

LAW AND ECONOMICS YEARLY REVIEW

ISSUES ON FINANCIAL
MARKET
REGULATION,
BUSINESS
DEVELOPMENT AND
GOVERNMENT'S
POLICIES ON
GLOBALIZATION

Editors

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Mission

The “Law and Economics Yearly Review” is an academic journal to promote a legal and economic debate. It is published twice annually (Part I and Part II), by the Fondazione Gerardo Capriglione Onlus (an organization aimed to promote and develop the research activity on financial regulation) in association with Queen Mary University of London. The journal faces questions about development issues and other several matters related to the international context, originated by globalization. Delays in political actions, limits of certain Government’s policies, business development constraints and the “sovereign debt crisis” are some aims of our studies. The global financial and economic crisis is analysed in its controversial perspectives; the same approach qualifies the research of possible remedies to override this period of progressive capitalism’s turbulences and to promote a sustainable retrieval.

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PRESENTATION

1. The positive opinion expressed to this Review by the international scientific Community suggests continuing on the path already taken. The Journal – alongside with its founders’ intentions – seems to succeed in its goal to give birth to an important international *forum* of scholars views and policy makers perspectives. The debate which has developed out of such *forum* is aimed at creating lines of convergence on certain significant questions of law and economics.

In the first year, the focus of the contributions has been dedicated to various aspects of the financial crises highlighting best practices and issues, which are important to identify solutions to address Euro zone-related difficulties. As a result thereof, a complex series of issues surfaced, the origins of which derive not only from the economic gap between the different EMU state members, but also from their deep cultural diversity, representing a clear hurdle in the behavioral harmonization needed to achieve forms of more cohesive integration.

In particular, the analysis carried out by this Review – upon the identification of the origins out of which the financial crises and sovereign debts have stemmed, as well as the remedies activated by Europe in its quest for solutions to those problems which are not slowing down its growth – initially highlighted the difficulty to find a sustainable economic model, the new institutional architecture for EU financial system supervision, the effects of European economic crises on the organizational governance and professions.

Thereafter, a particular focus was given to specific aspects of the restructuring process, from the proposed European Stability Mechanism (ESM) to suggestions

for improving bank risk management, credit rating agencies and some selected aspects of the European sovereign debt crisis.

The result of such analysis led to a sufficiently broad overview over the research field covered by the Review, which has been further enriched with the evaluation of the impact of the crisis on democracy levels (and, accordingly, the ability of Parliaments to be involved in the governance process), as well as certain States' specific reactions (Germany, Italy and Russia).

In addition, the analysis carried out by this Review allows to underline the need of behavioral changes, linked to new business policies, regulatory objectives; more generally, this research provides the ideas to mark a common framework for shaping the future European States Union.

2. Furthering its programmatic commitment, the intention of the Review for the two portions of the current year is to focus on the envisaged «European Banking Union» and analyse certain aspects regarding derivative financial operations.

The choice to address such topics is linked to the significant importance played by the latter in law and economic dissertations. The «European Banking Union» project – as the first essay in this issue will illustrate in detail – should represent a turning point with respect to EU member state financial integration and revitalise the EU member state unification process by virtue of the single banking supervision mechanism. Nonetheless, material hurdles on the way to achieve a «political union» still exist; such goal, in particular, is opposed by various centripetal forces and individualistic interests of certain States, which are not willing to lose long-standing consolidated privileges and/or are very little inclined to adopt solidarity behaviours towards other EU member states (of which

virtuous states beware due to the little rigorous behaviour, far from reflecting forms of austerity).

The analysis of “derivative contracts” concerns aspects of the financial activity which, given their complexity and the specificity of the relevant field of application – trigger specific social and economic consequences. This is why both legal scholars and operators of the relevant financial sector shall highlight the differences between such type of transactions and the traditional credit intermediation, assess the significant risks associated with derivative financial transactions, and identify certain criteria limiting the involvement in such transactions to specific types of operators.

Focusing on such particular financial transactions does not only help financial operators in evaluating the technical specificities of financial instruments which are increasingly important on the market, but it also provides useful indications to lawmakers in order to improve the quality of rules, so to avoid (or at least limit) the use of such instruments to meet demands different from those which originally determined their success.

As a result thereof, the use of those toxic assets which have contaminated the markets and caused unbalance in the economic system could be limited.

3. As a renewal of the original indication as to the systemic structure of the Review, it is our intention to widen our observation to other issues different from those covered in the parts of the single-issue magazine.

In effect, our wish is to stimulate an important topic-based international gathering which, in consideration for the specificity of the issues being addressed, may become an observatory on business relations, financial activities and sovereigns shortcomings. In particular, the focus will be placed on various aspects concerning issues of primary importance in the definition by leading

countries of their development policies, the analysis of new supranational economic and financial relationships or amendments to the organizational rules aimed at implementing more intense and pervasive forms of integration among States.

Such in-depth analysis will lead us to consider best practices and solutions that are pivotal to understand which instruments shall be adopted at a national, international, and global level, by managing scarce resources for value creation in a turbulent globalised environment. In such perspective, we believe that the heading of such section shall read «focus on global perspectives».

Francesco Capriglione

Editor-in-Chief

EUROPEAN BANKING UNION.

A CHALLENGE FOR A MORE UNITED EUROPE

*Francesco Capriglione**

ABSTRACT: *The single supervision mechanism, enacted by European Council at the end of 2012, marks a significant “turning point” on the European integration process, by opposing the uncertainties and doubts Euro sceptics, determined by the recent financial crisis, a technical project that intends to strengthen the construction of Union. This mechanism aims to realize a banking supervision geared to the homogenization of operational forms and, therefore, proper to enhance strong forms of coordination and cooperation between Member States. On the basis of this program, we can believe that only by passing 28 different banking regulatory systems will become possible to overcome the problems and conflicts which continue to be experienced in the Union, by introducing corrective changes to the current recessionary situation.*

This has led to the creation of a European Banking Union and the assignment to the ECB of supervisory powers over those banks, whose operational size is able to affect the stability of the financial system. This assignment is coherent with the unitary character of the “money-credit” phenomenon and, therefore, into account of the link between the governance of credit and monetary; it also recognizes the role of the ECB in recent years through the so-called unconventional operations (from the “Security Market Programme” plan to the “Long Term Refinancing Operations” and, subsequently, to the Medium-Term Objective) to cope with the exceptional events that arose in the financial markets. Then we have to believe that it is undoubtedly legitimate for the institution in question to take on its new role, on additional considerations relating to the

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possibility provided for in paragraph 6 of Article 127 of the FEU Treaty to confer upon the ECB “specific tasks” in the prudential supervision of credit institutions.

Various substantial obstacles, such as wide cultural diversity and also conflicting interests between the different EU countries, may hinder the achievement of the objectives indicated above. In this context, a particular role is played by the United Kingdom, which was not so keen to join the Euro zone and which recently decided to renegotiate its participation in the Union. Therefore, it is difficult to say what will be the results of such an innovative construction, and what are the chances of a positive outcome to an intervention which is heavily engaging European institutions. It seems that such a goal will only be achievable when each Member State accepts diversity with a sharing spirit, when solidarity becomes a citizen in Europe, making concrete a far-off vision for a common life.

SUMMARY: 1. Introduction. - 2. The financial crises and the problems of the euro zone. - 3. *(continued)*: the need for a “turning point” in policy. - 4. The European Banking Union and a “single banking supervision mechanism” in the euro area: the EU Commission’s proposal... - 5. *(continued)*: ...the Regulation of the European Council ... - 6. *(continued)*: ... effects on the institutional architecture for EU financial system supervision... -7. The contents of the single supervision mechanism... - 8. *(continued)*: ... the effects on the interactions between the EU and the national authorities. - 9. New role of the ECB... - 10. *(continued)*: ... and its legitimacy for banking supervision. - 11. A first step towards a European political union? - 12. *(continued)*: the barriers to change. - 13. *(continued)*: the particular position of United Kingdom. - 14. Concluding remarks.

We must not fear the future, be afraid of change. We can build nothing by defending s6entrenched positions and our own particular interests; all of us stand to lose. What is needed is awareness, solidarity and foresight.

Ignazio Visco, May 2013

1. On December 13th, 2012 the European Council approved the single supervisory mechanism for the euro. This was one of the measures identified in mid-2012 by the same European Council for economic recovery in the EU. The intervention by the Commission (which in September had presented the proposal that served as the basis for negotiation) ascribes specific importance to this project by granting its detailed implementation to the EU institution competent to represent the interests of “Europe” as a whole.

This has led to the creation of a European Banking Union and to the assignment to the ECB of supervisory powers over those banks whose operational size is able to affect the stability of the financial system.

This is a project consistent with the unitary character of the “money-credit” phenomenon. It focuses on the link between the governance of credit and monetary policy;¹ hence there is an expectation of a valid surveillance action specifically geared to the homogenisation of operational forms and, more generally, to the rebalancing of financial markets and economic systems.

When considered carefully, the unitary control function assigned to the ECB is a clear signal of the regulator’s purpose to ensure, in this way, that there are uniform rules at the European level for the carrying out of banking business. This should facilitate the pursuit of the objective of “sound and prudent management”, to be implemented under the guidance of an innovative supervision method (i.e. one that is able to guarantee equivalent powers vis-à-vis all intermediaries).

In the end, it appears, therefore, that there is regulatory guidance that co-ordination and cooperation may take appropriate procedural significance only through the completion of “27 different banking regulatory systems... all

¹ See CAPRIGLIONE and SEMERARO, *Financial crisis and sovereign debt: the European Union between risks and opportunities*, in *Law and Economics Yearly Review*, 2012, part. I, pp. 50 ff.

based on national rules and national rescue measures”.² In this way the financial sector crisis will be properly addressed, avoiding possible situations of contagion and an increase of sovereign debt.

There is no doubt, therefore, that the programme of the European Council is based on the objective of defining a framework aiming at improving competition, and this should be followed by desirable benefits in terms of productivity and development, due mainly to a new climate of confidence in the financial system. More generally, this project is likely to be linked to the more important objective of facilitating the establishment of more cohesive forms of integration between EU Member States, so as to give specific substance to the process of “political union” among them.

In this context, the positive endorsement by the Finance Ministers of the Member States to the “Agreement” reached at the European Council meeting on 27-28 June 2013 (an agreement for the handling of future bank failures according to functional procedures, to prevent risks of financial instability in the euro area) is surprising.³ Envisaging a number of measures related to the risk of failure of banks and financial institutions, the agreement established the so-called “bail-in”, i.e. the participation of shareholders and creditors if the crisis procedure was applied, but confirmed, however, the exclusion from the participation of those with bank balances less than EUR 100,000.

More precisely, according to the Single Resolution Mechanism provided for in the agreement, the use of common resources can only occur as a result of a bail-in, and will apply first the share capital and subordinated loans, then ordinary bonds, and finally deposits in excess of EUR 100,000, up to an absorption of losses equal to at least 8% of the financial liabilities of the bank. Deposits un-

² See EUROPEAN COMMISSION, *Memo of 10 September 2012*, p.1

³ See in particular the comment by Minister Saccomanni defining it as “a good compromise in the direction of the banking union”, as reported by www.agi.it.

der EUR 100,000 and bonds covered by a double guarantee (which are actually not much used outside Germany) are excluded from a bail-in.⁴ Participation in the losses by shareholders and ordinary bondholders does not raise particular issues: it can be seen as a positive thing, creating a level playing field with investment conditions in non-banking companies, and also being aimed at overcoming the competitive distortions caused by the easier placement of securities issued by banks to retail customers.⁵

If it is acceptable to try to avoid distortions in the equity and bond markets in favour of banks, the “treatment” described above reserved for depositors appears much less clear. The safeguards in favour of depositors that are provided by law in almost all countries are in fact based on the recognition of the function played by depositors in providing finance to all sectors of the economy but first to non-financial sectors. The involvement of depositors, beyond the mere defence of what is perceived as the national interest in some states, can be justified on public interests grounds only by the dubious argument that it improves the efficiency of the system, by encouraging the “migration” of customers towards “healthier” banks: this sounds like a kind of externalization of the costs of supervision, which would end up being partially borne by customers. The link between this type of argument and the recent EU decisions emerges clearly in a Report by Beck, Gros and Schoenmaker presented to the European Parliament in March, in which opinions are expressed that seem to be closely related to the “literature” supporting the use of wide bail-ins.⁶

⁴ See EUROPEAN COUNCIL 27/28 JUNE 2013 (EUCO 104/2/13 REV 2, CO EUR 9 CON CL 6), *Conclusions*, Part III. See also BRAGANTINI, *Verso l’unione bancaria europea. Ora un passo indietro degli Stati*, in *Corriere della Sera*, 29 June 2013.

⁵ The advantage to banks in placing their securities with retail clients it is clearly shown by the “financial accounts” published by Banca di Italia which show that more than 95% of bonds held by Italian households are issued by banks (see www.bancaditalia.it).

⁶ See BECK, GROS and SCHOENMAKER, *On the Design of a Single Resolution Mechanism*, in *European Parliament*, DG for Internal Policies, Monetary Dialogue, Brussels, 18 February 2013, p.

Without addressing here the issue of the quality of the appraisal that is actually available to savers and retail investors, the “bank run” and other negative effects of the Cypriot crisis of 2013, which did not solely originate from uncertainty about how far creditors would be involved, should at least be remembered. The huge losses imposed in Cyprus on depositors whose deposits exceeded EUR 100,000 were welcomed by the President of the Eurogroup Dijsselbloem as an experiment that can be repeated, and caused high tension in the financial markets. In the words of the British press this was “*an open invitation to any investor with more than €100,000 in a euro zone bank to remove it without delay, which some then did*”.⁷ According to the US press, “*Investors will be watching to see if Europe stays true to its word that the Cypriot bailout was unique*”⁸. These reactions explain the determination with which President Draghi, in his constant efforts to protect the financial stability and functioning of financing mechanisms in the euro zone, denied the common interpretation by the public of the words of the President of the Euro group.⁹

Almost in an effort to forget the obvious interpretation of the sequence of events reported above, during the European Council meeting of 27 and 28 June 2013 a selection criterion (based on merit) for intermediaries operating in

41 which states: “*The best resolution mechanism will not work properly if the competent authorities continue to follow the principle that no bank should ever be allowed to fail, and that most creditors (including senior unsecured and large depositors) should always be guaranteed full payment. If this practice continues, investors will not price the risk of banks properly*”. In the same report it is stated that: “*Even the best designed SRM will be useless if the authorities are too afraid of the systemic consequences of large failure to let any banks ever go under. At present very little bail-in takes place and no single bank is allowed to fail because of the fear to cause another ‘Lehman’.*” (Ibid., p. 32).

⁷ See ELLIOTT, *Cyprus bailout: Dijsselbloem’s U-turn creates chaos in the markets*, in *The Guardian*, 25 March 2013, available www.guardian.co.uk

⁸ See CRIMMINS and CRUISE: *Rethinking banking risks after Cyprus*, in *International Herald Tribune*, 16 April 2013, p. 20.

⁹ See DRAGHI, President of the ECB, and CONSTANCIO, Vice-President of the ECB, *Introductory statement to the press conference (with Q&A)*, Frankfurt am Main, 4 April 2013.

the market was introduced, because the responsibility for the choice of the operator to whom they should entrust the management of their funds was handed over to savers. The reference to the need for flexibility, which was made in this case, does not justify, in my view, the abandonment of the “protection for savers/creditors” who do not participate in the “investments choice” implemented by the authorised intermediaries by handing over to them the management of an asset (their money) that is fungible.

A misunderstood *anchorage* to market principles (contrasting, however, with the hierarchical method for shaping the organisation of the EBU, as discussed below¹⁰), led the European Summit to disregard the advice to Mario Draghi that “*Cyprus may in no way be seen as a model*”.¹¹ Notwithstanding the enthusiasm shown by many commentators, the agreement reached at the European Council meeting held in June can indeed be regarded as a partial formal endorsement of the intervention approach used in Cyprus, that has thus become a “model” for the euro zone: a hypothesis that (only three months earlier) had appeared execrable and to be “exorcised”.

Moreover, this also contradicts the specific behaviour that in some countries, such as Italy, has allowed the confidence of savers in the financial system to be maintained, with the procedures for crisis management being carried out in a traditional way and concluded without the involvement of depositors.¹²

¹⁰ See paragraph 4.

¹¹ See *Editorial* “BCE, tassi invariati allo 0,75%. E Mario Draghi rassicura: Cipro non è un modello”, available at www.huffingtonpost.it

¹² Typical in this regard is the adoption in Italy of DM September 27, 1974, the so called “Sindona Decree”, which “authorised the Bank of Italy to grant banks protecting the depositors of institutions into compulsory liquidation, advances at the subsidized rate of 1%”; see SABBATELLI, *Tutela del risparmio e garanzia dei depositi*, Padova, 2012, p. 49 and ONADO, *Gli anni di piombo della finanza italiana. Ambrosoli, Baffi, Sarcinelli e la difesa della legalità*, 2009, p. 9 (www.portale.unibocconi.it).

Thus there are intrinsic difficulties in the pursuit of the purpose of recovery through the implementation of the EBU that is mentioned above. This is also the case with regard to the effects of the “single supervisory mechanism” on the current high-level architecture of the European financial system and on the domestic structures of the national supervisory authorities (whose current competences and functions will clearly need to be redefined in good time).

It goes without saying that various substantial obstacles, such as wide cultural diversity (giving room to different methodological approaches that are difficult to reconcile), and also conflicting interests between the different EU countries may hinder the achievement of the objectives indicated above. In this context a particular role is played by the United Kingdom, which was not so keen to join the euro zone and which recently decided to renegotiate its participation in the Union.

It is clear that, on the basis of the assessment above, there is an uncertain outlook for the possibility of a successful end to the long and difficult march (started more than half a century ago) towards the full integration of the EU countries. The purpose of this analysis is to verify whether the statements made above are correct, by making reference to guidance arising from the special regulations and, therefore, the definition (carried out at EU level) of the instruments needed for the implementation of a new model for banking organisation in Europe.

2. Economic and legal studies have clearly highlighted the causes of the financial crisis and the sovereign debt crisis that, in recent years, have shaken large parts of the world, and especially the EU countries.¹³

¹³ See, among others, MASERA, *La crisi globale: finanza, regolazione e vigilanza alla luce del rapporto de Larosiere*, in *Rivista trimestrale di diritto dell'economia*, 2009, pp. 147 ff., available

As regards the European regional context, the effectiveness of remedies against recognised regulatory shortcomings is limited. A need for adequate intervention therefore remains, intervention that is able to remove the numerous obstacles to the desired recovery, allowing a rebuilding of confidence in the market (as mentioned above).

