainty on the benefits commonly expected from the Banking Union. Firstly, I highlight the limits of EU supervisory centralisation as shaped by the reforms enacted after the 2008 financial crisis. Secondly, I analyse the limits of the SSM, which is to some extent still grounded on supervisory cooperation despite the fact that the ECB has powers of direction and substitution with respect to national supervisors. I argue, in particular, that the SSM represents a system of semi-strong centralization, which may still give rise to agency problems particularly in the relationships with supervisors of non-euro area countries that are still governed by the EU system of enhanced cooperation. Thirdly, I examine the decoupling of supervision from regulation deriving from the fact that the ECB lacks sufficient regulatory powers when acting as a supervisor of the Eurozone banking systems. The separation of regulation – which is harmonized (often with excessive detail) at EU level - and supervision – which is centralized in the euro area – may create problems to the extent that the single supervisor cannot create a prudential rulebook for the Eurozone, but is subject to EU prudential regulation and national law provisions often unduly limiting its supervisory discretion.

Keywords: Banking Union, Single Supervisory Mechanism, SSM, supervisory centralisation, regulatory harmonisation, banking regulation, prudential supervision

JEL Classifications: E58, G21, G28, K20, K22

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Single Supervision and the Governance of Banking Markets:

Will the SSM Deliver the Expected Benefits?

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1. INTRODUCTION

In this paper, I analyse the likely impact of the SSM on banking markets. After summarizing what economists and policy makers predict about the Banking Union's consequences for cross-border banking and financial integration in Europe (para. 2), I highlight the uncertainty affecting similar predictions through a critical analysis of supervisory centralisation in the EU and in the Eurozone. Firstly, I examine the transformation of EU banking regulation and supervision after the crisis and find that regulatory harmonization is not matched by strong supervisory centralization (para. 3). Secondly, I identify the main weaknesses of the Single Supervisory Mechanism with respect to its complex organisation and incompleteness (para. 4). Thirdly, I analyse the single rulebook and find that regulatory harmonization leaves little room for supervisory discretion and that banking regulation is increasingly decoupled from supervision (para. 5). I conclude that the limits highlighted in this paper, with respect to EU supervisory centralisation, to the SSM and to the single rulebook throw a degree of uncertainty on the predictions commonly made by economists and policy makers on the Banking Union's likely impact on financial markets.

2. IMPACT OF THE BANKING UNION ON FINANCIAL MARKETS

The European Banking Union will no doubt have an impact on the governance of banking markets in the euro area. In addition to enhancing financial stability and easing the monetary policy of the European Central Bank, the Banking Union will better level the playing field for banks in the euro area, increase competition and possibly lead to further consolidation in the banking sector. Moreover, it will enhance cross-border integration of banks and banking markets by making their operating conditions more similar across member States. The extent to which all these consequences will be produced and the speed of the relevant process, however, depend on multiple

factors, including the successful performance of the SSM and the existence of credible and efficient resolution mechanisms.[1]

2.1 **Financial integration**

Prior to the crisis the EU financial system had become relatively integrated. The interbank market integration, in particular, rapidly followed the introduction of the single currency. However, the retail banking markets remained largely fragmented along national lines and bank mergers predominantly occurred between institutions of the same country. Also equity and bond markets remained fragmented along national lines despite some progress in integration. The financial crisis undid financial integration exactly in the area in which cross-border integration was more successful, i.e. the interbank market.[2] The euro-area financial system is therefore in an unsatisfactory state and economic growth remains anaemic as a result.

Fragmentation characterizes post-crisis EU financial markets. One of the main causes of fragmentation is the bank-sovereign feedback loop, i.e. the strong correlation between banks' finances and Member States' debts after 2008. This correlation goes in both directions creating a vicious cycle between bank risks and sovereign risks. In countries where the domestic supervisor proved overly permissive towards national champions, the national responsibility for crisis resolution meant that the difficulties of banks were passed on to public finances, which inevitably deteriorated.[3] Examples are offered by Ireland and Spain, where the rescue of ailing banks has drawn huge amounts of public resources. In other countries, such as Greece and to a lesser extent Italy, causality initially went in the opposite direction. Huge public debts plagued domestic banks as a result of the strong domestic

1 See Véron 2015; Ferran 2015; Busch 2015.
2 Sapir and Wolff 2013.
3 See Pisani-Ferry, Sapir, Véron and Wolff 2012 emphasizing that banks that were European in ordinary circumstances became national in crisis times, as they depended on national governments for support.

component of their bond portfolios.[4]

National politicians and public authorities tried to avoid the risk of making taxpayers pay for the consequences of credits extended by national banks across borders.[5] As a result, banks and national supervisors restricted the circulation of liquidity across borders, including transfers of capital within cross-border banking groups. The interbank markets ceased to function since intermediaries rather preferred to allocate their liquidity to non-interest bearing deposits at the European Central Bank. In addition, there has been a significant flight of funds from peripheral countries to central ones, even though the interest rates offered by the latter produced negative returns in real terms.[6] In brief, the mechanisms of monetary policy stopped working, showing that the single currency required financial integration.[7] Moreover, the financial system of the Eurozone fragmented along national borders leading to the formation of severe macroeconomic imbalances. [8] In some countries, the supply of credit fell dramatically. The remuneration of bank deposits and the interest rates paid on bank loans diverged considerably between countries making it plausible that, rather than a single currency, there were as many 'euros' as countries in the monetary union.

The Banking Union emerged as a remedy to the crisis of the single currency. Before the 2008 financial crisis, most countries, including the euro-countries, were reluctant to transfer further sovereignty to the European institutions in this crucial sector. The legislation approved in 2010 following the De Larosière Report to reform the European supervisory architecture was basically the result of a political compromise and represented a weak form of centralization (section 3 below). However, after the 2011 sovereign debt crisis, the Banking

4 See Coeuré 2012.
5 See Pisani-Ferry, Sapir, Véron and Wolff 2012, arguing that banks have been encouraged by national authorities to cut cross-border lending.
6 See Elliott 2012.
7 See Constâncio 2012, arguing that a high degree of financial integration, where financial institutions diversify their assets and liabilities across Eurozone countries, is essential for an effective transmission of monetary policy.
8 See ECB (2012).

Union was seen as the main remedy to break the vicious circle between banks and sovereigns and reactivate the channels for the transmission of monetary policy. In fact, centralized supervision makes it possible to curb the national interest, while common mechanisms for resolving banking crises will contribute to cutting the link between banks and sovereigns. The Banking Union should stop the fragmentation process in the Eurozone and lay the ground for renewed financial market integration.

