

Tröger, Tobias H.

## Working Paper

The single supervisory mechanism - Panacea of quack banking regulation? Preliminary assessment of the evolving regime for the prudential supervision of banks with ECB involvement

SAFE Working Paper, No. 27 [rev.]

## Provided in Cooperation with:

Leibniz Institute for Financial Research SAFE

*Suggested Citation:* Tröger, Tobias H. (2014) : The single supervisory mechanism - Panacea of quack banking regulation? Preliminary assessment of the evolving regime for the prudential supervision of banks with ECB involvement, SAFE Working Paper, No. 27 [rev.], Goethe University Frankfurt, SAFE - Sustainable Architecture for Finance in Europe, Frankfurt a. M., <https://doi.org/10.2139/ssrn.2311353>

This Version is available at:

<https://hdl.handle.net/10419/146952>

### Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

### Terms of use:

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Tobias H. Tröger

# The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?

SAFE Working Paper Series No. 27

Center of Excellence SAFE Sustainable Architecture for Finance in Europe

A cooperation of the Center for Financial Studies and Goethe University Frankfurt

House of Finance | Goethe University  
Grüneburgplatz 1 | D-60323 Frankfurt am Main

Tel. +49 (0)69 798 34006 | Fax +49 (0)69 798 33910  
info@safe-frankfurt.de | www.safe-frankfurt.de

# The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?

PRELIMINARY ASSESSMENT OF THE EVOLVING REGIME FOR THE PRUDENTIAL SUPERVISION OF BANKS WITH ECB INVOLVEMENT

(first draft: August 16, 2013; this version: September 10, 2014)

**Tobias H. Tröger**

Professor of Private Law, Trade and Business Law, Jurisprudence  
Goethe-University, Frankfurt am Main, House of Finance

Grüneburgplatz 1  
60323 Frankfurt am Main  
Germany

Phone +49 69 798 34236

Fax +49 69 798 34536

troeger@jur.uni-frankfurt.de

**Abstract:** This paper analyzes the new architecture for the prudential supervision of banks in the euro area. It is primarily concerned with the likely effectiveness of the SSM as a regime that intends to bolster financial stability in the steady state.

By using insights from the political economy of bureaucracy it finds that the SSM is overly focused on sharp tools to discipline captured national supervisors and thus under-incentivizes their top-level personnel to voluntarily contribute to rigid supervision. The success of the SSM in this regard will hinge on establishing a common supervisory culture that provides positive incentives for national supervisors. To this end, the internal decision making structure of the ECB in supervisory matters provides some integrative elements. Yet, the complex procedures also impede swift decision making and do not solve the problem adequately. Ultimately, a careful design and animation of the ECB-defined supervisory framework and the development of inter-agency career opportunities will be critical.

The ECB will become a *de facto* standard setter that competes with the EBA. A likely standoff in the EBA's Board of Supervisors will lead to a growing gap in regulatory integration between SSM-participants and other EU Member States.

Joining the SSM as a non-euro area Member State is unattractive because the current legal framework grants no voting rights in the ECB's ultimate decision making body. It also does not supply a credible commitment opportunity for Member States who seek to bond to high quality supervision.

JEL classification: G21, G28, H77, K22, K23, L22.

Keywords: prudential supervision, banking union, regulatory capture, political economy of bureaucracy, Single Supervisory Mechanism (SSM), European Central Bank (ECB), European Banking Authority (EBA)

# THE SINGLE SUPERVISORY MECHANISM – PANACEA OR QUACK BANKING REGULATION?

PRELIMINARY ASSESSMENT OF THE NEW REGIME FOR THE PRUDENTIAL  
SUPERVISION OF BANKS WITH ECB INVOLVEMENT

Tobias H. Tröger\*

1	Europe’s Hamiltonian moment? .....	2
2	The summer of 2012 .....	7
2.1	The disintegration of the EMU and the re-fragmentation of the internal market for financial services .....	7
2.2	The Spanish (and Cypriot) banking crisis as the straw that broke the camel’s back .....	9
3	Distribution of competences within the SSM and beyond .....	11
3.1	Shared responsibilities in cross-border supervision .....	12
3.2	The SSM .....	14
3.2.1	The ECB’s role in prudential supervision .....	14
3.2.2	Interplay with NCAs .....	20
3.2.3	Subsidiaries and branches .....	21
3.3	Assessment .....	22
3.3.1	Lessons from the political economy of administration: bureaucrats’ incentives .....	23
3.3.1.1	Relevance of NCAs’ contributions .....	23
3.3.1.2	Bureaucrats’ incentives .....	24
3.3.2	Integrative prospects of internal decision making procedures, ECB-set framework, and NCA-ECB career paths .....	27
3.3.2.1	Internal decision making procedures .....	27
3.3.2.2	ECB-set framework, and NCA-ECB career paths .....	30
4	Coexisting standard setters - a Europe <i>à deux vitesses</i> in banking supervision? .....	31

---

\* Professor of Private Law, Trade and Business Law, Jurisprudence, Goethe University Frankfurt am Main, Germany. Principal Investigator at the Center of Excellence Sustainable Architecture for Finance in Europe (SAFE) and Fellow at the Center for Financial Studies (CFS). The author wishes to thank symposium and workshop participants at McGill University, University of Ottawa, Jesus College Oxford, the University of Frankfurt, and the Joint Seminar of the German Bar Association and the Bar Council of England and Wales. Comments and critique from Giovanni Dell’Ariccia, Mathias Dewatripont, Guido Ferrarini, Gérard Hertig, Jan Pieter Krahn, Patrick Leblond, Ashoka Mody, Helmut Siekmann, Eddy Wymeersch, Chiara Zilioli, and an anonymous referee were particularly beneficial.

4.1	EBA-rulemaking and ECB-supervision compared .....	32
4.2	Euro-area dominance of EBA decision making or standoff? .....	34
5	Non-participating Member States .....	37
5.1	Close cooperation .....	37
5.2	Second-class SSM-Participation: no ultimate say in ECB-decision making .....	38
5.3	SSM is no “lobster trap” .....	39
5.4	Candidates for close cooperation? .....	40
6	Concluding remarks (also) on the bigger picture .....	41

## I EUROPE’S HAMILTONIAN MOMENT?

The sovereign debt crisis in the euro area has been regarded as an event that could prompt closer fiscal integration in the E.U. that would potentially resemble Alexander Hamilton’s debt assumption plan of 1790.<sup>1</sup> In fact, the impetus to retroactively cure a perceived defect of the European Monetary Union (EMU)<sup>2</sup> seems to be much stronger than the historical catalyst for the U.S. developments that started with Hamilton’s original proposal: the unsustainable debt burden of U.S. states at the time amounted to 13.39% of GDP, which is why its assumption raised prospective federal debt-levels to no more than 42.29% of GDP,<sup>3</sup> whereas on the eve of Europe’s recent advances, the Member States of the euro area alone owed an amount

<sup>1</sup> The comparison originates with Thomas J. Sargent, *Nobel Lecture: United States Then, Europe Now*, 120 J. POLIT. ECON. 1, 10-29 (2012). For an astute analysis cf. C. RANDALL HENNING & MARTIN KESSLER, FISCAL FEDERALISM: US HISTORY FOR ARCHITECTS OF EUROPE’S FISCAL UNION (2012), available at <http://www.bruegel.org/download/parent/669-fiscal-federalism-us-history-for-architects-of-europes-fiscal-union/file/1537-fiscal-federalism-us-history-for-architects-of-europes-fiscal-union/>. For a brief comparison of the evolution of the two-level supervisory architecture in the U.S. with that of the SSM see Maria Nieto & Eugene White, *Will bank supervision in Ohio and Austria be similar? A transatlantic view of the Single Supervisory Mechanism*, VOXEU, March 22, 2013, <http://www.voxeu.org/article/will-bank-supervision-ohio-and-austria-be-similar-transatlantic-view-single-supervisory-mechanism>.

<sup>2</sup> For pre-sovereign solvency crisis contributions that argued for adding a banking component to the EMU model Martin Čihák & Jörg Decressin, *The Case for a European Banking Charter 7 – 12* (Int. Monetary Fund, Working Paper No. 173, 2007), available at <http://www.imf.org/external/pubs/ft/wp/2007/wp07173.pdf>; Nicolas Véron, *Is Europe Ready for a Major Banking Crisis?* 4-6 (Bruegel Pol’y Brief No. 3, 2007) available at <http://www.bruegel.org/download/parent/234-is-europe-ready-for-a-major-banking-crisis/file/659-is-europe-ready-for-a-major-banking-crisis-english/>. The general theory of optimum currency areas that typically considers close fiscal integration with a common transfer mechanism an essential precondition for successful currency areas originates with Robert A. Mundell, *A Theory of Optimum Currency Areas*, 51 AM. ECON. REV. 657, (1961), Ronald McKinnon, *Optimum Currency Areas*, 53 AM. ECON. REV., 717, (1963) and Peter B. Kenen, *The Theory of Optimum Currency Areas: An Eclectic View*, in MONETARY PROBLEMS IN THE INTERNATIONAL ECONOMY 41, (Robert A. Mundell & Alexander K. Swoboda eds., 1969). For a survey of the literature see Tamim A. Bayoumi & Barry J. Eichengreen, *Operationalizing the Theory of Optimum Currency Areas* (Center for Econ. Pol’y. Res., Discussion Paper No. 1484, 1996), available at <http://www.cepr.org/pubs/dps/DP1484.asp>.

<sup>3</sup> Richard Sylla, *Financial Foundations: Public Credit, the National Bank, and Securities Markets*, in FOUNDING CHOICES: AMERICAN ECONOMIC POLICY IN THE 1790S 67 (Douglas A. Irwin and Richard Sylla eds., 2011); SAMUEL H. WILLIAMSON, WHAT WAS THE U.S. GDP THEN? (2014), available at <http://www.measuringworth.com/usgdp/>.

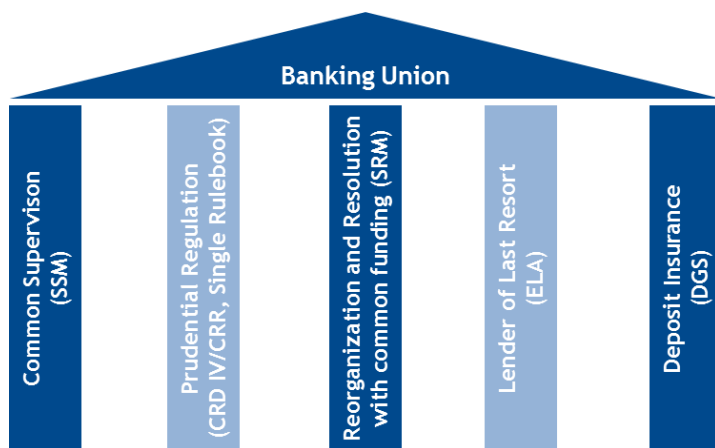
equivalent to 92.2% of GDP.<sup>4</sup> Yet, precisely these staggering numbers also explain the reluctance of governments in fiscally rather strong E.U. Member States<sup>5</sup> when it comes to confronting their electorate with bolder leaps towards an encompassing economic, fiscal and political integration of the euro area: *prima vista* they could be misrepresented as an unconditional bail-out of irresponsible foreigners, a view that would be oats for populist opposition parties. The political economy hence suggests that a pragmatic approach of piecemeal integration is the most sensible real world option to progress in the current *mêlée*.<sup>6</sup>

---

<sup>4</sup> Newsrelease, eurostat, Euro area government debt up to 92.2% of GDP, euroindicators 114/2013 (July 22, 2013), available at [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-22072013-AP/EN/2-22072013-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22072013-AP/EN/2-22072013-AP-EN.PDF).

<sup>5</sup> Although, in line with common sentiment the highest ratios of government debt to GDP at the end of the first quarter of 2013 were recorded in Greece (160.5%), Italy (130.3%), Portugal (127.2%) and Ireland (125.1%), it is worth noting that both France (91.9%) and Germany (81.2%) exhibit debt to GDP-ratios (eurostat, *supra* note 4) in the vicinity or even beyond the 90%-threshold that was regarded as a peril to long-term prosperity in an influential, yet contested contribution, *cf.* Carmen Reinhart & Kenneth Rogoff, *Growth in A Time of Debt*, 100 AM. ECON. REV., PAPERS & PROC. 573, (2010); but see also Thomas Herndon, Michael Ash & Robert Pollin, *Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff* (U. of Mass. Amherst, Pol. Econ. Res. Inst., Working Paper No. 322, 2013), available at [http://www.peri.umass.edu/fileadmin/pdf/working\\_papers/working\\_papers\\_301-350/WP322.pdf](http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_301-350/WP322.pdf).

<sup>6</sup> For an account of the broader political agenda of the European “four presidents” see HERMAN VAN ROMPUY, JOSÉ MANUEL BARROSO, JEAN-CLAUDE JUNCKER & MARIO DRAGHI, TOWARDS A GENUIN ECONOMIC AND MONETARY UNION (2012), [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/134069.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf). On the dense intertwining of a successful banking union with reinforced fiscal and political integration in Europe, Jean Pisani-Ferry et al., *What Kind of European Banking Union?* 15, 19 (Bruegel Pol’y Contribution No. 12, 2012), available at <http://www.bruegel.org/download/parent/731-what-kind-of-european-banking-union/file/1595-what-kind-of-european-banking-union/>; Nicolas Véron, *Europe’s Single Supervisory Mechanism and the Long Journey Towards Banking Union* 3-4 (Bruegel Pol’y Contribution No. 16, 2012) available at <http://www.bruegel.org/download/parent/752-europes-single-supervisory-mechanism-and-the-long-journey-towards-banking-union/file/1614-europes-single-supervisory-mechanism-and-the-long-journey-towards-banking-union/>.



**figure 1** - elements of banking union

Political leaders' pledge to establish a European banking union<sup>7</sup> which would ensure an impartial and uniform implementation of a stringent regulatory and supervisory framework for all euro area banks could, if ultimately fulfilled, lead to a welcome contribution.<sup>8</sup> Of course, a set of stringent substantive rules that govern banks' operations and risk-taking behavior, an effective and rigorously enforced

supervisory and resolution regime together with common safety nets (*i.e.* a reliable deposit guarantee scheme and clearly defined central bank lender of last resort obligations)<sup>9</sup> arguably cannot do much to cure the current woes,<sup>10</sup> but are apt to make

<sup>7</sup> The catchword refers to a centralization of pivotal instruments of banking policy on the supranational level which serves to preserve and advance the integration of the European (euro area) banking system, for an early proposal Wim Fonteyne et al., *Crisis Management and Resolution for a European Banking System* (Int'l Monetary Fund, Working Paper No. 70, 2010), <http://www.imf.org/external/pubs/ft/wp/2010/wp1070.pdf>.

<sup>8</sup> On the general desirability of a euro area banking union, see e.g. Rishi Goyal et al., *A Banking Union for the Euro Area 7-10* (Int'l Monetary Fund Staff Discussion Note 13/01, 2013) available at <http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf>; Pisani-Ferry et al., *supra* note 6, at 3-4; Véron, *supra* note 6, at 2; for a skeptical assessment of the projects ultimate political feasibility, Douglas C. Elliott, *Key Issues on European Banking Union: Trade-Offs and Some Recommendations 45-6* (Brookings Global Econ. & Dev. Working Paper No. 52, 2012) available at <http://www.brookings.edu/~media/research/files/papers/2012/11/european-banking-union-elliott/11-european-banking-union-elliott.pdf>. To be sure, even beyond a common currency, the goal of market integration can militate in favor of a mutualization of banking policy among the 28 Member States of the E.U., for a discussion see Pisani-Ferry et al., *supra* note 6, at 7.

<sup>9</sup> For an analysis of the individual components an ideal banking union should feature (figure 1) see Goyal et al., *supra* note 8, at 7-8, 12-20, Pisani-Ferry et al., *supra* note 6, at 6-15; see also Eddy Wymeersch, *The Single Supervisory Mechanism or "SSM", Part One of the Banking Union 2*, 6-7 (Nat'l Bank of Belgium Working Paper No. 255, 2014) available at <http://ssrn.com/abstract=2427577>. Political statements are somewhat murky when it comes to DGS and don't even mention lender of last resort duties, European Commission, *Update – The banking union 7-8* (Memo No. 12/478, 2012), available at [http://europa.eu/rapid/press-release\\_MEMO-12-478\\_en.pdf](http://europa.eu/rapid/press-release_MEMO-12-478_en.pdf), VAN ROMPUY, BARROSO, JUNCKER & DRAGHI, *supra* note 6, at 4. In fact, as a reaction to predictable political headwind from certain Member States who fear a far-reaching mutualization of liabilities and the asymmetric sharing of costs, the creation of a common DGS is no longer a Council priority, cf. European Council Conclusions 13/14 December 2012, at 4, EUCO 205/12, available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/134353.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134353.pdf). Equivalent conflicts delayed and compromised the promulgation of a resolution regime with common funding of backstops to combat systemic events (see *infra* at note 237 & 238 and accompanying text). On the other hand, the harmonized set-up of substantive banking regulation was adopted relatively fast, cf. European Parliament and Council Directive 2013/36 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, Amending Directive 2002/87/EC and Repealing

future calamities less likely and limit their impact if indeed all elements of the banking union depicted in figure 1 are ultimately introduced.

If regulatory intervention can indeed advance the goal of creating a more resilient financial system,<sup>11</sup> its foremost feature has to be its effectiveness as judged with particular regard to its stringent implementation and enforcement.<sup>12</sup> Only the latter will reaffirm lost confidence in the financial system's stability as the indispensable basis for sustainable credit-funded growth in the long run.<sup>13</sup> The predicament of designing and launching the Single Supervisory Mechanism (SSM) as the first step<sup>14</sup> towards a comprehensive banking union was to find ways that the SSM contributes to both combating the ongoing sovereign debt crisis<sup>15</sup> as well as fostering the steady state in the long run.

---

Directives 2006/48/EC and 2006/49/EC, 2013 O.J. (L 176) 338 (EU) [hereinafter: CRD IV] and European Parliament and Council Regulation 575/2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation 648/2012, 2013 O.J. (L 176) 1 (EU) [hereinafter: CRR].

<sup>10</sup> Some commentators see the banking union's potential contribution to ongoing crisis-management in the removal of tail-risks and contingent sovereign liabilities, e.g. Goyal et al., *supra* note 8, at 5, 9-10, 20, 26. Yet, this depends on how the banking union relates to "legacy assets", to wit whether direct ESM-recapitalizations or other supranational funds will become available for balance sheet risks incurred under national supervision prior to the SSM becoming operational, *infra* note 44.

<sup>11</sup> For a recent skeptical view that emphasizes the detrimental impact of complex regulation which diminishes the importance of reputation and substitutes it for technical expertise without restraining behavior in an equivalent, meaningful way JONATHAN R. MACEY, THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET 254-9 (2013). On the conventional rationale for prudential banking regulation and supervision Sudipto Bhattachary, Arnoud W. A. Boot & Anjan V. Thakor, *The Economics of Bank Regulation*, 30 J. MONEY CREDIT BANK., 745(1998).

<sup>12</sup> Goyal et al., *supra* note 8, at 8; Thomas F. Huertas, *Banking Union: What Will it Mean for Europe* 3 (LSE, Financial Markets Group, Special Paper 213, 2012) available at [www.lse.ac.uk/img/workingPapers/specialPapers/PDF/SP213.pdf](http://www.lse.ac.uk/img/workingPapers/specialPapers/PDF/SP213.pdf); Eddy Wymeersch, *The European Banking Union, a first analysis* 4 (Ghent U. Fin. L. Inst., Working Paper No. 07, 2012), available at <http://ssrn.com/abstract=2171785>.