More generally, the difficulties in establishing the EMU and proceeding towards a progressive restriction of national sovereignty are clearly highlighted: they are coupled with the never-tamed eurosceptic pressures and the emergence of tendencies aiming at retrieving national identity.¹⁴

In such a scenario, the end of the recession, the growth of debt-to-GDP ratios and the *credit crunch* – which is the objective of a large part of the euro area – appears to be closely related to the end of the “systemic crisis” (which hit many European countries); however, this will require the “flaw” in the monetary and financial architecture of the EMU, represented by “*the view that for monetary union a union that is also political would not also be necessary*” to be addressed properly.¹⁵

There is, therefore, a need to have regard to an operational programme (activated by the EU) aimed at promoting greater cohesion and unity, i.e. able to

at www.rtde.luiss.it; SAVONA, *Il governo dell'economia globale*, Venezia, 2009; VISCO, *La crisi finanziaria e le previsioni degli economisti*, Lecture on being presented as a Master in Public Economics, University of Rome “La Sapienza”, 4 March 2009; CAPRIGLIONE, *Misure anticrisi tra regole di mercato e sviluppo sostenibile*, Torino, 2010; COLOMBINI, *Crisi finanziarie. Banche e Stati*, Torino, 2011; CAPRIGLIONE and SEMERARO, *Il Security Market Programme e la crisi dei debiti sovrani. Evoluzione del ruolo della BCE*, in *Rivista trimestrale di diritto dell'economia*, 2011, I, p. 257 ff.

¹⁴ See, among others, MONTEODORO, *Economia della crisi, trasformazione dello Stato, governo dei giudici*, in *Rivista trimestrale di diritto dell'economia*, 2009, I, pp. 66 ff; MONTEODORO, *Mercati democrazia e potere costituente: categorie giuridiche e necessità storica del cambiamento*, in *Aperta contrada*, 3 August 2012; GUARRACINO, *Supervisione bancaria europea (Sistema delle fonti e modelli teorici)*, Padova, 2012, *passim*; GRASSO, *Crisi dei mercati e sovranità dello Stato: qualche elemento di discussione*, in *Aperta Contrada* 16 July 2012.

¹⁵ See MASERA, *Ecco i compiti a casa per l'inconcludente Unione europea*, in *Il foglio*, 30 November 2011.

eliminate or at least mitigate the deep diversity that still marks the European situation. The attempt to make a quick correction of imbalances accumulated over decades, and the implementation of fiscal austerity policies and excessive rigour (which, on the other hand, were not accompanied by appropriate spending review measures) do not seem to have delivered – at least in some countries, such as Italy – the positive effects that were expected¹⁶. Therefore, in order to solve the problems currently afflicting the euro area, other roads must be followed and other options must be chosen so to clarify the destiny of the “old continent”, avoiding the uncertainties of today (that are of course also giving rise to unavoidable negative socio-economic consequences).

Hence the importance of acknowledging – in the context outlined – the geopolitical conditions of the euro area that include, on the one hand, different abilities to react to the current recession and, on the other hand, a widening of the economic gap between Member States.

It is true that, as I have already pointed out on another occasion, the sovereign debt crisis – leading to investors having no confidence in respect of certain countries – has caused, in its initial stage, an increase in the spread on Government bonds, with an obvious increase in refinancing costs.¹⁷ This problem was overcome with difficulty by the adoption of rigorous measures, which,

¹⁶ For Italy see the emergency legislation represented by: Law Decree of 6 December 2011, no. 201 “Urgent provisions for growth, fairness and consolidation of public finances” (the so-called “salva Italia”), converted by law 22 December 2011, no. 214; Law Decree of 24 January 2012, n.1 “Urgent provisions for competition, infrastructure development and competitiveness” (the so-called “Cresci Italia”), converted by law 24 March 2012, n.27; Law Decree of 9 February 2012, n.5 “Urgent provisions for the simplification and development” (the so-called “semplificazione”), converted by law 4 April 2012, n.35.

In this complex legislation, as I’ve already observed elsewhere, there is a “*grief*” that represents an obstacle to the transposition of the petitions of civil society and thus to the establishment of the conditions necessary for a desired change (an ability to connect and balance these petitions with statute law), see CAPRIGLIONE, *Globalizzazione, crisi finanziaria e mercati: una realtà su cui riflettere*, in *Concorrenza e mercato*, 2012, p. 867 ff.

¹⁷ See CAPRIGLIONE, *Mercato, regole democrazia*, Torino, 2013, Chapter IV.

however, were not able to match the effect of the positive rebalancing of the spread with an improvement in the overall situation; hence the widespread defaults and closures of profitable businesses, and an increase in unemployment (especially among young people), all indicators of a sad “bulletin of war”, with a final outcome that is clearly not reassuring.¹⁸

Moreover, the crisis, since it had an impact on some situations that were already distressed, has sometimes produced even more negative, and sometimes destructive, consequences (which have put at stake the very existence of some populations). This situation is even harsher when it is compared with what happened in contexts where good production capacity was further supported by the market trends (positive for the countries concerned). This had the obvious result of allowing different levels of development and so widening the existing differences from those Member States that were experiencing difficulties.

The specific nature of the scenario under analysis is therefore clear; it is characterised by Germany, increasingly geared towards putting itself forward as the “engine” of the Union, accompanied by other Member States who just managed to limit and reduce the risks of the crisis (the Netherlands, Austria, Slovakia and Finland), and a group of other countries, mainly from the south of Europe, where the recession has led to a situation of growing difficulty.

Such significant differences signal the existence of problems in the possibility of proceeding together towards the goal of a close integration, of the intended convergence towards the desirable development of a political Union. This is so despite the adoption of specific internal “reorganisation measures” (in

¹⁸ Indeed, newspapers in the last two years, while listing the sad effects of the crisis, pointed out the tragic by-product of the latter when it hits people suffering from unemployment, debt burdens, tax pressures and uncollected debts. It is clear that, in these cases, a vicious circle can be created that often leads to depression and in some cases to suicide; see, among many, the editorial of *Corriere della Sera* of 3 May 2012 entitled “*La catena dei suicide: Tre in un giorno a causa della crisi*”.

countries such as Italy), the attempts to remedy the failure of a banking system that fuelled speculative bubbles (as was the case in Spain), and the welcome objective of trying to remain at all costs in the Union, either by putting an end to practices of repeated *mala gestio* or through the introduction of austerity measures of particular strictness (as in the case of Greece).

In this context – and also taking into consideration the doubts cast on the possible concrete implementation of the unifying process that started with the Treaty of Maastricht – the conditions are set for the reaffirmation of national identities. Indeed, the latter is welcomed by some political parties in certain Mediterranean countries who, without caring about the disastrous effects of a possible return to national currencies, support the return to their national currencies as the key solution for overcoming the difficulties caused by the crisis (the cause of which is in this way ascribed to the introduction of the euro)¹⁹. In Germany and some north European countries, on the other hand, the said reaffirmation of national identities is mainly driven by a logic aimed at preventing the “risk of contamination” (and, therefore, at avoiding the risk of dispersion of national wealth caused by the participation in the restructuring of the debts of third parties).²⁰

Within such a framework, the different impacts of the crisis – aggravated by citizens’ protests (as in the case of the riots and chaos that have occurred in Spain and Greece), by political uncertainties and by a “stiffening” of relationships between the Member States – certainly make it difficult to define joint

¹⁹ See, in that respect, the statements of Roberto MARONI, Secretary of “La Lega”, supporting the initiative of a referendum on the euro in 2013, as reported by many newspapers; see for example the editorial published by Italia.co of 15 August 2012 entitled “*Lega, Maroni: Un referendum per uscire dall’euro*”.

²⁰ See the cover of the German newspaper Bild of 18 June 2012 in which pictures of Mariano Rajoy, Barack Obama, José Manuel Barroso, François Hollande and Mario Monti were followed by the phrase “*Diese Fünf wollen an unser Geld!*”.

programmes for the convergence of different positions. The objective of a desired “exit” from the crisis seems inevitably to become more difficult to achieve, despite the promises of the politicians! In the background lies “euroscepticism”, that has been mentioned above and is always ready to make its “voice” heard in order to support critical arguments against the economic benefits of EMU membership.

In seeking possible, desired solutions – taking into account the efforts of the countries now facing serious difficulties (Spain, Portugal, Ireland and Cyprus), which are sometimes dramatic (Greece), as well as the new political will to get out of the shallow water of “self-preservation” (Italy) or to reduce expenditure to resume consumption (France) – the call to unity embedded in the messages addressed by Mario Draghi to Germany should not be ignored. Being aware of the “weight” of Germany in the euro system, the President of the ECB has, indeed, underlined that: *“Germany is an open and integrated economy, so it is not surprising that a slowdown in the rest of the euro area has an impact here ... it is less often noted how problems in the wider euro area affect the financial situation in Germany... Financial developments in Germany are the mirror-image of financial developments in the rest of the euro area ... the stability of the euro area as a whole will also be to the benefit of Germany”*.²¹

3. The financial crisis has created in many European countries an increasing sense of uncertainty, which is linked to the difficulty of identifying the technical procedures needed to overcome the recession that has been provoked, in recent years, by the deterioration of public finances and, particularly, by the

²¹ See the speech by DRAGHI, President of the ECB, *Kapitalismus in der Krise? Die Zukunft der Marktwirtschaft der Volksbanken, Raiffeisenbanken* organised by Genossenschaftsverbände V., Frankfurt am Main, 7 November 2012.

perspective of a significant reduction in GDP.²² It raises the belief that the turmoil that spread over a large part of Europe, due to the “financial turbulence” from a source outside the continent, was encouraged by endogenous structural deficiencies and political delays accumulated over time!²³

Indeed, the politics reveals the limits of an action that does not take proper account of the reality to which it is addressed; this suddenly highlights a progressive separation from the citizenry and an inability to reconcile opposite trends and to understand examples coming from below. The outrage and discontent are spreading into increasingly large areas! In some countries – such as Italy – the political system is breaking down, opening up to imaginative programmes of change based on illusory references to mechanisms of “participatory democracy”, on the basis of which the inspiration for theories that contrast with a *decrease* in rationality and economic efficiency is found.²⁴

This reality, when it refers to the realisation of the objectives of the European Union, results in a sort of *disappointment* about the actual validity of the programme of integration that forms the basis of the EU. People criticize the dominant role assumed by Germany, and impute to austerity measures and the austerity imposed by the EU most of the negative consequences of the current

²² See Bank of Italy, *Rapporto sulla Stabilità Finanziaria*, April 2012, available at bancaditalia.it.

²³ In this regard, see the remarks of SPINELLI, *L'analisi. La latitanza dei partiti*, published in *Repubblica.it*, 3 October 2012, and the considerations formulated by GUZZETTI (*Speech to 88th World Day of Saving*, Rome 31 October 2012, p. 9), who underlined that “*the international crisis in Italy has amplified weaknesses already existing and never addressed with much effort. The fiscal evasion, the corruption, the public bureaucracy are threats that must be defeated if we want the economic growth and the protection of savings*”.

²⁴ See SERGE LATOUCHE, *L'economia svelata. Dal bilancio familiare alla globalizzazione*, Bari, 1997; *Il mondo ridotto a mercato*, Rome, 1998; *Immaginare il nuovo. Mutamenti sociali, globalizzazione, interdipendenza Nord-Sud*, Rome, 2000, particularly the considerations that – through criticisms of the economic concept in *formal terms* – offer theoretical assertions in which the refusal of instrumental rationality, consumerism and so-called sustainable development are at the basis of the release of the continental society from the difficult search for growth processes, typical of an “economistic universal dimension”.

“crisis”. In particular, mistakes made by the European Union “post-Maastricht” are highlighted: the EU has not implemented the design of political unification that had led her to create the euro.²⁵ This follows a generalized belief that tends to look for the same opportunity for accession to the indicated programme or, at least, to establish with new parameters the continuity of our presence in the euro zone.

This highlights, therefore, the generalized environment of mistrust in relation to a stable future of EMU that I have previously mentioned. Concretely, we are witnessing a destruction of the efforts made by some countries in the last two years, in order to introduce corrective measures to change the current recessive situation. In this context, one can highlight the ups and downs of the stock exchanges, which reflect the threats of a possible catharsis and the hopes for a possible rebirth. This operating logic reflects the state which, at present, is faced by monetary union; there – as we have just pointed out – troubled countries are struggling to turn towards recovery and to comply with the requests for the *right* rigour essentially asked by Germany (which itself, moreover, has proved unwilling to follow lines of solidarity (despite some remarks on this recently made by the Head of the Government of that country)).²⁶

This determines the resurgence of concerns about the economic advantages of accession to the EMU. In these circumstances to think of a *united Europe*, united not only economically but also politically, becomes increasingly

²⁵ See, among others, GUARINO, *Diritto ed economia. L'Italia, l'Europa, il mondo*, Rome, 2011; SAVONA, *Eresie, Esorcismi e scelte giuste per uscire dalla crisi. Il caso Italia*, Catanzaro, 2011; MASERA, *Ecco i compiti a casa per l'inconcludente Unione europea*, n. 15; DI TARANTO, *Le basi problematiche della moneta europea*, in *Aspenia, I futuri del capitalismo*, 2012, n. 56, pp. 176-183; DI TARANTO, *Il salvataggio temporaneo di Atene? Vantaggioso solo per Berlino*, in *Milano Finanza*, 16 March 2012.

²⁶ See the editorial published in *The Telegraph*, 9 October 2012 “*Debt crisis: as it happened*”, in which the German Chancellor Angela Merkel, promising “new level of partnership” with Greece, was said to have given only a symbolic message of solidarity to the Greek people.

difficult! This is a reality on which we need to reflect. I argued on this subject on another occasion, demonstrating the ambivalence that sees some countries, such as Italy, on the one hand reactive to the crisis and capable of dealing with it by making serious sacrifices and renunciations, and, on the other hand reluctant to abandon a road characterized by individualism, cunning, and carelessness.²⁷

What are the specific causes of this situation? To what extent is it due to the financial crisis and, more generally, to the degenerative effects of an advanced capitalism striving towards an unstoppable growth? These are the concerns that need to have an urgent response in order to verify the effectiveness of the prospect of change in the present European socio-economic context.

Certainly clear implications of the close relationship between *market* and *policy* appear, given the constraints that the former is able to exert on the latter (considered as its ability to result in a profitable government action). Indeed, critical judgment expressed by the markets about some countries ends up aggravating the difficulties that they face in overcoming the current phase of recession; this has obvious repercussions on the rising costs that these countries have to bear in order to finance themselves²⁸. Similarly, it can be said that the economic *agere*, with no reference to *cohesion* and *solidarity* (that must characterize the sense of belonging to a community), has given space to a reality that – by aggravating the imbalances in distribution within countries and between countries – seems contrary to any prospect of political unification.

There is no doubt that the recent events have highlighted the uncertainties of a common programmatic action, vindicating criticisms made in the past.²⁹

²⁷ See CAPRIGLIONE, *Mercato, regole democrazia*, n. 17, chapter VI.

²⁸ See paragraph 2.

²⁹ See VISCO, *La crisi finanziaria e le previsioni degli economisti*, n. 13, who dryly observes that “the problems raised in 2007 on market of structured products linked to *subprime mortgages* have provoked the crisis, but the conditions in which it could start and spread rapidly were already determined over time”; on this matter see also MASERA, *The Recent Disruptions in Fi-*

The *exceptional nature* of this situation leads to the adoption of particular solutions in search of a desirable “way out” of these difficulties. Emblematic is the case of Italy, where, to avoid the abyss of an irreversible process, a *technical government*, was, for the first time, appointed, which was willing to adopt rules based on strictness (and, therefore, aimed at the realisation of structural changes and spending cuts or, more simply, measures to simplify the apparatus of the system), and subsequently to deal with the *governance of large agreements* (in which parties who are traditional opponents are forced to collaborate, with obvious diffusion of the previous bipolar system).

One must understand, also, the widespread need for renewal, strongly perceived in Europe, for the recovery of the project of Community integration that, in its perspective, could (or should) go beyond mere economic union. The need to enter into a coalition oriented towards forms of “constructive cooperation” (characterized by a mutual obligation and free from selfish positions and unacceptable attempts at dominance) animates the spirit of a *new Europe* (that can maybe arise from the *impasse* in which it currently stands). The understanding that has been acquired that the individualization of problems does not give room to the possibility of a “collective defence” identifies, in this context, the necessary conceptual support for the starting of a “getting together” that will, one hopes, have more profitable outcomes than those of the recent past.

We can identify the signs of a significant “turning point” in the programme for setting up the Community. A reformatory logic is taken as the basis for this, in view of the re-definition of the priorities to be pursued (restarting investment, reducing levels of youth unemployment, rebalancing the labour market, etc.) and the need to overcome certain operational rigidities, linked to the

nancial Markets: implications for the implementation of Basel II and MASERA, Financial turbulence and the capital standard paradigm: a sequel, in Quaderni del Club Università G. Marconi, 2008, n. 1, pp. 5 ff. and pp. 43 ff.

low flexibility of some Member States and the excessive bureaucratization of the current system.

It is clear that the crisis is acting as a catalyst in determining new forms of convergence in the direction of more concordant and consistent interventions in the euro zone. Apart from considerations with regard to operational choices of a political nature, one should emphasize the need to relate the complexity of the objectives with the undertaking of responsible and independent behaviour (that is not subject to constraints *other* than those resulting from compliance with Community rules).

In this context we can set the recent statements of François Hollande in which – announcing a radical change in French policy – he proposed a new European initiative that provides for “political union within two years” and a “European economic government”.³⁰ Is this the beginning of a line of behaviour that shows an awareness of a “*duty ..(to).. get Europe out of its state of prostration*”?³¹ Can we trust the contents of this proposal? It is right to consider whether we can hope, and can assume that behind the words of the French President there is a strong will to implement those words, having faith in the creation of a United States of Europe, the reality of which seems to be coherent with the evolutionary process of the Union.

The clear, unequivocal formula used in the French President’s proposal (“political union”) seems to leave no room for doubt with regard to the process to be undertaken. Of course it envisages an uphill path that is rough because of difficulties, in which victory over complexity will be given mainly for concrete actions that are taken and, therefore, for the achievement of the objective of realising the “European dream”.

³⁰ See MONTEFIORI, *Il manifesto Hollande «Governo economico per i Paesi dell'euro»*, editorial published in *Corriere.it*, 17 May 2013.

³¹ See MONTEFIORI, *Ibidem*.

4. In the light of the above, moving to the study of the “European banking union” project, it is worth making a preliminary point that, in the economic literature, the evaluation of this project is strictly tied to an evaluation of the Maastricht Treaty resolutions and, therefore, to some extent, criticisms are attributed to the project that belong to the original structure of the EMU, which would have given poor evidence of itself during the recent financial crisis³².