3.2 **Likely impact of the Union on financial integration**

Three types of positive effects are predicted as a consequence of the Banking Union.[9] Firstly, cross-border banking groups should function better, as they will be able to optimise their internal management of capital and liquidity and reduce compliance costs. Unified supervision should also create greater trust among banks. Secondly, consolidation should occur in the European banking sector. Indeed, the weak profitability and excess capacity of this sector suggest that efficiency gains could derive from more consolidation. This and the repair of bank financial accounts should set the stage for a new phase of mergers and acquisitions. Thirdly, the role of capital markets should be enhanced. Corporate bond financing is becoming an important alternative to bank financing also in Europe. The shift towards more capital market-based intermediation should go forward, also considering regulatory incentives for banks to hold liquid instruments rather than loans. The European Commission pursues a strategy in this direction through the launch of a Capital Markets Union project.[10]

In the following sections, I try to establish how likely these effects are by critically assessing some of the limits of EU supervisory centralisation (section 3), of the SSM (section 4) and of the Single Rulebook when analysed from the perspective of the Banking Union

9 Constâncio (2014); Véron 2015.

10 European Commission, Building a Capital Markets Union, Green Paper, Brussels, 18.2.2015.

(section 5).

3. Supervisory Centralisation in the EU

In this section, I highlight the limits of EU supervisory centralisation both from a historical perspective and with regard to the current situation, which is characterised by enhanced supervisory cooperation within the European System of Financial Supervisors (ESFS).

3.1. **Traditional approach**

The traditional approach to EC banking regulation is epitomized by the Second Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of credit institutions.[11] The fundamental aim of the Second Directive was 'to create a single Community-wide banking market with no internal barriers to the movement of banking services and to the establishment of branches within the Community'.[12] The instruments for attaining this banking market included the creation of a single banking license through mutual recognition and the assurance of minimum Community standards on prudential supervision. Other Community directives and recommendations supplemented the basic standards of supervision envisioned by the Second Directive.[13]

The single license is a form of supervisory centralization, to the extent that the home country of a credit institution undertakes supervisory activities, including authorization, which are recognized by the host member States.[14] In particular, the single licence reflects the 'lead supervisor' model of centralization, for the home supervisor has almost exclusive responsibility

11 See Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, (1989) OJ L 386/1.

12 See Gruson and Feuring 1991.

13 For a comprehensive overview, see Zavvos 1990.

14 See Ferrarini and Chiodini 2012, p 216.

over branches established in other EEA (host) countries. However, mutual recognition only applies to cross-border branches, while ‘solo’ supervision of subsidiaries falls under the competences of the authorities of their state of incorporation. The single license system has promoted *de facto* harmonization of banking regulation in Europe well beyond the Community’s directives and recommendations, as a result of the liberalization of banking and capital markets, and of increased cross-border competition on those markets. Nevertheless, there are clear limits to the traditional European approach. Firstly, the instruments used (directives and recommendations) for the approximation of banking laws in Europe left wide differences in prudential regulation and supervision. Secondly, the single supervisor’s model clearly suffers from national biases in the performance of supervisory tasks by the authorities concerned, which also determine a lack of trust between home and host authorities particularly in crisis situations.[15] Thirdly, the single license system has enjoyed limited success in practice, for international banking groups often chose to establish subsidiaries rather than branches in other member States.[16]

3.2 **The de Larosière framework**

As a result of the 2008 financial crisis, the de Larosière Report highlighted that ‘convergence towards high global standards … is critical’ and that the implementation and enforcement of these standards must occur through ‘a strong and integrated system of regulation and supervision’.[17] According to the Report, the European Institutions and the level 3 committees should have initiated a concerted effort to equip the EU financial sector with a consistent set of core rules by the beginning of 2013: ‘a process should be set-up, whereby the key-differences in national legislation will be identified and removed’.[18] The Report also emphasized the need for EU

15 *Ibidem*, p 200.
16 See Dermine 2006.
17 See The High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, *Report*, Brussels, 25 February 2009.
18 *Ibidem*, 50.

supervisory repair, starting from the lack of adequate macro-prudential supervision the objective of which is to limit the distress of the financial system as a whole.[19] As to micro-prudential supervision – whose main goal is to supervise and limit the distress of individual financial institutions, thus protecting the customers of the institution in question – the Report suggested the establishment of a European System of Financial Supervisors (ESFS) constituting 'an integrated network of European financial supervisors, working with enhanced level 3 committees (Authorities)'.[20] In the proposed framework, the supervisor of the home member State would continue to function as the first point of contact for the firm, whilst the European centre should coordinate the application of common high-level supervisory standards, guarantee strong cooperation with the other supervisors and that the interest of host supervisors are properly safeguarded.[21]

The EU legislation approved on 24 November 2010 to reform the European supervisory architecture closely tracks the de Larosière Group's recommendations and represents a significant step towards regulatory convergence and centralisation of cross-border supervision.[22] New regulations established a two-pillar structure comprising the European Systemic Risk Board (ESRB) for macro-prudential supervision, and the European System of Financial Supervision (ESFS) for supporting supervisory coordination and convergence of supervisory standards. The ESFS includes a network of national supervisors coordinated by European Supervisory Authorities deriving from the transformation of pre-existing European Supervisory Committees. The creation of a centrally coordinated network was aimed at enhancing effective cooperation between competent authorities in the supervision of cross-border financial institutions, while leaving day-to-day supervision to national authorities.[23]

For the banking sector, the European Banking Authority (EBA) was established as a

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19 *Ibidem*, 38.
20 *Ibidem*, 47.
21 *Ibidem*.
22 See Recine and Teixeira 2009.
23 See Ferrarini and Chiarella 2013.

Community body with legal personality. The authority has the following main tasks: '(a) to contribute to the establishment of high quality common regulatory and supervisory standards and practices […]; (b) to contribute to the consistent application of legally binding Union acts [...]'.[24] EBA's rulemaking includes the drafting of regulatory technical standards, which the Authority must submit to the Commission for endorsement after a public consultation on the same (Article 10, para. 1); and the drafting of implementing technical standards, which the Authority must also submit to the Commission for endorsement.[25] As regards rule-making, the role of EBA must be seen in the wider context of the increased use by the Commission of comitology powers, following the introduction in the Lisbon Treaty of the new categories of delegated and implementing acts (Articles 290 and 291). Through delegated acts the European Parliament and the Council confer delegated powers on the Commission for the adoption of implementation measures. Implementing acts can be used, according to Article 291, when a 'legally binding Union act [..] identifies the need for uniform conditions of implementation'. These acts, which are of a technical and administrative nature, are adopted by the Commission, i.e. the EU executive, and overseen by the Member States[26]. Moreover, EBA issues guidelines and recommendations addressed to competent authorities or financial institutions with a view to establishing consistent, efficient and effective supervisory practices within the ESFS and to ensuring the common, uniform and consistent application of Union law. The competent authorities shall make every effort to comply with those guidelines and recommendations, and in the case of non-compliance inform EBA of its reasons.[27]

3.3 **Limits of EU supervisory centralisation**

The European supervisory model just analysed is one of "enhanced cooperation". Indeed,

24 See Art. 8, par. 1 (a) (b), Regulation (EU) No 1093/2010 of the European Parliament and the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) (EBAR).