<sup>13</sup> To be sure, the banking union cannot counter fears associated with a Member State's exit from the euro area that would impair deposits by way of re-denomination, Pisani-Ferry et al., *supra* note 6, at 16. The European Central Bank (ECB) sought to address these anxieties revolving around the euro area's integrity in the announcement of its Outright Monetary Transaction (OMT) program, Press Release, European Central Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012), [http://www.ecb.int/press/pr/date/2012/html/pr120906\\_1.en.html](http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html). The German Constitutional Court (Bundesverfassungsgericht) deems the latter to both transgress the ECB's mandate and to violate the prohibition of monetary financing of Member States' budgets, Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jan. 14, 2014, 67 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 907 paras. 56-94 (2014); for an english translation *cf.* [http://www.bverfg.de/entscheidungen/rs20140114\\_2bvr272813en.html](http://www.bverfg.de/entscheidungen/rs20140114_2bvr272813en.html).

<sup>14</sup> On the optimal phasing-in of the banking union itself, Pisani-Ferry et al., *supra* note 6, at 16-7; Goyal et al., *supra* note 8, at 22-4.

<sup>15</sup> In this regard, it arguably contributes already that the SSM was established, because it affirms political leaders' commitment to do more to address the crisis than to present long-term visions, Pisani-Ferry et al., *supra* note 6, at 15, 16. A more tangible advantage for crisis containment sometimes associated with the introduction of the SSM is contingent on the treatment of pre-existing debt overhangs (legacy liabilities), *see infra* note



This paper is primarily concerned with the new architecture's long-term prospects. In this context, increasing centralization must not always represent a value in itself, particularly so if it leads to hybrid forms that combine supranational dominance with persistent inter-agency cooperation. The evolving institutional framework has to exhibit obvious advantages over available alternatives. The specific set of rules introduced has to be the plausibly superior option at hand to promote the overall objectives.<sup>16</sup>

The final promulgation of an operational set of rules for a SSM<sup>17</sup> already raises doubts with regard to the effectiveness of the first pillar of the evolving regime. In fact, a closer look at both the events that triggered the legislative initiative (*infra* 2) and the distribution of competences between the ECB and national competent authorities (NCAs) within the SSM (*infra* 3) show that the new architecture was strongly influenced by availability heuristics and is thus more rooted in a mistrust *vis-à-vis* (captured)<sup>18</sup> national supervisors than in the ambition to provide an integrative framework that optimizes effective transnational supervision. Against this background, it comes as no surprise that the SSM Regulation will be more con-

---

44. Only if ECB-oversight also inaugurated the option to recapitalize those banks that accumulated their losses under national supervision directly with funds from the European Stability Mechanism (ESM) or other supranational funds, could the SSM redound to calming markets: it has been argued that immediate mutualization of systemic risks allowed adequate provisioning of impaired assets, thus bought time for their value-preserving, post-crisis liquidation, and hence contributed to severing the bank-sovereign-link with its negative externalities Goyal et al., *supra* note 8, at 9-10, 20-21, 26. Others have proposed a clean and neat separation-scheme that contemplates mutualization only in the exceptional case of legacy liabilities exceeding a sovereign's capacity and under the precondition of clear cost-sharing agreements, Pisani-Ferry et al., *supra* note 6, 16, 17. Some commentators have voiced fierce criticism with regard to the introduction of common backstops, albeit without addressing the macro-economic issues and pointing *inter alia* to the perils of common funded, indirect monetary budgeted financing instead, Uwe H. Schneider, *Inconsistencies and unsolved Problems in the European Banking Union*, 24 EUR. J. BUS. L. 452, 453-4, 456-7 (2013).

<sup>16</sup> Goyal et al., *supra* note 8, at 22 acknowledge that an "incoherent banking union" could result in "an architecture that is inferior to the current national-based one." See also Pisani-Ferry et al., *supra* note 6, at 6 and *infra* 2.1.

<sup>17</sup> The trilogue between Parliament, Commission and Council led to a compromise (cf. Press Release, European Parliament Committee on Economic and Monetary Affairs, Banking Supervision Deal Struck by EP Negotiators and Irish Presidency (Mar. 19, 2013), *available at* <http://www.europarl.europa.eu/news/en/pressroom/content/20130318IPR06653/pdf>) that translated into Council Regulation 1024/2013, Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions, 2013 O.J. (L287) 63 (EU) [hereinafter: SSM Regulation] which was adopted by the Council on October 15, 2013 (Press Release, European Council, Council approves single supervisory mechanism for banking (Oct. 15, 2013), *available at* [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/139012.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/139012.pdf)).

<sup>18</sup> The concept describes how and when interest groups dominate regulatory decision processes Jean-Jacque Laffont & Jean Tirole, *The Politics of Government Decision Making: A Theory of Regulatory Capture*, 106 Q. J. ECON. 1089, (1991); with a particular view to banking regulators Daniel C. Hardy, *Regulatory Capture in Banking* (Int'l Monetary Fund, Working Paper No. 34, 2006), *available at* <http://www.imf.org/external/pubs/ft/wp/2006/wp0634.pdf>.

cerned with providing sharp tools to discipline reneging national authorities but may prove problematic when it comes to inducing optimal cooperation between the ECB and non-opportunistic national supervisors. Yet, the latter remains vastly essential for the proper functioning of the new supervisory framework and requires a careful fine-tuning of incentive structures within the SSM that may militate against effective decision-making procedures. Moreover, the ECB's position within the SSM creates a *de facto* standard-setter alongside the European Banking Authority (EBA). This observation carries the potential to countervail the goal of incrementally increasing the uniformity of actually observed supervisory practices in the E.U. as a critical component of the single market for financial services (*infra* 4). Finally, the reserved assessment is amplified once the attractiveness of the SSM is gauged from the vantage of non-euro area Member States who may thus abstain from joining the SSM although their participation is desirable to facilitate market integration in the E.U. (*infra* 5).

## 2 THE SUMMER OF 2012

It is long established that bank and sovereign debt crises constitute events that have the potential for mutual reinforcement.<sup>19</sup> Against this background the banking union was explicitly initiated as a tool to “break the vicious cycle between banks and sovereigns”.<sup>20</sup> However, its specific design is best understood if the actual triggering events are scrutinized more closely.<sup>21</sup>

### 2.1 THE DISINTEGRATION OF THE EMU AND THE RE-FRAGMENTATION OF THE INTERNAL MARKET FOR FINANCIAL SERVICES

In fact, it was the reoccurrence of mutually reinforcing twin crises that ultimately overrode the political resistance against a more incisive centralization in banking regulation and supervision.<sup>22</sup> The summer of 2012 saw increasing and per-

---

<sup>19</sup> GERMAN COUNCIL OF ECONOMIC ADVISORS, ANNUAL REPORT 2011/2012 (2011) 137-8, *available at* [http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/Sonstiges/chapter\\_four\\_2011.pdf](http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/Sonstiges/chapter_four_2011.pdf); Tobias H. Tröger, *Organizational Choices of Banks and the Effective Supervision of Transnational Financial Institutions*, 48 TEX. INT'L L.J. 178, 189-90 (2013). For empirical evidence from the euro area see Stefan Gerlach, Alexander Schulz & Guntram B. Wolff, *Banking and Sovereign Risk in the Euro Area* (Center for Econ. Pol'y Res., Discussion Paper No. 7833, 2010), *available at* <http://ssrn.com/abstract=1640355> who identify an aggregate risk factor sensitive to both bail-out likelihood/magnitude and fiscal strength as main determinant of sovereign spreads.

<sup>20</sup> Press Release, European Council, Euro Area Summit Statement (June 29, 2012), *available at* [http://consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131359.pdf](http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf).

<sup>21</sup> On the developments see also Elliot, *supra* note 8, at 6-7 who conceives the crisis as impetus “to overcome parochial interests and organize European banking more intelligently”, *ibid.*, p. 9.

<sup>22</sup> The E.U.'s immediate response to the shortcomings identified in the de Larosière Report as causal components in the run-up to the financial crisis of 2007 and 2008 had already lead to the creation of new supranational supervisory authorities. For critical assessments see Eddy Wymeersch, 'The Reforms of the European Financial Supervisory System', 7 EUR. COMPANY & FIN. L. REV. 240, 252-64 (2010); Niamh Moloney, *EU Financial Market Regulation After the Global Financial Crisis: More Europe' or More Risk?*, 47 COMMON MKT.

sistent sovereign and private sector imbalances as a sign of a critical disintegration of the EMU. Return spreads for euro area government bonds widened and money and capital market rates incrementally diverged across the euro area.<sup>23</sup> These developments encumbered the implementation of a uniform monetary policy within the EMU, as, for instance, slashes in monetary policy rates had little or no effect in certain Member States.<sup>24</sup> Banks' cost of doing business hinged partly upon their home Member State's fiscal strength and the consequential credibility of its backstops, thus establishing a pro-cyclical link between private and sovereign borrowing costs.<sup>25</sup>

This observable loss of a level playing field for the provision of financial services in the internal market could be attributed to the general deterioration of confidence in the viability of the banking sector that brought Member States' bail-out capacity to the fore.<sup>26</sup> Leaving immediate crisis containment aside,<sup>27</sup> the long-term counterstrategy to revamp trust in financial institutions in the steady state required *inter alia* no more than effective prudential supervision and an operable resolution regime that would impede future build-ups of risk concentrations apt to undermine systemic stability. Put differently, recent events in the euro area called for centralization only if and where the alternatives were *per se* less effective.<sup>28</sup> Clearly, tasking an institution on the supranational level that is entirely unseasoned in pertinent regard does not provide an argument in itself.<sup>29</sup>

---

L. REV. 1317, p. 1332-35, 1365-72 (2010); Guido Ferrarini & Filippo Chiodini, *Nationally Fragmented Supervision over Multinational Banks as a Source of Global Systemic Risk: a Critical Analysis of Recent EU Reforms*, in FINANCIAL REGULATION AND SUPERVISION: A POST-CRISIS ANALYSIS (Eddy Wymeersch, Klaus J. Hopt & Guido Ferrarini eds., 2012); Guido Ferrarini & Luigi Chiarella, *Common Supervision in the Eurozone: Strengths and Weaknesses* 26-37 (Eur. Corp. Governance Inst. Law Working Paper No. 223, 2013), available at <http://ssrn.com/abstract=2309897>; Gianni Lo Schiavo, From National Banking Supervision to a Centralized Model of Prudential Supervision in Europe, 21 MAASTRICHT J. EUR & COMP. L. 110, 114-8 (2014).

<sup>23</sup> European Central Bank, *Financial Integration in Europe*, 17-28, 31-35 (Apr., 2012), available at <http://www.ecb.eu/pub/pdf/other/financialintegrationineurope201204en.pdf>.

<sup>24</sup> For the ECB's assessment see European Central Bank, *Monetary and Fiscal Policy Interactions in a Monetary Union*, 7 MONTHLY BULLETIN 51 (2012), available at <http://www.ecb.eu/pub/pdf/mobu/mb201207en.pdf>. See also Goyal et al., *supra* note 8, at 6 figures 2 and 3; Jean Pisani-Ferry & Guntram B. Wolff, *Propping Up Europe?* 7-12 (Bruegel Pol'y Contribution No. 7, 2012) available at <http://www.bruegel.org/download/parent/721-propping-up-europe/file/1572-propping-up-europe/>.

<sup>25</sup> Goyal et al., *supra* note 8, at 7.

<sup>26</sup> Chiara Angeloni & Guntram B. Wolff, *Are Banks Affected by their Holdings of Government Debt?* (Bruegel Working Paper No. 7, 2012), available at <http://www.bruegel.org/download/parent/717-are-banks-affected-by-their-holdings-of-government-debt/file/1564-are-banks-affected-by-their-holdings-of-government-debt/>.

<sup>27</sup> See *infra* note 44.

<sup>28</sup> Schneider, *supra* note 15, at 454 argues that pushing Member States to "implement efficient banking supervision" would have been the "right answer" to current problems and predicts negative impacts of centralization for countries with (allegedly) efficient supervision.

<sup>29</sup> Eilis Ferran & Valia Babis, *The European Single Supervisory Mechanism*, 13 J. Corp. L. Stud. 255, 264 (2013) point to the ECB's missing track-record as a supervisor and conclude that there is „absolutely no guarantee that the ECB will do a better job in supervi-

It seems intuitive, though that the incrementally transnational character of contemporary banking should be traced by an equivalent supervisory architecture that minimizes negative cross-border externalities.<sup>30</sup> Cross-country comparisons, a broader information base, and the lower susceptibility to national preferences<sup>31</sup> could constrain the build-up of excessive risk concentrations in good times.<sup>32</sup> In times of crises, a transnational perspective would counter desires to cut foreign activities in order to stabilize the national banking system and would hence prevent the (re-)fragmentation of financial markets.<sup>33</sup>

However, the desirability of more centralization remained a matter of dispute among European politicians, not least because a banking union as a crisis response has to be designed carefully with regard to its long-term ramifications for pan-European institutions. Ultimately, resistance crumbled only in light of the revelations during the flaring Spanish and Cypriot banking crises.

## 2.2 THE SPANISH (AND CYPRIOT) BANKING CRISIS AS THE STRAW THAT BROKE THE CAMEL'S BACK

After the first rumors of a private sector participation in the efforts to reduce the Greek sovereign debt load to sustainable proportions had corrupted the confidence in the viability of the European banking sector in July 2011,<sup>34</sup> the EBA con-

---

sion than many national supervisors“. Wymeersch, *supra* note 9, at 6 notes that putting the ECB in charge of supervision does not yet save the European financial system. On the other hand Ferrarini & Chiarella, *supra* note 22, at 42, note 115 see ECB-involvement as an asset.

<sup>30</sup> Pisany-Ferry et al. (2012, p. 3-4); Goyal et al., *supra* note 8, at 7, 8, 14; with particular view to crisis management Ferrarini & Chiarella, *supra* note 22, at 6-19; for a general assessment of banks' risk-taking behavior under nationally fragmented supervision and resolution, Dirk Schoenmaker, *Banking Supervision and Resolution – the European Dimension* 6 L. & FIN. MARKETS REV.52, 53-4 (2012); DIRK SCHOENMAKER, GOVERNANCE OF INTERNATIONAL BANKING – THE FINANCIAL TRILEMMA 69-89 (2013).

<sup>31</sup> See also *infra* 3.3.2.

<sup>32</sup> Clearly though, informational advantages of a supranational supervisor only accrue with regard to banks with sizable cross-border operations, Pisani-Ferry et al., *supra* note 6, at 9. Of course, it is conceivable that parallel behavior and/or risk exposure of many small and medium sized, purely domestic institutions may pose systemic risks of wider proportions, André Sapir, Martin Hellwig & Marco Pagano, *A contribution from the Chair and Vice Chairs of the Advisory Scientific Committee to the discussion on the European Commission's banking union proposals*, 2 REPORTS OF THE SCIENTIFIC ADVISORY COMMITTEE, Oct. 2012, at 3, available at [http://www.esrb.europa.eu/pub/pdf/asc/Reports\\_ASC\\_2\\_1210.pdf?abc5e4da5bbceb4abc5e4da5bbceb47d6c17141baba12a5](http://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_2_1210.pdf?abc5e4da5bbceb4abc5e4da5bbceb47d6c17141baba12a5). Yet, such patterns can in principle also be identified by NCAs as the primary systemic risk occurs on domestic markets.

<sup>33</sup> See e.g. Rachel Epstein & Martin Rhodes, *International in Life, National in Death? Banking Nationalism on the Road to the Banking Union* 9-14 (Working Paper, April 2014) available at <http://www.ecpr.eu/Filestore/PaperProposal/ebcf60c9-0053-4f10-b60a-633a07c93e9e.pdf> who present anecdotal evidence how re-fragmentation of the Single Market for financial services was partly driven by national supervisors against banks' preferences. SSM Regulation, art. 1(1) indeed explicitly deems preserving „the unity and integrity of the internal market“ a core aim of the SSM. For a discussion of this systemic approach that does not cater directly to individual depositors' interests, Wymeersch, *supra* note 12, at 14.

<sup>34</sup> Tröger, *supra* note 19, at 190-1.

ducted *inter alia* a capital exercise to calm the markets. As a result, it gauged the overall need for additional own funds at the relevant Spanish banks at € 26.17 bn.<sup>35</sup> Yet, the burst of the bubble in the residential construction market in May 2012 revealed that then nationalized Bankia S.A., the nation's largest mortgage lender, needed to be bailed-out with a capital infusion of € 19 bn, after the Spanish government had converted an earlier € 4.5 bn rescue loan into voting stock.<sup>36</sup> Over time it was revealed that obscuring accounting practices (dynamic provisioning, a.k.a. "cookie jar-accounting")<sup>37</sup> and dubious pre-insolvency debt restructurings (liquidity management exercises)<sup>38</sup> that were at least tolerated by the competent supervisor (Bank of Spain) had helped to disguise a problem that smoldered for years and ultimately required a massive reorganization of the troubled parts of the banking sector. Euro area Member States provided additional funds of up to € 100 bn to back the bail-outs,<sup>39</sup> with an initial transfer of € 39.5 bn from the European Stability Mechanism (ESM) occurring in December 2012<sup>40</sup> and Spain's successful exit from the assistance program without further sizeable transfers in January 2014.<sup>41</sup>

It was the repeated pattern of insufficient and delayed information, the politically induced lax governance and oversight,<sup>42</sup> and the evident moral hazard problems<sup>43</sup> where an irresponsible national banking sector can rely on international aid<sup>44</sup>

---

<sup>35</sup> European Banking Authority, *The EBA Publishes Recommendation and Final Results of Bank Recapitalisation Plan as Part of Coordinated Measures to Restore Confidence in the Banking Sector* (Dec. 8, 2011), available at <http://www.eba.europa.eu/-/the-eba-publishes-recommendation-and-final-results-of-bank-recapitalisation-plan-as-part-of-coordinated-measures-to-restore-confidence-in-the-banking> [hereinafter European Banking Authority, *Recommendation & Final Results*].

<sup>36</sup> Christopher Bjork & Jonathan House, *Spain Moves to Rescue Bankia*, WALL ST. J. (Online), May 9, 2012, <http://online.wsj.com/article/SB10001424052702304070304577394220289946192.html#>; Tommy Stubbington & David Roman, *Bankia Bailout Hits Spanish Bonds*, WALL ST. J. (Online), May 28, 2012, <http://online.wsj.com/article/SB10001424052702303807404577431784097492256.html>.

<sup>37</sup> For a critical review of these accounting practices, Fiona Mann & Ian Michael, *Dynamic Provisioning: Issues and Applications*, in 2002 FIN. STABILITY REV. 128, p. 133, available at <http://www.bankofengland.co.uk/archive/Documents/historicpubs/fsr/2002/fsr13art6.pdf>.

<sup>38</sup> For a detailed description of the events at Bankia, Hans-Joachim Dübel, *The Capital Structure of Banks and Practice of Bank Restructuring* 22 – 31 (Center for Fin. Stud., Working Paper No. 04, 2013), available at [https://www.ifk-cfs.de/fileadmin/downloads/publications/wp/2013/CFS\\_WP\\_2013-4.pdf](https://www.ifk-cfs.de/fileadmin/downloads/publications/wp/2013/CFS_WP_2013-4.pdf).

<sup>39</sup> Charles Forelle & Gabriele Steinhauser, *Latest Europe Rescue Aims to Prop up Spain*, WALL ST. J., Jun. 11, 2012, at A1; Sara Schaeffer Muñoz, David Enrich & Christopher Bjork, *Madrid's Handling of Bankia Repeats a Pattern of Denial*, WALL ST. J., June 11, 2012, at A1.