More specifically, our analysis starts from the remark that the asymmetries (by which the Union is marked out) represent a disintegrating factor and are compounded by the absence of mechanisms for risk sharing,³³ as a consequence, the optimistic praise of some³⁴ for the positive results of economic convergence appear to be completely out of place, since *“from 1999 to 2007 the intra-euro area differences accentuated, real exchange-rate misalignments aggravated, current-account imbalances widened and net foreign asset positions built up”*.³⁵

Hence the consideration that the arrangement of a “unique mechanism” (able to confer upon the ECB *“a direct responsibility over the 150 European major banks”*), foreordained for the realisation of a banking union, as opposed to the fragmentation of existing forms of supervision in the EU, is actually crucial in order to *“break the loop between banks and sovereign countries and the moral*

³² See SARCINELLI, *L'unione bancaria europea e la stabilizzazione dell'Eurozona*, in *Moneta e credito*, 2013, pp. 7 ff.

³³ See BAYOUMI and EICHENGREEN, *Operationalising the Theory of Optimum Currency Areas*, in VV.AA., *Market Integration, Regionalism and the Global Economy*, Edited by Baldwin - Cohen - Sapir - Venables, Cambridge, 1999, p. 187 ff.

³⁴ See FRANKEL and ROSE, *The Endogeneity of the Optimum Currency Area Criteria*, in *Economic Journal*, 1998, vol. 108 no. 449, pp. 1009-1025.

³⁵ See PISANI-FERRY, *The Known Unknowns and Unknown Unknowns of EMU*, *Bruegel Policy Contribution n. 18*, available at www.bruegel.org

hazard connected to the rescue, by the taxpayer, of the main banks”.³⁶ In this respect, significance is given to the circumstance that this “banking union” qualifies as the “most important in the world”, as it includes “total assets ... amounting to about 40 trillion euro ... (where) .. the corresponding figure for the U.S. is 8 trillion euro”; this is the reason why it is not incorrect to presume that such an innovative form of integration of supervisory policies may lead to diverse beneficial effects for the real economy. Certainly, the importance of credit institutions for the financing of the corporate sector within the euro area (calculated at 70% of the total)³⁷ permits one to recognize, within the uniformity of supervision techniques, the prerequisite for increasing productivity, which is crucial in order to revive economic growth in the EU.

From another viewpoint, relevance is then given to the possibility – started by an accurate conjunction of overall EU interventions (*i.e.* including the EFSF / ESM ones [the so-called bailout fund] which, as we know, are entrusted with the task of rebalancing the markets) – of preparing Member States for complying with “*the specific recommendations*” addressed to single countries and, ultimately, overcoming the risks that have so far undermined the economic revival, by decreasing “*the potential of Europe to benefit from a gradual improvement in the global economic outlook*”.³⁸

With this premise, one understands the reason why the European Commission – invoking the need to avoid the risk of further EU financial market fragmentation – shared the aforesaid EU Council’s project, by submitting a pro-

³⁶ See MASERA, *Moneta europea credito nazionale*, in *la Repubblica* of June 17, 2013.

³⁷ See MASERA, *ibidem*, where it is pointed out that, by contrast, in the United States such percentage amounts to only 30%.

³⁸ See EUROPEAN COUNCIL, *Conclusions of June 29, 2012*, Euco 76/12.

posal,³⁹ to which a Council Regulation has recently given legal concreteness, that confers specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions.⁴⁰ In this respect, importance should be given to President Barroso's speech at the last working session of the EU Council summit (June 2012), which was aimed at clarifying the intention to fight euro-scepticism in the EU through the setting-up of the EBU. The words "*I know that many people were sceptical about the prospects for this summit. And I hope that they were pleasantly surprised when they heard the news this morning...*" demonstrate the unequivocal confidence that "*this banking union will be designed in a way that fully respects the integrity of the single market*", and highlights the belief that "*a stable euro is in the interest of the whole European Union*".

Therefore, one assumes a legal and institutional reality aimed at standardising banking activity, achieved through the control of the banking sector in a uniform mode. The reference to a "unique mechanism" of supervision is considered a suitable precondition to the centralisation of controls, consistent with the composition of the European financial system, which is marked by the presence of "*some main banks with an international profile (e.g. Deutsche Bank, BNP Paribas, Unicredit)*", which actually shows the need for these institutions to have a single spokesman.⁴¹ This spokesman thus represents the emblematic premise for equality between operational positions, capable of preventing systemic crises, which have serious effects that negatively affect a variety of regulations (which, of course, entails a different stringency for single applicable legal

³⁹ See EUROPEAN COMMISSION, *Communication on a roadmap for completing the banking union over the coming year*, included in EU Document COM (2012) 510 final of September 12, 2012.

⁴⁰ See EUROPEAN COUNCIL, *Inter-institutional Directive 2012/0242 (CNS)*.

⁴¹ See MASCIANDARO, *Gli sprechi ci sono, ma Bankitalia resta un istituto di eccellenza*, available at www.ilfattoquotidiano.it

frameworks). The assumption of this goal implies the pursuit of a form of convergence which promotes innovative sharing schemes and, therefore, allows the fulfilment of conditions for stability and progress.

There is no doubt, in fact, that getting over the crisis through which Europe is struggling allows a global review of the provisions regulating finance or, more precisely, the sector of banking intermediaries, whose action can significantly affect the dynamics required for the kick-off of an adequate form of recovery. The EU Commission, when outlining the framework of interventions re-mitted to the aforesaid unique mechanism of supervision, took into account the failures of the original structure of the EMU during the crisis, based on a peremptory criterion “*anchored to the market (bailout ban, potential sovereign insolvency, prohibition of debts monetization)*”, by proposing to give further prominence (in the organisation of the supervision schemes at hand) to the “*hierarchical propelled method*”.⁴² Hence a supervisory system should be built which, falling within the ambit of a federal process,⁴³ highlights the abandonment of a significant part of national sovereignty.⁴⁴

The proposal under examination – while providing for the “*transfer at European level of specific tasks... of supervision over banks established in the Member States within the euro zone*” through a close interaction between the ECB and local supervisory authorities – recognizes a significant role for the ECB, which is expressly empowered to “*carry out, on its own decision, the supervision of all banks in the euro zone... (and) ... in particular ... banks that receive a public financial assistance*”. We are in the presence of changes that deeply reform the current schemes of banking supervision, by intensely amending “*the internal*

⁴² See SARCINELLI, *L'unione bancaria europea e la stabilizzazione dell'Eurozona* n. 32, p. 14.

⁴³ See CLARICH, *La vigilanza bancaria, tra ordinamento nazionale e ordinamento europeo*, presentation to the conference entitled “*Verso la vigilanza unica in Europa*”, organised by the Bank of Italy, Rome, June 17 2013.

⁴⁴ See CAPRIGLIONE, *Mercato, regole democrazia*, n. 17, pp. 60 ff.

symmetry of EFSF (European Financial Stability Facility), due to the fact that the segment connected to the micro prudential supervision “*would make an important breakthrough towards the federal authority model, since such segment is delegated to an entity which is not an agency, but one of the EU entities provided by the EU Treaty*”⁴⁵.

In order to achieve the optimal arrangement for a single EU market for financial services, the unique mechanism of supervision is associated with other measures (*i.e.* the creation of a “common deposit guarantee scheme” and “integrated banking crises management”) designed to “*strengthen the foundations of the banking sector and restore confidence in the Euro*”. It is clear that the harmonization of prudential supervision schemes becomes part of a hypothetical reconstruction of the new European regional context; the set of principles that, according to President Van Rompuy,⁴⁶ will qualify the spirit of such harmonization, as underlined in the literature, leading to “*Banking Union, Fiscal Union, a Competitiveness Union and Political Union*”.⁴⁷

It goes without saying that the intervention under discussion tends to enhance the conditions for the stability and integrity of the EU internal market, preventing such conditions from being postponed over time. On the other hand, the Commission is fully aware of the difficulties underlying the implementation of the banking restructuring plan; in this perspective, reference is made both to the consideration of the need “*to avoid discrepancies between the euro zone and the rest of the EEA*” and to “*consistent supervisory practices*” which avert the danger of “*regulatory arbitrages*” (aimed at exploiting possible regulatory

⁴⁵ See GUARRACINO, *Supervisione bancaria europea. Sistema delle fonti e modelli teorici*, n. 14, p. 139.

⁴⁶ See the speech of 26 June 2012 “Towards a Genuine Economic and Monetary Union”, available at www.consilium.europa.eu

⁴⁷ See WYMEERSCH, *The European Banking Union. A first analysis*, Universiteit Gent, Financial Law Institute, WP, 2012-07, October 2012, p. 1.

differences), as well as to the European Banking Agency (EBA)'s invitation to develop "*a common guide for supervisory activity*".

Therefore, it is possible to identify the conditions for integrating a single rule book with which the provisions (to be adopted by the ECB), ancillary to the exercise of the prudential supervision ("*in the context of the specific structure... created by the single supervisory mechanism*"), shall comply. The above is confirmed, *inter alia*, by the explanation that "*when an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area, the ESM could, following a regular decision, have the possibility to recapitalize banks directly*"; this procedure, recalled at the beginning of this paragraph, certainly will be founded "*on appropriate conditionality, including compliance with state aid rules*", according to the executive guidelines to be formalised in a "*memorandum of understanding*".⁴⁸

5. As anticipated, the European Council Regulation, approved in May 2013, has set out the tasks of the ECB for the exercise of prudential supervision over the banking union's credit institutions. An accurate framework for the banking union's operative mode is provided in the Regulation, allowing the interpreter to identify both the scope of the legislation governing the unique mechanism of supervision and the powers ascribed to the ECB, save for the fact that all the authorities involved in the operation of the SSM are subject to a duty of cooperation (a wide explanation of which is provided).

The set of provisions aimed at reforming the "single market" is fully consistent with the guidelines of the European Parliament, which in the past rec-

⁴⁸ See EUROPEAN COMMISSION, *Communication on a roadmap for completing the banking union over the coming year n. 39*, as well as indications included in the document available at www.consilium.europa.eu

ommended measures similar to those now being implemented.⁴⁹ As a result of these provisions, a further acceleration has been given to the EU work concerning the relevant banking issues (*i.e.* capital and liquidity requirements, coverage of local deposit guarantee schemes, frameworks for crisis recovery and resolution), which will be defined taking into account the outcomes derived from the practical tests provided in the Regulation.

Although an accurate analysis of the legislation at hand is skipped over in this paper, it is worth giving an account of a few specific aspects thereof, in view of their relevance for the purpose of a complete evaluation of the EU regulator's leanings. Reference is made, first of all, to the circumstance that, in order to estimate exactly the dimension of the "tasks" assigned to the ECB, which are strictly connected to the carrying out of prudential supervisory functions, it will not be possible to disregard an evaluation of the extent (more precisely, of the typical contents) of the said form of control.

In particular, the delimitation of the analysis indicate above brings the interpreter back to the resolutions on supervision provided, within the ESFS (European System of Financial Supervision) definition, in favour of the authorities included in this system.

This is because the entities composing the system are empowered with specific competences, among them the regulatory power expressly attributed to the EBA, which, therefore, turns out to be responsible for tasks typical of prudential supervision bodies.⁵⁰ However, save for the need to verify how a coordi-

⁴⁹ See the European Parliament resolution of 7 July 2010, including some recommendations to the Commission on the management of cross-border crises in the banking field (2010/2006, INI).

⁵⁰ See PELLEGRINI, *L'architettura di vertice dell'ordinamento finanziario europeo: funzioni e limiti della supervisione*, in *Rivista trimestrale di diritto dell'economia*, 2012, I, p. 57, which points out functions and roles of the new European financial authorities; TROIANO, *Interactions Between EU and National Authorities in the New Structure of EU Financial System Supervision*, in *Law and Economics Yearly Review*, n.1/2012, pp. 104 ff. available at www.laweconomics year-

nation/conciliation between the current members of the ESFS and the ECB is conceivable at the current time (an issue that will be discussed hereinafter),⁵¹ we deem it opportune to point out right now that any possible solution has in any event to deal with the dynamics of the binomial regulation/discretion (which, in terms of concreteness, has to be taken into account in order to identify the real extent of the powers fixed by the legislation under examination).

That said, according to the indications that can be inferred from the wording of Article 1 of the Regulation, the “*competences of supervisory authorities ... of Member States*” concerning types of interventions which, although seemingly connected to the scope of controls taken into account by the legislation under examination, cannot strictly speaking be related thereto, are intended to be outside the regulatory scope at hand. In particular, consideration should be given to the anti-money laundering tasks carried out by the local supervisory authorities, in respect of which one believes that the European authority (on which the entire supervisory mechanism depends) has however to start *ad hoc* relationships, or any other form of collaboration/cooperation with the competent local bodies in order to combat (in line with a strengthened international practice, long implemented by several EU directives) the phenomenon of the illegal circulation of money.⁵²

Particular importance has then to be paid to the powers of the ECB to “*authorise*” and withdraw the authorisation of credit institutions intending to

lyreview.org.uk). See also FERRAN, *Understanding the New Institutional Architecture of EU Financial Market Supervision*, in *Legal Studies Research*. Paper Series, University of Cambridge, Faculty of Law, n. 20/2011, p. 34 f., at www.ssrn.com; TARANTOLA, *La vigilanza europea: assetti, implicazioni, problemi aperti*, Lezione al Master in Diritto Amministrativo e Scienza dell'Amministrazione, Università degli Studi di Roma Tre, April 8, 2011, available at www.bancaditalia.it, p. 16.

⁵¹ See paragraph 6.

⁵² The anti-money laundering provisions are included in several Directives, starting from 91/308/EEC and 2001/97/EC, which were repealed and replaced by Directive 2005/60/EC, as consolidated in Directive 2006/70/CE.

carry out banking activities, establish branches or provide services “*in a non-participant Member State*”, and to assess “*applications for the acquisitions or transfer of qualified holdings in credit institutions*”; an authorisation power that may also be carried out *vis-à-vis* the “*credit institutions established in a non-participant Member State that wish to establish a branch or provide cross-border services in a participant Member State*” (Articles 4 and 14).

These are provisions aimed at including in the prudential perspective a pre-emptive intervention for the carrying out of banking activity, believing it to be fundamental, for the purpose of a sound and efficient management of such activity, to refer the verification of the relevant technical requirements to the authority (on which the unique supervisory mechanism depends). Likewise, attention should be paid to the entrusting of the ECB with the task of assessing the acquisition and disposal of qualified holdings; this task is aimed at verifying the continuity of solid and suitable ownership (from a financial perspective), which is thus essential in order to “*avoid undue restrictions to the internal market*” (recital 22). Significant, however, is the provision in the Regulation that safeguards some Member States’ privileges regarding the adoption by the relevant local supervisory authorities of “*a decision project with which to propose to ECB the granting of the authorisation*” (Article 14 (2)).

Before making an in-depth analysis of this issue,⁵³ it should immediately be said that the substantial referral of pre-authorisations to local supervisory authorities – however admissible in view of the need to simplify (or, more precisely, accelerate) the carrying out of the authorisation process – risks rendering an important regulatory innovation meaningless (or, at least, downsizing it to a large extent). Indeed, this is softened by the possibility of shifting the implementation of a provision – to be considered fundamental, in view of the actual

⁵³ See paragraph 7.

realisation of a level playing field within the European economic and financial reality – in a perspective of objective equivalence (among participating countries).

The assignment to the ECB of typical instruments which are usually related to the achievement of adequate levels of capitalisation for supervised entities is also significant. In this respect, the criterion that *“the safety and soundness of a credit institution depend also on the allocation of adequate internal capital, having regard to the risks to which it may be exposed”* gained ground (recital 25). The overall powers conferred upon the ECB – which may apply *“if deemed necessary... higher requirements for capital buffers than applied by the national competent authorities”* (Article 5 (2)) – demonstrates the undeniable willingness of the European regulator to ensure that the operator of the unique mechanism has all the powers necessary to perform the duties conferred upon it.

Within the logical context outlined above, one can look at the rationale underlying the investigatory powers of the ECB: it is entitled *“to conduct investigations and on-site inspections, where appropriate in cooperation with national competent authorities”* (recital 47). This combination of powers results in an ability to access information available to the credit institution, save, of course, for the obligation (in the provision of these powers) not to deviate from the duties of strict cooperation with the competent local authorities, from which the legislation under examination takes its inspiration (Article 9 (2)).

More particularly, the Regulation devotes a section to general investigatory powers (Article 10 onwards), by analytically enumerating the natural and legal persons to which the ECB could address a request for information. Therefore, several modes of carrying out the duties in question are specified therein, including on-site inspections at the premises of legal persons, in respect of

which, where necessary, “it requires authorisation by a judicial authority according to national rules” (Article 13 (1)).

It is clear that the regulatory framework at hand takes into account the evolution in information and inspection regimes which, in a dynamic, open and competitive market context – without restraining the autonomy of those belonging to the financial system – have become instrumental in the setting-up of favourable conditions for the development of this sector.⁵⁴ Therefore, the resort to the store of information available to the local banking supervisory authorities is certainly relevant for the achievement of the results that the European legislator had in mind when drafting the unique supervisory mechanism. Accordingly, one can share the legislative hypothesis of a continuous relationship between the ECB and the local supervisory authorities.

By contrast, there is a thesis – relying on the principle that “*within the EU the competence to supervise single banks mainly remains at a national level*” (recital 5) – that comes to the conclusion that, in such a case, one is in the presence of a flexible allocation of competences, from which derive the wide scope of powers reserved to domestic supervisory entities within the mixed-composition scheme (national and European) required by law.⁵⁵ This does not seem to be consistent with the spirit of the Regulation. A careful reading of the provisions concerning the methods of “coordination” between the different banking supervisory entities does not seem to permit any form of administrative devolution that leaves unchanged, in terms of concreteness, the powers previously attributed to the domestic authorities; in this respect, as mentioned

⁵⁴ See BERIONNE and TARANTOLA, *Commento sub art. 51 tub*, in VV. AA., *Commentario al testo unico delle leggi in materia bancaria e creditizia*, edited by F. Capriglione, Padova, 2012, volume II, pp. 597 ff.

⁵⁵ See CLARICH, *La vigilanza bancaria, tra ordinamento nazionale e ordinamento europeo*, n. 43.

above, the extent of the powers conferred upon the ECB leaves no doubt. Accepting the option of a democratization of the system, and proceeding down the road shown by the EU legislator by means of the provisions we have examined, implies a renunciation of long-established privileges, a narrowing of the boundaries of sovereignty, and an abandonment of any fruitless attempt at self-preservation!

6. The Commission's proposal, as well as the provisions of the recently adopted Council Regulation, demonstrates a principle that – in giving life to a structural reform aimed at a greater economic and monetary integration of the Union – brings up sensitive issues with regard to the coordination of the objectives set out in the pre-existing European financial reality.