25 See Art. 15, par. 1, EBAR.

26 See Busuioc 2013, p 115.

27 See Art. 16, para. 1 and 3, EBAR.

the creation of the ESFS and the ESAs, rather than changing the allocation of powers and responsibilities amongst authorities, has enhanced coordination mechanisms. At the same time, the "lead supervisor" model of centralisation, which is embodied by the single licence, only refers to the supervision of branches and to the consolidated supervision of subsidiaries. However, some coordination mechanisms address the externalities that may derive from the exercise of the home supervisor's powers over foreign established branches. Under the CRD, upon determination that a branch is systemically significant, host authorities have the right to take part in coordination mechanisms otherwise reserved to foreign-owned subsidiaries' supervisors.[28] Moreover, the consolidating supervisor has enhanced coordination powers for consolidated supervision over the whole group (including its foreign subsidiaries).[29] On the whole, the home supervisor's role on foreign established branches has been slightly reduced, while the consolidating supervisor's role over foreign subsidiaries has been enhanced. EBA represents a central, pan-European authority with some binding powers. However, its role is limited to technical standards' setting; implementation of European banking law provisions; and coordination among national supervisory authorities. The EBA lacks direct supervisory powers either in normal times or in emergency situations. The described framework, while clearly a step towards centralization and a considerable political compromise, is based on delegation of supervisory powers to the lead home (or consolidating supervisor) and on cooperation among authorities. Both delegation and coordination carry relevant costs and are likely to fail in crisis situations, due to misalignment of incentives between national authorities. In addition, the current framework seems to lack the centralized mechanisms needed to solve these problems.[30]

4. Supervisory Centralisation in the Eurozone

28 See Art. 51 CRD.
29 See Art. 112 CRD.
30 See, for further analysis, Ferrarini and Chiarella 2013, pp 39 – 41.

In this section, I analyse the Single Supervisory Mechanism (SSM) and assess the type of supervisory centralisation that is effected through the same. I show, in particular, that the SSM is largely grounded on cooperation and delegation mechanisms, even though it is more than simply a system of enhanced cooperation given the powers vested on the ECB.

4.1 **The SSM concept**

4.1.1 *Tasks*

The Single Supervisory Mechanism (SSM) is the first pillar of the European Banking Union consisting of the European Central Bank (ECB), which retains responsibility for its functioning, and the national supervisory authorities of the euro area. The tasks conferred on the ECB include the following: to authorise credit institutions and withdraw their authorisations; to assess applications for the acquisition and disposal of qualifying holdings in credit institutions; to ensure compliance with prudential requirements on credit institutions (in areas like own funds requirements, large exposure limits, liquidity, leverage, etc.) and with requirements to have in place robust governance arrangements, including 'fit and proper' requirements for bank managers, risk management processes, internal control mechanisms, remuneration policies, etc.; to carry out supervisory reviews, including stress tests, and other supervisory tasks concerning recovery plans and early intervention.[31]

In view of carrying out these tasks and ensuring high standards of supervision, the ECB applies all relevant Union law and where the latter consists of directives the national legislation transposing the same. To that effect, the ECB shall adopt guidelines and recommendations, and take decisions subject to and in compliance with the relevant Union law. The ECB may also adopt regulations, but only to the extent necessary to organize or specify the modalities for carrying out

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31 See art. 4 (1) Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions , OJ 29.10.2013, L 287/63 (SSMR).

those tasks.[32] The ECB carries out its tasks within a single supervisory mechanism (SSM) composed of the ECB and national competent authorities, and is responsible for the effective and consistent functioning of the same. The ECB and national competent authorities are subject to a duty of cooperation in good faith and an obligation to exchange information. National authorities are responsible for assisting the ECB with the preparation and implementation of any acts relating to the tasks conferred on the ECB by the regulation.[33]

The SSM covers – either directly or indirectly – all credit institutions established in participating countries, although most tasks related to the supervision of those institutions that are considered as less significant are normally carried out by the national authorities.[34] The criteria under which banks fall under the direct supervision of the ECB include size, importance for the economy of the EU or of a Member State, and significance of cross-border activities.[35] Under those criteria, banks accounting for about 80 per cent of euro area banking assets are under the direct supervision of the ECB.[36] A bank is directly supervised by the ECB if any of the following conditions are met: (i) assets of the bank exceeding €30 billion, (ii) ratio of total assets to GDP of the home Member State exceeding 20 per cent, or (iii) national competent authorities defining the institution as significant. An institution may also be considered as significant by the ECB if it has significant cross-border assets or liabilities, relies upon ESM financial assistance, or is among the three largest institutions in its home Member State (which will determine direct supervision of largest banks in smaller countries). The ECB retains the power to bring any bank under its direct supervision, if deemed necessary.[37]

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32 See Art. 4 (3) SSMR.
33 See Art. 6 SSMR.
34 See Art. 1 SSMR.
35 See Art. 6 (4) SSMR.
36 See De Sousa and Wolff 2012.
37 According to Art. 6 (4) SSMR, 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.

4.1.2 *Powers*

The responsibilities for credit institutions indirectly supervised by the ECB are shared between the latter and the national authorities according to the criteria stated in Art. 6 (5) and (6). The ECB shall issue regulations, guidelines or general instructions to national competent authorities, according to which the latter perform the supervisory tasks conferred upon the former. When necessary to ensure consistent application of high supervisory standards, the ECB may decide to exercise directly all the relevant powers for one or more credit institutions. Moreover, the ECB shall exercise oversight over the functioning of the system, may at any time make use of its investigatory powers, and may request information from the national competent authorities on the performance of the tasks carried out by them. National competent authorities, on their turn, carry out and are responsible for the tasks conferred upon the ECB by Art. 4 and adopt all relevant supervisory decisions within the framework and procedures referred to in Art. 6 (7). They report to the ECB on a regular basis on the performance of the supervisory activities performed and remain exclusively responsible for consumer protection and anti- money-laundering tasks, receiving notifications from credit institutions related to the right of establishment, supervising activities of third countries credit institutions' branches, and supervising payment services.[38]

The ECB is provided with the same powers as those available to competent supervisory authorities under EU law.[39] To the extent necessary to carry out its tasks under the new regulation, the ECB may require, by way of instructions, national authorities to make use of their powers where the regulation does not confer the same on the ECB.[40] Moreover, the ECB is vested with broad investigatory powers which include requiring credit institutions and other legal or natural persons to

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38 See the 22nd considerandum of the SSMR.

39 According to Art. 9 (1) SSMR, 'for the exclusive purpose of carrying out the tasks conferred upon it by Article 4 (1), (2) and 5 (2), the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union law. For the same exclusive purpose, the ECB shall have all the powers and obligations set out in this regulation. It shall also have all the powers and obligations, which competent and designated authorities shall have under the relevant Union law, unless otherwise provided for by this regulation. In particular, the ECB shall have the powers listed in Sections 1 and 2 of this Chapter'.