<sup>40</sup> Art Patnaude, *ESM Issues Debt for Spanish Bank Recapitalization*, WALL ST. J. (Online), Dec. 5, 2012, <http://online.wsj.com/article/SB10001424127887324640104578160753000745828.html#>.

<sup>41</sup> European Commission, *Post-programme surveillance for Spain*, [http://ec.europa.eu/economy\\_finance/assistance\\_eu\\_ms/spain/](http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/).

<sup>42</sup> *The Bankia Disaster*, WALL ST. J. (Online), Jan. 1, 2013, <http://online.wsj.com/article/SB10001424127887323320404578215392185006694.html>.

<sup>43</sup> Goyal et al., *supra* note 8, at 12.

that ultimately generated the political will to initiate a banking union among the euro area Member States at the end of June 2012.<sup>45</sup> However, the outcome of the legislative process establishing the banking union's first pillar is not the comprehensive supranationalization of prudential supervision that was consistently endorsed by the Commission.<sup>46</sup> The political compromise for the SSM institutes the ECB as the *de iure* supreme overseer but relies *de facto* on NCAs to do the bulk of the daily supervisory work. In line with the incidents that eventually brought forth the SSM, the ECB will be more of a whipper-in for national supervisors than an operationally autonomous, supranational watchdog. The SSM is thus based on the premise that NCAs can't be trusted and that the most pressing problem in designing an effective supervisory architecture lies in overcoming the forbearance NCAs may show *vis-à-vis* national champions ("home bias").

The following part of this paper will make this point in more detail. It thus prepares the ground for an assessment of the SSM's probable operability and provides guidance for fine tuning some of its key features.

### 3 DISTRIBUTION OF COMPETENCES WITHIN THE SSM AND BEYOND

The institutional innovation brought by the SSM can be best understood if compared to the general European supervisory architecture. Financial institutions today typically operate across national borders.<sup>47</sup> As a consequence, their supervision

---

<sup>44</sup> It is an unresolved issue, how "legacy assets" will be treated once the SSM commences its operational activities. SSM Regulation, art. 33(4), prescribes an entrance exam in which the ECB currently assesses those banks' balance sheets that will henceforth fall under its direct supervision, cf. ECB, *Note Comprehensive Assessment October 2013*, <https://www.ecb.europa.eu/pub/pdf/other/notecomprehensiveassessment201310en.pdf>. However, despite the acknowledged urgent case for transparency, *ibid*, at 10-11; Pisani-Ferry et al., *supra* note 6, at 15, 16, it is unclear how those risks that have been incurred under national supervision, will be eliminated or hedged once the ECB has uncovered them. The Council's pledge that national backstops will be in place, Press Release, European Council, Conclusions, at 10 (June 26, 2013) [http://europa.eu/rapid/press-release\\_DOC-13-5\\_en.pdf](http://europa.eu/rapid/press-release_DOC-13-5_en.pdf), doesn't help much where Member States budgets are strained.

<sup>45</sup> European Council, *supra* note 20.

<sup>46</sup> *Commission Communication, Action for Stability, Growth and Jobs*, at 5, COM (2012) 299 final (May 30, 2012), available at [http://ec.europa.eu/europe2020/pdf/nd/eccomm2012\\_en.pdf](http://ec.europa.eu/europe2020/pdf/nd/eccomm2012_en.pdf). Accordingly, the explanatory memorandum of the *Commission Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions*, at 5, COM (2012) 511 final (Sept. 12, 2012) [hereinafter: *Commission Proposal SSM Regulation*] stated: "One of the key elements of the banking union should be a Single Supervisory Mechanism (SSM) with direct oversight of banks, to enforce prudential rules in a strict and impartial manner and perform effective oversight of cross border banking markets."

<sup>47</sup> On the efficiency rationale Michael H. Moskow, *Cross-Border Banking: Forces Driving Change and Resulting Regulatory Challenges*, in *CROSS-BORDER BANKING: REGULATORY CHALLENGES* 4-5 (Gerard Caprio, Jr., Douglas D. Evanoff & George G. Kaufman eds., 2006); Jonathan Fiechter et al., *Subsidiaries or Branches: Does One Size Fit All?* 5 (Int'l Monetary Fund Staff Discussion Note No. 4, 2011), available at <http://www.imf.org/external/pubs/ft/sdn/2011/sdn1104.pdf>. For evidence on the potentially positive effects of internal capital markets in cross-border banking groups see also Ralph

raises specific challenges as sovereign authorities are bound to exchange information and cooperate closely. In the E.U. context, Member States banking laws that distribute competences among NCAs in cross-border scenarios are profoundly harmonized and accept some centralized decision-making power of the EBA (*infra* 3.1). For the euro area the SSM constitutes an island solution because it provides a degree of centralization on the supranational level unavailable elsewhere. Yet, even within the SSM NCAs will retain critical tasks in day-to-day supervision (*infra* 3.2). Hence, the overall assessment of the new regime turns out rather skeptical: the SSM is pervaded with cooperative elements in an essentially non-cooperative game without paying close attention to the acting public officers', i.e. bureaucrats' affirmative incentives that could induce much needed voluntary contribution. It relies instead heavily on strong sanctioning powers. The direly needed elements to ameliorate the incentive structures partly contradict effective decision-making procedures (*infra* 3.3).

### 3.1 SHARED RESPONSIBILITIES IN CROSS-BORDER SUPERVISION

As table 1 indicates, the reformed CRD IV/CRR-framework for the prudential supervision of European banks<sup>48</sup> relies on responsibilities shared between host and home Member States<sup>49</sup> with a limited, albeit buttressed role for the EBA that has gained momentum to settle—upon reference from a dissenting NCA—disputes that arise among home and host Member States' supervisors.<sup>50</sup> Moreover, the regime still

---

Haas & Imam van Lelyveld, *Internal Capital Markets and Lending by Multinational Bank Subsidiaries*, 19 J. FIN. INTERMEDIATION, 1, (2010); Martijn K.J. Cremers, Rocco Huang & Zacharias Sautner, *Internal Capital Markets and Corporate Politics in a Banking Group*, 24 REV. FIN. STUD. 358 (2011).

<sup>48</sup> The pertinent European rules on prudential supervision cover mainly deposit-taking credit institutions (CRR, art. 4(1)(1)) and investment firms (CRR, art. 4(1)(2)) and European Parliament and Council Directive 2004/39 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC, art. 4(1)(1), 2004 O.J. (L 145) 1 (EC) [hereinafter: MiFID]), yet only the authorization of credit institutions, cf. CRD IV, arts. 8, 49. With regard to their banking affiliates financial holding companies (CRR, art. 4(1)(20)), mixed financial holding companies (CRR, art. 4(1)(21)) and mixed-activity holding companies (CRR, art. 4(1)(22)) are included in consolidated supervision, cf. CRD IV, arts. 119 et seq. Financial firms that are included in national prudential bank regulation and supervision remain outside the E.U.'s regulatory grip.

<sup>49</sup> CRD IV, art. 3(1) subpara. 39, CRR, art. 4(1) subpara. 43 define the home Member State as that in which a financial institution was authorized. CRD IV, art. 3(1) subpara. 40, CRR, art. 4(1) subpara. 44 define the host Member State as that in which a financial institution has branches or provides services. Hence, strictly speaking, the home/host-terminology is restricted to branch-structures. Under a subsidiary-structure the (host) supervisor responsible for the incorporated group-affiliates is referred to as "competent authority" whereas the (home) supervisor is termed "consolidating supervisor", cf. *e.g.* CRD IV, art. 112. For simplicity, the home/host-terminology is used in a broader sense here and also encompasses Member States home to a parent institution and Member States hosting their subsidiaries.

<sup>50</sup> The EBA upon reference of disputes between home and host supervisors may ultimately compel NCAs to take specific actions/refrain from such actions *see* European Parliament and Council Regulation 1093/2010 Establishing a European Supervisory Authority (European Banking Authority), Amending Decision No 716/2009/EC and Repealing Commission Decision 2009/78/EC, art. 19, 2010 O.J. (L 331) 12 (EU) [hereinafter: EBA Regulation].

depends critically on banks' organizational choices, to wit, whether they conduct their foreign activities through a branch<sup>51</sup> (legally dependent satellite) or a subsidiary<sup>52</sup> (legally independent affiliate).<sup>53</sup>

	<b>Home Member State</b>	<b>Host Member State</b>	<b>EBA</b>
<b>Subsidiary Structure</b>	Authorization and supervision of parent, CRD IV, arts. 8(1), 49(1) Consolidating supervision of group, CRD IV arts. 49(2), 111(1)	Authorization and supervision of legally independent subsidiaries in cooperation with consolidating supervisor (parent home Member State authority), CRD IV arts. 8(1), 49(1), 112(1) Participation in consolidating supervision, CRD IV art. 113(1)(2)	Binding decision if (i) consolidating or host supervisor fail to carry out duties, CRD IV 112(2) (ii) consolidating and host supervisor cannot settle dispute, art. 113(3) CRD IV
<b>Branch Structure</b>	Authorization and supervision of bank, including foreign activities (onsite investigations, etc.), CRD IV art. 49(1), 33, 41(1), 52	No authorization (E.U. passport), CRD IV art. 17 Supervision of liquidity endowment in cooperation with home supervisor, CRD IV arts. 156, 50 (2)(3) Closer cooperation, particularly with regard to liquidity risks, with home supervisor if branch is significant, CRD IV art. 51(2)	Binding decision if (i) home supervisor does not ensure banks' compliance with CRD IV/CRR, CRD IV, art. 41(2) (ii) host supervisor seeks to take measures opposed by home supervisor, CRD IV art. 50(4) (iii) home supervisor does not take operational steps required by CRD IV art. 86(11), CRD IV art. 51(2)

**table 1** - home-/host Member State competence and cooperation under CRD IV/CRR-framework

This regime will remain unaltered with regard to all banks established outside the euro area, including those chartered in E.U. Member States that do not expressly opt-in to the SSM.<sup>54</sup> In fact, in relation to non-participating Member States (and third countries) the ECB will only assume the role of host/home authority for branches and subsidiaries in the (consolidated) supervision of transnational banks

<sup>51</sup> CRR, art. 4(1)(17).

<sup>52</sup> CRR, art. 4(1)(16) and Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, art. 1, 1983 O.J. (L 193) 1.

<sup>53</sup> For a detailed description of the pre-CRD IV/CRR legal framework (European Parliament and Council Directive 2006/48 Relating to the Taking Up and Pursuit of the Business of Credit Institutions, 2006 O.J. (L 177) 1 (EU) [hereinafter Banking Directive]) with particular regard to this pivotal distinction, *see* Tröger, *supra* note 19, at 202-13.

<sup>54</sup> SSM Regulation, art. 2(1). For the preconditions under which a "close cooperation between the ECB and the national competent authority" can be established for the prudential supervision none-euro area banks within the SSM *see id.*, art. 7(2) and *infra* 5.1.



under CRD IV/CRR, SSM Regulation, arts. 17, 4(1)(b), 4(1)(f), and 4(2).<sup>55</sup> It will carry relatively more weight in colleges of supervisors as it will represent a more sizeable portion of the transnational group.<sup>56</sup>

Even though common supervision in the euro area by its very nature can only have a limited reach, the SSM could have at least provided for an island-solution that abolished both the distinction between branch/subsidiary-structures and the friction-prone cooperative elements. Yet, the SSM does neither level the differences entirely that arise from banks' organizational choices, nor adhere to a strong model of supranational centralization<sup>57</sup> that would expulse NCAs entirely from performing critical functions in prudential supervision.

## 3.2 THE SSM

In order to predict the effectiveness of the evolving regime and identify the mechanics that will prove important when it comes to fine-tuning the supervisory apparatus, this part scrutinizes relevant features of the SSM. With regard to supervision in the euro area, the ECB will become the predominant institution vested with broad powers to determine and oversee supervisory practices (infra 3.2.1). Yet, in day-to-day operations it will also depend in important respect on the input and commitment of NCAs (infra 3.2.2).<sup>58</sup> Furthermore, the ECB's power to shape supervisory practices cannot override the substantive differences in prudential regulation that continues to hinge on whether cross-border banking groups' operate through branches or subsidiaries and thus draws on a distinction that is partly unaligned with actual risk structures (infra 3.2.3).

### 3.2.1 THE ECB'S ROLE IN PRUDENTIAL SUPERVISION

The compelling advantage of tasking the ECB with supervisory obligations is that it rests on a relatively sound constitutional basis in the founding Treaty.<sup>59</sup> Moreover, vesting supervisory competences and powers with the ECB, instead of another supranational authority, will arguably create synergies with its mandate for monetary policy and lender of last resort duties within the Eurosystem.<sup>60</sup> Yet, this is

<sup>55</sup> *Infra* 3.2.3.

<sup>56</sup> Wymeersch, *supra* note 12, at 25.

<sup>57</sup> Ferrarini & Chiarella, *supra* note 22, at 20-1, 50-60.

<sup>58</sup> The institutional structure of the SSM resembles that of the Eurosystem that consists of the ECB and national central banks (NCBs) of those Member States whose currency is the euro.

<sup>59</sup> Treaty on the Functioning of the European Union, art. 127(6), Mar. 30, 2010, 2010 O.J. (C 83) 47 [hereinafter: TFEU], Wymeersch, *supra* note 12, at 6-7, 8-9; Ferran & Babis, *supra* note 29, at 256; but see also Jacopo Carmassi, Carmine Di Noia, & Stefano Micossi, *Banking Union: A federal model for the European Union with prompt corrective action* 3 – 4 (Center for Eur. Pol'y Stud., Policy Brief No. 282), available at <http://www.ceps.eu/ceps/dld/7308/pdf>; Wymeersch, *supra* note 12, at 24 who challenge the SSM's openness to non-euro area Member States on legal grounds.

<sup>60</sup> Pisani-Ferry et al., *supra* note 6, at 11; Goyal et al., *supra* note 8, at 14. It has to be noted though, that emergency liquidity assistance (ELA) as a non-specified function of a central bank will remain sourced through national central banks on their own responsibility

ambivalent, as the ECB's dual mandate is also a source for difficult policy trade-offs (*infra* 6) that account for convoluted governance arrangements (*infra* 3.3.2.1).

From the outset, the SSM should not, and will not, cover all institutions subject to prudential regulation and supervision under CRD IV/CRR.<sup>61</sup> Despite the significantly broader scope of TFEU art. 127(6) that also pertains to financial institutions,<sup>62</sup> SSM supervision will be limited to credit institutions as defined in E.U. legislation.<sup>63</sup> Furthermore, even those credit institutions' activities not covered by supra-national prudential regulation will not fall within the remit of the SSM.<sup>64</sup> This contradicts lessons from the financial crisis of 2007/08 that exposed risks for financial stability that reside outside the traditional banking sector<sup>65</sup> which led both the U.S. and the U.K. to more encompassing and flexible approaches in prudential supervision.<sup>66</sup> The SSM's constriction to deposit taking institutions may in part be attributed to the fact that it is primarily geared towards intercepting the European feedback loop between banks and sovereigns. The broader agenda of implementing a regulatory framework for sustainable finance that is attuned to the lessons of the global financial crisis is pursued in parallel and may correct some of the current architecture's shortcomings.<sup>67</sup>

---

and liability, *cf.* Protocol (No. 4) on the Statute of the European System of Central Banks and of the European Central Bank, art. 14(4), 2012 O.J. (C 326) 320 [hereinafter: ESCB and ECB Statute].

<sup>61</sup> *Supra* note 48. For a critical view Stijn Verhelst, *The European Single Supervisory Mechanism: A Sound First Step in Europe's Banking Union?* 15 (Egmont Royal Inst. for Int'l Rel., Working Paper, Mar. 2013), available at <http://www.egmontinstitute.be/papers/13/eur/Single%20Supervisory%20Mechanism.pdf>.

<sup>62</sup> Although secondary legislation cannot bind the interpretation of the TFEU, it is indicative that CRR, art. 4(1) subpara. 26 defines the latter as "undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the" banking activities listed in CRD IV, Annex I, points 2 to 12 and 15.

<sup>63</sup> SSM Regulation, art. 1 subpara. 2. Commentators have pointed to possible tensions in consolidated supervision where the remit of national prudential banking regulation also encompasses, for instance non-deposit taking institutions that grant credit, Wymeersch, *supra* note 12, at 5; Schneider, *supra* note 15, at 455.

<sup>64</sup> E.g. activities as central counterparties are explicitly exempt, SSM Regulation, art. 1 subpara. 2.

<sup>65</sup> Gary Gorton, *The Panic of 2007*, in MAINTAINING STABILITY IN A CHANGING FINANCIAL SYSTEM 131-262 (The Federal Reserve Bank of Kansas City ed., 2009); Gary Gorton, *Information, Liquidity, and the (Ongoing) Panic of 2007*, 99 AM. ECON. REV., PAPERS & PROC. 567-72 (2009); Tobias Adrian & Adam B. Ashcraft, *Shadow Banking Regulation* 10-26 (Fed. Res. of N.Y. Staff Reports No. 559, 2012) available at [http://www.newyorkfed.org/research/staff\\_reports/sr559.pdf](http://www.newyorkfed.org/research/staff_reports/sr559.pdf); Gary Gorton & Andrew Metrick, *Securitized Banking and the Run on Repo*, 104 J. Fin. Econ. 425-51 (2012).

<sup>66</sup> Ferran & Babis, *supra* note 29, at 259; see also Wymeersch, *supra* note 12, at 17-8.

<sup>67</sup> For the initiatives regarding the shadow banking sector see European Commission, *Green Paper Shadow Banking*, COM (2012) 102 final (Mar. 19, 2012), available at [http://ec.europa.eu/internal\\_market/bank/docs/shadow/green-paper\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf); European Commission, *Communication to the Council and the European Parliament, Shadow Banking – Addressing New Sources of Risk in the Financial Sector*, COM (2013) 604 final (Sept. 4, 2013), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0614:FIN:EN:PDF>.

Originally, the Commission intended to establish the ECB as an omnipotent supranational watchdog at least for euro area credit institutions. According to the Commission's concept, the ECB should be in charge of all the major tasks in prudential supervision, *i.e.* licensing and authorizing credit institutions, ensuring compliance with own funds requirements etc., monitoring internal capital adequacy assessment processes, verifying internal governance arrangements,<sup>68</sup> stress-testing etc.<sup>69</sup> with regard to all euro area banks. However, it was clear from the outset that the ECB would be in no position to brave the gargantuan challenge of supervising the more than 6.000 banks in the euro area on a stand-alone basis.<sup>70</sup> Instead, the Commission Proposal acknowledged that "within the SSM national supervisors are in many cases best placed to carry out such activities, due to their knowledge of national, regional and local banking markets, their significant existing resources and to locational and language considerations, and therefore enable[d] the ECB to rely on national authorities to a significant extent."<sup>71</sup> Yet, with the ECB's pervasive power to issue instructions *vis-à-vis* national competent authorities,<sup>72</sup> the latter were basically relegated to providing auxiliary assistance,<sup>73</sup> policing money laundering prohibitions, and enforcing consumer protections.<sup>74</sup>

During the legislative process the ECB's role in direct supervision was confined to the euro area's most important financial institutions (table 2) and a stronger role for participating Member States' competent authorities within the SSM was re-installed under a "hub and spokes"-arrangement for less significant banks.<sup>75</sup>

---

<sup>68</sup> Sapir, Hellwig & Pagano, *supra* note 32, at 4 have argued that vesting the competence to supervise banks' internal governance structures will be critical for the SSM's overall effectiveness.