In particular, as mentioned in the previous paragraph, the regulatory provisions in question have an impact on the specific competences of the bodies that make up the ESFS, whose structure – validated as of January 2011 – is divided into three newly established supervisory authorities, with competences in, respectively, banking (EBA), markets and financial instruments (ESMA), and insurance and occupational pensions (EIOPA). This complex authoritative structure – which is referred to in the Regulation as the “ESA” (European Supervisory Authorities) or, more simply, the “Authorities” – is complemented by a new institution called the European Systemic Risk Board (ESRB), that is responsible for macro-prudential supervision, being intended to monitor potential risks to financial stability, operating in strong conjunction with the ECB,⁵⁶ and supervised by a Joint Committee of the three authorities mentioned above.⁵⁷

⁵⁶ See EU Regulation of 24 November 2010, relative to the macro-prudential supervision of the European financial system, which established the abovementioned Committee; See PELLEGRINI, *L'architettura di vertice dell'ordinamento finanziario europeo: funzioni e limiti della supervisione*, n. 50, where the analysis of the functions of *European Systemic Risk Board high-*

The different institutions of the system have the task of ensuring the proper application of the rules relating their respective sectors, with the objectives of preserving financial stability, fostering trust and ensuring an appropriate protection for consumers of financial services.⁵⁸ A “system architecture” is therefore identified in which the positive outcome of the actions taken is based on a cooperative policy between the different authorities, and this is also stated in the regulations they adopt. The particular network of organisations (which contributes to its structure) is functional to the objective of enhancing the principles on which the EU is founded, taking into account not only the horizontal dimension of the relationships that can be activated (in a logic of mutual respect) between the authorities of the ESFS, but also the possibility of activating forms of vertical connection between these institutions and the competent national authorities in the relevant policy areas.

However, if we want to assess the impact of the supervisory mechanism only on the European apparatus we have described, we must have regard, on the one hand, to the objectives that are pursued by the Authorities and, on the other, to the fact that the Authorities have jurisdiction that goes beyond the perimeter of the euro zone. The main issue is, therefore, the implications arising from the operation of the ECB (to which the Council Regulation granted specific supervisory tasks) “*in the context of the ESFS*”, given the duty of cooperation be-

lights that its President is the President of ECB (p. 58), who notes the personal connection and the intention that the work that will be carried out through joint efforts.

⁵⁷ The Committee is one of the two joint bodies provided for in the arrangement of the top authorities of the European financial system, the other being formed by the Board of Appeal (whose members are people with adequate professional qualifications in the financial field, chosen jointly by the Boards of Directors of the three ESAs from a shortlist of candidates pre-selected by the European Commission), which has jurisdiction to hear appeals brought against a decision of the ESA in cases pursuant to Art. 60 of the Regulations, without prejudice to the possibility that decisions may be challenged before the Court of Justice of the EU. See TROIANO, *L’architettura di vertice dell’ordinamento finanziario europeo*, in *Elementi di diritto pubblico dell’economia*, Padova, 2012, p. 553, footnote 33.

⁵⁸ See TROIANO, *L’architettura di vertice dell’ordinamento finanziario europeo*, n. 57, p. 552.

tween the three authorities (EBA, ESMA and EIOPA) that make up the ESFS. It is not a coincidence that the Regulation stresses the need for the ECB to “*carry out its tasks ... without prejudice to the competence and the tasks of the other participants within the ESFS*” (recital 31).

If analysed in depth, it is the regulatory function that has a specific centrality in the interaction between the diverse institutions forming the Authority which, in the Union, has been bestowed with control powers. In this sense, it is worth mentioning the attention that scholars have given to the role of the EBA in the new European institutional reality, correctly underlining that “*the Regulation... of 2010 ... does not assign... to the EBA functions of direct supervision on the intermediaries, but rather a task of building the regulatory framework ... (leaving) ... supervisory powers ... to the respective national authorities*”.⁵⁹ Remaining on the subject of regulation, we need to keep in mind that the ESRB is competent to decide on inputs and guidelines for the prevention of macro-systemic risks, a disciplinary power that, in this context, can be considered parallel to the powers exercised by the EBA.⁶⁰

In the aftermath of the Commission’s proposal on the “European Banking Union”, I put forward the need to proceed with the adoption of adequate forms of cooperation between the recently established European Supervisory Banking Authority and the European Central Bank (because of the new tasks entrusted to the latter). This was not only to avoid the risk of overlapping functions (resulting from the union in the same person of the president of the ECB and that of the ESRB), but also in order to allow continuity for the EBA’s actions. The EBA, in fact, reflects in its decisions the views of all the EU Member States, so that, in

⁵⁹ See TROIANO, *La nuova configurazione istituzionale dell’EBA*, presentation to the conference entitled “*Verso la vigilanza unica in Europa*”, n. 43.

⁶⁰ See CAPRIGLIONE, *Le amministrazioni di controllo del mercato finanziario. La particolare posizione della Banca d’Italia*, in *Riv. trim. dir. econ.*, 2011, I, p. 14.

its activity, it must take into account the collective interests, aiming at the improvement of cooperation, so as to ensure protection in equal terms, while developing appropriate levels of operational balance in Europe. In this regard, I found the peculiar open application envisaged by the Commission for the regulation of the matter significant, given the possibility of allowing even those Member States that have not adopted the euro to cooperate closely with the ECB, if they are to participate in the single supervisory mechanism.⁶¹

Indeed, the possible extension of the banking union to countries that are not currently part of the Euro system is a crucial part of building the new regulatory framework. In order to set in clear motion a gradual connection between all EU Member States, the power allowed to Member States to join the EBU, considering the broader success of the new banking markets integration model, could cause unavoidable conflicts and/or lack of agreement on supervisory policies (especially if they are deemed contrary to domestic interests, an example of which is the reluctance of the UK to accept the *Tobin tax*).

In this context, the theme of the relationship between the EBA and the ECB has a peculiar centrality, as has been emphasized in the literature.⁶² In fact, this relationship has the particular reconciliatory function of the different (and often conflicting) trends, subject to preservation of the respective prerogatives and competences. There is a difficult path ahead with regard to future relationships between these institutions, with difficulties that have inspired a careful scholar to recognize the need of an extension of the mission entrusted to the

⁶¹ See CAPRIGLIONE, *Mercato, regole democrazia*, n.17, p. 87.

⁶² See WYMEERSCH, *The European Banking Union. A first analysis*, n. 47, p. 20; GUARRACINO, *Dal meccanismo di vigilanza unico (ssm) ai sistemi centralizzati di risoluzione delle crisi e di garanzia dei depositi: la progressiva europeizzazione del settore bancario*, in *Riv. trim dir ec.*, 2012, I, p. 207, who stresses that “the recent draft reform of banking supervision in the euro zone, as proposed by the Commission last September, also plans to intervene in the governance of the EBA in order, among other things, to ensure their decision-making capabilities and prevent the formation of blocking minorities by States whose currency is the euro”.

European Banking Agency. That mission now also includes the role of “*substantial mediation between blocks of countries (being configurable between members and non-members of the single supervisory system) in the construction of a unified system of rules*”.⁶³

There is no doubt that such a reconstruction seems worthy of appreciation, given that, from a formalistic legal standpoint, it is possible to give an appropriate coordination to the guiding criteria that are at the foundation of the financial banking system, created on the basis of the indications contained in the *de Larosière Report*.⁶⁴ In particular, the Report’s objectives were achieved through cooperation (in the execution of supervisory tasks) that does not go beyond the autonomy and independence recognized by the regulator and, therefore, it appears that they “*should be consistent with the functioning of the internal market for financial services and with the free movement of capital*” (recital 12 of the Regulation).

Moving on to consider what the EBA’s strategy will be in the near future, we arrive at the conclusion that the role of the Authority will be reduced in a way that is not yet clearly identified. I refer in particular to the case (which is likely to occur) in which an activity that is meant to be performed among often-conflicting positions, inevitably ends up not being performed in a sufficiently proactive way (in order not to place an excessive burden on certain consolidated realities present in the countries participating in the banking union). This is independent of whether the Authority will refuse to adopt decisions that are

⁶³ See TROIANO, *La nuova configurazione istituzionale dell’EBA*, n. 59.

⁶⁴ The proposals of the working group, led by DE LAROSIÈRE, the current head of the European financial order, included the European Systemic Risk Council (ESRC), headed by the President of the ECB, assisted by the “European System of Financial Regulators” (ESFS), which consists of a network of national authorities who cooperate with the three new European institutions mentioned above (EBA, EIOPA and ESMA) in order to safeguard the stability of individual financial firms and protect investors.

unlikely to be accepted by one of the two “blocks” of States subject to the Regulation.

It is true that, among the inspiring criteria of the Regulation, it is expressly provided that the EBA “*is entrusted with developing draft technical standards and guidelines and recommendations ensuring supervisory convergence and consistency of supervisory outcomes within the Union*” (recital 32), but it is equally true that this principle is referred to in an express provision of a contextual ECB power to “*adopt regulations in accordance with art. 132 of the Treaty on the Functioning of the EU*” (i.e. to the extent necessary to fulfil its mission). Even “stress tests” are recognized as prudential assessments of the ECB, “*where appropriate in coordination with the EBA*”. Nevertheless stress tests, from their first application (July 2010 and July 2011), appeared likely to be considered a prerogative of the EBA.⁶⁵ This inevitably creates a risk of duplication and friction between the two authorities, with the additional threat that the systemic coherence required by the regulator might be undermined.

Undoubtedly, the basic ambivalence underlying the possibility (provided for by the Commission) of a broad application of the European Banking Union rules may lead to distortion in the functioning of the current supervisory system. As highlighted in the pages that follow, in the absence of a political union (and looking ahead to a political union), it is necessary, within the EU, to reach a difficult understanding, which – beyond hypocrisies and individualisms – demonstrates the existence of a genuine desire to “get together”, and thus lay the foundations for a cultural convergence to which the unification process that is currently in place can be reconnected.

⁶⁵ The use of stress tests in order to assess the level of capitalisation of the banking system shows the cooperation between the stability regulators that is needed in the current economic climate. See VEGAS “*Audizione nel corso dell’Indagine conoscitiva sui rapporti tra banche e imprese con particolare riferimento agli strumenti di finanziamento*”, Rome, February 2012, at www.consob.it.

7. The construction of the single supervision mechanism provides the “transfer to the European level of specific, key supervisory tasks for banks established in the euro area Member States”.⁶⁶ According to this, the mechanism underlies tight forms of interaction between the ECB and the national supervising authorities, and is able to link European control and the local banking industry. “Single supervision” sums up the legal framework, which is characterized by the regulator’s aim not to waste the knowledge of the relevant national authorities. The basic assumption is related to the goal of optimizing the supervisory activity they have carried out date.⁶⁷

Hence, the target of financial stability is based on a cognitive process which considers the conditions of the supervised intermediaries. This is the early assumption which sets the ECB new tasks related to the supervision of all entities which belong to the *European Banking Union*.

On this topic there are some regulatory criteria provided by the initial Recitals of the European Regulation of May 2013 and by its normative provisions. Here the targets of the interventions (*i.e.* addressing the risks threatening the stability of the banks, authorising new banks’ operational activity, checking qualified participations, controlling capital adequacy and mitigating risk) can be detected by looking at the necessary corrective measures (which even relate to supervision on a consolidated base and over financial conglomerates).

⁶⁶ See the relevant *Proposal of EC*, 12 September 2012.

⁶⁷ See EUROPEAN COMMISSION, *doc COM (2012) 510 final*, 12 September 2012.

Another purpose of this reform appears from the conclusion of an interview with EC commissioner BARNIER, of 30 August 2012 in the *IlSole24Ore*, published under the title “*Così la BCE vigilerà su tutte le banche europee*”, where it is pointed out that the entry into force of the single supervisory mechanism – as proposed by the European Council of June 2012 – will allow the ESM to recapitalise the banks directly.

The supervision activity is oriented in two different ways, as it is also aimed at intervention regarding: a) leverage; b) liquidity; c) capital reserves; d) violation of capital requirements; and e) resolution of the banking crisis.

These are the tools that, to date, have been used for local supervision. The transferring of the tasks to the ECB (which has a specific power of investigation, as is necessary to exercise the supervision activity) – beyond the legislative text which asserts, in this context, a fair weighting with the powers of the national authorities – takes place in a way that is a radical innovation in the legal framework of banking supervision, whose boundaries are no longer national.

Having said that, the following statement is important: *“full independence”* (i.e. independence from any undue political influence and other form of regulatory capture) for the ECB, which *“should dispose of adequate resources”* and should have *“the powers conferred on competent authorities by Union law. This includes powers conferred by those acts on the competent authorities of the home and the host Member States and the powers conferred on designated authorities”* (recitals 38, 39 and 77).

Within this new framework the European Central Bank has an equal position (on the authoritative plan) with national authorities, united with an independent status in the exercise of its functions, aimed at guaranteeing efficiency, more than at ensuring that it has a primary role in the leadership of supervision. In this respect, there are no limitations on its actions, which is why the Regulation states that *“the ECB should be able to exercise supervisory tasks in relation to all credit institutions authorised in, and branches established in, participating Member States”* (recital 13).

In this context, the Regulation recognizes that the ECB is *“well-placed to carry out such an assessment without imposing undue restrictions to the internal market”* (recital 16), and takes the opportunity to confer on the ECB *“the task to*

apply requirements ensuring that credit institutions have in place robust governance arrangements, processes and mechanisms, including strategies and processes for assessing and maintaining the adequacy of their internal capital” (recital 19).

Also highlighted is the following advantage: *“in addition to supervision of individual credit institutions, the ECB’s tasks should include supervision at the consolidated level, supplementary supervision, supervision of financial holding companies and supervision of mixed financial holding companies, excluding the supervision of insurance undertakings”, and powers of “early intervention ... (to be coordinated) ... with the relevant resolution authorities” (recitals 20 and 21); these powers are wide enough also to include “the protection of depositors and improving the functioning of the Internal Market” (recital 23).*

In this legal document, the remark that it is necessary to cooperate *“with the national authorities which are competent to ensure a high level of consumer protection and the fight against money laundering” (recital 22a)* appears meaningful.

It seems obvious that there is a regulatory intention to draw a line between banking supervision (where the ECB’s activity oversees the national authority’s intervention) and other areas of national competence (related to consumer protection and money laundering) where the ECB is only required to cooperate.

In the same vein, the call made to *“the ECB and the national competent authorities of non-participating Member States ..(to)... conclude a memorandum of understanding describing in general terms how they will cooperate with one another in the performance of their supervisory tasks” (recital 11a)* is relevant.

The supervision regime provided for non-euro Member States is a sort of attenuation of the ECB’s powers of intervention within the specific limits set in

the memorandum mentioned above. The statements of the Regulation confirm these guidelines, moving from the wide requirement for the ECB to perform tasks aimed at the safety and soundness of credit institutions. These tasks – according to the *“duty of care for the unity and integrity of the internal market”* (Art. 1) – refer to all the entities supervised according to Directive 2006/48/EC, and in any case *“the ECB shall carry out the tasks conferred upon it by this Regulation in respect of the three most significant credit institutions in each of the participating Member States, unless justified by particular circumstances”* (Art. 5(4)).

This is the standard precondition for a list of the interventions that are involved in the complex function of supervision (as designed by the legislative acts of financially developed countries). Hence, the reference is to the authorisation of credit institutions mentioned earlier and to the right to withdraw the authorisations of credit institutions (Art. 4 (1,a)), and to the establishment of *“a branch or provid(ing) cross-border services in a non-participating Member State”* where there is a real substitution of the ECB in place of the national supervising authority (justified by the distinctive features of this case).

Following this, there is the *“supervision on a consolidated basis over credit institutions’ parents established in one of the participating Member States”*; the *“supplementary supervision of a financial conglomerate”* (Art. 4(1i, j)); and the power to apply *“instead of the national competent or national designated authorities ...higher requirements for capital buffers”* (Art. 4(2)).

Naturally, the *“ECB shall be responsible for the effective and consistent functioning of the single supervisory mechanism”* (Art. 5(1)), and is also able *“at any time, on its own initiative after consulting with national authorities or upon request ..., (to) decide to exercise directly itself all the relevant powers for one or more credit institutions”* (Art. 5(5b)). Moreover the ECB *“shall, in consultation*

with national competent authorities ... and on the basis of a proposal from the Supervisory Board, adopt ... a framework to organise the practical modalities of implementation of the relevant regulations (Art. 5(7)), being able to use the information sent by the national authorities, which *“shall report to the ECB on a regular basis on the performance of the activities performed”* (Art. 5(6)) or *“may (be) require(d), by way of instructions, ... to make use of their powers ... where this Regulation does not confer such powers on the ECB”* (Art. 8(1)).

A composite intervention framework has been drawn up in which, beyond the regulatory provisions mentioned above, there are several rules which allow the ECB to: *“address instructions to the national competent authority of the participating Member State whose currency is not the Euro”* in order to strengthen cooperation (Art. 6), and to *“develop contacts and enter into administrative arrangements with supervisory authorities, international organisations and the administrations of third countries”* (Art. 8). This puts the ECB in the middle of the developing dynamics of banking supervision.

In addition there is a recognition of specific investigatory and supervisory powers (Art. 10 onwards) which are aimed at implementing the framework of the ECB's tasks; the ECB is able to *“impose administrative pecuniary sanctions of up to twice the amount of the profits gained or losses avoided”* (Art. 15).

That being so, there is a *unique* attribution of a primary role for the ECB in the exercise of its own functions, under the single supervisory mechanism. This is why the choice of an integrative path cannot be separated from the type of institutional modification recently defined in the Euro zone.

8. The Regulation of the European Council (May 2013) mentioned above is grounded on the consideration (advanced by the Lisbon Treaty) that the competence to supervise individual banks is primarily assigned to national authori-

ties.⁶⁸ The logical consequence is that, to achieve a better integration among the national entities, there is a dramatic need for coordination.

Conversely, the analysis of the Regulation highlights the ECB's prominent role *in subjecta materia*, hence confirming a hypothesis formulated in the recent literature. More specifically, it has been affirmed that we are observing a “*substantial centralization of prudential supervision ...in the hands of the ECB... that has exclusive competence for a wide range of tasks*”.⁶⁹

It seems that the European regulator has crafted this mechanism in an attempt to smooth (and overcome) the differences characterizing the various national banking systems. The rationale behind this quest is to assist with the integration/collaboration process between the national authorities and the ECB.

The pivotal position assigned to the ECB by the Regulation should play an important role in favouring an optimal integration of the banking system and in avoiding antagonism between member countries. Furthermore, it could also prevent the rise of “old stereotypes and old tensions” (that in turn influence public opinion and politicians), which are antithetical to the pro-European spirit.⁷⁰ In other words, the socio-political consequences of this Regulation should not be underestimated, as the Regulation could attenuate the differences and lessen the gap between Member States.