40 See Art. 9 (1), last period, SSMR.

provide information; conducting all necessary investigation of any relevant person; conducting all necessary on-site inspections at the business premises of the relevant legal persons (after being authorised by a judicial authority if national law so requires).[41] The ECB is also vested with specific supervisory powers for the exercise of which it is assisted by national authorities, in the areas of authorisation of credit institutions and assessment of acquisitions of qualifying holdings.[42] Furthermore, the ECB is empowered to require institutions to hold funds in excess of capital requirements; to reinforce arrangements, processes, mechanisms and strategies; to present a plan to restore compliance with supervisory requirements; to apply a specific provisioning policy; to restrict or limit the business, operations or network of institutions; to limit variable remuneration; to use net profits to strengthen own funds.[43] The ECB is also provided with a sanctioning power, but only where institutions breach a requirement under directly applicable acts of Union law.[44] In other cases, the ECB – where necessary for carrying out the tasks conferred upon it by the regulation – may require national competent authorities to open proceedings with a view to taking action in order to ensure that appropriate sanctions are imposed in accordance with relevant EU law and national legislation.[45]

Non-participating Member States whose currency is not the euro will be able to enter into close cooperation with the ECB (sub-sec. 4.3 below), under the condition that the national authority will abide by the ECB guidelines and requests, and provide all necessary information that the ECB may require.[46]

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41 See Art. 10-13 SSMR.

42 See Art. 14 (2) e 15 (2) SSMR.

43 See Art. 16 (2) SSMR.

44 Art. 18 (1) SSMR states that the ECB may impose administrative pecuniary sanctions 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 of a legal person in the preceding business year.

45 See Art. 18 (5) SSMR, further stating that this provision shall be applicable in particular to any administrative sanctions or measures to be imposed on members of the management board of an institution who under relevant national legislation are responsible for a breach.

46 In particular, under these agreements supervisory tasks remain to local supervisors. Therefore the ECB has no direct binding power.

4. 2 **The SSM as a centralisation mechanism**

4.2.1 *Delegation and cooperation within the SSM*

The SSM is largely grounded on delegation to national authorities and supervisory cooperation, despite strong powers conferred on the ECB. Indeed, the latter performs its supervisory tasks within the SSM, which is also comprised of national competent authorities. Both the ECB and these authorities are subject to a duty of cooperation and to one to exchange information[47]. These duties should prevent, at least in part, information asymmetries between the periphery and the centre of the SSM. However, this model is not simply one of enhanced cooperation between supervisors, given that the ECB has responsibility for the system, together with powers of direction and substitution with respect to national supervisors. The SSM has, in other words, a hierarchical structure that should enable it to solve the problems of coordination between authorities thanks to the leading position of the ECB. Nonetheless, agency problems remain between the ECB and the national authorities, to the extent that the latter can exploit information asymmetries to protect national interests especially in times of crisis. They may, for example, delay the transmission of important information to the ECB or procrastinate taking action against national banks that are under their direct supervision in circumstances in which the European interest to financial stability would require their intervention.

An architecture based on cooperation and delegation under the direction and control of a central authority was to some extent unavoidable, given that more than 6000 banks are based in the euro area, of which the top 150 cover 80 per cent of banking assets.[48] The largest institutions (and the ones to be identified according to special criteria) are under direct ECB supervision. However, national authorities provide the latter with all information necessary and assist the same in the

47 See Art. 6 (1) and (2) SSMR.
48 See IMF 2013a.

preparation and implementation of acts relating to its supervisory tasks.[49] The remaining institutions are supervised by the national authorities and only indirectly by the ECB. Reference to national authorities was dictated by resource constraints and political expediency, but also by the existence in the eurozone of different legal, accounting and taxation frameworks, as well as of many languages and business contexts[50]. Full centralization was not an option even with regard to cross-border banks, given that supervisory resources are mainly national and firm proximity is important in supervision. However, decentralisation should not reduce the role of the single supervisor to the mere validation of decisions taken locally, given the need for supervisory consistency with respect to the entire banking system of the euro area.[51] In essence, a balance had to be struck between centralization and delegation also taking into account the size of *banks* and their domestic or cross-border nature. Delegation is more justified in the case of domestic institutions, but the ECB is rightly empowered to instruct national authorities and also to replace the same in the supervision of one or more institutions[52]. However, delegation is needed also in the case of cross-border banks, even though the ECB will keep a more direct hold on their supervision.

4.2.2 *Semi-strong centralisation through the SSM*

Whether this complex model of delegation and cooperation will work in practice is early to assess. Nevertheless, I would argue that the SSM, despite being a remarkable step towards a single supervisor's model, still represents a semi-strong form of centralization for it still relies, to some extent, on supervisory cooperation. As already shown,[53] cooperation mechanisms tend to fail in case of a crisis, for supervisors pursue their national interest rather than the European one, while delegation allows the delegated authority to exploit its informational advantage. Cooperation and information duties are insufficient to

49 See Art. 6 (2) and (3) SSMR.
50 See Troger 2013.
51 See IMF 2013b.
52 See Art. 6 (5) SSMR.
53 See Ferrarini and Chiodini 2012.

counter similar difficulties, for the national supervisors' incentives often go in the opposite direction, particularly when facing a crisis. Moreover, the direction and substitution powers of the ECB, which are aimed to prevent failures in the supervisory system, may be impaired by the non-cooperation of local supervisors, including non-compliance with their information duties. In addition, enforcement of national legislation against credit institutions may be difficult to the extent that the ECB lacks locus standi before the national courts. While recourse to the European Court of Justice may be too slow for effective enforcement, the alternative of the ECB asking national supervisors to bring the relevant claims in national courts may encounter procedural difficulties, in addition to creating agency problems in the relationship between the central and the delegated supervisor.[54]

Similar comments also apply to the regime included in the regulation with respect to administrative sanctions. The ECB is empowered to impose these sanctions only for breaches of requirements deriving from directly applicable acts of Union law and only with regard to legal persons. In all other cases the ECB may require national competent authorities to open proceedings in order to ensure that effective, proportionate and dissuasive sanctions are imposed.[55] A similar regime is justified on at least two grounds. From an organizational perspective, it would be difficult for the ECB to run proceedings for the imposition of administrative sanctions under the different domestic laws that may be applicable in individual cases. From a legal perspective, the sanctioning power of the ECB under national law and the locus standi of the same in national courts would appear to be problematic. This explains the recourse in the regulation to two different sanctioning regimes, depending on whether the relevant breaches refer to EU law or national law. However, the limits of the choice made are obvious, for the delegation to national

54 See, for a complete treatment of jurisdictional issues, Arons 2015.
55 See Art. 18 (1) and (5) SSMR.

authorities carries agency problems that might impair the effectiveness of enforcement, particularly considering that these authorities would run the relevant proceedings under their own responsibility and would be free not to impose sanctions as a result of the same.

An additional and difficult question is whether the national authorities keep their power of initiative in relation to sanctioning proceedings, so as to be able to impose sanctions even if not required by the ECB. Art. 18 (5) does not exclude this possibility, which would however run against the logic of the SSM and the responsibilities of the ECB, at least in the case of banks which are directly supervised by the latter.