<sup>69</sup> *Commission Proposal SSM Regulation*, art. 4(1). Wymeersch, *supra* note 12, at 15 alludes to confusion if "matters will show up ... that are not in the remit of the ECB". However, supervisory responsibilities and related powers not explicitly conferred on the ECB remain at NCAs, *SSM Regulation*, art. 1(5), and arguably do not require centralization. *E contrario*, where supervisory responsibilities are indeed conferred on the ECB, no such responsibilities and related powers under national law persist in parallel. Overlapping or duplicated competences, as assumed by Ferran & Babis, *supra* note 29, at 266, cannot occur as a matter of law, although disputes over the precise delineation of competences can certainly arise in practice. *See also infra* 3.3.1.2. Moreover, as a consequence, significant banks will have to deal with oversight from both the ECB (for the supervisory tasks falling in the remit of the SSM) and NCAs (for the remaining tasks), Schneider, *supra* note 15, at 455.

<sup>70</sup> But *see also* Goyal et al., *supra* note 8, at 12 arguing that a banking union should aim at supranational supervision of *all* banks, "regardless of size, complexity and cross-border reach"; for an assessment that advocates the centralized definition of baselines but allows differences in "size, activity and business model" to be accounted for in supervisory practices and competences Wymeersch, *supra* note 12, at 17.

<sup>71</sup> *Commission Proposal SSM Regulation*, Explanatory Memorandum, at 5.

<sup>72</sup> *Commission Proposal SSM Regulation*, art. 5(4).

<sup>73</sup> For a detailed description cf. Wymeersch, *supra* note 12, at 13-4.

<sup>74</sup> *Commission Proposal SSM Regulation*, recital 22; Ferran & Babis, *supra* note 29, at 264-5. Wymeersch, *supra* note 12, at 5, 15-6 points to overlaps where aiding and abetting money laundering or pervasive misselling may imperil confidence in a bank.

<sup>75</sup> For a detailed description *see* Wymeersch, *supra* note 9, at 28-32; Gunnar Schuster, *The Banking Supervisory Competences and Powers of the ECB*, 25 EUR. J. BUS. L., SPECIAL ISSUE 3, 4-6 (2014); Klaus Lackhoff, *Which Credit Institutions will be supervised by the*

<b>characterization of financial institution</b>	<b>SSM Regulation</b>	<b>Precondition for direct ECB supervisory competence</b>
significant	art. 6(4) subpara. 5	participating Member States' three largest banks
significant	art. 6(4) subpara. 2	(alternatively) bank's <ul style="list-style-type: none"> <li>i. large size (presumed if total assets &gt; € 30 bn)</li> <li>ii. importance for EU/Member State's economy (presumed if total assets to GDP-ratio &gt; 20% and total assets &gt; € 5 bn)</li> <li>iii. ECB confirmation of participating Member State notification indicating significance for domestic economy</li> </ul>
significant	art. 6(4) subpara. 3	ECB decision if bank has subsidiaries in at least two participating Member States and substantial cross-border activities (foreign to total assets/liability ratio)
significant	art. 6(4) subpara. 4	direct EFSF/ESM recapitalization
less significant	art. 6(5)(b)	ECB decision after consultation/on request of NCA if insufficient oversight (particularly, in case of indirect EFSF/ESM recapitalization)

**table 2** – direct ECB supervisory competence according to SSM Regulation

Table 2 indicates that the rather nested manner in which the SSM Regulation distributes the supervisory competences within the SSM should not blur the ECB's considerable pull as the primary supervisor: 121 top financial institutions that, according to slightly overstating preliminary estimates, account for 80 to 91% of the assets held by the industry in the euro area will fall under direct ECB supervision.<sup>76</sup> It is important to note that the relevant criteria have to be applied at the highest level of consolidation, *i.e.* subsidiaries of a significant parent institution are automatically regarded as significant themselves and will thus fall indiscriminately under direct ECB supervision.<sup>77</sup>

It is a consequence of the sub-optimally coordinated phasing-in of the banking union in a rugged political process that the adequacy of the criteria applied to categorize banks (table 2) cannot be judged conclusively by analyzing the SSM alone. The policy considerations that should drive the decision which banks to include in direct supranational oversight are largely dependent on the function and

---

*Single Supervisory Mechanism*, 28 J. INT'L BANKING L. & REG. 454 (2013); Lo Schiavo, *supra* note 22 at 126-30, 131-2.

<sup>76</sup> European Central Bank, *List Of Supervised Entities Notified Of The ECB's Intention To Consider Them Significant*, June 26, 2014, available at <https://www.ecb.europa.eu/ssm/pdf/SSM-listofdirectlysupervisedinstitutions.en.pdf?6dfe13ea9224b4f2f313c8c9dd05bc96>; for estimates of total assets based on the assumption that up to 180 banks would fall within the ambit of ECB supervision *cf.* Guntram B. Wolff & Carlos De Sousa, *A Banking Union of 180 or 91%?*, BRUEGEL BLOG (Dec. 13, 2012), <http://www.bruegel.org/nc/blog/detail/article/965-a-banking-union-of-180-or-91-percent/>; Goyal et al., *supra* note 8, at 15.

<sup>77</sup> SSM Regulation, art. 6(4) subpara. 1. *See also infra* 3.2.3.

design of the other institutions of a banking union (resolution regime, deposit insurance, backstops).<sup>78</sup> Yet, it should be noted that the relevant criteria do not necessarily link direct ECB oversight to a bank's significant cross-border operations, *i.e.* do not align it with comparative informational advantages a supranational supervisor necessarily has (*supra* 2.1), although of course, size can be regarded as a rough proxy for transnational operations and interconnectedness.

For all less significant banks, the system of NCAs' shared responsibilities in prudential supervision under CRR/CRD IV (table 1) in principle remains untouched within the SSM.<sup>79</sup> Notably, both the authorization of credit institutions and the assessment of notifications of acquisitions and disposals of qualified holdings is conferred on the ECB regardless of an applicant's or target's significance.<sup>80</sup> Similarly, the ECB, as a consequence of its mandate and expertise in financial stability issues, will have the power to deploy macro prudential tools (capital buffers) with regard to all euro area banks even against NCAs' objections.<sup>81</sup>

However, even where no primary ECB-competence is established, ECB-coordination and oversight is supposed to ensure enhanced consistency and integration of supervisory practices, *i.e.* in relation to the NCAs the ECB shall safeguard the implementation of the supervisory approach that it observes in direct supervision.<sup>82</sup> To that end, the ECB will be empowered to issue regulations, guidelines, or general instructions to NCAs.<sup>83</sup> Hence, it will have extraordinary clout to shape NCAs' actual supervisory practices in great detail.<sup>84</sup> The ECB-formulated framework will compel NCAs to notify the ECB in advance of any material supervisory procedure, further assess these procedures if the ECB so requests, and forward draft supervisory deci-

---

<sup>78</sup> For a discussion *see* Pisani-Ferry et al., *supra* note 6, at 9-10.

<sup>79</sup> SSM Regulation, art. 6(6).

<sup>80</sup> SSM Regulation, arts. 4(1)(a) and (c), 6(6). The ECB will grant bank licenses as proposed by NCAs in a "no objection" procedure, SSM Regulation, art. 14(2). It can withdraw authorizations on a proposal from the NCA or on its own initiative, SSM Regulation, art. 14(5). In the latter case, as long as no SRM is in operation, NCAs can object to the ECB withdrawal-decision if a delay is necessary to orderly resolve the institution or/and maintain financial stability, SSM Regulation, art. 14(6). Similarly, the ECB ultimately decides on whether to oppose a share acquisition after an extensive review by NCAs on the grounds of their proposal, SSM Regulation, art. 15. For a detailed description of the ECBs supervisory powers *see* Wymeersch, *supra* note 9, at 45-6.

<sup>81</sup> SSM Regulation, art. 5(2), (4). For a critical assessment of such a centralization that contradicts NCAs' idiosyncratic expertise in judging local markets, Véron, *supra* note 6, at 6. The concerns that the ECB may henceforth assume an even more dominant position within the decision making process of the European Systemic Risk Board (ESRB), Ferran & Babis, *supra* note 29, at 282-3, are unrelated to the ECB's macroprudential tools as they simply follow from the ECB's position in the ESRB's General Board and participating Member States' NCAs' plausible tendency to follow the ECB in lockstep once the SSM is operable (*see also infra* 4.2).

<sup>82</sup> Ferran & Babis, *supra* note 29, at 264.

<sup>83</sup> SSM Regulation, art. 6(5)(a).

<sup>84</sup> Ferran & Babis, *supra* note 29, at 265 observe that if the ECB-defined framework takes the form of "prescriptive supervisory rules" it will annul most of the leeway to supervise in a judgment-led manner that accounts for local idiosyncrasies.

sions for comments to the ECB.<sup>85</sup> As a matter of law, the ECB will thus be able to control and influence supervisory practices virtually at the grass-roots level. Moreover, it will have to make exhaustive use of these competences, as monitoring of the SSM's proper operation will be one of the core tasks conferred on the ECB under TFEU art. 127(6).<sup>86</sup> To facilitate this assignment, the ECB can not only react to *ex ante*-approaches from NCAs, but also proactively request information concerning the performance of their supervisory tasks.<sup>87</sup> Furthermore, it can verify or complement the information received by using its investigatory powers *vis-à-vis* euro area banks that allow *inter alia* information requests, general investigations, offsite diligence and (judicially authorized) onsite inspections.<sup>88</sup>

Finally, NCAs will also be coerced to cautiously maneuver within the ECB-set framework for the prudential supervision of the euro area's less significant banks, as they will face the permanent and pervasive threat of being ousted as competent supervisor by the ECB. SSM Regulation art. 6(5)(b) vests power with the ECB to assume at any time on its own initiative the competence to directly supervise less significant banks if their supervision falls short of the consistent high supervisory standards the SSM is supposed to adhere to, particularly where these institutions benefit from indirect recapitalizations with funds from supranational coffers.<sup>89</sup> Of course, this may prove an empty threat if the ECB does not have sufficient resources at its disposal that enable it to actually supplant ailing NCAs and take over all their tasks immediately.<sup>90</sup> Yet, neglecting shaky banks' monetary restrictions, at least retrieving the pertinent costs will be possible: The ECB will levy cost-covering annual fees from supervised credit institutions<sup>91</sup> and can thus recover expenditures incurred from preempting a NCA in the supervision of less significant banks.

Yet, the pertinent feature of the legal set-up adds to the overall picture that sees the ECB as the sole guarantor of the consistent, impartial and stringent supervision of euro area financial institutions and exhibits a general mistrust towards NCAs as a direct function of the events that brought about the sweeping institutional reforms (*supra* 2.2). In sum, the ECB as the SSM's primary supervisor will be provided with heavy sticks, yet the carrots for NCAs seems missing.

---

<sup>85</sup> SSM Regulation, art. 6(7)(c).

<sup>86</sup> SSM Regulation art. 6(5)(c).

<sup>87</sup> SSM Regulation art. 6(5)(e).

<sup>88</sup> SSM Regulation, arts. 6(5)(d), 10-13. For a detailed description of the ECBs supervisory powers see Wymeersch, *supra* note 9, at 42-4.

<sup>89</sup> The wording of SSM Regulation, art. 6(5)(b) could be interpreted as empowering the ECB to exercise supervisory powers in individual incidents. Yet, to ensure the proper functioning of the SSM where NCAs are in charge, the ECB already can rely on its right to instruct NCAs to make use of their powers under national law, SSM Regulation, art. 9(1) subpara. 3 (*infra* 3.2.2). Hence, the provision should be read as a broad power and obligation to preempt NCAs completely. For a similar view Wymeersch, *supra* note 9, at 33.

<sup>90</sup> According to SSM Regulation, art. 28, the ECB will be responsible for devoting the necessary financial and human resources to exercise its supervisory functions. With regard to SSM Regulation, art. 6(5)(b) this could mean that the ECB has to hold available *inter alia* a buffer of qualified personnel that enables it to take over the supervision of less significant banks without delay that would otherwise result from hiring ad hoc.

<sup>91</sup> SSM Regulation, art. 30.

### 3.2.2 INTERPLAY WITH NCAs

Even though the humongous challenge the Commission's proposal of direct ECB supervision of all euro area banks (*supra* 3.2.1) would have meant has been superseded by a more modest concept, the sizeable responsibilities conferred on the ECB suggest that much of the supervisory legwork will have to be performed "close to the ground". It is at least comprehensible that the novel supervisory architecture seeks to integrate NCAs in order to capitalize on their knowledge of national, regional and local banking markets, their longstanding expertise particularly with regard to the interpretation and application of (harmonized) national banking regulation,<sup>92</sup> and their advantages with regard to location and language-skills. As a consequence, the ECB is tasked with devising a general "framework to organise the practical modalities" of the interplay between itself and the NCAs not only with regard to the supervision of less significant institutions (*supra* 3.2.1) but also with regard to that of the euro area's biggest banks that fall under its direct oversight.<sup>93</sup> Yet, first and foremost, NCAs will also be tightly involved in the supervision of significant institutions, starting with uncovering the factual basis for various ad hoc or ongoing supervisory measures (e.g. onsite-verifications, evaluation of internal risk models),<sup>94</sup> up to and including drafting decisions for the ECB.<sup>95</sup> Moreover, the ECB will have to rely on NCAs when it comes to enforcing prudential regulation as it can impose administrative sanctions autonomously only if banks breach directly applicable E.U.-law,<sup>96</sup> *i.e.* violate regulations (TFEU art. 288(2)), but can only require NCAs to open proceedings if banks violate (harmonized) national law thereby coercing reluctant NCAs into quasi-representative actions.<sup>97</sup>

---

<sup>92</sup> See also *infra* 3.3.1.1.

<sup>93</sup> SSM Regulation, art. 6(7). This general framework has recently been adopted, *cf.* European Central Bank Regulation 468/2014 establishing the Framework for Cooperation within the Single Supervisory Mechanism between the European Central Bank and National Competent Authorities and with National Designated Authorities [hereinafter: SSM-Framework Regulation], 2014 O.J. (L 141) 1. For an overview see *Klaus Lackhoff, The Framework Regulation for the Single Supervisory Mechanism (SSM) – An Overview*, 29 J INT'L BANKING L. & REG. 498 (2014).

<sup>94</sup> It is this involvement of NCAs which – if it was effective – could largely mute concerns that ECB supervision would be "too distant", *cf.* Schneider, *supra* note 15, at 454.

<sup>95</sup> SSM Regulation, art. 6(7)(b). The literature has voiced concerns that even tasking NCAs with preparatory work for ECB supervisory decisions may constitute an impermissible delegation of discretionary powers, Ferran & Babis, *supra* note 29, at 265 pointing to ECJ Case C-9/56, *Meroni v. High Authority*, 1958 E.C.R. 133. Yet, this seems debatable; for a very generous approach see also Wymeersch, *supra* note 12, at 7, 10, 11 note 35, 12. The tight grip of the ECB on NCAs' auxiliary services and its unfettered competence to render the final supervisory decision warrant to doubt that the issue does pertain to NCAs' discretionary powers. Moreover, it is not an exercise of hair-splitting that the competences NCAs *retain* as circumscribed in the SSM Regulation have never been conferred on the ECB by a regulation under TFEU art. 127(6), *i.e.* no administrative (re-)delegation occurs.

<sup>96</sup> SSM Regulation, art. 18(1) allows for a punitive disgorgement of actual or estimated profits.

<sup>97</sup> SSM Regulation, art. 18(5). For a pessimistic assessment Ferrarini & Chiarella, *supra* note 22, at 57. On the modes of enforcing prudential regulation within the SSM see also Andreas Witte, *The Application of National Banking Supervision Law by the ECB: Three*

More generally, the ECB can always push NCAs to take the actions necessary to carry out the tasks conferred on it by issuing instructions.<sup>98</sup> However, any form of such “compelled cooperation” makes daily operations arduous and thus raises doubts with regard to the effectiveness of the new regime. The latter can hardly be

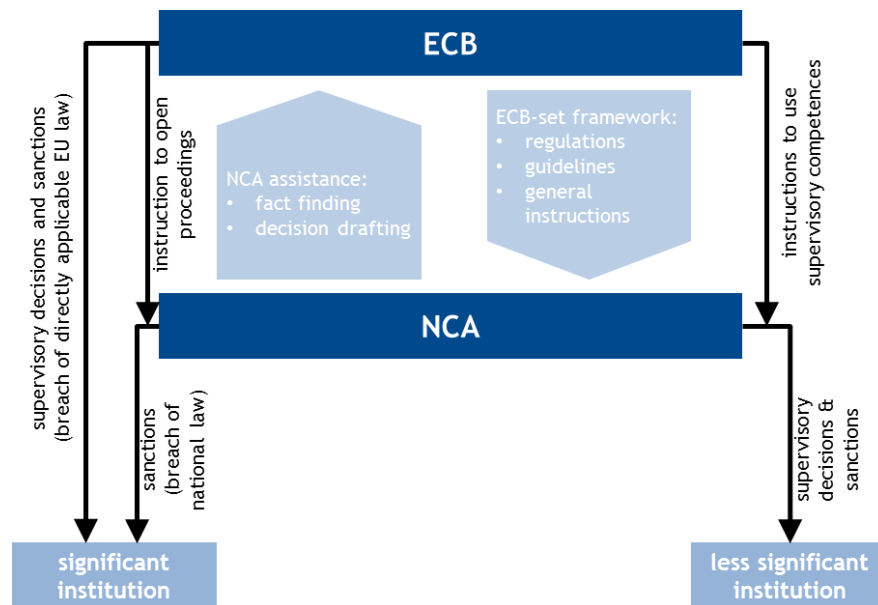


figure 2 - ECB/NCA interplay within the SSM

dispelled by reference to the anemic legal obligation to cooperate within the SSM.<sup>99</sup>

### 3.2.3 SUBSIDIARIES AND BRANCHES

It has been argued elsewhere that the distinction between subsidiaries and branches is unaligned with the actual risk structures in transnational financial institutions and that the considerable differences in the supervisory framework that follow from it should be leveled.<sup>100</sup> The SSM cannot remedy these shortfalls entirely because it provides only a discrete distribution of supervisory competences within the euro area but does not alter the pertinent substantive regulation.<sup>101</sup>

If a significant institution from a participating Member State branches into another participating Member State, the ECB will be the sole supervisor, *i.e.* it will not only carry out the tasks of the home but also those of the host supervisor (*supra* 3.1 table 1).<sup>102</sup> The supervisory tasks to be performed under the roof of the ECB, however, remain unaltered and thus diverge from those to be observed if a transnational bank conducts its foreign operations under a subsidiary structure. Furthermore, the ECB will be the competent host supervisor if an institution from a non-participating Member State branches into the euro area,<sup>103</sup> *i.e.* there will be a single

*Parallel Modes of Executing EU Law?*, 21 MAASTRICHT J. EUR. & COMP. L. 89-109 (2014); Sven H. Schneider, Sanctioning by the ECB and national authorities within the Single Supervisory Mechanism, 25 EUR. J. BUS. L., SPECIAL ISSUE 18 (2014).

<sup>98</sup> SSM Regulation, art. 9(1) subpara. 3. On the precise scope of the ECB’s supervisory powers *see also* Schuster, *supra* note 75, at. 6-9.

<sup>99</sup> SSM Regulation, art. 6(2) subpara 1. For an optimistic view Ferrarini & Chiarella, *supra* note 22, at 54.

<sup>100</sup> Tröger, *supra* note 19, at 199-200 and 220-1.

<sup>101</sup> For other areas where the traditional distinctions based on organizational form will persist, Wymeersch, *supra* note 12, at 19; Wymeersch, *supra* note 9, at 36-7.

<sup>102</sup> SSM Regulation, art. 17(1).