In addition, the decision to block the possibility of granting the European Commission a veto power over national budgets – advanced by the German

⁶⁸ See paragraph 5, and n. 46.

⁶⁹ See GUARRACINO, *Dal meccanismo di vigilanza unico (ssm) ai sistemi centralizzati di risoluzione delle crisi e di garanzia dei depositi: la progressiva europeizzazione del settore bancario*, n. 62, p. 208.

⁷⁰ From this perspective, it is fundamental to consider the opinions expressed by MONTI and VAN ROMPUY in the wake of the criticism by the German media of the conduct of Mario DRAGHI. MONTI underlined the need to contrast the “*dangerous phenomenon based on populist tendencies that aim to disintegrate most of member states, even if to a different extent*”, while VAN ROMPUY advocated the advent of a new concept of Europe grounded on mutual trust. See Milano finanza, September 8th 2012, at it.finance.yahoo.com.

Chancellor at the recent European Council (Brussels, 19 October 2012) – should be interpreted accordingly.

In fact, the proposal formulated by Angela Merkel was an attempt to prevent the creation of a European banking supervision system and, at the same time, an effort to avoid the direct recapitalisation of banks by the European Stability Mechanism (ESM).⁷¹

In order to clarify how the ECB will coordinate its activity with the activities of the Member States (which still retain an active role in the single supervisory mechanism) it is necessary to consider the intention to create a system of “*banking supervision across the Euro area [that] abides by high common standards*”.⁷² The underlying hope is for the creation of a widespread climate of trust among Member States.

Moreover, the regulator has assigned a prominent role to the cooperation among Member States that is so crucial for the development of common mechanisms of protection, thus allowing “*appropriate oversight of an integrated banking sector and a high level of financial stability in the EU and the Euro area in particular*”, and avoiding the risk of modifying the *equilibrium* among their competences.⁷³

Financial stability is then pursued without dramatically altering the existing framework, in a way that is coherent with the principles of subsidiarity and proportionality expressed by Article 5 of the Treaty on European Union (EUT).

Nevertheless, in spite of the attempt to respect the peculiarities of the Member States that are affected by the Regulation, it is apparent that the inno-

⁷¹ See Il Sole24 Ore, “*Vertice Ue, sì alla vigilanza Bce sulle banche. Monti: non serve un super-commissario ai bilanci*”, October 19th, 2012.

⁷² See Explanatory Memorandum of the Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM(2012) 511 final, paragraph 1.

⁷³ *Ibidem*, paragraph 3.

vations discussed above will significantly affect the functioning and the competences of national authorities.

Consequently, conveying supervisory power to the ECB clearly diminishes the importance of the role played by the national authorities (which still have to collaborate with the ECB to guarantee the efficient enforcement of the supervision process and also to ensure adequate information flows). From this perspective it is important to note that the Regulation entirely preserves the position of national authorities only with regards to competences not expressly transferred to the ECB!⁷⁴

In fact, prominent personalities have noted how *“the ultimate responsibility for all the banks in the euro area will lie with the ECB, but to a varying degree and with modalities differentiated according to the banks’ characteristics”*. Perhaps it seems *“unrealistic to imagine centralizing every task”*, but it is clear that *“the ECB will take decisions on the banking sector as a whole, with reference for example to supervisory recommendations and guidelines, including stress testing”*.⁷⁵

It is therefore clearly acknowledged that the European regulator has attributed to the pivotal institution of the European financial system a crucial role, that is evidently superior to the role of the national authorities. The unconditional reliance on national institutions has obviously not been neglected, and their activity is constantly taken into account.

Another issue is the use of the structures that are currently at the disposal of the national authorities, given the contraction of their functions. A possible solution could be to exploit the absolute powers of certain supervisory bodies

⁷⁴ See paragraph 7.

⁷⁵ See VISCO, *Address at 2012 World Savings Day*, Rome, 31 October 2012, p. 12, at www.bis.org.

by assigning them a prominent role in supervision at the European level, and to allow for a competition mechanism among financial institutions.⁷⁶

This hypothesis is certainly noteworthy as it is grounded on a meritocratic criterion, and hence it encourages competition, in line with the fundamental principles of the European Union; nevertheless, there is the opportunity to re-organise domestic structures in order to adapt their shape to the actual breadth of their duties (hence, showing absolute respect for the principle of parsimony).

From this perspective, I have analysed a possible restructuring of competent authorities in each Member State, which would eventually implement the corrections needed to adapt their characteristics to their new role.⁷⁷ It is obvious that to oppose these changes would be both without motive – as it would be contrary to the natural evolution of the European context – and unreasonable – since it would be in contrast with the aggregating criterion described above. And in fact, such behaviour would contribute to a distortion of the meaning of “participation” in the *new Europe*, by preserving an anachronistic survival of national identities.

9. The identification of the entity to be entrusted with the role of banking supervisor at a regional level as a result of the European “crisis” has, since the analysis carried out by the de Larosière Group, been central to the problems that politicians and scholars have faced in the systematic review of the basis of the financial system of the EU.

The reference to the possibility of the ECB exercising skills of micro-prudential supervision (in addition to those regarding macro-control that are assigned to its chairman as the head of the ESRC) – however justified it may be

⁷⁶ See MASCIANDARO, *Gli sprechi ci sono, ma Bankitalia resta un istituto di eccellenza*, n. 41.

⁷⁷ See CAPRIGLIONE, *Mercato, regole democrazia*, n.17, pp. 112 ff.

because of the great technical skills and high reputation enjoyed by that institution – has been considered, in the first instance, with perplexity, given the possible impact of this function on the conduct of the fundamental task it exercises in the area of monetary stability. In particular, there has been a fear of *insane* commingling resulting from political pressure and interference of various kinds, which are considered to present an undoubted risk to the ECB's independence; hence the surprise which met the decision (adopted by the Council of the European Parliament in June 2012⁷⁸) to choose the institution in question for the realisation of the single supervisory mechanism.⁷⁹

Properly understood, the reasons that justify the delegation of banking supervision to the European Central Bank are listed in the timely communication made to the European Parliament and the Council by the Commission on September 12, 2012.⁸⁰ Indeed, on this occasion it became clear that, in order to move towards greater integration and cohesion among the forms of supervision at a European level, the ECB should be given powers of banking supervision in accordance with the provisions of Art. 127, paragraph 6, of the TFEU, in which, in fact, states that: “*The Council, acting unanimously ... may delegate to the Eu-*

⁷⁸ See *Dichiarazione del vertice della zona euro* of 29 June 2012, on the website of the European Council, which, inter alia, reads: “The Commission will soon present proposals for a single supervisory mechanism based on Article 127, paragraph 6. We ask the Council to take them into consideration as an emergency measure by the end of 2012.”

⁷⁹ See RUDING, *The Contents and Timing of a European Banking Union: Reflections on the differing views*, CEPS Essay, 30 November 2012, p. 3, at www.ceps.eu.

⁸⁰ See *Una tabella di marcia verso l'Unione bancaria*, doc. COM(2012) 510 final. This Communication was preceded by the announcement (on 6 September 2012) made by Mario Draghi of potentially unlimited purchases of government bonds maturing in one to three years issued by European countries in difficulty (the so-called OMT programme), an operation that marked a turning point in the recovery of credibility of the single currency. On this subject see also VAN ROMPUY, *Verso un'autentica Unione economica e monetaria*, Brussels, 26 June 2012, EUCO, 120/12, Presse 296, PR PCE 102; VISCO, *Intervento all'Assemblea ordinaria dell'ABI* (Roma, 11 July 2012) where it is stated that “the decisions of the Summit of Heads of State and Government of the euro area and the European Council of 28 and 29 June ... have reiterated their desire to preserve the single currency and to break the vicious circle between sovereign debt crisis and the condition of the banks”.

European Central Bank specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions, excluding insurance companies”.

This is a criterion in line with the evolutionary process that, in the last two years, has characterized the role of the ECB, whose duties were progressively expanded with the adoption of varied measures (from the “*Security Market Programme*” plan to the “*Long Term Refinancing Operations*” and, subsequently, to the MTO [“*Medium-Term Objective*”]) to cope with the exceptional events that arose in the financial markets. It is clear, therefore, and has been held to be consistent with the “design” in question, so that next to a “single banking supervision system” there are “*with the necessary conditions of tax sharing, European funds and mechanisms to protect depositors and resolve crisis*”.⁸¹

Moreover, even studies on the position of the European Central Bank that outline the legal and institutional framework dwell at length on the specificity of its functions (that is, the fulfilment of the objectives of the ESCB), for which Art. 127 of the FEU Treaty mentioned above and the Statute itself give significant powers.⁸² In the face of amenability to the scheme of Central Bank

⁸¹ See VISCO, n. 80, paragraph 1.

⁸² See, *ex multis*, SMITS, *The European Central Bank*, London, 1997; PAPADIA and SANTINI, *La banca centrale europea*, Bologna, 1998; BERK, *Banca centrale e innovazione finanziaria. Una rassegna della letteratura recente*, in *Moneta e credito*, 2002, pp. 345 ff.; AMTENBRINK and DE HAAN, *The European Central Bank: An independent specialised organization of community law. A Comment*, in *Commercial Market Law Review*, 2002, vol. 39, pp. 65 ff.; VELLA, *Banca centrale europea, banche centrali nazionali e vigilanza bancaria: verso un nuovo assetto dei controlli nell'area dell'euro?*, in *Banca e borsa*, 2002, I, pp. 150 ff.; VELLA, *La nuova banca centrale europea*, in *www.lavoce.info* del 18/9/2012; PELLEGRINI, *Banca Centrale Nazionale e Unione Monetaria Europea*, Bari, 2003, capitolo VI; VV.AA., *La banca centrale europea*, Belli and Santoro eds., Milano, 2003; MALATESTA, *La Banca centrale europea*, Milano, 2003, *passim*; MALATESTA, *Unione monetaria, banca centrale europea e allargamento dell'unione europea*, *Liuc Papers*, n. 148, 2004; LODDO, *Banca centrale, vigilanza e efficienza del mercato del credito*, Milano, 2007; VILLANI, *Istituzioni di diritto dell'Unione Europea*, Bari, 2008; SICLARI, *Il parere della Banca Centrale Europea nel procedimento legislativo nazionale*, in *Rass. Parl.*, 2009, pp. 841 ff.;

accountability – from which derives a peculiar liability regime free from particular obligations and with discretion to define objectives and instruments⁸³ – the technical aspect that distinguishes the function is emphasized. This aspect is considered crucial for the control of the currency, which would be based on the power “*for the primary purpose of the law of price stability, as well as the powers to be exercised independently*”, according to a formula successfully tested in Germany with the Bundesbank.⁸⁴

As I had occasion to point out years ago, the typical position of the ECB – whose qualification is different from that of other bodies of the European Community – seems indicative of a reality rooted in a sense of distrust of policy mechanisms and, therefore, oriented to avoid their excesses.⁸⁵ The aim was for the institution to have technical neutrality, so as to enable it to act autonomously in the choices within its jurisdiction (without submitting to restrictions and/or redress of any sort). Not surprisingly, as early as in the aftermath of the Maastricht Treaty, it was duly stated in the doctrine that “*the powers ... lost at the national level by representative institutions are then acquired by Community level institutions that are not representative, or as in the case of the ECB, by efficient techno-structures*”.⁸⁶

With reference to “prudential supervision”, the tasks assigned to the ECB by the Community adjustment prior to the “European banking union” project are limited to an essentially consultative function; this can be inferred from the

ECB, *The monetary policy of the ECB: 2011*, European Central Bank, 2011; PITRUZZELLA, *Austerità finanziaria verso crescita economica nel dibattito dell'Eurosistema*, in *Quaderni costit.*, 2012, pp. 427 ff.; COSTI, *L'ordinamento bancario*, Bologna, 2012, pp. 154 ff.

⁸³ See BERETTA, *L'autonomia della Banca centrale: riflessioni in prospettiva europea*, in *L'autonomia della Banca centrale. Verso una nuova Costituzione in Italia e in Europa*, ed. Velo, Bari, 1995, pp. 31 ff.

⁸⁴ See PAPADIA and SANTINI, *La banca centrale europea*, n. 82, p. 28.

⁸⁵ See CAPRIGLIONE, *Moneta*, in *Enc. dir.*, III aggiornamento, Milano, 1999, pp. 761 ff.

⁸⁶ See SORRENTINO, *La Costituzione italiana di fronte al processo di integrazione europea*, in *Quaderni costituzionali*, 1993, n. 1, p. 111.

provisions of Art. 25.1 of its Statute, which entitles it to “*provide advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and on the implementation of Community legislation ... (on the subject, as well) ... of credit institutions and ... (on) ... stability of the financial system*”. Moreover, it is significant that the statutory regulations, in line with the provisions of the FEU Treaty, allow the possibility that the ECB might “*perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions, except insurance companies*” (Art. 25.2).

On the systematic plan, the complex device mentioned above reflects a criterion based on the principle of subsidiarity, which we have referred to previously;⁸⁷ according to this, “*the Community shall take action only if the Member States cannot act in a satisfactory manner*”, that is, if it is able to achieve certain purposes better than the Member States.⁸⁸ For this reason we see the significant contribution made so far by the domestic national supervision authorities; a solution which, for the protection of the interests in the financial assets, trusts in the guarantee of supervision at a national level. We therefore find a construction in which subsidiarity – carrying out a function that curtails the tendency towards the expansion of the powers given to the Community⁸⁹ – in some ways sees the convergence of the values of German liberalism and Catholic social

⁸⁷ See *supra*, previous paragraph.

⁸⁸ See PELLEGRINI, *Banca Centrale Nazionale e Unione Monetaria Europea*, n. 82, p. 215.

⁸⁹ On this subject see DE CARLI, *Sussidiarietà e governo economico*, Milano, 2003, where we analyse the importance of the principle of subsidiarity also with regard to the instrumental function of “*rapprochement*” between the States belonging to the European Community. See also CAPRIGLIONE, *La sussidiarietà nella definizione di alcune importanti questioni di governo dell'economia*, in VV.AA., *Problemi attuali della sussidiarietà*, edited by De Marco, Milano, 2005, pp. 93 ff.

doctrine, leading to the overall coherence of the institutional relationships that are identified within the European regional area.⁹⁰

10. In the light of this disciplinary framework – and returning to an examination of the reasons that lead us to believe that it is undoubtedly legitimate for the institution in question to take on its new role – we must report on additional considerations to those we have already discussed, relating to the possibility provided for in paragraph 6 of Article 127 of the FEU Treaty to confer upon the ECB “*specific tasks*” in the prudential supervision of credit institutions.

We should recall, in particular, the scope of Community legislation which entrusts to the ECB the task of maintaining prices in equilibrium. The analysis of this function – to be considered more complex than its mere attribution to monetary data expressing a certain values of goods and services – allows us to understand the meaning in the same way as the European regulator. In other words, the assessment of the interaction of prices with “economic determinants” (a system that is defined as equilibrium) allows one to bring the essence of the concept of “price stability” to that of “stability of certain economic determinants”; it therefore becomes conceivable that an appropriate recognition can be given in terms of the legitimacy of the ECB to perform tasks that, at present, are assigned to the European Union Banking Authority. The need to justify its new supervisory functions cannot be satisfied just by making a generic refer-

⁹⁰ See STROZZI, *Il ruolo del principio di sussidiarietà nel sistema dell’Unione europea*, in *Riv. it. dir. pubbl. comunit.*, 1993, pp. 69 ff.; TIZZANO, *Le competenze dell’Unione e il principio di sussidiarietà*, in *Il diritto dell’Unione europea*, 1997, pp. 229 ff.; BERTI, *Sussidiarietà e organizzazione dinamica*, in *VV.AA., Problemi attuali della sussidiarietà*, n. 89, p. 40, which is devoted to a broad reflection on the application of this principle in the European Union; DE CARLI, *Introduzione* in *VV.AA., Diritto e protagonismo della società civile*, Bari, 2009, p. 16, where the author emphasizes the use of this principle for the transition to forms of governance that characterize the systems of government based on the participation “in support ... of ... subsidiarity”.

ence to the role of the body in charge of the conduct of monetary policy in the EU.

A timely response in this regard is the definition of the benefits underlying the goal of “price stability”, as defined by the ECB.⁹¹ Indeed, the clarification that *“the objective of price stability refers to the general level of prices in the economy. It implies avoiding both prolonged inflation and deflation. Price stability contributes to achieving high levels of economic activity and employment”*, which is followed by the specification of the technical procedures (improving transparency and minimising distortions of inflation and deflation [limiting the impact on the economic behaviour of tax and benefit systems], and preventing forms of arbitrary redistribution of wealth and income as a result of unexpected inflation or deflation) that relate to the possibility of pursuing these objectives – demonstrates, unequivocally, that in Community legislation there is no accurate definition of the maintenance of “price stability”, which is the primary objective of the ECB.

This lack of clarification by the European regulator about what is meant by the phrase in question, and indeed, having regard to the quantitative data expressed therein (*“refers to the general level of prices in the economy”*), suggests that it is only a delimitation of the sphere within which one can find an explanation for the activities of the ECB.

A different, more significant, conclusion is reached when taking into account that a measure of the benefits in question is represented by “efficiency”, which is to be reached in this way, through the process of resource allocation. A well-considered price stability (defined appropriately, even if in a non-unitary way) fulfils a central role in this process, placing itself among the determinants

⁹¹ See in this respect the institutional position of the ECB indicated on its website, under the title *“Benefits of price stability”*, at www.ecb.europa.eu.

of an efficient allocation of resources. It follows that stable prices, by contributing to the definition of the real value of assets, affect decisions (spending and investment) of economic agents, which are precisely taken in reliance on criteria that reflect this logic. This, justifiably, seems to be the ultimate aim of the “price stability” provided for by Community legislation.

It is clear that the ECB – when its actions are joined to the efficient allocation of resources – is authorised to expand those actions in areas which, albeit indirectly, interact with the sphere of interests represented here, drawing from its fully legitimate powers which also extend to cover interventions of banking supervision. On this premise, the opportunity to assign tasks to the ECB for the supervision of credit intermediaries appears to be connected, with, among other things, the previous activities of the ECB to act as the disbursing agency for funds to banking institutions in difficulty because of the “crisis”;⁹² activities to which I referred earlier when recalling the so-called unconventional operations undertaken in the last two years to reduce the financial situation of serious economic hardship with which these institutions are involved.⁹³

In carrying out this activity, the ECB has interpreted its role in arrangements designed to encompass interventions that, at first, did not appear to fall strictly under the notion of “price stability”, which must be the teleological orientation of all its actions. Conversely, a more detailed analysis allows us, as we have seen, to link the activity in question to the more general purpose of an “efficient allocation of resources”, in view of the adequate forms of equilibrium and stability of the European systems; this aim, for the reasons given above, appears to underlie the purpose of this institution that, in terms of concreteness,

⁹² See, *ex multis*, CAPRIGLIONE and SEMERARO, *Il security market programme e la crisi dei debiti sovrani. Evoluzione del ruolo della BCE*, n. 13.