4.3 **ECB cooperation with other authorities**

4.3.1 *EBA and non-euro countries' authorities*

The SSM focus on the eurozone determines the need for the ECB to cooperate with other authorities. These are, first of all, the ESAs forming the ESFS, including the European Banking Authority. The tasks and responsibilities of the EBA remain essentially unchanged[56]. The ECB shall participate in the Board of Supervisors of the EBA. It will also participate in colleges of supervisors without prejudice to the participation of national competent authorities of participating Member States in these colleges. As mentioned above, the regulation establishing the EBA has been modified to ensure that the EBA can carry out its tasks in relation to the ECB by clarifying that the notion of 'competent authorities' includes also the latter.[57] In addition, considering that the ECB will coordinate the position of the euro area Member States, the voting modalities currently provided for in the EBA regulation have been reviewed, so as to ensure that EBA's decisions are taken in a

56 The SSMR confirmed the powers of EBA to harmonize technical standards for regulation and supervision and its role as a not binding mediator. In particular, the EBA will be responsible for the preparation of a single rulebook applicable to all banks in the EU and a supervisory handbook.

57 See new Art. 1(2) EBAR.

more balanced way.[58]

With reference, however, to the Member States not participating in the single currency, the ECB and the competent authorities of those Member States may establish a cooperation stipulating a memorandum of understanding that outlines the terms for their cooperation in carrying out their respective supervisory duties under the Union law (the "close cooperation" regime of art. 7 of SSMR). In particular, the Member State whose currency is not the euro that decides to participate in the SSM has to communicate to the other Member States, the Commission, the ECB and the EBA its request to establish a close cooperation with the ECB in which it engages to ensure that its competent national authority shall comply with the guidelines and requirements of the ECB and shall communicate all information which the ECB may need on credit institutions established in that Member State[59]. The ECB has the power to formulate instructions to the competent national authorities of the participating Member State whose currency is not the euro, and can decide, if this does not cause harm to the integrity of the SSM, to suspend or terminate cooperation if the Member State does not conform or does not comply with the information requirements[60].

4.3.2 *Possible impact of "close cooperation"*

As a result, the SSM does not modify substantially the general framework of EU banking regulation and supervision, save for what provided with respect to the EBA's position vis-à-vis the ECB. Indeed, the introduction of the SSM does not affect the models of enhanced cooperation and lead supervision on which the EU general framework is based. These models still characterise bank supervision in Europe, while a model of semi-

58 See new Articles 40 and 44 of EBAR, which foresee both an independent panel making proposals to the Supervisory Board and a simple majority of the latter including a simple majority of its members from participating Member States and a simple majority of its members from non-participating Member States.

59 See Art. 7 (2) SSMR.

60 See Art. 7 (5) and (6) SSMR.

strong centralization is in place for Eurozone countries. Of course, this picture could change substantially if a sufficient number of non-euro countries adhere to the system of "close cooperation" foreseen by the regulation. By opting into close cooperation with the ECB, a non-euro country shall become a participating Member State and will be subject to a regime similar to that applicable to euro countries[61]. Assuming that the great majority of EU Member States participated in the SSM, as a result of many non-euro countries opting-in, the problems of cooperation with the EBA and the competent authorities of non-participating countries would be substantially reduced.

However, the incentives for a non-euro country to participate in the Banking Union are unclear. No doubt, extending common supervision to all EU countries would work in the interest of systemic stability, as argued throughout this paper. However, the theoretical soundness of this argument will not necessarily determine its acceptance in practice. Indeed, by participating to the SSM a member State will give up most of its supervisory powers in favour of the ECB. The incentives for politicians to proceed along a similar route are doubtful. While the loss of sovereignty would be clearly visible, the gains in terms of systemic stability and financial integration would be difficult to explain to the average voter. Moreover, these benefits will depend on a sufficient number of non-euro countries opting-in. If this number is low, the incentive to participate will be modest, determining a collective action problem which is not easily solved. Furthermore, non-participating Member States shall enjoy some voting power within the EBA's Supervisory Board, which might create a sufficient incentive not to join the SSM. Therefore, recent efforts to rebalance the voting power within the EBA Supervisory Board - which are officially justified by reference to the need to protect the financial interests of the Union - paradoxically reduce the incentives for non-euro countries to participate to the SSM

61 See Art. 2 (1) SSMR.

5. A SINGLE RULEBOOK FOR THE EUROZONE?[62]

In this section, I analyse the limits of the single prudential rulebook both in general and from the SSM perspective, and ask whether the ECB should have regulatory powers complementing its supervisory functions. Similar powers would entitle the ECB to issue rules forming, in perspective, a single prudential rulebook for the Eurozone.

5.1 **New features of the single rulebook**

While the first stage of EU post-crisis reform focused on the institutional structure of rulemaking, the second stage was centred on the review of core EU rules concerning prudential supervision of banks, implementing the so-called Basel 3 Accord. The new CRD/CRR package brought about two important innovations to EU prudential rulemaking. Firstly, despite being rather detailed, the CRR and CRD foresee that further provisions will be adopted at level 2 through regulatory and implementing technical standards. These standards have to be based on a draft prepared by the ESAs and then endorsed by the Commission through a complex procedure, which establishes restrictions to the autonomous decision-making of the Commission. In particular, if the Commission does not endorse a draft regulatory standard or amends it, it has to inform the ESA, the European Parliament and the Council, which may ask for clarifications.[63] Secondly, a large part of the new prudential requirements have been for the first time enacted through a EU regulation (CRR), i.e. an instrument that is directly applicable in the Member States. Moreover, the whole package was inspired by the principle of maximum harmonisation, so as to avoid the uneven implementation by Member States, which has been considered as a key ingredient in the run-up to the crisis. Indeed, the old directives left much flexibility to national authorities in the definition of key prudential elements - such as the notion of capital, prudential filters for unrealised gains and losses, the determination of risk weights (e.g. for real estate exposures) - while pressure by banks on

62 This section draws on Ferrarini and Recine 2015.
63 See the discussion by Busuioc 2013, pp 111–125.

national authorities led to soft approaches and regulatory competition.[64] However, the heterogeneity of the regulatory environment complicated significantly the effective supervision of cross-border groups.

5.2 **A rigid rulebook**

In a parallel study with Fabio Recine,[65] we make a few examples showing the limits of the single prudential rulebook, that we define as rigidity, complexity and excessive level of detail. I summarize two of these examples below, focussing on the new provisions on bankers' pay and on macro-prudential supervision. .