<sup>103</sup> SSM Regulation, art. 4(2).



host supervisor even if branches are established in different participating Member States. Finally, the ECB will serve as the home supervisor if a significant institution from a participating Member State branches into a non-participating Member State.<sup>104</sup>

The ECB will serve as both the consolidating supervisor and the competent authority in a subsidiary structure if the parent institution authorized in a participating Member State is significant.<sup>105</sup> It is a consequence of determining whether a bank is significant at the highest level of consolidation,<sup>106</sup> that if a significant parent establishes a subsidiary that would in itself be regarded as less significant, the ECB not only assumes the role of the consolidating supervisor but also directly supervises the subsidiary. Thus, contrary to the procedures laid out in CRD IV (*supra* 3.1 table 1), the ECB does not cooperate with NCAs in the consolidated supervision of significant institutions. The ECB also participates as the competent authority in the consolidated supervision of significant subsidiaries if the parent institution is authorized in a non-participating Member State.<sup>107</sup>

In sum, European banks will benefit to a significant degree from a centralization of competences as the mere reduction of supervisory points of reference they have to turn to lowers their costs of compliance.<sup>108</sup> Yet, from the policy maker's point of view, a pivotal drawback of the regulatory regime survives: the supervisory tasks, methodologies and processes as determined by substantive banking regulation will continue to differ depending on the banking groups' organizational structures and will not necessarily accord with banks' actual risk structure.<sup>109</sup> To be sure, within the SSM the actual supervisory practice arguably will not differ significantly between the organizational structures only because the relevant tasks in prudential oversight are tailored differently, because they will ultimately be performed in their entirety by a single supervisor (ECB). However, this *de facto* equalization is a back-door solution and does not represent sound banking policy.

### 3.3 ASSESSMENT

The literature that seeks to evaluate the new supervisory structures generally dwells on the tacit assumption that the specific supervisory tasks will be performed seamlessly along the lines of competence defined by the SSM Regulation. However, experience with national supervision teaches that in reality frictions occur where

---

<sup>104</sup> SSM Regulation, art. 4(1)(b).

<sup>105</sup> SSM Regulation, art. 17(2).

<sup>106</sup> *Supra* 3.2.1 at note 76.

<sup>107</sup> SSM Regulation, art. 4(1)(g).

<sup>108</sup> Wymeersch, *supra* note 9, at 36.

<sup>109</sup> For a similar assessment see Dirk Schoenmaker & Sander Oosterloo, *Financial Supervision in an Integrating Europe*, 5 INT'L FIN. 1, 8 (2005); Schoenmaker and Oosterloo, *Cross-Border Issues in European Financial Supervision*, in: THE STRUCTURE OF FINANCIAL REGULATION 264, 275-7 (David Mayes & Geoffrey Wood eds., 2007); Eva Hüpkes, *Form Follows Function – A New Architecture for Regulating and Resolving Global Financial Institutions*, 10 EUR. BUS. ORG. L. REV. 369, p. 374-5 (2009); Ferrarini & Chiodini, *supra* note 22, at 197.

inter-agency cooperation is required and that interfaces between hub and spokes constitute potential fault-lines. To conceptualize expected losses in the systems overall effectiveness, it is useful to draw lessons from the political economy of administration and look at top-level bureaucrats' incentives,<sup>110</sup> particularly of those in NCAs (*infra* 3.3.1). From this perspective, it is important that the supervisory architecture provides not only sticks but also carrots. The SSM certainly provides a heavy club for the ECB to discipline NCAs. Yet, the perks that could integrate their top personnel in order to induce optimal voluntary efforts are less pronounced and ultimately hinge on developing a common organizational culture within the SSM. Moreover, integrative elements partly have the potential to hamper swift supervisory decision making (*infra* 3.3.2).

### 3.3.1 LESSONS FROM THE POLITICAL ECONOMY OF ADMINISTRATION: BUREAUCRATS' INCENTIVES

#### 3.3.1.1 RELEVANCE OF NCAs' CONTRIBUTIONS

NCAs will perform at least preparatory or auxiliary services in establishing the factual grounds for supervisory decision making (direct ECB-supervision) or they will execute prudential supervision for less significant banks within the ECB-defined supervisory framework, under the permanent threat to be ousted (indirect ECB-supervision).<sup>111</sup> Obviously, the critical proposition underpinning such an institutional framework is that national supervision is generally more hospitable towards detrimental domestic interests, and that hence the ECB has to be established primarily as a “whipper-in” for NCAs who are seen with inherent mistrust.<sup>112</sup>

It has been suggested here that the emphasis on strong powers for the hub *vis-à-vis* the SSM's spokes is explicable by availability heuristics that look mainly at the most recent events which triggered the reform efforts and indeed exhibit egregious cases of captured and thus forbearing NCAs.<sup>113</sup> Understandably, this focus becomes even more pronounced, as direct supranational recapitalizations through the ESM will be made expressly available,<sup>114</sup> because the move arguably contributes to

---

<sup>110</sup> The underlying assumption is that the internal organization of public authorities allows motivating the rank and file to act—by and large—in accordance with the agencies' general policies as determined by its top executives. In any case, optimizing the internal governance and incentive structures does not pose a problem unique to the context of inter-agency cooperation.

<sup>111</sup> *Supra* 3.2.1, 3.2.2, and figure 2.

<sup>112</sup> For this rationale for centralization on the supranational level *supra* 2.1. But see also *infra* 3.3.1.2 and 6.

<sup>113</sup> *Supra* 2.2.

<sup>114</sup> On the ESM's approved direct bank recapitalization instrument see Eurogroup, *ESM direct bank recapitalisation instrument* (June 20, 2013), available at <http://www.eurozone.europa.eu/media/436873/20130621-ESM-direct-recaps-main-features.pdf>; European Stability Mechanism, *FAQ on the main features of the future ESM direct bank recapitalisation instrument*, (June 28, 2013), available at <http://www.esm.europa.eu/pdf/FAQ%20Direct%20Bank%20Recapitalisation%20280620131.pdf>.

calming markets,<sup>115</sup> but also exacerbates the potential for moral hazard. Yet, it could also be asked if learning would have improved national supervision or whether lax oversight is indeed necessarily associated with it. After all, in light of the severe economic and social problems that currently shake, for instance Spain, Ireland, and Iceland, with hindsight, lenience towards national champions may not have been such a great idea—and may not be seen as such by the electorate in particular. Moreover, it was just the Bank of Spain that foreknowingly discouraged massive CDO investments of the country’s largest cross-border banking groups who did thus comparably well in the crisis of 2008/09.<sup>116</sup>

These general policy considerations don’t have to be explored in detail as political leaders have determinedly embarked on a trajectory of more centralization in prudential supervision. However, it should be kept in mind that the new structure of semi-strong centralization with (critical) NCA-involvement has the potential for problems that may not only cancel out some of the advantages of centralization but also make its key advantage, forestalling forbearance of captured NCAs, partly unachievable.

Both legislators<sup>117</sup> and scholars<sup>118</sup> recognize that taping local knowledge about domestic markets, administrative practices, law etc. that resides in NCAs is important. If indeed the contribution of NCAs is vital for the SSM’s overall effectiveness, the query becomes whether public officers at NCAs, *i.e.* agents who actually discharge the duties vested with their supervisory authorities, who either offer or refuse to exchange information and to collaborate with due diligence, are sufficiently incentivized to contribute to high-quality supervision.<sup>119</sup>

### 3.3.1.2 BUREAUCRATS’ INCENTIVES

To posit that the success of the SSM depends on the incentives of (top-level) bureaucrats in charge at the competent authorities dwells on the realistic assumption that the public agencies involved should not be treated as black boxes that generate flawless output in implementing policy goals. From this perspective, it is important to remember the motivating forces identified in the line of research that applies methodologies from organizational theory to the political and administrative pro-

---

<sup>115</sup> *Supra* note 15.

<sup>116</sup> See Mark Scott, *The Rise of Santander: A Spanish Bank Emerges as a Winner in Global Crisis*, SPIEGEL ONLINE, Oct. 2, 2008, <http://www.spiegel.de/international/business/the-rise-of-santander-a-spanish-bank-emerges-as-a-winner-in-global-crisis-a-581838.html>.

<sup>117</sup> *Supra* note 71.

<sup>118</sup> Sapir, Hellwig & Pagano, *supra* note 32, at 3; Goyal et al., *supra* note 8, at 15; Ferran & Babis, *supra* note 29, at 265; Kerstin Neumann, *The supervisory powers of national authorities and cooperation with the ECB – a new epoch of banking supervision*, 25 EUR. J. BUS. L., SPECIAL ISSUE 9, 11 (2014).

<sup>119</sup> Goyal et al., *supra* note 8, at 14 recognize the importance of “incentive compatibility” between the ECB and NCAs.

cess.<sup>120</sup> Methodologically, the object of investigation can be scrutinized by using the analytical inventory of agency-theory: bureaucrats constitute agents who not only have some discretion that allows them to adapt to unforeseen contingencies,<sup>121</sup> but also grants them leeway to take hidden action and pursue their own interest, because bounded rationality of principals—ultimate (citizens) or intermediate (legislators)—prevents the writing of complete contingent constitutions and laws that would secure the untainted pursuit of the common good.<sup>122</sup> In fact, the intrinsic motives that are commonly identified as driving agency personnel in their exercise of office account for actions that serve the principals’ interest only sub-optimally.<sup>123</sup>

According to standard analysis bureaucrats are driven by a desire to increase their personal power and to augment their prestige.<sup>124</sup> They thus seek to enlarge their agency’s size, competence, and right to intervene in the affairs of those falling within the scope of its mandate. They will discharge their duties in a way that allows them to acquire a favorable reputation among their peers, in the general public, and in the media. Moreover, opportunities to advance their future career in administration, politics, or the private sector motivate their behavior, which makes them prone to promoting the interests of those who offer the most desirable job opportunities in the long term and can result in regulatory capture.<sup>125</sup> Finally, agency personnel seek to avoid liability for false actions or forbearance and will consequentially have a proclivity to follow approved practices that can be verified in any review, even if new developments occur.

To be sure, these observed preferences do not necessarily warrant a pessimistic perception of bureaucrats’ effectiveness,<sup>126</sup> but they highlight that these individuals are not robots that are automatically programmed to serve the public interest by quasi-mechanically enforcing prudential regulation, along the lines of legally devised competences, and free of self-interest.

---

<sup>120</sup> Programmatic contributions include GORDON TULLOCK, *THE POLITICS OF BUREAUCRACY*, (1965), Barry R. Weingast & William J. Marshall, *The Industrial Organization of Congress*, 96 J. POLIT. ECON. 132, (1988) and Terry M. Moe, *Politics and the Theory of Organization*, 7 J.L. ECON. & ORG. 106, (1991).

<sup>121</sup> On the positive aspect of “adaptive efficiency” DOUGLAS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 80-1 (1990).

<sup>122</sup> For an overview of various political agency models see TIMOTHY BESLEY, PRINCIPLED AGENTS? 98 – 172 (2006).

<sup>123</sup> See generally George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Canice Prendergast, *The Motivation and Bias of Bureaucrats*, 97 AM. ECON. REV. 180 (2007). For the role of cognitive biases that tend to aggravate the deviation from desirable outcomes see Stephen J. Choi & Adam C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1 (2003). For an analysis with a particular view to the governance of financial supervisors see Luca Enriques & Gérard Hertig, *Improving the Governance of Financial Supervisors*, 12 EUR. BUS.ORG. L. REV. 357 (2011).

<sup>124</sup> WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 36-42 (1971).

<sup>125</sup> Supra note 18.

<sup>126</sup> For at least ambiguous assessments of the complex web of incentives and its inherent trade-offs, see Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167 (1990); Gordon Tullock, *A (Partial) Rehabilitation of the Public Interest Theory*, 42 PUB. CHOICE 89 (1984).

Analyzed from this vantage, the incentives to contribute to supervisory efforts within the SSM are potentially suboptimal, particularly from the perspective of „subordinate“ NCAs. Both, the preparatory and information-gathering services in direct ECB-supervision and the ECB-framed oversight over less significant credit institutions represents anything but a gain in power or prestige for thus far independent NCAs —particularly because they will be deprived of the competence to supervise systemic institutions.<sup>127</sup> Ceding ground to the ECB may occur only reluctantly, turf wars loom large.<sup>128</sup> Moreover, professional and/or political upward mobility on the national level is rather unlikely to result from good “auxiliary services” discharged in the background. *Vice versa*, it may not constitute the most attractive or career-boosting task that ECB-bureaucrats will perform with utmost diligence, to supervise a tiny euro area Member State’s three largest banks.

In sum, incentives to voluntarily contribute with ample commitment to ECB-led, high-quality supervision are not immediately apparent. To be sure, the problem will not be an open blockade or outright sabotage of the ECB’s efforts, but a lack of incentives to do more than work-to-rule and go the extra mile instead certainly impends. Proposals for an effect-based regulation that aligns supervisory competences as closely as possible with bureaucrats’ incentives as long as political realities do not allow to avoid the thickets of inter-agency cooperation altogether, have sought to address precisely the lurking lack of positive motivations.<sup>129</sup> They are based on the insight that improving the supervisory architecture does not only hinge on devising clear responsibilities and hierarchies to compel close cooperation and dense exchange of information by law.<sup>130</sup> To be sure, the ECB can rely on a set of tough enforcement tools in relation to NCAs<sup>131</sup> and does not have to put its hope in informal institutions that normally provide the only available sanctions for non-cooperative

---

<sup>127</sup> Tröger, *supra* note 19, at 218.

<sup>128</sup> It is indicative in this respect that the Bundesbank—that participates in banking supervision in Germany—stresses that the SSM is based on the “principle of decentralization” (!) and points to its network character, and thus, at least rhetorically, augments the position of NCAs, Bundesbank, *European Single Supervisory Mechanism for banks – a first step on the road to a banking union*, BUNDESBANK MONTHLY REP., July 2013, at 13, 16, available at [http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly\\_Report/2013/2013\\_07\\_monthly\\_report.pdf](http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report/2013/2013_07_monthly_report.pdf).

<sup>129</sup> Katharina Pistor, *Hosts Dilemma: Rethinking EU Banking Regulation in Light of the Global Crisis* (Eur. Corp. Governance Inst., Fin. Working Paper No. 286, 2010), available at <http://ssrn.com/abstract=1631940>; Tröger, *supra* note 19, at 220-1. See also FINANCIAL SERVICES AUTHORITY, THE TURNER REVIEW 99 (2009), available at [http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](http://www.fsa.gov.uk/pubs/other/turner_review.pdf) and the “lead supervisor model” as developed in EUROPEAN FINANCIAL SERVICES ROUNDTABLE, REPORT ON THE LEAD SUPERVISOR MODEL 26-28 (2005), available at <http://www.efr.be/documents%5Cpublication%5C22676EFRlsvfinal-June2005.pdf>.

<sup>130</sup> But see Goyal et al., *supra* note 8, at 14, 15 who focus exclusively on “clear responsibilities”, “strong oversight and accountabilities” of NCA’s and argue that ECB’s early intervention powers “provide incentives for cooperation” (*id.*, p. 23), again relying exclusively on the stick for motivation.

<sup>131</sup> *Supra* 3.2.1 and 3.2.2.

behavior in transnational contexts.<sup>132</sup> But they only can be brought to bear where the ECB has detected or suspects deficits in a NCA's supervisory practice. If bureaucrats in NCAs are not positively incentivized to voluntarily unveil deficits that their idiosyncratic know-how allows them to detect, even the most plausible advantage of supranational supervision, forestalling forbearance as a function of NCA's "home bias", is endangered, because the ECB will simply lack the resources to generally investigate daily supervisory practices of NCAs.<sup>133</sup>

### 3.3.2 INTEGRATIVE PROSPECTS OF INTERNAL DECISION MAKING PROCEDURES, ECB-SET FRAMEWORK, AND NCA-ECB CAREER PATHS

Organizational theory has long embraced the importance of the top level's benign reputation for respecting the legitimate concerns of subordinates as a centerpiece in inducing optimal commitments and efforts of a firm's employees.<sup>134</sup> Translated into the SSM-context, the ECB's legally defined lead role within the SSM requires complements that integrate NCAs and lead to a commonly embraced supervisory identity within the SSM.

#### 3.3.2.1 INTERNAL DECISION MAKING PROCEDURES

An important aspect of the integrative prospects that help achieve the goal of providing positive incentives for NCAs to contribute voluntarily to optimal supervisory efforts within the SSM may flow from their representation in SSM-decision making bodies, most importantly the ECB Supervisory Board.<sup>135</sup> This newly established body will plan and execute the ECB's supervisory tasks<sup>136</sup> and will be composed of a Chair (external candidate) and a Vice-Chair (Member of ECB Executive board),<sup>137</sup> four ECB-representatives not directly involved in monetary tasks, and one

---

<sup>132</sup> For an account of the self-enforcing mechanisms that international law normally has to rely on ANDREW T GUZMAN, *HOW INTERNATIONAL LAW WORKS: A RATIONAL CHOICE THEORY* 33-48 (2008).

<sup>133</sup> Ferran & Babis, *supra* note 29, at 265.

<sup>134</sup> David M. Kreps, *Corporate Culture and Economic Theory*, in *PERSPECTIVES ON POSITIVE POLITICAL ECONOMY* 90, 93, 125 (James E. Alt & Kenneth A. Shepsle eds., 1990).

<sup>135</sup> Its creation is owed to legislators' vow to strictly separate monetary policy and supervisory functions of the ECB, SSM Regulation, recital 65 and 73, art. 25. In the same vein, the ECB is obliged to pursue only the objectives set out in SSM-Regulation, art. 1(1) (safety and soundness of credit institutions, stability of the financial system, and unity and integrity of the internal market) when carrying out supervisory tasks. On the ECB's determination to effectively implement the separation in its internal procedures, Vitor Constâncio, Vice-President of the ECB, Speech at the BAFT-IFSA 2013 Europe Bank-to-Bank Forum, Establishing the Single Supervisory Mechanism (Jan. 29, 2013), *available at* [http://www.ecb.int/press/key/date/2013/html/sp130129\\_1.en.html](http://www.ecb.int/press/key/date/2013/html/sp130129_1.en.html).

<sup>136</sup> SSM Regulation, art. 26(1).

<sup>137</sup> SSM Regulation, art. 26(1), (3). The goal is to further separate supervisory and monetary policy functions by limiting overlaps in top-personnel, cf. SSM Regulation, recital 66; Ferran & Babis, *supra* note 29, at 269. *Commission Proposal SSM Regulation*, art. 19(2) prescribed the Chair be selected from the Executive Board, accepting a far larger intersection with monetary policy functions.

representative from each participating Member State's NCA.<sup>138</sup> This composition makes for an overweight of NCAs in the Supervisory Board, because at least 18 of the 24 full members of the Supervisory Board will be delegates from Member States' supervisors. It translates into a NCA-dominance of the Board's decision making. Although voting weights had been favored for all Board decisions during the legislative process,<sup>139</sup> the inclusive and simple solution prevailed: decisions will be taken with simple majority under a one member one vote-rule with a casting vote for the Chair in case of a draw.<sup>140</sup> A weighted voting process only applies under SSM Regulation, art. 26(7), where regulations are to be adopted.<sup>141</sup> Quite importantly, ECB-representatives on the Board will have a voting capacity equal to the median of NCA-representatives and will hence not be in a position to command decisions.<sup>142</sup> Furthermore, a Steering Committee with ten members and up to seven NCA-representatives will technically prepare Supervisory Board decisions, *i.e.* draft the drafts etc.<sup>143</sup>

In sum, despite the allocation of the most important supervisory powers at the ECB, the decision making process of the newly created Supervisory Board makes ECB-led supervision essentially a common activity of Member States. At first glance, this gives it significant integrative potential that could induce voluntary collaboration within the SSM. Yet, at least for bureaucrats from those NCAs that thus far supervised a significant banking sector autonomously, the mere participation in the decision making process on the supranational level arguably does not compensate the visual loss in power and prestige, despite the larger geographic scope of the new activities. Moreover, even the feeble integrative moment comes at the price of a rather bloated size of the Supervisory Board which raises doubts regarding its ability to act in a swift and determined manner.<sup>144</sup>

---

<sup>138</sup> SSM Regulation, art. 26(1), (5). Where the NCA is not the central bank, a central bank representative can also be brought to Supervisory Board meetings. However, such twin-attendance does not impact on voting rights, SSM Regulation, art. 26(1) subpara. 1.