⁹³ See *supra*, previous paragraph.

is indirectly authorised to put in place the operational choices deemed adequate for this purpose.

In this logical context, there is no doubt that the use by the ECB of financial resources ordinarily intended for the performance of its institutional duties must have as an adequate counterpart the ability to enable the direct monitoring of the operational and management forms (or, rather, conditions) of European banks (which connects the requirement for a “sound and prudent management”, as an obvious assumption, with the ability to proceed according to criteria of efficient allocation).

It is evident, however, that the opportunity to come to a unified monetary policy and prudential supervision of credit intermediaries – which has long been a matter of reflection by those who study the doctrine⁹⁴– has been strengthened by the need to remedy the structural deficiencies of the European financial system (which emerged in relation to the crisis situation and the negative implications of sovereign debt), to which we have just referred. In the face of the original grant to the ECB of a particular competence in the field of macro-prudential controls,⁹⁵ the specific construction takes into account what we have previously examined: on the one hand, the specific requirement of governing (or, rather, ensuring the balance of) cash flow, and on the other hand the peculiar role played in recent times by the European Central Bank, whose action (an appropriate balance between monetary policy and banking) has reduced the difficulties faced by a large proportion of European credit intermediaries.

Thus, the orientation of the European regulator could arise from the intent to catch up with streamlined, system-level, supervisory arrangements, and

⁹⁴ See, *ex multis*, GOODHART and SCHOENMAKER, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, Oxford Economic Papers, New Series, vol. 47(4) (October 1995), pp. 539 ff.

⁹⁵ See paragraph 6.

the stability developed and tested in recent times. The effectiveness of the latter does, in fact, define the normative content of the regulations approved in May 2013, in which – as we have already had occasion to observe – wide scope is given to the preservation of the independence of the ECB, so as to prevent the risk of any conceivable reduction in its autonomy (as a result of the activation of the new role of banking supervisor). From this we can see the importance attributed to the issue in question, and the rest can be deduced not only from the provisions of the TFEU (Article 130) and the Statute of the ESCB-ECB (Article 7), but also from a correct interpretation of the rules concerning the internal organisation of the ECB.

On this issue it is necessary, however, to clarify that the legislation of some Member countries constitutes an obstacle to the independence of the ECB, because the organisational form of the apparatus at the top of the financial system can give rise to doubts as to whether the actions of the institution in question are fully removed from the influence of politics.

This applies, in particular, to the complex discipline in Germany that regulates the subject matter of our examination, since the *Grundgesetz* (German Basic Law of 1949) states, in Art. 88, that the Federation should establish a bank and currency institution, the Deutsche Bundesbank; this of course, is to be counted among the components of the so-called “state apparatus” and, as such, the holder of information (or more exactly, input) sourced from policy. That said, having regard to the requirements, regulations and procedures for the appointment of the “*Vorstand*” (the organ of government of the Deutsche Bundesbank), it may be concluded that the presence in it of members appointed by the government (Article 7, paragraph 3 of the *Gesetz über die Deutsche Bundesbank*) constitutes a valid reason for recognizing, in this case, a connection or direct link between the political and the technical worlds, with obvious negative

consequences at the level of the autonomy and independence of the ECB (in which the “board of directors”, pursuant to Art. 10 of the Statute of the ESCB-ECB, includes “*the governors of the national central banks of the Member States whose currency is the euro*”).

Critical interpretations of this kind appear to be unacceptable, as the independence of the ECB must be determined by reference to the methods of making decisions in that institution. And in this regard, one can detect the fact that the ECB’s deliberations have achieved results that do not constitute some sort of summation of the will of the Governors of the national central banks (which would be based on the *specificities* of different positions). In fact, the deliberations are the result of a process – carried out on the basis of a collegial method – that allows the diversity of individual indications (attributable to members of the Board) to be overcome in the unity of the final manifestation of will, which is determined in the manner described above.

11. As pointed out above, the primary objective of the European banking union is to overcome the legal and procedural differences highlighted by the crisis in relation to the supervision of credit intermediaries. The financial disruption that has occurred since 2007 has indeed shown – in addition to the limits of a regulation which is not able to prevent banks from adopting behaviour that adversely affects financial markets⁹⁶ – that the interventionist measures adopted by national supervisory authorities, which have often acted in a “haphazard

⁹⁶ See INTERNATIONAL MONETARY FUND, *An EU Framework for Cross-Border Crisis Management in the Banking Sector*, European Commission Consultation, Washington, 29 January 2010, p. 3.

and uncoordinated” way, as several scholars have noted,⁹⁷ have been ineffective.

However, limiting the scope of the measures adopted by the EU institutions to such a purposive context would mean giving a restrictive interpretation to such measures, without a wider reference to the general context of the establishment of the European banking union. It is worth considering that such a union is planned at a critical time for the EU, characterised by stronger winds of euroscepticism which, at times, lead one to suppose that the sad option of an implosion of the EMU will occur; a time, moreover, which sees a necessary acknowledgement of the need for change in order to overcome the European “economic disarticulation” which is caused by *differences* that are often referable to the specific cultural characteristics of the “old continent” peoples.⁹⁸

Therefore, it is legitimate to ask whether, in order to carry out the purpose of implementing measures to achieve a more complete prevention (aimed at avoiding events like the ones that have occurred in the past few years and have wrecked the economic system and fed the well-known current recessionary phase), a different interpretative option must be researched.

In other words, it is worth considering the event from a different perspective, taking things *further* than the mere revision of the rules which govern financial intermediaries and markets, but without going so far as the establishment of a European banking union. In the same area one may remark that forms

⁹⁷ See COX, DORUDI, GORDON, NEWSOME, STADELMANN, STRANGE and O’SULLIVAN, *United Kingdom regulatory reform: Emergence of the twin peaks*, in *Compliance Officer Bulletin*, 2012, vol. 95, p. 29.

⁹⁸ For recent thoughts on the implications of the differences, see STIGLITZ, *The inequality at the time of the Great Recession*, Report of the Fiftieth SIEDS Scientific Summit on “*Economic and social transformations at inception of the third millennium: analysis and outlooks*”, held at the European University of Rome on 29-31 May 2013. The thesis put forward in that paper – according to which, if the inequality index (the so-called Gini index) increases, then the “multiplier” effect of the investments reduces, with an obvious aggregate decrease in economic activity and, therefore, in Gross Domestic Product – appears to be material.

of intervention with particular qualities (which are consequences of the envisaged convergence of European supervisory actions) may be a prelude to the realisation of an integration process of much more strength and substance than the one carried out so far. Hence, the starting-up of an innovative unitary control mechanism in the European context could be deemed as being aimed at objectives which go beyond the contingent referability to the improvement of the management of financial intermediaries.

Indeed, the identification (in clear-cut ways) of the best practices applicable, in similar circumstances, to subjects with similar qualitative and quantitative characteristics lead to an objective unity (besides a substantial behavioural equality) in carrying out the supervisory activity. Such an operational mode confers a peculiar direction on such supervisory activity, defining its function as the means by which the general interests connected with the activity are realised.

The requirement that determinations relating to many intermediaries facing similar difficulties are made together at the same decision level constitutes the unavoidable basis for a real *homogenization* of financial systems. Therefore, it appears to be plausible that the sense of union is enhanced among those aiming at increasing levels of coordination and operational cooperation, which are known to be the objectives of the European integration process.

It is worth considering that such a mix of interventions allows one to look beyond the mere purpose of a positive interaction on the operational dynamics of banking intermediaries. Indeed, it appears to be related to the realisation of a new architecture of the financial and economic system, in order to better manage its complexity. Finance interacts in a more complete way in the “investment - undertaking - productivity” relationship which is, by this means, animated by a new impulse that will have a positive impact on the outlook of the economic

system; in general, this is in *favour* of more strict forms of cohesion within the EU.

It is evident that a teleological dimension can be assigned to this subject matter that is much wider than the one deriving from the simple configuration of a unitary synthesis of control instruments, and that is aimed at improving operational practices and, therefore, preventing future turbulence in the financial markets. There is no doubt that such a conceptual hypothesis – in line with the longstanding position of scholars on the relationship between EU law and the supervision role⁹⁹ – is consistent with what is likely to be the aim of the European regulator to correlate the regulatory intervention under discussion with the changing economic and financial reality.

In fact, the introduction of a unitary control mechanism - because it ensures the stability of the system - identifies ways in which participants interact with the market that are inspired by the aim of achieving a level playing field, including from a regulatory standpoint. Therefore, pursuing the “sound and prudent management” of the participants in the relevant sector becomes a necessary condition for a higher level of competition, which is grounded on the seriousness (in terms of financial standing) of the “initiatives” and on the adoption of organisational modalities that are adequate for carrying on a complex activity such as financial activity, which (because its original configuration, related to the mere credit intermediation, is overcome) is significantly enriched. Moreover, the reforms of the structural and functional modalities of the supervisory authorities of the local financial system, which will be carried out as a conse-

⁹⁹ See, among others, ORSELLO, *Il diritto dell’Unione europea*, in *Trattato di diritti amministrativo*, edited by Santaniello, Padua, vol. XXXII, 1999; RIDOLA, *Diritti di libertà e mercato nella “costituzione europea”*, in *Quaderni costituzionali*, 2000, n. 1, pp. 15 ff.; ZILLER, *La tutela del risparmio tra obiettivi e competenze della Unione europea*, in *Il diritto dell’economia*, 2008, pp. 15 ff.; VILLANI, *Istituzioni di diritto della Unione Europea*, Bari, 2008.

quence of the new competences assigned to the ECB, should also be taken into account.¹⁰⁰

Therefore, it seems that there are sufficient reasons for an extensive interpretation of the regulatory intervention we are analysing, when we consider such an intervention as a significant “first step” towards a more articulated route to European political union. What is more, the recent indications given by François Hollande that were mentioned above point in the same direction!¹⁰¹ However, on reflection, various types of obstacles prevent any value beyond the mere recognition of being a step forward towards the route of integration being assigned to the establishment of the European banking union... with the result that an EU political union remains, for the time being, still relegated to the sphere of “*wishful thinking*”!

As will be described in more detail below, there are structural causes, deep cultural differences and interests in conflict with the existence of a political union which impede the immediate realisation of such a union.

In the past, in the late 1980s, during a period that was particularly important in the process of the redefinition of the European geopolitical framework (the fall of the Berlin Wall, German reunification and the despair in the Communist Party of the Soviet Union) first the *Delors Report* and then the implementation of the “single currency” identified the route for a renewed perspective on the development of “Europeanism” in the economic, juridical and institutional fields.¹⁰²

¹⁰⁰ Scholars have had several occasions to pronounce on the effect of the Community on the structural and functional modalities of the local financial system supervisory authorities; see, among others, MERUSI, *Le leggi del mercato. Innovazione comunitaria e autarchia nazionale*, Bologna, 2002; GIRAUDI, *La regolazione: il concetto, le teorie, le modalità. Verso una tipologia unificante*, in *Riv. it. polit. pubbl.*, 2004(1), pp. 74 ff.; MONTEDORO, *Mercato e potere amministrativo*, Napoli, 2010.

¹⁰¹ See paragraph 3.

¹⁰² See CAPRIGLIONE, *Mercato, regole, democrazia*, n.17, p. 38 ff, and bibliography therein.

Nowadays, to set against the difficulties faced by the EU States caused by the financial crisis and their sovereign debts, the introduction of the “single supervisory mechanism” might act as a catalyst in order to awaken sleeping interests in a rebuilding of Europe, thus helping to overcome the tensions between the States; we acknowledge that an extraordinary effort must be put in place to realise a political union of the European peoples, from which all States will benefit.

It is necessary to read the EU intervention mentioned above in a way consistent with the real context; in this way, it is possible to suppose that such an intervention forms part of a “small steps policy” towards forms of a more cohesive cooperation ... steps which are, moreover, essential if we are to avoid the alternative of an implosion or, at least, a material dilution of the EU integration programme.

12. Reference has been made several times in this article to the presence of impediments to the process of EU integration, which adversely affect its concrete realisation and cause inevitable delays or even the postponement of the establishment of a political union *sine die*.

The basis of this reality is, first of all, the deep cultural diversity among the peoples of the “old continent”¹⁰³; this diversity causes deep differences in the approaches taken to deal with the issues connected to overcoming the current recession and, furthermore, to identify the interests on which social-economic growth and development programmes should be based.

The above differences often bring out conflicting interpretations of the rules of the Treaties and, as a consequence, of the guidelines indicated in those

¹⁰³ See CAPRIGLIONE and SEMERARO, *Financial crisis and sovereign debt: the European Union between risks and opportunities*, n. 1, pp. 65 ff.

same Treaties; in fact, notwithstanding the statements of the representatives of the various States to ensure that such guidelines are *shared*, as a matter of fact they are only formally approved by the States. As a matter of fact, there is an increasing estrangement from the original EU ideals and a growing disappointment in the expectations of positive results connected with the realisation of a European unitary framework, first in the economic and then in the political field.

Following this logical order, it is self-evident that the position of the Member States who favour a gradual enlargement of the European Union seems to have an opposite effect on the purpose of the integration. Indeed, the progressive expansion of the Union, marked by the history of the latest crises,¹⁰⁴ has not been adequately confirmed by a federalist option and, in the end, as a matter of fact, has increased the differences; therefore, such an expansion is in conflict with the actual implementation of the unification sought by the EU founding fathers,¹⁰⁵ thus condemning the relevant process to a certain movement backwards.¹⁰⁶ In the end, the expansion that has been achieved interacts adversely with the undertaking and the motivations (peace, stability, prosperity and European unity) on which the project which led to the current reality was based.

This highlights a structural situation of the Union, which in my opinion constitutes the most important factor for the disaggregation of the EU. The pro-

¹⁰⁴ The enlargement of the European Union – open to any European State which is democratic, a guarantor of a free market and able to implement European laws – found, after the fall of the Berlin Wall, a wide implementation thanks to the Treaty of Athens (2002) and the Treaty of Luxembourg (2007); see OLIVI and SANTANIELLO, *Storia dell'integrazione europea: dalla guerra fredda alla costituzione europea*, Bologna, 2005; PISCIOTTA, *L'Europa post comunista dal crollo del Muro di Berlino all'integrazione europea*, in *Rivista di Studi Politici Internazionali*, 2010, pp. 77 – 9.

¹⁰⁵ In this respect, please see the federalist option of ROSSI and SPINELLI, *Manifesto per l'Europa libera e unita*, 1941, and the well-known text of SCHUMAN, *Pour l'Europe*, Paris, s.e., 1963. See also DI MAIO, *Alcide De Gasperi e Konrad Adenauer - Tra il superamento del passato e il processo di integrazione europea (1945-1954)*, Turin, 2004.

¹⁰⁶ See PISTONE, *L'integrazione europea. Uno schizzo storico*, Turin, 1999, *passim*.

posals of certain States to increase the number of States admitted to the Union – which, as is known, includes 27 States as of today – certainly represented an impediment to the necessary cohesion in the Union and, therefore, to the existence of the conditions required for a shared political union.

There is no doubt that a particularly high number of participants – which may have been reached too early (*i.e.* in a phase of the integration process in which the levels of ideological maturity essential to overcome differences through political unification were still far off) – does not assist with making the system resilient. It results in noticeable dysfunctional trends, which certainly do not favour a necessary common feeling, which is a feature that would characterise any sense of “belonging”, in the specific circumstances, to the “European nation”.

The situation would have been quite different if the original core States that gave life to the European Community, numbering six and then fifteen, were driven by a strong universal will to “stay together”. Perhaps a more intense Community-minded spirit would have acted as catalyst in promoting – among them and in a reasonably short period of time – a form of political aggregation (to be achieved after a period of joint operational activity aimed at ensuring adequate legal and economic convergence), in order to build at first a joint reference centre with a view to the subsequent extension of membership to other States.

However “*if*” did not become history ... and the course of history shows a different reality, which is testified to by the significant relationships and agreements ratified by several conventions entered into over the last half century. The reality outlined so far seems therefore destined to remain limited (for an unforeseeable period) to relationships within the economic and financial fields (relationships that in recent years, due the imposition of specific burdens and

constraints, seem to be an obstacle to the growth of certain Member States, rather than a positive factor for development).

On that basis, and as we wish to analyse further the causes which hinder European integration, it should be noted that the large number of EU Member States has emphasized the difficulties in coordination among those Member States, and moreover has favoured the creation (that is, the distinguishing) of “groups” of States that have non-identical features. In this regard, the distinction between those States that have chosen to participate in the European Monetary Union and those that have chosen to remain outside at the time of the establishment of the euro system has been significant. This allows the identification of a further cause of separation within the EU, since belonging to one or the other group is clearly an assumption for operational choices and development programmes which often do not converge (even when they are not in conflict). These are the reasons for the entirely uphill path that characterises the routes of the Union.

The project of a “European banking union” then has an impact on the framework we have outlined. In the light of the above, it is self-evident that the underlying unifying strength is sometimes opposed, either intentionally by certain States who are willing to postpone its applicability for a time, or by the unwillingness of others to accept cooperation and the logic of the Union if these may undermine “excellence positions” (to which such States aim) or “relationships created with non-EU States” (to which such States are linked by an established practice).

In particular, notwithstanding that the reasons which should lead to the adoption of a single supervisory mechanism are generally recognised, there is still unjustified resistance to its establishment or attempts to limit its scope, according to a logic that relies upon the autonomous ability of certain Member

States to manage a possible crisis. In this regard the awareness of a general trend of local supervisory authorities to minimise domestic issues is relevant;¹⁰⁷ the national authorities are wrongly convinced that in this way they can defend the realities of their own States. On the contrary, as appropriately underlined by the scholars, the important principle of “the level playing field”, which is implicit in the adoption of a single supervision system, would avoid the default of a national bank (including a medium-sized one) creating “much turmoil in the financial markets and angst among savers”.¹⁰⁸

Likewise, we should note the same with respect to the intention to create a structure, for the seventeen States who are members of the European Monetary Union, that can potentially be extended to the other States that as of today are outside the euro zone. Notwithstanding that certain analyses – carried out with reference to criteria based on a costs/benefits ratio – have shown that the UK and Sweden are among the main beneficiaries of the European Banking Union,¹⁰⁹ there is no doubt that it is unlikely that they will request such membership, and this is confirmed by the first reactions to the relevant proposal presented by the Commission.¹¹⁰ Separately, one should also consider that in the end the States not interested in European supervision will unavoidably express, in the relevant European venues, *votes* and *judgements* in conflict with the suc-

¹⁰⁷ See GROS, *A Banking Union Baby Step*, Project Syndicate, 2 July 2012.