5.2.1 *CRD IV provisions on bankers' pay*

The FSB principles and standards on sound compensation practices leave the individual States free to adopt either a regulatory or a supervisory approach to bankers' pay. The majority of jurisdictions follow a mixed model, combining more or less detailed rules with *ex post* supervisory action. US regulation, for instance, includes only few primary rules leaving wide scope to the Fed's regulatory and supervisory powers.[66] On the contrary, the EU approach is based on level 1 and 2 directives leaving narrow room to supervisory discretion. Not only has the EU followed a mostly regulatory approach to the implementation of international principles, but it has also departed from these principles by introducing an unprecedented cap on variable remuneration in CRD IV. In another paper,[67] I show that the rationale for this cap is flawed and that unintended consequences may derive from it as a result. I also argue that the cap on variable pay may be inconsistent with other aspects of the regulation of pay, which reflect the international principles and respond to a logic that is to some extent different from that followed by the EU legislator.

For present purposes, the CRD IV provisions on executive pay - particularly the bonus-cap

64 Enria 2012.
65 Ferrarini and Recine 2015.
66 See Ferrarini and Ungureanu 2011.
67 Ferrarini 2015.

introduced by the same - help understand the limits of the single rulebook as it now stands also in other areas. Firstly, the willingness of politicians to directly intervene in the regulation of issues that are clearly salient from their voters' perspective led to the formulation of detailed provisions, rather than high-level principles that should generally characterize level 1 directives. Secondly, regulation of technical issues - like the appropriate balance of fixed and variable pay - in level 1 directives has not only politicised these issues, but also led to a rigid approach to the same. Thirdly, the use of directives at both level 1 and 2 has widened the scope of banking regulation to the point of depriving supervisors of the discretion needed to a sensible approach to bank surveillance. As a result, the professional competences and independence of banking supervisors are not fully exploited, while political interference with banking regulation and supervision risks distorting the same for reasons other than technical ones.

5.2.2 *Macro-prudential supervision*

One of the main novelties of the CRD/CRR package is the introduction of a macro-prudential perspective to complement traditional micro-prudential supervision. The new rules are aimed at addressing systemic risks, which derive from macroeconomic imbalances, and preventing risk contagion.[68] An important issue in this respect is how to strike the right balance between maximum harmonisation in the European single rulebook, as a safeguard for the single market, and allowing national authorities to introduce more stringent prudential requirements (higher capital requirements in particular) so as to reflect the Member States' different economic cycles. A compromise was reached based on a number of recommendations by the ESRB[69] and two exceptions were introduced to the maximum harmonisation principle contemplated in the CRD/CRR package.

Firstly, Article 133 (1) CRD allows Member States to introduce a systemic risk buffer of

68 See Art. 133 (Requirements to maintain a systemic risk buffer) CRD IV and Art. 458 (Macro-prudential or systemic risk identified at the level of a Member State) CRR.

69 See ESRB, letter March 29, 2014, Principles for the development of a macro-prudential framework in the EU in the context of the capital requirements legislation, <https://www.esrb.europa.eu/pub> accessed 24 November 2014.

Common Equity Tier 1 capital in order to prevent and mitigate long term non-cyclical or macro-prudential risks not covered by CRR, i.e. 'a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State.'[70] Before setting a systemic risk buffer the competent authority shall notify the Commission, the ESRB, EBA and the competent and designated authorities of the Member States concerned one month before the publication of its decision.[71] Within two months of notification the Commission, taking into account the assessment of the ERSB and EBA, shall adopt an implementing act authorizing the proposed measure 'if it is satisfied that the systemic risk buffer does not entail disproportionate adverse effects on the whole or parts of the financial system of other Member States or of the Union as a whole forming or creating an obstacle to the proper functioning of the internal market.'[72]

Secondly, Article 458 CRR enables a national competent authority[73] to impose stricter prudential requirements to address systemic risks where the same 'identifies changes in the intensity of macro-prudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State and which that authority considers would be better addressed by means of stricter national measures'.[74] Article 458 (2) (d) provides for a broad set of possible measures (instruments) concerning the level of own funds, large exposure limits, public disclosure requirements, the level of capital conservation buffer, liquidity requirements, risk weights for the residential and commercial property sector, and intra-financial sector exposures.[75] However, these measures may only be applied if the national authority can justify that the identified systemic risk cannot be adequately and effectively

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70 Art. 133 (2) CRD IV specifies that the Member States shall designate the authority on charge of setting the systemic risk buffer and of identifying the set of institutions to which it applies.

71 See Art. 133 (11) and (12) CRD IV.

72 See Art. 133 (15) CRD IV.

73 Under Art. 458 (1) CRR, Member States shall designate the competent authority for the purposes of this Article.

74 See Art. 458 (2) CRR.

75 See ESRB, Handbook on Operationalising Macro-prudential Policy in the Banking Sector, 3 March 2014, <https://www.esrb.europa.eu/pub> accessed 24 November 2014.

addressed by other instruments.[76] Furthermore, the national authority is subject to a cumbersome notification and approval process, involving opinions from the ESRB and EBA on the envisaged national measures, a possible proposed implementing act of the European Commission and a final decision by the European Council.[77]

Also the SSM Regulation deals with the issue of macro-prudential tasks and tools. On one side, the power of national authorities to apply measures addressing macro-prudential risks is confirmed, with the specification that the concerned authority shall notify its intentions to the ECB ten working days in advance.[78] On the other side, the ECB is empowered to apply higher requirements for capital buffers than applied by the national competent authorities or national designated authorities of participating Member States, to be held by credit institutions in accordance with relevant Union law in addition to own fund requirements, and to apply more stringent measures aimed at addressing systemic or macro-prudential risks at the level of credit institutions subject to the procedures set out in the CRR and CRD.[79] A duty is also foreseen for the ECB to cooperate with national authorities, including the duty to notify its intention in advance to the same and to consider their objections before proceeding with a decision as appropriate.[80]

To sum up, our second example shows an area where (macro)prudential regulation is potentially decoupled from supervision, for the measures in question can be adopted by a body other than the ECB, such as a national competent or designated authority. However, also the ECB can adopt similar macro-prudential measures instead of the national authorities. This is therefore a case where the ECB is explicitly granted regulatory powers. Nonetheless, when adopting macro-prudential measures also the ECB must go through a cumbersome process foreseen by Union law, which

76 See Art. 458 (2) (c) CRR.

77 See Art. 458 (2) CRR, on the notification of the draft national measures and the underlying reasons to the European Parliament, the Council, the Commission, the ERSB and EBA; and Art. 458 (4) CRR on the Council's power to adopt an implementing act to reject the draft national measures on a proposal from the Commission. The Council shall only reject the draft national measures if one or more conditions are not met with relating to the changes in the intensity of macro-prudential or systemic risk; the inadequacy of the CRD/CRR general requirements; the absence of disproportionate effects of the national measures.

78 See Art. 5 (1) SSMR.

79 See Art. 5 (2) SSMR.

80 See Art. 5 (3) SSMR.

involves the ESRB and EBA (in an advisory capacity) and the Commission and the Council for the final adoption of the measures.