<sup>139</sup> The proposals were driven by the desire to reflect the sizes of national banking sectors, Alex Barker, Peter Spiegel & Miles Johnson, *Germany demands more power on banking*, FIN. TIMES (Online), Oct 9, 2012, <http://www.ft.com/cms/s/0/264ff186-1230-11e2-868d-00144feabdc0.html#axzz2blKEElpc>.

<sup>140</sup> SSM Regulation, art. 26(6).

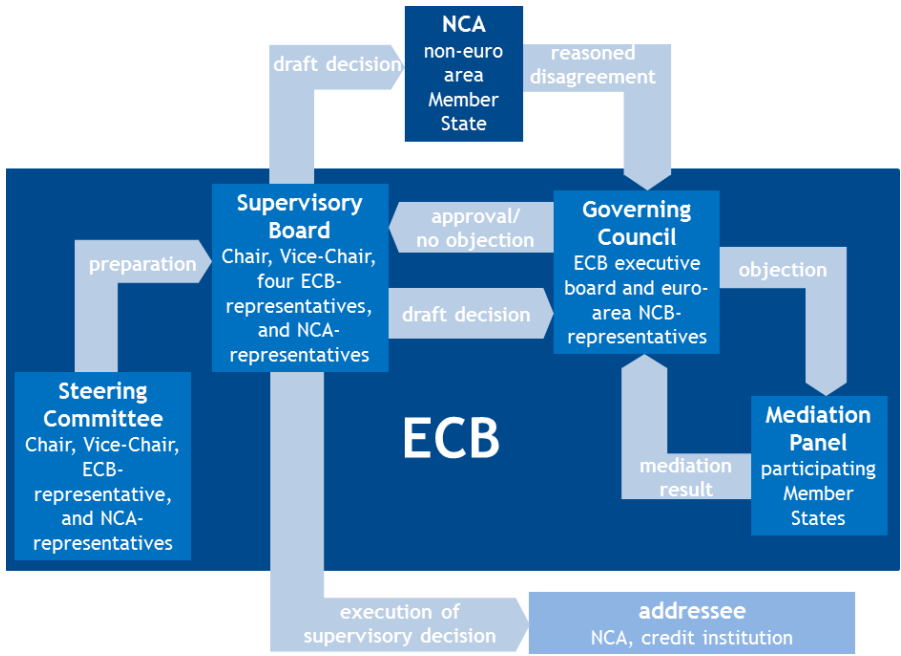
<sup>141</sup> SSM Regulation, art. 4(3) subpara. 2 allows the ECB to adopt regulations "only to the extent necessary to organize or specify the arrangements for carrying out of the tasks conferred on it" by the SSM Regulation.

<sup>142</sup> SSM Regulation, art. 26(7).

<sup>143</sup> SSM Regulation, art. 26(10). The Committee will consist of the Supervisory Board's Chair, its Vice Chair, one more ECB representative and up to seven NCA representatives, according to a rotation scheme to be determined by the Supervisory Board.

<sup>144</sup> Goyal et al., *supra* note 8, at 29; Ferran & Babis, *supra* note 29, at 270.

However, the integrative capacity of internal decision making procedures is also attenuated, as constitutional concerns arguably compel Governing Council involvement in each and every ECB supervisory decision.<sup>145</sup> This follows from the Governing Council’s character as the ECB’s ultimately responsible decision making body.<sup>146</sup> The ultimate legislation has not subscribed to the view that the relation between the Supervisory Board and the Governing Council is a matter of the ECB’s internal organization and thus grants leeway to limit the decisions that have to be brought before the Council.<sup>147</sup> SSM Regulation, art. 26(8) provides for a procedure that seeks to uphold the separation of monetary policy and supervisory functions but also reflect the



**figure 3** - ECB supervisory decision making

constitutional requirements. It demands of the Governing Council to object explicitly to the draft decisions submitted by the Supervisory Board in writing, stating in particular monetary policy concerns, within ten days during normal times and 48 hours in crisis situations.<sup>148</sup> If the Council objects, a mediation panel will try to resolve the diverging views among participating Member States, SSM Regulation, art. 25(5). However, regardless of the outcome of the mediation, ultimately the Governing Council’s decision will prevail, *i.e.* in order to reach a supervisory decision the result of the mediation has to be adopted by the Governing Council (figure 3).

<sup>145</sup> *Commission Proposal SSM Regulation* art. 19(3) allowed the Governing Council to „delegate clearly defined supervisory tasks and related decisions regarding individual or a set of identifiable credit institutions“ to the Supervisory Board. This was deleted to reflect the Governing Council’s ultimately responsible under the TFEU and the ESCB and ECB Statute, *infra* note 148.

<sup>146</sup> The latter has constitutional status as it is codified in TFEU arts. 129(1), 283(1) and ESCB and ECB Statute, arts. 9(3), 10(1). For a detailed discussion of the resulting conflict between well-designed supervisory institutions and Treaty pre-settings that largely override expediency considerations, Ferran & Babis, *supra* note 29, at 267-8; Véron, *supra* note 6, at 6-7.

<sup>147</sup> Wymeersch, *supra* note 12, at 7, 10, 11 note 35, 12.

<sup>148</sup> The Governing Council can only approve or object to Supervisory Boards draft decisions, *i.e.* it cannot amend and shape them according to own perceptions.



Of course, at least euro area Member States<sup>149</sup> also dominate the Council.<sup>150</sup> Yet, it is not NCAs and their top-level bureaucrats who are representing their Member States, even where prudential banking supervision is vested with NCBs, because the Governing Council assembles the heads of NCBs' monetary policy arms. Hence, the invariable involvement of the Governing Council weakens both the integrative potential that the internal decision making process holds, the speed and resoluteness of decision making in the multi-layer governance arrangement,<sup>151</sup> and the supervisory expertise that ultimately flows into supervisory decisions.<sup>152</sup>

The critical aspect is that the internal decision making process both holds integrative potential, as it provides for a broad and meaningful involvement of representatives from all participating Member States' NCAs. Yet, this—together with the invariable requirement of Governing Council approval—makes arriving at an outcome quite cumbersome. In any case, at least from the perspective of large Member States with a significant banking sector, a perceptible loss of relevance for their NCAs and its top-level bureaucrats persists.

---

### 3.3.2.2 ECB-SET FRAMEWORK, AND NCA-ECB CAREER PATHS

The SSM's capacity to integrate NCAs and provide proper incentives for their bureaucrats ultimately depends on the ECB-set framework for the cooperation between ECB and national competent authorities and particularly how it is animated in day-to-day supervisory practice. It is a good sign that the Supervisory Manual which will be the backbone of the organization of common supervision, was prepared by joint ECB/NCA committees and working groups.<sup>153</sup> Furthermore, mixed teams<sup>154</sup> may provide an excellent opportunity to incentivize NCAs adequately and induce them to feed their expertise into common supervision.<sup>155</sup> To achieve that goal, they have to be set up in a way that NCA-representatives not only serve as drudges for the ECB gentry. Unfortunately, the SSM Framework Regulation struc-

---

<sup>149</sup> On the situation of participating Member States whose currency is not the euro see *infra* 5.2.

<sup>150</sup> Again, the relation is 6 to 18, *i.e.* the President, the Vice-President and four other Members of the Executive Board on the ECB-side, together with the 18 governors of NCBs, TFEU art. 283(1), (2) and ESCB and ECB Statute, arts. 10(1) and 11(1).

<sup>151</sup> The process becomes even more complicated, where participating Member States whose currency is not the euro disagree with draft decision of the Supervisory Board. For a detailed description of the applicable procedure cf. *infra* 5.2 and figure 3.

<sup>152</sup> Ferran & Babis, *supra* note 29, at 268. Commentators have expressed concerns that the Supervisory Board will be a practically powerless advisory body, Wymeersch, *supra* note 12, at 12. Yet, this need not be true. Some of the weaknesses in the governance structure may be "corrected" in practice: as the supervisory expertise will reside in the Supervisory Board and its working-level staff, *i.e.* the ECB's supervisory department, benefits from specialization and routinization may accrue if the Governing Council's ultimate responsibility is executed by rubber-stamping draft supervisory decisions in normal times.

<sup>153</sup> EUROPEAN CENTRAL BANK, SSM QUARTERLY REPORT 2014/I 8-13 (2014), <http://www.ecb.europa.eu/pub/pdf/other/ssmqr20141en.pdf>.

<sup>154</sup> SSM Regulation, art. 31(2) provides for an ECB arranged, mixed composition of supervisory teams.

<sup>155</sup> Goyal et al., *supra* note 8, at 15, 27.

tures the joint ECB-NCA supervisory teams in a way that once again bolsters the unfettered ECB dominance and implicitly expresses mistrust *vis-à-vis* NCAs. In particular, the coordinator of the teams necessarily has to be an ECB representative<sup>156</sup> and the ECB at all times has the right to reject NCA representatives as joint team members.<sup>157</sup>

Against this background it becomes all the more important, that the exchange and secondment of staff could,<sup>158</sup> if carefully designed, provide career-opportunities for NCA-bureaucrats inducing them to cooperate from the start. More generally, career paths should be designed in a way that good supervisory performances at NCAs may translate into upward mobility to the ECB, turning the SSM into a true unit for promotion purposes. As long as NCA-bureaucrats' can procure their next job within the public sector only from their domestic minister of finance, it is clear where their loyalties lie and that the latter may not militate in favor of stringent supervisory practices where national champions are targeted.

#### 4 COEXISTING STANDARD SETTERS - A EUROPE À DEUX VITESSE IN BANKING SUPERVISION?

The amendments to the European supervisory architecture also affect the EBA's role, both directly and indirectly.<sup>159</sup> The London-based authority received more clout as an operational supervisor. It will henceforth be able to request relevant information directly from financial institutions<sup>160</sup> and will no longer have to rely on data provided by NCAs, particular to conduct stress tests on a sound factual basis.<sup>161</sup> Quite importantly, the EBA retains the power to require competent authori-

---

<sup>156</sup> SSM Framework Regulation, art. 3(1).

<sup>157</sup> SSM Framework Regulation, art. 4(3).

<sup>158</sup> SSM Regulation, art. 31(1).

<sup>159</sup> In accordance with the provisions of the Joint Declaration on practical arrangements for the codecision procedure (2007 OJ (C 145) 5), the European Parliament reached an agreement at first reading that was adopted by the Council on October 15, 2013 (European Council, *supra* note 17), resulting in the European Parliament and Council Regulation 1022/2013 Amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its Interaction with Council Regulation (EU) No 1024/2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions, 2013 O.J. (L 287) 5 (EU) [hereinafter: EBA Amendment Regulation].

<sup>160</sup> EBA Amendment Regulation, art. 1(18)(b) amending EBA Regulation, art. 35(6).

<sup>161</sup> The EBA conducted a stress test involving Europe's 90 largest banks immediately before the severe repercussions that the Greek sovereign debt crisis had in the European banking sector became visible during the summer of 2011 Tröger, *supra* note 19, at 190-1 and concluded that the bulk of participating institutions was sufficiently resilient due to high tier-one capital ratios, European Banking Authority, *2011 EU-wide Stress Test – Aggregate Report*, (July 15, 2011), available at [http://www.eba.europa.eu/documents/10180/15935/EBA\\_ST\\_2011\\_Summary\\_Report\\_v6.pdf/54a9ec8e-3a44-449f-9a5f-e820cc2c2f0a](http://www.eba.europa.eu/documents/10180/15935/EBA_ST_2011_Summary_Report_v6.pdf/54a9ec8e-3a44-449f-9a5f-e820cc2c2f0a). Among other things, this experience shows that NCAs tend to report data to the supranational stress tester in a way that supports a strong performance of "their" national banks, *see also* Véron, *supra* note 6, at 6.

ties to take supervisory actions in emergency situations<sup>162</sup> and ultimately act in place of the competent supervisory authority.<sup>163</sup> Such EBA powers also apply if the competent supervisory authority does not remedy a breach of immediately applicable Union law.<sup>164</sup> This competence also holds in relation to the ECB,<sup>165</sup> after the Commission's plan to partly insulate the ECB from direct EBA-interference was not carried forward to the political compromise.<sup>166</sup> However, as matter of practice it seems unlikely that the EBA—clearly under-resourced for this purpose—will meddle with day-to-day supervisory activities both within and outside the SSM.<sup>167</sup> Hence, the most important development seems to be related to the EBA's core task as E.U.-wide standard setter. In this capacity, it will be confronted with a *de facto* rivaling institution (*infra* 4.1). At the same time its internal decision making procedures will become more cumbersome and thus conjure up the peril of a standoff between rivaling blocks of NCAs (*infra* 4.2).

#### 4.1 EBA-RULEMAKING AND ECB-SUPERVISION COMPARED

---

<sup>162</sup> EBA Amendment Regulation, art. 1(7)(b) amending EBA Regulation, art. 18(3). The amendment (“competent authorities” instead of “national authorities”, *see infra* note 165) clarifies that it is also the need for coordination between NCAs and the ECB in emergency situations that warrants EBA intervention.

<sup>163</sup> The EBA may adopt individual decisions addressed directly to financial institutions if the competent authority does not take required actions in emergency situations, EBA Regulation, art 18(4).

<sup>164</sup> EBA Regulation, art. 17(6) requires that the NCA does not remedy the breach after receiving a formal Commission opinion that takes the EBA recommendation into account.

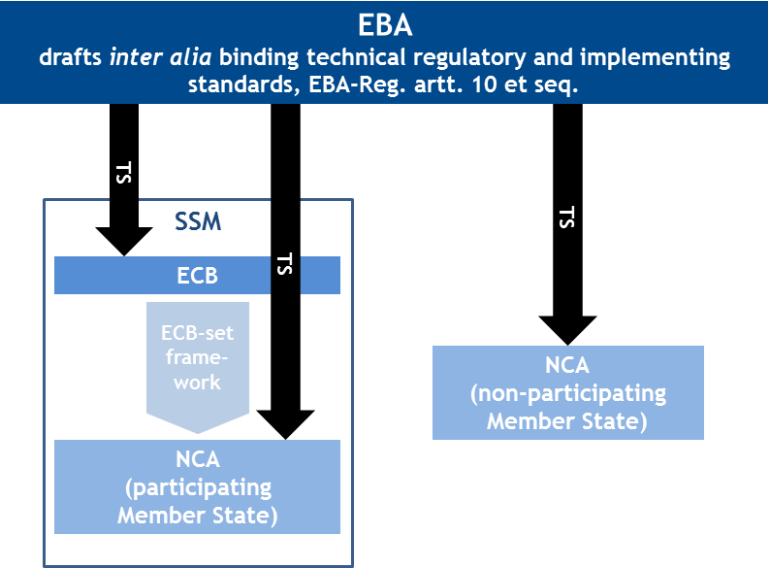
<sup>165</sup> For purposes of the application of the EBA Regulation, the ECB in its supervisory capacity will be regarded as a competent authority treated indiscriminately like an NCA, EBA Amendment Regulation, art. 1(2) amending EBA Regulation, art. 2(2)(f).

<sup>166</sup> The Commission sought to allow the ECB an explained non-compliance with EBA-opinions in emergency situations and disputes with NCAs, *Commission Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) as regards its Interaction with Council Regulation (EU) No.../... Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions*, arts. 18(3a), 19(3a), COM (2012) 512 final (Sept. 12, 2012) [hereinafter: *Commission Proposal EBA Amendment Regulation*]. The rationale was seen in the ECB's independent status—flowing from its role as central bank responsible for monetary policy—that prohibits *inter alia* subordination to other E.U. bodies, TFEU art. 130, ESCB and ECB Statute, art. 7. After all, E.U. legislation subscribed to a bolder interpretation of the constitutional framework that limits the unconfined independence requirement to the ECB's monetary policy mandate. For a discussion *see* Ferran & Babis, *supra* note 29, at 24; Elke Gurlit, *The ECB's relationship to the EBA*, 25 EUR. J. BUS. L., SPECIAL ISSUE 14, 16 (2014).

<sup>167</sup> The EBA will also have the competence to ultimately decide quarrels between NCAs and the ECB in accordance with the procedure laid down in EBA Regulation, art. 19(3), *supra* note 50 and table 1, as these provisions remain unchanged by the EBA Amendment Regulation. Yet, as the ECB assumes the role of home and host competent authority within the SSM (*supra* 3.2.3), relevant disputes may occur only in relation to non-participating Member States' NCAs. EBA Regulation, art. 19(1) requires an explicit referral to the provision in Union law for the EBA to receive decision-making power. As such referral is lacking in the SSM Regulation, disagreement of NCAs with ECB measures within the SSM may not be brought before the EBA.

Another source of potential frictions in the new supervisory architecture results from the ECB's relation to other institutions within the European System of Financial Supervision (ESFS), in particular to the EBA in its capacity as gap-filling rule maker. At the outset, ECB (SSM) and EBA pursue different ends. The ECB and the NCAs enforce supranational and (harmonized) national banking regulation in the participating Member States, whereas the EBA devises binding regulatory and implementing technical standards (TS) to be adopted by the Commission that clarify and fill gaps in E.U. banking regulation,<sup>168</sup> a task which is still critical for integrating actual supervisory practices despite the increasing harmonization of substantive banking regulation.<sup>169</sup>

SSM Regulation art. 4(3) subpara. 2 stipulates explicitly<sup>170</sup> that the ECB in carrying out its supervisory tasks will be bound by the TS, will have to consider EBA guidelines and recommendations in accordance with EBA Regulation, art. 16, and will be subject to a European supervisory handbook that will describe best practices in supervisory methodologies and processes.