¹⁰⁸ See RUDING, *The Contents and Timing of a European Banking Union: Reflections on the differing views*, n. 79.

¹⁰⁹ See SCHOENMAKER and SIEGMANN, *Efficiency Gains of a European Banking Union*, Duisenberg School of Finance, VU University Amsterdam, 31 January 2013, p. 17.

¹¹⁰ See RUDING, *The Contents and Timing of a European Banking Union: Reflections on the differing views*, n. 79, p. 4, where he states that “the UK has already declared its intention to opt-out”, even if “its first signal was that it would not block the proposal as such”.

cess of such proposals or, at least, aimed at limiting their scope, in this way feeding “the undesirable development of a multi-speed Europe”.¹¹¹

It follows that the convergence of a series of directives, regulations, execution measures and recommendations, as well as of similar instruments, in a single European *Rulebook* ultimately assumes an importance which is mainly conceptual, notwithstanding that it reflects the need for an integrated regulatory system. Hence scholars have pointed out that the possibility of making such an objective concrete is still far away, without prejudice to the acquired knowledge that local supervisory bodies, even though they reduce the internal strains of a single system, bring to light cross-border frictions, unavoidably giving further space to regulatory arbitrage.¹¹²

In the following paragraph, we make reference to the peculiar position of United Kingdom, but the limited interest shown by Germany for the “European Banking Union” project is worth mentioning here. This State, because of the specific German federal structure, wishes to maintain forms of “national control” over a number of local and regional banks (*Landesbanken* and *Sparkassen*); hence, it is only willing to transfer, in the European context, the supervision of the largest banks, those which are subject to systemic risks or risks connected with cross-border operations.¹¹³

This position is certainly based on an individualistic position related to the circumstance that Germany, being able to (financially) support any downturns of its own banks, does not wish to be involved in supporting actions to be started by EU institutions on behalf of foreign banks (which may have defaulted). Once again, Germany is tending to adopt an attitude that, as well as reveal-

¹¹¹ See RUDING, *The Contents and Timing of a European Banking Union: Reflections on the differing views*, n. 79, p. 4.

¹¹² See WYMEERSCH, *The European Banking Union. A first analysis*, n. 47, p. 5.

¹¹³ See RUDING, *The Contents and Timing of a European Banking Union: Reflections on the differing views*, n. 79, p. 2.

ing an absolute lack of any spirit of solidarity, seems to express an intention to excel which is grounded on the awareness of its own virtues!¹¹⁴

13. As mentioned above, in the context of the differences characterising the EU special mention should be made of the United Kingdom. In the light of the cultural features and behaviour it has frequently adopted with respect to the determination of European policies, the United Kingdom has often given the impression of a sort of *indifference* towards the remainder of the continent or, more precisely, an intention not to be thoroughly involved in the events of a Europe that is maybe perceived as a foreign reality, too far away from the domestic reality which is considered to have priority in all things.

Notwithstanding this, the United Kingdom was among the first European States to recognise the need to commence a European constitution process after the Second World War, boosting the movement in favour of a gradual integration of the continent.¹¹⁵ However, the United Kingdom did not participate in the first steps of the European constitution programme and, therefore, remained outside the start-up phase of the intergovernmental cooperation among certain European States, which led to the Treaties of Rome of 1957 establishing

¹¹⁴ See CAPRIGLIONE, *Mercato, regole, democrazia*, n.17, p. 181.

¹¹⁵ In this respect, the important speech made by Winston Churchill in Zurich on 19 September 1946 should be recalled. In this, the illustrious statesman, intervening at a moment of severe uncertainty in international relationships, asked for the reconstruction of the “European family” in a sort of United States of Europe, as a guarantee against the dangers of a new, terrible world war. He did not give any indication on the institutional form of such a supra-national organisation, but stated that both the United Kingdom and the Soviet Union would have to be supporters, but not also members, of such a new Europe. In order for this to come into being, Churchill promoted the creation of a European Council, which – as we know – was established after many years; see *Churchill Commemoration 1996. Europe Fifty Years on: Constitutional, Economic and Political Aspects*, edited by Thürer and Jennings, Zürich, Europa Institut-Wilton Park, Schultess Polygraphischer Verlag, 1997; *Winston Churchill, His Complete Speeches 1897-1963*, edited by R. R. James, New York, London, 1974, vol. VII; FONDAZIONE EUROPEA LUCIANO BOLIS, *I movimenti per l’Unità Europea 1945-1954*, Minutes of the International Meeting held in Pavia in October 1989, edited by Pistone, Milan, 1992.

the European Economic Community (EEC) and EURATOM (the European Community for Atomic Energy).¹¹⁶

The politics of the United Kingdom towards Europe in the second half of the twentieth century give rise to a long and lively discussion, in relation to which the roles carried out by the Tory Harold MacMillan and by Labour's Harold Wilson are particularly important. The application by the United Kingdom to become a member of the European Economic Community, which was filed a number of times, and the veto on its access by France – as well as highlighting the particular position of a State approaching a Europe of “six” – reveal the difficulties incurred by the British politicians in overcoming the obstacles implied in the transition from a global reality (to which it entirely belonged) to a regional one (in which it only participates in the relevant decisional framework).¹¹⁷ The end of the French veto (with the coming of Pompidou, who succeeded de Gaulle in 1969) marked the opening of negotiations that concluded in 1973 with the United Kingdom's entry into the Common Market.¹¹⁸

The “choice for Europe” (ratified by a referendum), however, did not occur in a climate of great empathy for the remaining part of the continent, where political integration could have been regarded as being necessarily linked to economic integration. The number of those in favour of political integration remained extremely limited, while the intention to benefit from the EU mecha-

¹¹⁶ The treaties subscribed by the representatives of the six promoter States provided for the institution of a European parliamentary assembly (composed of 142 deputies appointed by the parliaments of the six member States of the Community), which would have assumed the name “European parliament” only in 1962. The members of the European parliament have only been directly elected since 1979.

¹¹⁷ See PARR, *Britain's Policy towards the European Community. Harold Wilson and Britain's World Role, 1964-1967*, London, 2005; TOOMEY, *Harold Wilson's EEC application: Inside the Foreign Office 1964-7*, University College Dublin Press, 2007.

¹¹⁸ See GOZZANO, *L'ingresso dell'Inghilterra nel Mercato Comune Europeo*, available at www.cvce.eu; Gozzano welcomes this entry is welcomed as a boost for the Community, as it would allow the same to be able to match the USA and the Soviet Union in the future.

nism based on intergovernmental methods seemed to prevail. A traditional affection for *sovereignty* (in all its diversified components) is the base of a behavioural trend which, on the one hand, is comprehensible (in the light of the economic improvement that was sought for exports, employment, etc.) and, on the other hand, appears to be contradictory, given the strong feelings of euro sceptics (among whom in the 1970s were influential politicians, including Sir Teddy Taylor who resigned as a Minister in the *Heath Government* as soon as he became aware of the decision to subscribe to the Treaties of Rome).¹¹⁹

Also abandoning sterling is considered to be giving up sovereignty! The United Kingdom, therefore, did not subscribe to the “single currency” and since 1992 (*i.e.* since the Maastricht Treaty) its politics in European affairs seem to be aimed at safeguarding its national interests. Obviously, this implies frequent requests for rule adjustments (or rather, amendments) and the adoption of positions which are not consistent with an intention of full adherence, which is indeed required in a logic of integration where the common interest should prevail over the particular interests of the participants to the Union. It is not accidental that the analysis carried out by the scholars with respect to such reality is summarised in evaluations that sometimes make reference to a “gatekeeper” action put in place by the British government vis-à-vis the European Community (for the purpose of safeguarding national sovereignty), and sometimes to a clear “quasi-indifference” of the United Kingdom towards the European construction.¹²⁰

¹¹⁹ See CACOPARDI and others, *Ingresso del Regno Unito nella CEE. La Gran Bretagna nella CEE/UE*, available at www.geocities.ws

¹²⁰ See, among others, GEORGE, *Britain and the European Community: The Politics of Semi-Detachment*, Oxford, Clarendon Press, 1992; MORAVCSIK, *Preferences and power in the European Community: A liberal intergovernmentalist approach*, in *Journal of Common Market Studies*, 1993, No. 4, p. 473 ff.

Following that argument, the positions taken by the United Kingdom on some of the most important issues concerning the coordination measures for the economic and banking policies of the European Union can be explained. In this respect, it is worth considering, first of all, the report prepared by the House of Lords on the euro zone crisis and, in particular, on the proposal of the “*fiscal compact*” (and subsequent measures).¹²¹

The statement made therein according to which in December 2011 “*the United Kingdom indicated it would stand aside*”, together with the description of this proposal as being outside the architecture of the EU Treaty, clearly show the intent of the United Kingdom to avoid any form of responsible involvement in the events of the euro system. At the same time, the declaration according to which the United Kingdom will abide by any decisions of the European Court of Justice (which will also pronounce on whether Member States are obliged to implement the balanced budget rule within their national laws), highlights a respect for EU institutions and guidelines that, though formally unexceptionable, certainly does not seem to be very consistent with the declaration mentioned above (which is clearly aimed at avoiding possible exclusion).

Likewise, the declaration made in respect of the revision of the rules related to capital requirements (CRD IV) is relevant for the purpose of identifying the indifference (or the substantial feeling of separation) of the United Kingdom towards the fortunes of the continent – or, more exactly, from the processes aimed at realising more stable economic and financial conditions for the Member States.¹²² In this regard, the United Kingdom has made belated and undetermined arguments (a fear of noncompliance with the “Basel 3” agreement

¹²¹ See HOUSE OF LORDS, *European Union committee, 25th report of session 2010–2012, The euro area crisis*.

¹²² See COUNCIL OF THE EUROPEAN UNION, 2 April 2013, 7748/13, ADD 2 (Addendum 2 to the note, point “1”).

and of “impact evaluation” of the provisions on remuneration) in order to give an express refusal to a package of laws aimed at guaranteeing financial stability and compliance with the EU’s international duties in the banking regulatory sector.¹²³ As well as limiting the support given to EU initiatives, such arguments essentially show an intent to have a postponement (intended to delay the realisation of the common programmes); an intent that is certainly in conflict with the participative spirit which should animate EU members and is without doubt a cause of hesitation as to whether there is the presence of an effective will to remain in the EU for a long time.

It has been mentioned in the preceding paragraph that the United Kingdom has determined not to adhere to the European Banking Union;¹²⁴ it should be specified that this position seems to *protect* the United Kingdom’s historical financial autonomy. Such a position is indeed justified by means of a logic that identifies, in the separation of supervisory mechanisms (and, therefore, in the possibility of continuing to manage banking supervision without external interference), an unavoidable assumption that the “London financial market”, which traditionally represented the expression of a completely free operational environment, has assumed a role of excellence worldwide and will hold this without any competitors whatsoever.

Let the truth be told! It is not accidental that Mario Draghi, President of the European Central Bank, in his speech on the “Political debate surrounding the United Kingdom’s EU”, has recently declared “*I cannot say which of the two*

¹²³ Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and the Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate).

¹²⁴ See *supra*, in particular n. 26.

*sets of arguments is stronger, the economic or the political ones, neither am I going to enter into a domestic policy debate, but what I can say is that Europe needs a more European UK as much as the UK needs a more British Europe”.*¹²⁵

This is the common wish of those who, notwithstanding the reasons for scepticism mentioned above, continue to believe in the good results that may arise from a profitable cooperation between the United Kingdom and the euro zone, as Draghi has further stated: “*With such deep interconnections, the UK and the euro area share a common interest: the stability in the functioning of our economic system and particularly our financial markets*”.

14. As far as the specific EU situation is concerned, the financial crisis – which has severely affected a wide range of States in the world in the last five years – has emphasized the existing differences between EU Member States. A spread of scepticism has shaken the overall balances of the euro zone: the “irreversibility” of the single currency is in doubt and significant impediments have arisen to the reconciliation of the interests involved. The objective of political union is moving away!

The recession caused by the crisis has highlighted the failure of *politics* (which has not been able to accomplish its institutional duties), worsening the sense of wholeness in relation to the opportunity (that is, convenience) of the EU perspective. In the end, achieving the double objective of overcoming the crisis (reopening the system to growth) and determining the conditions to re-start advanced integration mechanisms, with a view to a more cohesive and shared unification, is referred to as the *technique*.

¹²⁵ See STEEN, *Mario Draghi in City of London call for “more European UK”*, in *Financial Times* of 23 May 2013.

At the European level, the limits of the EU decisional forums, which are based on an *institutional quadrilateral* (Commission, Parliament, Council and European Council), did not allow the establishment of a line of politics (even cross-party) that was capable of overcoming the conflicts that impede the integration process. The substantial sharing of the decision-making power between the different EU bodies (linked up in a *co-decision* process) has proved to be ineffective for the purposes of setting up an actual democratic system, highlighting the failures of the regulatory system, which was certainly not improved, as expected, by the Treaty of Lisbon. No material effects followed in terms of a more intense *relationship* between Member States!

The “European Banking Union” project has an impact on this reality, referring the identification of common operational criteria to a technical regulatory scheme in an innovative way of “staying together” and, therefore, of restarting growth in the States, with the aim of realising a more united Europe. This is the challenge of the project, which, taking into account the particular difficulties of the current period, is intended to give a significant contribution to the overcoming of the crisis by means of common banking supervision rules aimed at improving competition (which should bring desirable productivity and development benefits). Such a project is, therefore, indicative of a clear option for a policy of “small steps” on the route of a common advance.

Thus, the “single supervisory mechanism”, on which the European Banking Union is based, traces the possibility of carrying on financial activity in similar ways in the European context into the setting of the specified new forms of public control on the credit sector. In this way, a higher economic productivity should be ensured, with the obvious expectation of shared actions in choosing optimum means and instruments aimed at pursuing the objectives of the common path that was started more than half a century ago.

In the architecture of recent reforms, the single supervisory mechanism is one of the three “*building blocks*” of the strengthened Union; the others are the Single Resolution Mechanism (described in the first paragraph of this article) and the Direct Bank Recapitalisation (by the ESM). Looking forward, a fourth element related to the common deposit guarantee mechanism would be added to the three “*building blocks*”.¹²⁶ Each of these elements is strategically linked to the others.

The single supervision system identifies the natural conditions for proceeding with the direct recapitalisation of credit institutions, thus eliminating the involvement of national governments. This elimination means that there are no further burdens on the indebtedness and deficits of States that are given aid. As a consequence, the effective ability of governments to fulfil both their own commitments and the commitments undertaken by their banks becomes certain (hence the need to lay down a limitation to *indirect* financial aid); it is plain that such a form of *direct* recapitalisation is aimed at breaking the “vicious circle” between banks and sovereign debt that was set up by the crisis. A necessary condition for the use of such an instrument (which is among the ESM’s resources) is the existence of a precise framework of rules governing crisis resolution, which is strictly defined *ex-ante*.¹²⁷

The ECB involvement in the programmatic plan under analysis should be deemed to be consistent with its role and institutional position. This is a legislative position which privileges the *technical neutrality* of the entity, which is allowed to act autonomously in carrying out the functions falling within its com-

¹²⁶ See the document published by the ESM on “*The main features of the future ESM direct bank recapitalisation instrument*”, available at www.esm.europa.eu

¹²⁷ Therefore, a reality different from the one observed during the Cyprus crisis of 2013 is highlighted, in which the uncertainty on the order and degree of hedging losses has contributed to increasing the disruption and the contagion risk. See FITCH, *Cyprus Stalemate Shows Dangers of Ad Hoc Crisis Response*, 21 March 2013, available at: www.fitchratings.com

petence (without being subject to any constraints and/or guidelines whatsoever). Hence, the establishment of a single supervision system sheds light on the material changes to the current configuration of the ESFS (which is the expression of the supervisory model recently adopted in order to deal with the turbulence of the financial crisis) and to the relationships between the European banking supervisory authority and the national authorities.

Potentially, the combination of the various elements described above defines a significantly effective institutional framework. Unfortunately, the first indications given by the *leading actors* appear to show doubt about the merit-based selection to be made by depositors, rather than considering the logic behind the supervisory activity carried out in those States that during the crisis have neither suffered public losses nor experienced cases of bank runs.¹²⁸ In any case, it appears that there is a scenario of major changes, most of which are still to be defined, that could lead to the end of the uncertainties that characterise the present times and, therefore, there could be a possibility of believing in a future evolution of the European integration process from a *political* perspective.

There are recent events that seem to point in a direction contrary to the achievement of such an objective. I refer to the declarations made by the Croatian Prime Minister Zoran Milanovic on the eve of the official admittance of Croatia to the EU, which stated: “We will maintain our sovereignty...The path of Croatia towards the full adherence...has been long and difficult...The European Union is complicated, it often works well, sometimes less...it is not and, as far as I am concerned, it will not be a *federation*”.¹²⁹ Such words specify, beyond doubt, the limits of the membership of this State in the EU, clarifying the intent

¹²⁸ See *supra*, paragraph 1.

¹²⁹ See the leading article “*La Croazia diventa il 28mo Paese UE*”, published in *laRepubblica.it*, available at www.repubblica.it

that membership is limited to the realisation of economic interests only (and eventually also becoming part of the single currency area).

The above implicitly confirms that among the various obstacles to the realisation of the political framework described above – that arise from the deep cultural differences and the different interests pursued (and from which we can see that the behavioural differences between people are not yet sufficiently small) – the obstacle represented by the enlargement of the EU area has primary importance.¹³⁰ As has already been highlighted, the growth in the size of the EU inevitably and implacably increases the difficulties related to integration and the fusion of non-homogeneous entities, with the obvious consequence that the purpose of membership for each new entrant is reduced to a mere economic and financial context.

From another point of view, it should be noted that the crisis has highlighted (or, rather, aggravated) the existing gap between European countries; in fact, while some of them, thanks to their own intrinsic capabilities, have been barely touched by the crisis (or, at least, have been adversely affected by the same to a limited extent), other countries, due to prior *mala gestio* habits or unjustified increases in their public debt, have been overwhelmed by the crisis or, at least, have reached the edge of the “abyss”. This gap seems to be much more significant since it gives scope for the leadership intentions of certain countries (which wish to become leaders of the whole EU, in the light of their *virtues*) and for the postponement strategies of others (which are not well-disposed towards accepting forms of incisive integration and, therefore, towards cooperating in order to realise institutional change in the EU). This is the reason for the material importance given to the realisation of the EBU, which seems to be designed

¹³⁰ See *supra*, paragraph 12.

to start an amendment process which goes beyond the incidental purpose of a banking union!