5.2.3 *Complexity of EU Financial Rule-making*

On the whole, the EU regulatory arena today sees many players acting under often unclear and overlapping mandates. In addition, reforms of the EU regulatory framework have produced several layers of rules, with no clear accountability for the final output. At Level 1, the EU institutions set out the main rules under Treaty procedures, which foresee a proposal from the Commission to be discussed and approved by the Council and the Parliament. These rules were originally conceived as high-level principles, but today tend to be very detailed, mainly pursuing a maximum harmonisation approach. At Level 2, the Commission and the EU regulatory agencies (EBA in the banking sector) make rules on the basis of mandates, which are set in Level 1 directives and regulations and foresee the issuance of delegated acts and regulatory technical standards under 'comitology' procedures. When directives are adopted at either level, Member States provide to their implementation through national rules which are adopted by parliaments, governments or regulators. At Level 3, the EU regulatory agencies (including EBA) issue guidelines and recommendations specifying the rules set at the other two levels.

The examples offered above clearly show the limits of this patchy approach to rule-making. As a result of the detailed character of most Level 1 measures and of maximum harmonisation, politicians often legislate on technical issues that would generally be better left to supervisors. The CRD provisions on bankers' remuneration show to what extent political interference can restrain corporate autonomy. They also show how supervisory discretion can be pre-empted by too detailed rules at Level 1 and 2. The macro-prudential provisions show how regulatory powers, which in this area are shared by national authorities and the ECB, are defined within a framework that foresees cumbersome controls by other EU institutions and EBA. Similar controls, albeit justified with respect to national authorities, make little sense in the case of the ECB.

5.3 **Should the ECB have more say in prudential rulemaking?**

5.3.1 *Decoupling regulation from supervision*

The ECB has only limited regulatory powers as to prudential supervision. Article 4 (3) of the SSM Regulation states that the ECB shall apply all relevant Union law and, where Union law is composed of directives, the national legislation transposing the same. Where the relevant Union law is composed of regulations and those regulations explicitly grant options to Member States, the ECB shall also apply the national legislation exercising those options. To that effect, the ECB shall adopt guidelines and recommendations, and take decisions subject to and in compliance with the relevant Union law. It shall in particular be subject to binding regulatory and implementing technical standards developed by EBA and adopted by the Commission in accordance with the EBA Regulation, and to the provisions of that Regulation on the European supervisory handbook developed by EBA. The ECB may also adopt regulations, but only to the extent necessary to organise or specify the arrangements for the carrying out of the tasks conferred on it by the SSM Regulation.[81] The limits to the ECB's regulatory powers in the area of prudential supervision highlight the decoupling of regulation from supervision in the Banking Union and raise the question whether the ECB could have more say in rule-making with respect to the Eurozone. Before analysing this question, we should consider the related issue of the ECB's nature both as a central bank and as a supervisory agency.

5.3.2 *The ECB as a central bank*

The Treaty established the ECB as an institution with exclusive competence on the tasks conferred on it by the Treaty.[82] It has exclusive powers to make regulations, take decisions, make

81 See sec. 4.4.1 above.
82 See Scheller 2006. For an in-depth analysis of the SSM tasks, focusing on the respective competences of

recommendations and deliver opinions to the extent necessary to implement its tasks and carry out its responsibilities within its area of competence. The ECB regulations and decisions enjoy the status of Union law. Moreover, the ECB is entitled to exercise its powers in individual cases within the limits set out by the EC Treaty and further defined by the Council (e.g. in the case of statistics, minimum reserve requirements and sanctions). The Treaty was lastly changed to clarify that the ECB is a EU institution, albeit with very specific features (as regards for instance budget, auditing and accountability). Article 282 TEU explicitly defines the ECB as a EU institution - like the Commission, the Council, the EP and the European Court of Justice - therefore removing legal uncertainty about its status. The fact that the ECB was previously included in a section of the Treaty concerning 'other institutions and bodies' already led some interpreters to qualify the ECB as an independent specialised organisation of Community law.[83]

5.3.3 *The ECB as a prudential supervisor*

The SSM Regulation assigns supervisory tasks to the ECB, somehow overlooking that it is a EU institution while assimilating the same to national competent authorities. In fact, the SSM regulation provides that 'the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union Law'.[84] The characterization of the ECB as a quasi-national authority marks a departure from its status as EU institution, as also shown by its limited rule-making powers and by its relative subordination to EBA and the ESRB. To be true, the ECB can adopt regulations, but only to the extent necessary to either organise or specify the arrangements for carrying out the tasks conferred on it by the SSMR. Before adopting a regulation, the ECB shall conduct open public consultations and analyse the potential related costs and benefits.[85] In addition, the ECB 'should exercise powers

the ECB and the national authorities, see D'Ambrosio 2015.

83 See Zilioli and Selmayr 2000, further developed in Zilioli and Selmayr 2001; for a different view, see Torrent 1999; Majone1998.

84 See Art. 9 (1) SSMR.

85 See Art. 4 (3) SSMR, making an exception for the case where such consultations and analyses are

to adopt regulations in accordance with Article 132 of the Treaty on the Functioning of the European Union (TFEU) and in compliance with Union acts adopted by the Commission on the basis of drafts developed by EBA and subject to Article 16 of Regulation (EU) No 1093/2010'.[86]

As a result, a new legal hierarchy is foreseen for the ECB which is subject to i) relevant Union law including the whole of primary and secondary Union law; ii) the Commission powers and decisions in the area of State aid, competition rules and merger control; iii) the single rulebook applicable in all Member States.[87] Also the ECB guidelines and recommendations, as well as the ECB decisions are subject to and must comply with 'the relevant Union law and in particular any legislative and non-legislative act, including those referred to in Articles 290 and 291 TFEU'. The ECB shall in particular 'be subject to binding regulatory and implementing technical standards developed by EBA and adopted by the Commission in accordance with Article 10 to 15 of Regulation (EU) No 1093/2010, to Article 16 of that regulation, and to the provisions of that Regulation on the European supervisory handbook developed by EBA in accordance with that Regulation'.

In addition, the amended EBA Regulation effects 'a rebalancing' of the position of the EBA vis-à-vis the ECB, strengthening EBA in an effort to avoid 'centrifugal forces'.[88] Firstly, EBA's powers towards the ECB have been specified. The regulation establishing the EBA has been modified to ensure that the same can carry out its tasks in relation to the ECB by clarifying that the notion of 'competent authorities' includes also the latter.[89] Under the amending regulation, the EBA's powers to resolve a cross-border disagreement between supervisors and to require action in an emergency situation have been amended in the sense that EBA could request the ECB to follow its decision, but not require the same to do so. The ECB will have either to comply or to provide

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disproportionate in relation to the scope and impact of the regulations concerned or in relation to the particular urgency of the matter, in which case the ECB shall justify that urgency.

86 *Ibidem*.