**figure 4** - EBA and ECB channels to integrate supervisory standards

However, the query pertains to the *de facto* relation of the ECB-defined supervisory framework (*supra* 3.2.2) and the EBA-drafted technical standards, its guidelines and recommendations and the European supervisory handbook. Although the further does not generally have the quality of a source of law,<sup>171</sup> particularly the Supervisory Manual will practically shape the application of the pertinent E.U.-Regulations and harmonized national laws within the SSM, *i.e.* determine the law in action, even though not that on the books: the ECB will compel compliance with its own interpretation of supranational legislation by forcing NCAs to adopt its own position and construe national implementing acts in conformity with it. This prediction does not neglect the fundamental difference between regulation and su-

<sup>168</sup> EBA Regulation, arts. 10-15.  
<sup>169</sup> For a bleak account of differences in supervisory practices, regulatory arbitrage and “home bias” that could be observed under the Banking Directive and national supervision, Wymeersch, *supra* note 12, at 3-4; similar Schneider, *supra* note 15, at 454.  
<sup>170</sup> The clarification is owed to the controversy surrounding the scope of the ECB’s independence, *see supra* note 166.  
<sup>171</sup> This is only the case where the ECB is entitled to promulgate regulations (TFEU art. 288(2)) as part of its supervisory framework, SSM Regulation, art. 4(3) subpara. 2 and *supra* 3.3.2.2 .

pervision. Yet, it posits that—as a matter of practice—the ECB will be significantly less encumbered in integrating supervisory standards than some commentators have argued,<sup>172</sup> even where substantive banking regulation remains (harmonized) national law. This is even more likely, as the ECB can not only rely on pure fiat but also on the adjudication of the European Court of Justice (ECJ) that consistently holds that Member States’ courts and administrative agencies have an obligation to interpret domestic legislation in a way that it conforms with E.U. law, both primary<sup>173</sup> and secondary.<sup>174</sup> As a consequence, the actual impact of the ECB-defined supervisory framework is very similar to that of the EBA’s TS, guidelines and recommendations and the European supervisory handbook (figure 4).<sup>175</sup> In fact, it goes even further as the ECB has sweeping powers to cram its interpretations down on NCAs (*supra* 3.2.1 and 3.2.2). This observation makes the ECB a *de facto* more powerful standard-setter than the EBA, because in relation to NCAs it can dictate the interpretation of harmonized banking regulation, at least as long as no challenge of its position is brought before the ECJ.<sup>176</sup>

Of course, the ECB will not blatantly renege against EBA-set supervisory standards. However, it can go further and proceed more rapidly in its efforts to integrate supervisory practices. Where binding TS have thus far not been proposed by the EBA it can prescribe the use of common methodologies or processes in the Supervisory Manual it has to devise for the SSM. This road may become even more attractive if the EBA’s capability to expedite the integration of supervisory practices becomes constricted as a result of amendments to the rules governing its decision making process in regulatory matters.

#### 4.2 EURO-AREA DOMINANCE OF EBA DECISION MAKING OR STANDOFF?

The creation of the SSM also provides for a looming euro area-dominance of the EBA Board of Supervisors, *i.e.* the decision making body responsible amongst others for EBA-rulemaking. To be sure, representatives of the NCAs will remain the sole voting-members of the Board reflecting its character as a common institution for all 28 Member States.<sup>177</sup> However, *Commission Proposal SSM Regulation* art. 4(1)(l) commissioned the ECB to “coordinate and express” a common position of euro area

---

<sup>172</sup> Wymeersch, *supra* note 12, at 5; Wymeersch, *supra* note 9, at 14-5; Ferrarini & Chiarella, *supra* note 22, at 52-3 identify the necessity to apply harmonized national law as a source of frictions that could compromise effective supervision. For a similar account that assumes that the ECB will indeed take out to respect any idiosyncracies of national legal systems, Schneider, *supra* note 15, at 455.

<sup>173</sup> Case 157/86, *Murphy v. Bord Telecom Eireann*, 1988 E.C.R. 673; Case 322/88, *Salvatore Grimaldi v. Fonds des maladies professionnelles*, 1989 ECR I-4407.

<sup>174</sup> Case C-106/89, *Marleasing SA v La Comercial Internacional de Alimentacion SA*, 1990 E.C.R. I-4135; Joined Cases C-397/01 to C-403/01, *Pfeiffer and others v. Deutsches Rotes Kreuz, Kreisverband Waldshut e.V.*, 2004 E.C.R. I-8878 para 115 et seq.; Case C-555/07, *Kücükdeveci v. Swedex GmbH & Co. KG*, 2010 E.C.R I-365 para 49 et seq.

<sup>175</sup> For a similar assessment *see* Schneider, *supra* note 15, at 456.

<sup>176</sup> *Cf.* SSM Regulation, art. 24(11).

<sup>177</sup> As to date, the ECB will only be represented by a non-voting member, nominated by the Supervisory Board, EBA Regulation, art. 40(1)(d) as amended by EBA Amendment Regulation, art. 1(21)(b).

Member States in the EBA Board of Supervisors (and its Management Board) for “issues relating to the tasks conferred on the ECB by this regulation”. It is quite plausible that prudential regulation *relates* to the supervisory tasks conferred on the ECB and that SSM-participants thus were expected to be ECB-synchronized in EBA-drafting of TF etc.<sup>178</sup>

However, the Commission proposed no substantive change to EBA Regulation art. 44(1) subpara. 2 that requires a qualified majority for the adoption of draft TS and other regulatory measures.<sup>179</sup> Yet, to prevent a walkover of non-participating Member States, the majority requirements for the pertinent Board of Supervisors’ decisions arguably had to be adapted accordingly. Hence, Parliament<sup>180</sup> successfully proposed to tighten the relevant thresholds by stipulating a double-majority requirement in addition to the qualified majority vote.<sup>181</sup>

*Commission Proposal SSM Regulation* art. 4(1)(l) was discarded in the political compromise. But even without an explicit mandate for the ECB to coordinate a common position, a proclivity of participating Member States to vote *en-bloc* may exist and be amplified over time with supervisory methodologies and procedures incrementally converging thanks to ECB coordination.<sup>182</sup> Hence, the amendment championed by Parliament arguably balances a looming euro group-dominance.<sup>183</sup> Indeed, it will quite effectively counter the peril that draft TS, guidelines and rec-

---

<sup>178</sup> Wymeersch, *supra* note 12, at 21. For a narrower interpretation of *Commission Proposal, SSM Regulation*, art. 4(1)(l) Ferran & Babis, *supra* note 29, at 27 note 169.

<sup>179</sup> *Commission Proposal EBA Amendment Regulation*, art. 1(7) amending EBA Regulation art. 44(1) subpara. 2.

<sup>180</sup> Conferring supervisory tasks on the ECB pursuant TFEU art. 127(6) requires only the consultation of Parliament in a special legislative procedure (TFEU art. 289(2)), whereas the concurring amendment of the EBA Regulation will find its legal basis in TFEU art. 114, and thus requires parliamentary consent in the ordinary legislative procedure (TFEU art. 294).

<sup>181</sup> EBA Amendment Regulation, art. 1 (24)(a) amending EBA Regulation, art. 44(1) subpara. 2.

<sup>182</sup> Ferran & Babis, *supra* note 29, at 27; Véron, *supra* note 6, at 8.

<sup>183</sup> This observation also explains the double-majority requirements for adopting supervisory decisions in emergency situations, EBA Regulation, art. 44(1) subpara. 7 as amended by EBA Amendment Regulation, art. 1(24)(a), and in matters pertaining to breaches of directly applicable E.U. law or cross-border disputes that apply in the latter cases as long as at least four Member States do not participate in the SSM, EBA Regulation, art. 44(1) subpara. 3 and subpara. 4 as amended by EBA Amendment Regulation, art. 1(24)(a). The amendments allow non-participating Member States to effectively block decision making. Moreover, in matters pertaining to breaches of directly applicable E.U. law, EBA Regulation, art. 17, and cross-border disputes, EBA Regulation, art. 19, EBA decisions will be drafted by an independent panel that is composed of the Board of Supervisor’s chairperson and six disinterested representatives from competent authorities, EBA Amendment Regulation, art. 1(22) amending EBA Regulation, art. 41. Ultimately, the double-majority requirement feeds concerns surrounding the EBA’s capacity as a decision maker in supervisory matters similar to those scrutinized *infra* for its rulemaking function. For a discussion see Ferran & Babis, *supra* note 29, at 26; on the (unintended) reverse consequences of *Commission Proposal EBA Amendment Regulation*, art. 1(7) amending EBA Regulation art. 44(1) subpara. 3 that made it very hard for non-participating Member States to veto decisions, Wymeersch, *supra* note 12, at 23.

ommendations etc. are adopted that would be perceived as entirely heteronomous from the perspective of non-participating Member States.

It need not be decided here whether it necessarily created negative externalities if participating Member States—with sometimes relatively small banking sectors<sup>184</sup>—could impose their views on adequate prudential banking regulation on dissenters. Euro area Member States may favor a different style of regulation, but there is no convincing evidence that their approach is inexpedient or even inimical. After all, the Commission was deliberately put in the position to weed out such outlandish regulatory blunders should they come out of the EBA.<sup>185</sup> With that in mind, one is tempted to ask if it was not the logic of the *de Larosière*-architecture with bolstered European Supervisory Agencies (ESAs) that individual Member States would have to accept majority decisions in order to achieve greater uniformity in regulation and its enforcement.<sup>186</sup> To be sure, the situation with coordinated and hence rather stable majorities poses a largely unanticipated scenario and the geographical distribution of Europe's financial services industry is such that the control of EBA-rulemaking would be external from the perspective of Europe's foremost financial center.<sup>187</sup>

Still, however, the focus on devising an institutional setup that primarily seeks to prevent coalitions from prevailing with their preferences in EBA decisions may be misguided. The promulgated double majority-requirement will also abet a paralysis of the Board of Supervisors and thus weakens the EBA's capacity to integrate supervisory standards through TFs etc.<sup>188</sup> The EBA's ability to act will be severely encumbered if no decision can be taken against either the ECB-orchestrated opposition of participating Member States or the resistance of non-participating Member States led by the Bank of England and its Prudential Regulation Authority. A plausible outcome will be that EBA rulemaking will attempt to paper over unresolvable conflicts by proposing rather vague TS etc. that allow implementing diverse supervisory approaches while being in full compliance with supranational regula-

---

<sup>184</sup> In June 2013, the aggregated balance sheet of U.K. monetary financial institutions accounted for 20.90% in the E.U. that of euro area MFIs for 72.15% that in other E.U. Member States for 6.95%, European Central Bank, Statistical Data Warehouse, MFI balance sheets (2013), <http://sdw.ecb.europa.eu/browse.do?node=2018811>. Véron, *supra* note 6, at 5 reports similar numbers, but overstates the U.K. share in his obviously flawed aggregation (total of 93.1%). Ferran & Babis, *supra* note 29, at 22 posit that the U.K. is „the location for almost 50 per cent of E.U. financial services business“.

<sup>185</sup> The Commission can decide not to endorse or to amend draft TS that exhibit severe defects, particularly if they contradict “fundamental principles of the internal market for financial services”, EBA Regulation, recital 23 with arts. 10(5)-(7) and 15(5)-(7).

<sup>186</sup> *High-level Expert Group on Financial Supervision in the EU, Report* 46-8 (Feb. 25, 2009) available at [ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf).

<sup>187</sup> See *supra* note 184. It is this indisputable situation which puts concerns into perspective that point to the double majority requirement's tendency to give non-participating Member States disproportionate influence in relation to their number, population and economic weight, Bundesbank, *supra* note 128, at 29. The latter indicators are simply less important than the relative size of the regulated industry which proxys a jurisdiction's affect- edness far more precisely.

<sup>188</sup> For a similar assessment see Ferran & Babis, *supra* note 29, at 27.

tion.<sup>189</sup> As a consequence, an incremental integration of supervisory practices under the auspices of the EBA may fall prey to this lurking standoff, whereas the ECB may proceed rapidly down this road by devising an ever tighter framework for the SSM.

## 5 NON-PARTICIPATING MEMBER STATES

The SSM represents an island-solution that is initially limited to Member States whose currency is the euro. As a consequence, the U.K. will not fall immediately within the remit of the SSM. Hence, the banking activities in Europe's foremost financial center<sup>190</sup> are fed into the transnational supervisory efforts only along the traditional lines of shared competences (*supra* 3.1). Obviously, on a micro-level, the stated goal of common supervision, to implement more uniform and integrated high-standard supervisory practices and the general rationale for supranationalizing prudential banking supervision (*supra* 2.1) speak strongly in favor of casting the net wide. On a macro-level, preserving the integrity of a single market where capital and services flow unimpeded across national borders is pivotal for the financial services industry and the prosperity of European polities.<sup>191</sup> Hence, the SSM in principle is rightfully hospitable towards new entrants as it offers an arrangement of close cooperation non-euro area Member States can opt-into (*infra* 5.1). Of course, an assessment of likely candidates for such a close cooperation cannot be limited to the attractiveness of the legal package,<sup>192</sup> yet the limited participation rights in ECB supervisory decision making suggest that it is rather un-alluring to submit to the euro area's supervisory architecture without adopting its currency (*infra* 5.2). What's more, the broad exit options for Member States in close cooperation prohibit the SSM from serving as an institutional device that allowed to signal a credible commitment to high quality supervision to markets (*infra* 5.3). All in all, the prospects of a broad participation of non-euro area countries are dim (*infra* 5.4).

### 5.1 CLOSE COOPERATION

Despite doubts relating to the lack of a sound legal basis for non-EMU participation,<sup>193</sup> Member States outside the euro area have the option to seek a "close cooperation" and thus opt into the SSM as full-fledged partners.<sup>194</sup> On request of the Member State the ECB will decide whether the preconditions for such a close coop-

---

<sup>189</sup> Ferran & Babis, *supra* note 29, at 27; Lo Schiavo, *supra* note 22, at 134-5.

<sup>190</sup> *Supra* note 184.

<sup>191</sup> Ferran & Babis, *supra* note 29, at 276.

<sup>192</sup> For a comprehensive discussion see Zsolt Darvas & Guntram B. Wolff, *Should non-euro area countries join the Single Supervisory Mechanism?* 6-10 (Bruegel Pol'y Contribution No. 6, 2013), available at <http://www.bruegel.org/download/parent/773-should-non-euro-area-countries-join-the-single-supervisory-mechanism/file/1652-should-non-euro-area-countries-join-the-single-supervisory-mechanism/>.

<sup>193</sup> Carmassi, Di Noia & Micossi, *supra* note 59, at 3-4; Wymeersch, *supra* note 12, at 24.

<sup>194</sup> *Commission Proposal SSM Regulation* arts. 6(3), 19(5) conditioned the representation of non-euro area Member States in the Supervisory Board on the ECB's decision establishing the close cooperation. For a discussion of this position of non-euro area participating Member States, Ferran & Babis, *supra* note 29, at 274-5.



eration are met, to wit if the domestic legal framework allows the ECB to function as the primary supervisor in relation to the pertinent NCA.<sup>195</sup> The Member State commits for a three year period from the ECB's decision and can request the termination of the close cooperation anytime thereafter.<sup>196</sup> The ECB can suspend or terminate the close cooperation if a procedure to remedy deficits fails, particularly if the Member State does not ensure, even after receiving a precise warning, its NCA's compliance with the ECB-set supervisory framework.<sup>197</sup> Once again, the ECB is equipped with strong tools to reign-in insubordinate NCAs.

## 5.2 SECOND-CLASS SSM-PARTICIPATION: NO ULTIMATE SAY IN ECB-DECISION MAKING

The key aspect that makes entering into a close cooperation relatively unattractive for Member States who do not—at least in medium term—aspire to introduce the euro could follow from the ECB's character as an institution of euro area Member States.

Participating Member States whose currency is not the euro will not be directly involved in ECB-decision making at the level of the Governing Council.<sup>198</sup> Hence, even though non-euro area SSM-participants are fully represented in the decision making process of the newly established Supervisory Board,<sup>199</sup> they will not take part in the Governing Council's ultimate determination whether supervisory decisions will be adopted or dropped (*supra* 3.3.2.1 and figure 3). Non-euro area Member States in close cooperation who disagree with a draft decision of the Supervisory Board only have a right to articulate their reasoned disagreement in order not to be bound by the pertinent decision if the Governing Council does not confirm the non-euro area Member State's objection.<sup>200</sup> If the Governing Council does not honor the Member State's concerns, the only remaining resort lies, however, in the immediate termination of the close cooperation on the affected Member State's request.<sup>201</sup> If, on

---

<sup>195</sup> SSM Regulation, art. 7(2). For a discussion of the contractual procedure Wymeersch, *supra* note 9, at 61-2.

<sup>196</sup> SSM Regulation, art. 7(6).

<sup>197</sup> SSM Regulation, art. 7(5).

<sup>198</sup> This follows from the Governing Council's function as the ultimately responsible decision making body of the euro area's monetary policy maker, defined in the TFEU and the ESCB and ECB Statute, *supra* note 146; Darvas & Wolff, *supra* note 192, at 3. For a discussion of the—largely unpromising—routes to redress the problems without a Treaty change *see* Ferran & Babis, *supra* note 29, at 21-2.

<sup>199</sup> SSM Regulation, art. 26(1) assigns a representative from each participating Member State's NCA full membership in the Supervisory Board. In light of the definitions in SSM Regulation, art. 2(1), (2), Member States that have opted for a close cooperation are thus put on equal footing with euro area members (*see also* SSM Regulation, art. 26(12) on the equal treatment of all participating Member States in the Supervisory Board's rules of procedure), as has been urged by the European Council Conclusions 18/19 October 2012, at 7, EUCO 156/12, *available* at [http://www.consilium.europa.eu/uodocs/cms\\_data/docs/pressdata/en/ec/133004.pdf](http://www.consilium.europa.eu/uodocs/cms_data/docs/pressdata/en/ec/133004.pdf). For a discussion of the evolution of the rule *see* Ferran & Babis, *supra* note 29, at 275.

<sup>200</sup> SSM Regulation, arts. 7(8), 26(8).

<sup>201</sup> SSM Regulation, art. 7(8).

the other hand, the non-euro area participant is opposed to an objection of the Governing Council that led to a change of the Supervisory Board's draft decision, it can submit its reasoned disagreement to the Council that will consider withdrawing or confirming its original objection within thirty days.<sup>202</sup> In case of a confirmation, the participating Member State has the option to avoid being bound by the ultimate decision, albeit at the risk of the ECB terminating or suspending the close cooperation.<sup>203</sup> In light of the incisive consequences of such a kick-out from the SSM, it has been suggested that the decision should be taken on the highest political (European Council) rather than on the more technocratic level (ECB).<sup>204</sup> Yet, the proposition was not seized during the legislative process, arguably because the decision is certainly primarily one of supervisory expedience and is thus wisely assigned to the highest decision making body within the SSM.

Even if concerns over a pervasive discrimination of non-euro area participating Member States may be unwarranted, also because they are prohibited as a matter of law,<sup>205</sup> it is a significant difference if a representative of the affected Member State can participate actively in the Governing Council's deliberations or if the Member State has to rely *dégagé* on the benevolent consideration of a position articulated *ex ante*. This may be a bitter pill to swallow for those E.U. Member States who indeed wish to signal their good will to further the common cause as part of their quest to join the euro-club. Yet, it may well prove unacceptable for others.

### 5.3 SSM IS NO "LOBSTER TRAP"

Moreover, the SSM does not provide a credible bonding option for those Member States whose currency is not the euro if they seek to credibly commit to high quality supervision of their banking sector.<sup>206</sup> For institutional choice to serve as a positive signal to markets it is indispensable that opportunistic changes to the original decision *ex post* are ruled out. The issue is to overcome a commitment problem that otherwise existed for Member States whose currency is not the euro if it was not for the support by the pertinent institutions.<sup>207</sup>

As the option to leave exists for those Member States whose currency is not the euro, especially if they are discontent with hard supervisory decisions, and—

---

<sup>202</sup> SSM Regulation, art. 7(7), 26(8).

<sup>203</sup> SSM Regulation, art. 7(7) subpara. 2-4.

<sup>204</sup> Véron, *supra* note 6, at 5.

<sup>205</sup> SSM Regulation, arts. 1(4), 26(12).

<sup>206</sup> The literature has discussed and advocated choice-based approaches where either jurisdictions, Gérard Hertig, Ruben Lee & Joseph A. McCahery, *Empowering the ECB to Supervise Banks: A Choice-Based Approach*, 7 EUR. COMPANY & FIN. L. REV. 171, 181–89, 194–210 (2010), or individual banks, Ivan Mortimer-Schutts, *EU Regulatory and Supervisory Convergence: The Case for a Dual System with Choice* (Am. Enterprise Inst., Working Paper No. 39, 2005), available at [http://www.gem.sciences-po.fr/content/publications/pdf/IMS\\_1205\\_Dual\\_EU\\_Reg\\_Struct.pdf](http://www.gem.sciences-po.fr/content/publications/pdf/IMS_1205_Dual_EU_Reg_Struct.pdf); Cihak & Decressin, *supra* note 2, could opt-into a European regime of banking regulation and supervision.