87 See Recital (32) SSMR.

88 This concept is used by Moloney 2015, para. 16.20.

89 See Art. (2) of Regulation (EU) No 1022/2013 of October 22, 2013 amending Regulation (EU) No 1093/2010, (2013) OJ L287/5 (Amending Regulation).

adequate justification for non-compliance.[90] Secondly, the amending Regulation confirms the powers of EBA to harmonize technical standards for regulation and supervision (so called European supervisory handbook).[91] Thirdly, EBA's governance has been changed. The ECB shall continue to participate in the Board of Supervisors of EBA through a non-voting representative. However, the voting modalities currently provided for in the EBA Regulation have been amended, so as to ensure that EBA's decisions are taken in a more balanced way.[92] Moreover, while in the Commission proposal of the SSM Regulation the ECB had the power to 'coordinate and express a common position' for the participating Member States, this approach has been abandoned by the Parliament in the final version, restoring the full freedom of the competent authorities of the participating Member States to agree on subjects within EBA's competence.[93]

On the whole, the ECB can influence EBA's rule-making only to a limited extent. The ECB representative on EBA Board of Supervisors is nominated by the ECB Supervisory Board and may be accompanied by someone with expertise on central bank tasks. However, differently from national authorities, he has no voting rights.[94] To partially correct this handicap the ECB representative is allowed to attend discussions concerning individual financial institutions, which in principle non voting members cannot attend, apart from the EBA Chairpersons and Executive Director. As to regulation and other topics (such as decisions on breach of Union Law, emergency decisions and settlement of disputes), the amended EBA regulation provides for a dual majority, according to which the needed qualified majority should include both a simple majority of SSM countries and a simple majority of non-SSM participating countries.[95]

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90 See Art. 1 (8) Amending Regulation.

91 See Art. 1 (5) Amending Regulation.

92 See Recital (14) Amending Regulation and Article 44 of the EBA Regulation as amended by Article 3 (24) Amending Regulation.

93 Article 4 (l) (l) of the proposed SSM regulation gave the ECB the power to 'coordinate and express a common position' for the participating Member States; see also the Explanatory Memorandum to the Commission's proposal at 4.2.1.

94 See Art. 1 (21) Amending Regulation.

95 See Art. 1 (24) Amending Regulation.

5.3.4 *Criticism of the current approach*

There is clearly an asymmetry between the ECB monetary and supervisory roles. On the one hand, the ECB is a fully-fledged EU institution with exclusive competence on monetary policy and strong regulatory powers in its area of competence. On the other, the ECB is a prudential supervisor replacing national authorities on the basis of a delegation by EU institutions. As a banking supervisor, the ECB enjoys limited regulatory powers being rather subject to both Union law and national law. Moreover, the ECB is subject to the powers of EBA as to dispute settlement, emergency decisions and breach of EU law. In addition, it is subject to the procedures provided for by the CRR when implementing macro-prudential measures. In some cases the ECB has an even more limited status than national authorities, lacking for instance voting rights within EBA Board of Supervisors.

The reasons supporting the current regulatory approach, including a single supervisor for the euro area without rule-making powers, are easily understood. Promoting the single market whilst assuring a level playing field requires a single set of rules across the EU. If the ECB became the rule setter for all EU banks, non-euro Member States would clearly be concerned that bank regulation was biased to Eurozone banks. Nonetheless, the present decoupling of regulation (which is made at EU level) from supervision (which is performed at either national or Eurozone level) makes the ECB appear like *Janus Bifrons,* the Roman god whose head had two faces (one oriented to the future and the other to the past). Even assuming that the ECB features as a central bank were rightly set aside when constructing the SSM, we should still consider whether the present approach, resulting from hard political compromises, leads to efficient and effective supervision. On one side, rule-making powers are generally considered as an important tool for supervisory authorities who can regulate either the structure of firms or their conduct in view of reducing the probability of bank

failures and safeguarding financial stability.[96] On the other, regulatory independence, i.e. a high degree of autonomy of independent supervisors in rule-making, is a well established international financial standard and crucially includes equipping supervisors with large discretion to set and change the rules flexibly.[97] I wonder whether a similar objective is fulfilled by the complex interaction between different layers of rules concerning the SSM, which make regulatory change a very cumbersome process involving several players.

To sum up, the present EU regime for prudential regulation – which is characterised by maximum harmonisation, several layers of regulation, multiple rule-makers and excessively detailed rules - may be suboptimal for the SSM and hinder its flexibility. Moreover, the SSM participating countries do not face the problem of regulatory competition, which maximum harmonisation is aimed to solve. Rather, the SSM will need a consistent and homogenous regulatory framework in order to make supervision uniform in the Eurozone. This is not to say that EU harmonization will become irrelevant from the Banking Union perspective. Indeed, harmonization will still be needed vis-à-vis the countries that do not participate in the SSM; furthermore, EU-wide banking groups clearly benefit from harmonisation of the rules in all countries where they are established.

However, a proper reading of the Treaty would already allow the delegation of regulatory powers to the ECB in its role as a prudential supervisor. Indeed, Article 127(6) of the TFEU states that specific tasks may be conferred upon the ECB 'concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings'. The notion of 'policies' could no doubt include some rule-making powers in the areas of prudential supervision that the Council could very well specify in its mandate to the ECB grounding the SSM.[98]

96 See D.T. Llewellyn 2013.
97 See Quintyn and Taylor 2002.
[98] For a full development of this argument see Ferrarini and Recine 2015.

VI. CONCLUDING REMARKS

In this paper, I have tried to assess the likely impact of the Banking Union and particularly of the SSM on Eurozone banking markets. Firstly, I analysed the predictions made by economists and policy makers with regard to the deeper integration of financial markets which may derive from the Banking Union. These predictions usually refer to the better functioning of cross-border banking groups, to the likely consolidation of banking firms across the euro area and to expansion of capital markets which is needed particularly for SMEs given the reduction of bank financing caused by Basel 3 types of measures. Secondly, I highlighted the limits of EU supervisory centralisation as shaped by the reforms enacted after the 2008 financial crisis, which led to a system of 'enhanced cooperation' that does not completely overcome the agency problems relative to supervisory cooperation. Thirdly, I analysed the limits of the Single Supervisory Mechanism, which is to some extent still grounded on supervisory cooperation despite the fact that the ECB has powers of direction and substitution with respect to national supervisors. I argued, therefore, that the SSM represents a system of semi-strong centralization, which may still give rise to agency problems particularly in the relationships with supervisors of non-euro area countries that are still governed by the EU system of enhanced cooperation. Fourthly, I examined the decoupling of supervision from regulation within the Banking Union, deriving from the fact that the ECB lacks sufficient regulatory powers when acting as a supervisor of the Eurozone banking systems. The separation of regulation – which is harmonized (often with excessive detail) at EU level - and supervision – which is centralized in the euro area – may create problems to the extent that the single supervisor cannot create a prudential rulebook for the Eurozone, but is subject to EU prudential regulation and national law provisions often unduly limiting its supervisory discretion. The limits highlighted in this paper with respect to EU supervisory centralisation, to the SSM and to the single rulebook help understanding the degree of uncertainty characterising the predictions commonly made by economists and policy makers with respect to the benefits expected from the Banking Union

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