<sup>207</sup> See generally Douglass C. North & Barry Weingast, *Constitution and Commitment: The Evolution of Institutions Governing Public Choice in 17th Century England*, 49 J. ECON. HIST. 803 (1989).

even more importantly—participating Member States who fail to live up to the SSM’s supervisory standards may be expelled,<sup>208</sup> the SSM is not the proverbial lobster trap required for credible bonding by submitting to stringent institutions.<sup>209</sup> It thus does not allow reaping the welfare benefits that would accrue in the form of lower financing costs for more stable banks and consequentially cheaper access to credit if such bonding was available.

#### 5.4 CANDIDATES FOR CLOSE COOPERATION?

It was indeed a strong incentive to join the SSM if the opt-in offered risk-sharing and least-cost bank resolution through ESM backing.<sup>210</sup> Yet this seems hardly an option, as the ESM was established by an intergovernmental Treaty of the euro area Member States outside of the E.U. framework and is thus not immediately available for non-euro area participating Member States<sup>211</sup>

Obviously, benefits associated with an opt-in can follow from higher supervisory quality and restrictions on regulatory arbitrage, reduced compliance costs for transnational financial institutions, and the termination of home/host-coordination requirements. The latter aspect is not straightforward though and very much depends on how (subsidiary or branch) and where (participating or non-participating Member State) foreign assets are held, because there is no direct ECB supervision of subsidiaries in non-participating Member States regardless of whether the group’s home Member State is in close cooperation or not.<sup>212</sup> However, these advantages that largely accrue in the private sector may not compel governments to cease sovereign rights. Hence, it will ultimately hinge on a non-euro area Member State’s individual situation if the option to join the SSM will be exercised.

The case seems stronger for Central European Member States who have pegged their currency to the euro and have a financial sector largely dominated by subsidiaries of foreign banks,<sup>213</sup> although of course joining the SSM would entail a significant seizure of sovereign rights in supervising these subsidiaries.<sup>214</sup> Supranationalizing supervision potentially counters the preference of consolidating home

---

<sup>208</sup> Darvas & Wolff, *supra* note 192, at 9 note 10 also point to the “very special status” of non-euro area countries that favor “purely national interests”. Similarly Lo Schiavo, *supra* note 22, at 135-6.

<sup>209</sup> For a theory comparing irrevocable commitments to high regulatory standards (mandatory disclosure rules) with a lobster trap Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, (2002).

<sup>210</sup> Goyal et al., *supra* note 8, at 29.

<sup>211</sup> See Treaty Establishing the European Stability Mechanism (ESM) and ECJ Case C-370/12, *Pringle v Government of Ireland, Ireland and The Attorney General*, 2012 E.C.R. I-■■■.

<sup>212</sup> See *supra* 3.2.1, 3.2.3. Darvas & Wolff, *supra* note 192, at 6 present case studies for a Danish and a Hungarian banking group.

<sup>213</sup> Wymeersch, *supra* note 12, at 23.

<sup>214</sup> See *supra* 3.1 and table 1. Darvas & Wolff, *supra* note 192, at 5, 14-5 show that if central and eastern European countries entered into close cooperation, direct ECB supervision would cover primarily foreign subsidiaries in these jurisdictions.

supervisors to push for downsizing foreign lending in a situation of domestic crisis.<sup>215</sup> To a certain degree, even non-participating Member States will benefit as free-riders from a dilution of the pertinent preference if the banking group's parent is a significant institution authorized in a participating Member State and thus falls within the remit of direct ECB supervision.<sup>216</sup> The ECB's motivation to compel a deleveraging in foreign jurisdictions may be less strong as it does not only serve the clearly defined national interests of the group's home Member State.<sup>217</sup> Yet, the non-participating Member State will still remain an "outsider" *vis-à-vis* the consolidating supervisor and may, at least at the margin, improve its position by joining the club as a full member with participation rights.

For political reasons it is hard to imagine that the U.K. will dare moving in a direction that may be perceived as approaching the EMU. However, it has to be kept in mind that the City of London has to swallow the bulk of centralized banking policy output anyway, for instance in the form of the comprehensively harmonized banking regulation (CRD IV/CRR)<sup>218</sup> that brings, amongst others, bonus caps for bank personnel<sup>219</sup> that are very unpopular in the City. In medium term, the U.K.'s choice will most likely depend on how its interests will be affected by the SSM, even though it stays on the sidelines.<sup>220</sup> Despite the legal obligation to abstain from any discrimination against non-participating Member States whose currency is not the euro,<sup>221</sup> the described mode in which the ECB-driven, closer integration of supervisory practices among participating Member States will operate (*supra* 4), suggests that widening gaps do neither conform with the rationale of a single market for banking services,<sup>222</sup> nor make life easier for the City's cross-border banks who might ultimately push for a pragmatic accession to the SSM.

## 6 CONCLUDING REMARKS (ALSO) ON THE BIGGER PICTURE

The assessment provided here is primarily concerned with the likely effectiveness of the SSM as a supervisory regime to improve steady state financial stability, *i.e.* the adequacy of the institutional arrangement for normal times-supervision.

---

<sup>215</sup> Generally on the conflicting preferences of home and host supervisors, Richard J. Herring, *Conflicts Between Home & Host Country Prudential Supervisors* (Wharton Financial Institutions Center, Working Paper Series No. 33, 2007), available at <http://fic.wharton.upenn.edu/fic/papers/07/0733.pdf>; Fiechter et al., *supra* note 47, at 18; see also Ferrarini & Chiarella, *supra* note 22, at 8-10, 14 et seq.

<sup>216</sup> *Supra* 3.2.1.

<sup>217</sup> In principle, the ECB cannot discriminate against non-participating Member States whose currency is not the euro, SSM Regulation, art. 1(4).

<sup>218</sup> Darvas & Wolff, *supra* note 192, at 4 argue that there will be "no material difference between countries in the SSM and those outside the-SSM" with regard to prudential regulation once CRD IV/CRR will be implemented. But see also those commentators that posit the persistence of significant divergences in national banking laws *supra* note 172.

<sup>219</sup> CRD IV, art. 94.

<sup>220</sup> However, it is clear that the practical modalities of the operation of the SSM will be shaped during the months prior to its becoming operational, thus giving "stragglers" only limited influence in this regard.

<sup>221</sup> SSM Regulation, art. 1(4).

<sup>222</sup> For a similar view, Ferran & Babis, *supra* note 29, at 276.

It hence does not look at (important) concerns regarding the ECB's accountability as a supervisor<sup>223</sup> or the legitimacy issues regarding the special review process involving the newly created Administrative Board of Review.<sup>224</sup> Furthermore, it is analytically indifferent with regard to the ramifications it has that a central bank will serve as the primary supervisor, *i.e.* it does not take into immediate account negative spillover effects for the ECB's monetary policy function that could add to the doubts.<sup>225</sup> The institutional combination of supervisory and monetary policy under one roof puts the central bank in a position to avoid hard supervisory decisions, potentially even cover own deficient oversight by easing monetary policy and thus modifying the focus on the inflation objective; it can also provide liquidity to banks despite their insolvency to secure price stability; it can refrain from withdrawing bank licenses if it faces losses as a bank creditor.<sup>226</sup> In fact, the ECB—without having a lender of last resort mandate<sup>227</sup>—has, at various stages during the ongoing sovereign debt crisis provided quasi-backstops to ailing banking systems through its instruments of monetary policy, e.g. by broadening the definition for eligible collateral against which it lends to banks, lowering the minimum credit rating for this collateral, reducing the haircut/increasing the advance rate for collateral banks presented, easing borrowing terms and conditions etc.<sup>228</sup> It is only the safeguards against such negative spillovers that influence the analysis as the attempts to separate the ECB's monetary policy function from its supervisory tasks complicates its decision making process (*supra* 3.3.2.1).

Other papers focus on the SSM's capacity to attenuate the current instabilities. As a consequence, these analyses evaluate the SSM essentially as a necessary precondition for direct ESM-recapitalizations. The latter arguably represents the cost-minimizing mechanism for the orderly reorganization of Europe's troubled banks.<sup>229</sup> However, if seen from that vantage, the SSM may actually exacerbate the too-big-to-fail problem in the long run, as larger bail-out capacities tend to produce

---

<sup>223</sup> SSM Regulation, arts. 20, 21. For an extensive discussion of these issues Ferran & Babis, *supra* note 29, at 270-3.

<sup>224</sup> SSM Regulation, art. 24.

<sup>225</sup> Specifically on these issues Donato Masciandaro & Maria Nieto, *Governance of the Single Supervisory Mechanism: Some Reflections* (Baffi Center Research Paper No. 149, 2014) available at [ssrn.com/abstract=2384594](http://ssrn.com/abstract=2384594). For a general discussion of the issue see Charles Goodhart & Dirk Schoenmaker, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, 47 OXFORD ECON. PAPERS 539 (1995); with a special view to the EMU, European Central Bank, *The Role of Central Banks in Prudential Supervision* (2001), available at [www.ecb.int/pub/pdf/other/prudentialsupcbrole\\_en.pdf](http://www.ecb.int/pub/pdf/other/prudentialsupcbrole_en.pdf); for an optimistic view of an insider Constâncio, *supra* note 135.

<sup>226</sup> Pisani-Ferry et al., *supra* note 6, at 11; Goyal et al., *supra* note 8, at 14.

<sup>227</sup> *Supra* note 60. Michel Aglietta, *A Lender of Last Resort for Europe*, in WHICH LENDER OF LAST RESORT FOR EUROPE 47 (Charles C. Goodhart ed., 2000); Charles Wyplosz, *Banking Union as a crisis management tool*, in BANKING UNION FOR EUROPE – RISKS AND CHALLENGES 19-21 (Thorsten Beck ed., 2012) perceive this as a deficit of the EMU.

<sup>228</sup> For a chronology of the relevant measures see European Central Bank, *Annex - Chronology of Monetary Policy Measures of the Eurosystem*, 11 MONTHLY BULLETIN I, I-IV (2011), available at <http://www.ecb.int/pub/pdf/mobu/mb201111en.pdf> and the assessment of Schoenmaker, *supra* note 30, at 56).

<sup>229</sup> Goyal et al., *supra* note 8, at 9-10, 20-21, 26. Already *supra* note 15.

correspondingly larger institutions whose growth may or may not be adequately controlled by structural prescriptions how banks should separate their business lines.<sup>230</sup>

The evaluation of the SSM ultimately depends on where the most virulent problems impeding effective prudential supervision are seen, to wit whether it is indeed the avoidance of regulatory forbearance triggered by NCAs' "home bias" that should shape the institutions of normal times-supervision. In this regard, the view that sees the SSM as a panacea<sup>231</sup> seems to be influenced by availability heuristics. However, even if avoiding capture is key, the SSM's institutional set-up seems suboptimal (*supra* 3.3.1.2) and requires carefully designed integrative elements that provide the carrots to complement the sticks (*supra* 3.3.2). Moreover, it has to be kept in mind that it obviously becomes harder for local interests to capture a supra-local supervisor.<sup>232</sup> Yet, this doesn't say much for instances where the interests of agents themselves are broader and may thus lead to potentially more devastating capture on a higher level.<sup>233</sup>

The effectiveness of common supervision also depends critically on the interplay with the resolution regime, particularly with the institutions of the SRM. Ultimately, only the credible option to close down a bank without systemic consequences lends momentum to supervisory authorities.<sup>234</sup> Moreover, as long as resolution and the pertinent safety net (backstop) remain national, Member States would still have to bear (in part) the fiscal consequences of the decisions of foreign/external supervisory authorities. Any arrangement without a symmetric burden-sharing mechanism obviously drives a wedge between participating Member States incentives and the social optimum.<sup>235</sup> In that sense, it is an important step into the right direction that SSM-participation automatically triggers SRM-membership.<sup>236</sup> Howev-

---

<sup>230</sup> *High-level Expert Group on reforming the structure of the EU banking sector, Final Report, at (Oct. 2, 2012), available at [http://ec.europa.eu/internal\\_market/bank/docs/high-level\\_expert\\_group/report\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf).*

<sup>231</sup> E.g. Ferrarini & Chiarella, *supra* note 22, at 40.

<sup>232</sup> Sumit Agarwal, Amit Seru & Francesco Trebbi, *Inconsistent Regulators: Evidence from Banking* (Nat'l Bureau of Econ. Research, Working Paper No. 17736, 2012), *available at* <http://www.nber.org/papers/w17736.pdf> show that U.S. federal supervisors observe more stringent supervisory practices than state authorities.

<sup>233</sup> *See e.g.* MACEY, *supra* note 11, at 231-250 for a deeply pessimistic account of the SEC being captured by Wall Street.

<sup>234</sup> Sapir, Hellwig & Pagano, *supra* note 32, at 2, 5-6 who point to the post Lehman-experience where authorities refrained from closing down banks for lack of operable resolution regimes that would limit contagion and provide for adequate loss allocation and burden sharing; *see also* Goyal et al., *supra* note 8, at 12; Ferran & Babis, *supra* note 29, at 263.

<sup>235</sup> Goyal et al., *supra* note 8, at 12, 22.

<sup>236</sup> Regulation 806/2014 of the European Parliament and of the Council Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and Amending Regulation 1093/2010 [hereinafter: SRM Regulation], arts. 2(a), 4, 2014 O.J. (L 225) 1. The package solution clearly adds to the complexity of the determination of Member States whose currency is not the euro whether to join the SSM: as SSM membership is firmly linked to SRM participation, the Outs currently don't know for sure what they are buying with an opt-in.

er, the Single Resolution Fund's (SRF) relatively slow filling, its ultimate dwarfism<sup>237</sup> and the delayed mutualization of the paid in means<sup>238</sup> make it clear that the new resolution regime does neither solve the backstop question quickly nor entirely.

Furthermore, the ECB had sound reasons not to become immediately involved in resolution that will always tend to have fiscal implications. Yet, because resolution powers will not be vested with the ECB due to precisely these sensible rationales, the separate resolution authority needs to have partly parallel supervisory powers to facilitate orderly reorganization and resolution.<sup>239</sup> It is hard to imagine that the participation of the Chair of the European Resolution Authority in the Supervisory Board's meetings<sup>240</sup> will solve all the looming coordination problems: the ECB is tasked with early intervention,<sup>241</sup> and will be in the position to pull the plug.<sup>242</sup> It is also competent to conduct recovery planning<sup>243</sup> but assumes only a consultative underpart in resolution planning that falls in the domain of the Single Resolution Board.<sup>244</sup> Clearly, the latter depends on the comprehensive inter-institutional flow of information gathered in ongoing prudential supervision which again is only safeguarded by a legal obligation to share all required information promptly.<sup>245</sup>

In sum, the institutional design of the SSM suffers from severe structural shortcomings that probably will not all be entirely solvable in supervisory practice once the system becomes operational. Generally, an improved institutional ar-

---

<sup>237</sup> SRM Regulation, art. 69(1) provides that the target level of 1% of all deposits benefiting from guarantee schemes (see Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, art. 2(1)(5), 2014 O.J. (L 173) 149) has to be reached only on January 1, 2024. The E.U. Commission estimates its size at €55 billion, Press Release, European Commission, A Single Resolution Mechanism for the Banking Union (April 15, 2014), [http://europa.eu/rapid/press-release\\_MEMO-14-295\\_en.pdf](http://europa.eu/rapid/press-release_MEMO-14-295_en.pdf).

<sup>238</sup> The SRF will start with national compartments that bear the resolution costs of banks that were licensed in the pertinent Member State in the first place. Over a transitional period an incremental portion of all the paid in means of the SRF (starting at 40% in 2016, jumping to 60% in 2017 and rising by additional 6.66% each subsequent year) may be deployed to fund resolutions occurring in any participating Member State if the pertinent national compartment proves insufficient. See Intergovernmental Agreement on the transfer and mutualisation of contributions to the Single Resolution fund, arts. 1(b); 5(a), (b); 12(2), May 14, 2014, <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT>.

<sup>239</sup> Pisani-Ferry et al., *supra* note 6, at 11. SRM Regulation, art.13 prescribes the exchange of information between the ECB/NCAs and the Single Resolution Board once they take measures of early intervention pursuant SSM Regulation, art. 16 or CRD IV, art. 104.

<sup>240</sup> SSM Regulation, recital 70.

<sup>241</sup> SSM Regulation, art. 4(1)(i), 16. Early intervention powers also reside at NCAs for less significant institutions, thus multiplying the coordination problem between supervisory and resolution authorities.

<sup>242</sup> Apart from withdrawing a bank's license, SSM Regulation, art. 4(1)(a), 14(5), the ECB also has the prerogative in assessing whether an institution is failing or is likely to fail and thus has to be resolved, SRM Regulation, art. 18(1).

<sup>243</sup> SSM Regulation, art. 4(1)(i); SRM Regulation, art. 10(2).

<sup>244</sup> SRM Regulation, arts. 8(2), (13); 10(1), (7); 12(1), (15).

<sup>245</sup> SRM Regulation, art. 8(12).

rangement requires the much dreaded change of the TFEU<sup>246</sup> that would open up political accountabilities of a different kind. However, in its current state, the SSM will certainly not be the much longed for panacea for Europe's current woes. To become more than a quack policy maker's initiative to display problem solving capacity,<sup>247</sup> substantial efforts to ultimately achieve what arguably could not be accomplished under conceived time-pressure in the first round will remain inevitable.

---

<sup>246</sup> See also Schneider, *supra* note 15, at 454 citing *Jeroen Dijsselblom* and hinting that the banking union was introduced accepting breaches of EU law.

<sup>247</sup> The picture of a quack regulator originates with Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Law*, 114 YALE L.J. 1521 (2005) and was carried over to financial regulation in Steven M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779 (2011).



## Recent Issues

No. 26	Michael J. Brennan, Holger Kraft	<b>Financing Asset Growth</b>
No. 25	Holger Kraft, Alexander Schmidt	<b>Systemic Risk in the Financial Sector: What Can We Learn from Option Markets?</b>
No. 24	Andrej Gill, Nikolai Visnjic	<b>Performance Benefits of Tight Control</b>
No. 23	Andrej Gill, Nikolai Visnjic	<b>Insight Private Equity</b>
No. 22	Dirk Bursian, Alfons J. Weichenrieder, Jochen Zimmer	<b>Trust in Government and Fiscal Adjustments</b>
No. 21	Stefano Corradin, Reint Gropp, Harry Huizinga, Luc Laeven	<b>Who Invests in Home Equity to Exempt Wealth from Bankruptcy?</b>
No. 20	Zeno Adams, Roland Füss, Reint Gropp	<b>Spillover Effects among Financial Institutions: A State-Dependent Sensitivity Value-at-Risk Approach</b>
No. 19	Reint Gropp, Christian Gruendl, Andre Guettler	<b>Hidden Gems and Borrowers with Dirty Little Secrets: Investment in Soft Information, Borrower Self-selection and Competition</b>
No. 18	Alfons J. Weichenrieder, Jochen Zimmer	<b>Euro Membership and Fiscal Reaction Functions</b>
No. 17	Holger Kraft, Frank Thomas Seifried	<b>Stochastic Differential Utility as the Continuous-Time Limit of Recursive Utility</b>
No. 16	Marius Ascheberg, Nicole Branger, Holger Kraft	<b>When do Jumps Matter for Portfolio Optimization?</b>
No. 15	Holger Kraft, Claus Munk, Frank Thomas Seifried, Sebastian Wagner	<b>Consumption Habits and Humps</b>
No. 14	Dirk Bursian, Ester Faia	<b>Trust in the Monetary Authority</b>