What will be the results of such an innovative construction, and what are the chances of a positive outcome to an intervention which is heavily engaging European institutions? It is difficult to give an immediate answer to these questions. The answer depends on the establishment of conditions which may actually lead to a different European Union that is more homogeneous...without conflicts or mental reservations! It seems that such a goal will only be achievable when each Member State accepts diversity with a *sharing* spirit...when *solidarity* becomes a citizen in Europe, making concrete a far-off vision for a common life, where peace and serenity are the conditions for the equality of all EU Member States.

A meeting between people, and their acceptance of a perspective of reciprocity, will be the only, true remedy for overcoming the present unease, to escape isolation, and to abandon hypocrisies, unrealistic ambitions and delays... being aware that “*we need boldness*” to open ourselves to the new, in order to avoid the possibility that “*utopias remain pure dreams of reason which produce monsters*”, as Remo Bodei has written.¹³¹ Today, on this difficult route, the responsible actions of those who continue to believe in the “European dream” and wait for tomorrow with trust and without fear shall be of guidance!

¹³¹ See BODEI, *Sogno e utopia*, Modena, 2009.

BANKING UNION IN THE MAKING

*Stefano Micossi**

ABSTRACT: *The Banking Union has become an extraordinary step in the Road Map to a “genuine economic and monetary union”, comparable for its implications to the creation of the single currency. There is a strong argument to the effect that it would help restore open financial markets within the Euro zone and the Union, together with well-functioning monetary policy transmission mechanisms. The analysis starts out by mapping the contours of the legal aspects of the national supervision of cross-border banks before going on to address the major questions regarding the EU proposal to establish a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM). The fact is that the regulatory construction appears incomplete and, as is, not capable of reversing the fragmentation of financial markets that is threatening the economic recovery in the periphery of the Euro zone and the very sustainability of sovereign debts. This paper considers that the fundamental mistrust between the EU member states that has prevented the construction of effective risk sharing arrangements for sovereigns has also impeded to travel the full way to banking union.*

SUMMARY: 1. Introduction - 2. The SSM - 3. The institutional setup of the SSM - 4. Supervisory approach. - 5. Deposit insurance and bank resolution - 6. The new ESM instrument for bank recapitalization. - 7. Concluding remarks

1. Since the June 2012 European Council and Euro summit, banking union has become a principal building block of the reinforced Economic and Monetary Union outlined in the four Presidents’ Road Map.¹ The immediate reason for this momentous decision was the urgent need to tackle the mutually reinforcing

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¹ See EUROPEAN COMMISSION, *Towards a genuine monetary and economic union*, Report by the Presidents of the European Council, the European Commission, the Euro group and the European Central Bank, Brussels, 26 June.

sovereign debt and banking crises in Spain which held the potential of wrecking the entire Euro zone financial system: centralization of supervision was decided as the precondition for intervention by the European Stability Mechanism (ESM) in the recapitalization of ailing Spanish banks, which would thus take place without further augmenting Spain's sovereign debt.² Ireland, overburdened by its decision to make good all of its banking losses with taxpayers' money – not least owing to German insistence – was seen as next in line.

An additional ill-effect of national supervision of cross-border banks, by both home and host country supervisors, has been informal action to impede the transfer within banking groups of pools of liquidity held by branches and subsidiaries of banks based in other member states of the Union. This behaviour, which is clearly inconsistent with the Single Market rules, reflects the segmentations of financial markets engendered by the opening of wide spreads in banks' borrowing costs and the progressive drying-up of the cross-border inter-bank market. At least to an extent, these spreads are a reflection of sovereign risk pricing rather than banks' specific risk profiles. By eliminating this anomalous component, the banking union would help restore open financial markets within the Euro zone and the Union, together with well-functioning monetary policy transmission mechanisms.

More broadly, the crisis brought in full light the role of reckless lending by "core" Euro zone banks in accommodating not only excessive government spending, but also housing bubbles and divergent wages and price inflation in the "periphery" in the build-up of unsustainable public and private debts (Figure 1).

In a highly integrated financial system, such as in the European Union, taming moral hazard and excessive risk-taking requires the simultaneous cen-

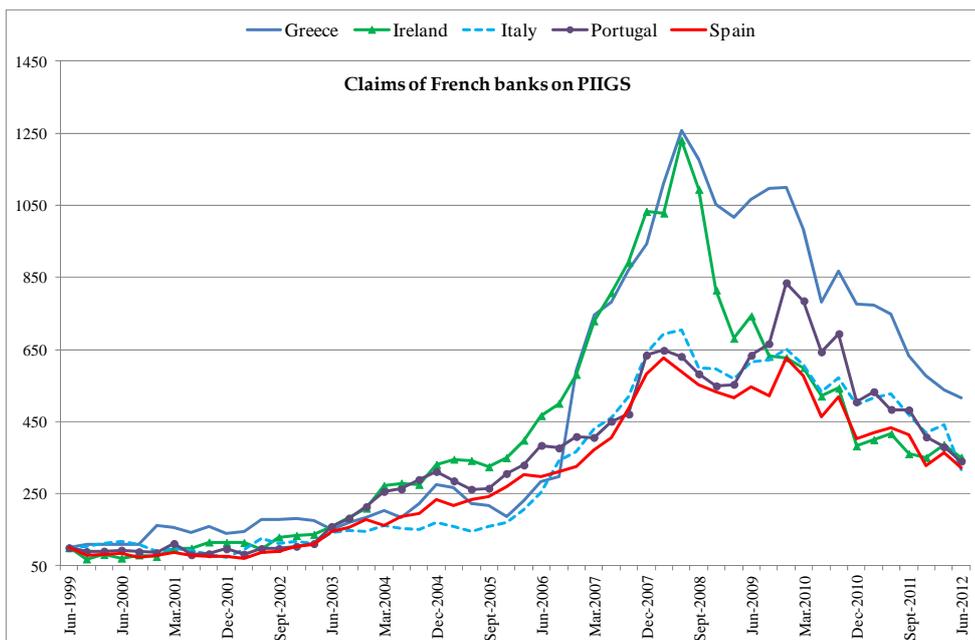
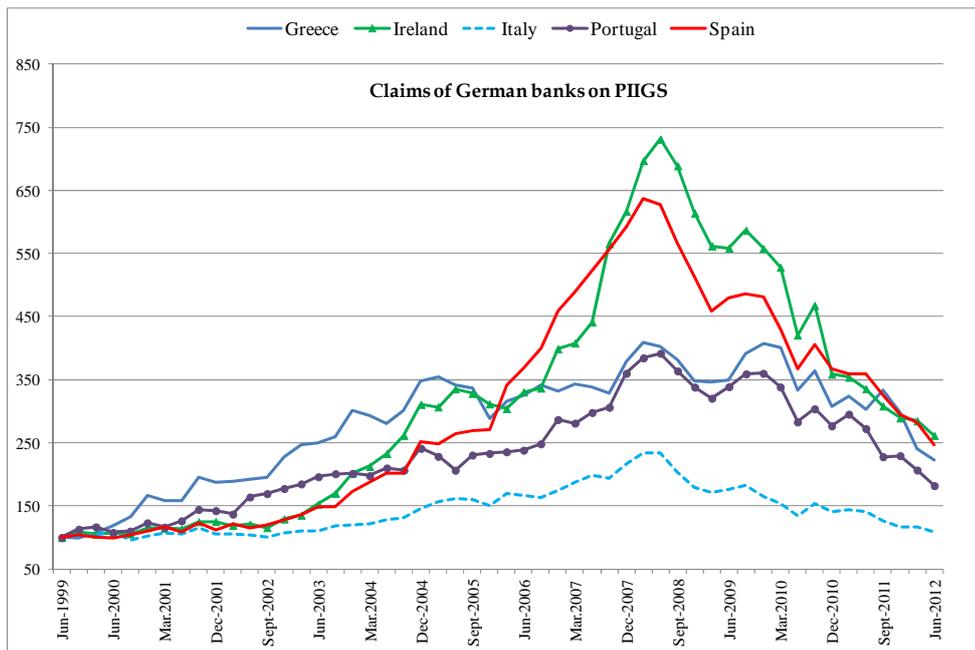
² See the *Euro Area Summit Statement* of 29 June 2012.

tralization of supranational banking supervision (or the Single Supervisory Mechanism, SSM), deposit insurance and crisis management (including resolution). The three functions are intimately interconnected and only their joint management can eradicate the expectation of national bail-outs and bankers' moral hazard.

In December 2012 the European Council further agreed that the building blocks of the banking union would consist of the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the possibility for the ESM to recapitalize banks directly; it also asked Council and Parliament to speed approval of harmonization directives for deposit insurance (DGS) and bank resolution already tabled by the Commission,³ and the European Commission to present a proposal for a Single Resolution Mechanism.

Figure 1: Claims of German and French banks on PIIGS (June 1999=100)

³ Proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes, Brussels, 12.7.2010, COM(2010)368 final, and Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM(2012) 280/3.



Source: Bank for International Settlements, 2012.

Agreement on the SSM Regulation was reached by the ECOFIN Council on December 14, 2012;⁴ the legal basis for entrusting management of the SSM to the ECB rests on Article 127 Paragraph 6 of the Treaty on the Functioning of the European Union (TFEU) and, accordingly, decisions on the SSM are to be taken “with special legislative procedure” by the Council acting “unanimously” and “after consulting” the European Parliament and the ECB. The European Council also agreed appropriate modifications of the European Banking Authority (EBA) powers and voting rules so as to ensure that Union countries not participating in the SSM will not see their rights in the Single Market weakened.

In the first semester of 2013, the European Council further agreed on the operational framework for the ESM direct interventions in bank recapitalization operations for Euro zone countries and the key aspects of the bank resolution directive, as will be described below. In July 2013 the European Commission tabled its proposal for the SRM.⁵

2. The SSM will comprise the ECB and the national supervisory authorities, and will be managed by a Supervisory Board established within the ECB and operating under the authority of the ECB Governing Council. Its tasks will include the licensing and withdrawal of license for the exercise of banking activity, the performance of all supervisory activities for supervised banks, including respect of European prudential rules and other banking directives as well as adequate governance for risk management and risk control, and assessment of acquisitions and sales of qualified stakes in other institutions, and consolidated

⁴ Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to prudential supervision of credit institutions, EF 316, ECOFIN 1080, Brussels, 14 December 2012.

⁵ Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions, COM(2013) 520 final of 10.7.2013.

supervision of bank holding groups. The SSM will be responsible for supervising all banks in participating countries, albeit its direct supervision will only apply to large cross-border banks (identified on the basis of quantitative and qualitative criteria of systemic relevance), while oversight of other banks will be entrusted to national supervisory authorities, under the control of the SSM Supervisory Board.

Non-euro member states of the Union may join voluntarily the SSM by signing a “close cooperation” arrangement entailing equal obligations to comply with SSM rules as well as equal rights of participation in the Supervisory Board (with special procedures to handle disagreements on specific decision by the Supervisory Board). This diverse legal arrangement was necessary owing to the ECB Statute, which provides that the ECB rules and decisions have legal value only vis-à-vis the members of the Euro zone (Article 42 Paragraph 1).

3. Three questions must be examined here: i) the separation of macro-monetary and micro-supervisory functions within the ECB, ii) the relationship between the ECB and EBA in the performance of supervisory tasks, and iii) the relationship to be established with existing national supervisory structures.

As to the first issue, the ECB is at present responsible for carrying the monetary policy functions, defined by Article 127(2) of TFEU, and in addition, its President chairs the European Systemic Risk Board,⁶ which is responsible for macro-prudential stability and for which the ECB also provides a secretariat.

Micro-supervision, the subject matter of the SSM, is an entirely different matter since concern for individual banks’ safety and soundness may at times

⁶ Significantly, the ESRB also has a Vice-Chair from a non-Euro zone country.

come into conflict with monetary policy goals.⁷ The argument is fairly simple: by construction, monetary policy is counter-cyclical (must lean against the economic cycle) while supervision is pro-cyclical (banks' balance sheets look better during expansions leading to less stringent supervisory constraints). The danger of mingling the two activities is not monetary policy laxity, since ECB procedures leave little leeway; it is rather the possibility for the monetary authority to become entangled in political controversies with the member states over the application of supervisory practices, which could detract from its perceived impartiality.

In this regard, the SSM Regulation could not go far enough, in that the new function is set up as an internal function of the ECB, exercised with delegated powers from the Governing Council of the ECB and under its "oversight and responsibility" (Article 19(3) of the SSM regulation). The desirable alternative would have been for the ECB to entrust the new Supervisory Board with full organizational autonomy, but this was considered inconsistent with the ECB Statute, and would therefore have required a Treaty change.

A related aspect on the governance of the SSM concerns the composition of the Supervisory Board which, unlike the ECB Governing Council, does not comprise an Executive Board made up of independent officials and entrusted with operational decisions, in full independence from member states' supervisors (the presence, within the Supervisory Board of a steering committee is not sufficient to overcome this weakness). As a result, there is a risk that supervisory decision on individual institutions will be taken as a result of political negotiations between national supervisors; and this, in turn, may spill over into the ECB

⁷ See GOODHART and SCHOENMAKER, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, in *Oxford Economic Papers*, 47, pp. 539-560 and IOANNIDOU, *A first step towards banking union*, in *VoxEU*, 16 October 2012.

Governing Council, were this be called to resolve disagreements between national supervisors within the Supervisory Board.

As to the second issue, EBA will remain in charge of ensuring not only a single rule book, but also uniform supervisory practices (the “*hand book*”). However, since some Union members may well decide not to join the SSM, notably including the United Kingdom and perhaps also Sweden, there is a risk of segmentation of the Single Market for banking and financial services, to the extent that over time the ECB came to develop divergent supervisory standards not accepted by non-euro countries. Precisely for this reason, the UK and other non-euro Union members have wanted to strengthen the standard setting powers of EBA in the domain of supervision (including the *rulebook* as well as the *handbook*, i.e. operational practices) and to require special majorities for EBA decisions so as to preserve the interest of countries not participating in the SSM.

As to the relationship between the Union and national supervisory structures, the Commission proposal had envisaged that the ECB would acquire “exclusive competences” in carrying out the tasks listed in Article 4 Paragraph 1 of the Regulation, and build up a new administrative structure for its fully centralized exercise. Quite differently, the Road Map had envisaged the creation of “a single supervision system with a European and a national level. The European level would have ultimate responsibility ... and would be given supervisory authority and pre-emptive intervention powers applicable to all banks. Its direct involvement would vary depending on the size and nature of banks.”

The solution eventually adopted, in line with the Road Map, basically replicates the network model for the enforcement of EU anti-trust law (Articles 101 and 102 TFEU) contained in Council Regulation 1/2003. As may be recalled, under that model, the centralized enforcer (the Commission) and national authori-

ties are both obliged to apply EU rules in individual cases; the allocation of cases is governed by guidelines set out by the EU level; information on individual proceedings flows systematically within the network of competition authorities; and the European authority may advocate any case in order to ensure the consistent operation of the system. Credit institutions subject to the direct oversight of the ECB will thus be identified on the basis of size (total asset value), relevance in the economy (ratio of total assets to GDP) and significance of cross-border activities; at all events the ECB will retain the power to advocate any individual case when it considers it necessary in order to maintain “high supervisory standards”.

The beauty of this system is that cases are almost automatically handled at the right level, thereby avoiding any unnecessary centralization of powers or duplication of structures, in full accordance with the principle of subsidiarity. As a result, national supervisory structures will be fully incorporated into the new supranational system, thus allowing full exploitation of their expertise and knowledge of national banking structures; and the need for fresh human and financial resources to manage the new supervisory tasks would be minimized.

4. The financial crisis highlighted, among many regulator failures, a widespread tendency by national regulators and supervisors to side with their troubled banks in hiding information from the public, delaying loss recognition and postponing corrective action, thus magnifying eventual losses.⁸ Transferring supervisory powers to the Union level can go most of the way in removing supervisory forbearance from the system; however, the system would be strengthened further by the adoption of Prompt Corrective Action as under the US Fed-

⁸ See CALOMIRIS and HERRING, *Why and How to Design a Contingent Convertible Debt Requirement*, Working Paper No. 11-41, Wharton Financial Institutions Centre, Philadelphia, PA. See VV. AA., *Time to Set Banking Regulation Right*, CEPS Paperback, CEPS, Brussels, March.

eral Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, which entails stronger constraints for supervisors to act in the general interest of depositors and investors. The key feature in this approach is that supervisors are obliged to intervene, or at least under a strong presumption to act, once certain publicly available capital thresholds are crossed.⁹

As to crisis management powers, they must be attributed to the EU level in order to establish a credible threat that bank shareholders and managers will be fully liable for the consequences of imprudent behaviour. An important matter here is where to place the borderline between supervisory corrective action and resolution proper. On this, the current SSM and SRM Regulations include, amongst supervisory powers to be transferred to the ECB, only early intervention “including recovery plans and intra-group financial support arrangements”, with the proviso that these powers will be exercised “in cooperation with the relevant resolution authorities”. And the SRM attributes most crisis management and resolution powers to a separate authority, the Single Resolution Authority, to be created in close proximity to the European Commission.

A better solution would have been to bring under the supervisory umbrella of the ECB all crisis-management measures: therefore including the power to order the suspension of dividends, recapitalization, management changes,

⁹ See BENSTON and KAUFMAN, *FDICIA after five years: A review and evaluation*, Working Paper 97-01, Federal Reserve Bank of Chicago, Chicago, IL. More precisely, some actions are mandatory and others are left to the discretion of supervisors; see Table 10 in EISENBEIS and KAUFMAN, *Cross-Border Banking: Challenges for Deposit Insurance and Financial Stability in the European Union*, Working Paper Federal Reserve Bank of Atlanta, Atlanta, GA, January. As for the capital indicators, the FDIC has referred to a combination of risk-weighted and unweighted capital ratios. However, overwhelming new evidence has shown that risk-weighted capital ratios are not reliable indicators of weakening capital and risk positions of banks requiring enhanced supervisory action. Straight (unweighted) leverage ratios, on the other hand, seem to provide consistent forecasts of emerging trouble sufficiently in advance for supervisors to intervene in a timely fashion (see HALDANE, *The dog and the frisbee*, paper presented at the Federal Reserve Bank of Kansas City’s 36th Economic Policy Symposium, “*The Changing Policy Landscape*”, Jackson Hole, WY, 31 August).

asset disposal and bank restructuring, up to the creation of a “bad” bank.¹⁰ With these powers in the hand of the ECB – as they are under the US FDIC system and in some EU member states – deterrence would be stronger and all danger of supervisory forbearance reappearing as a result of political negotiations within the new resolution authority would be precluded.

5. It must be understood that a supranational system is not an optional feature since otherwise there would strong incentives for national supervisors to free ride on protection offered by others.¹¹ The paramount requirement, in designing the Union’s deposit insurance, is that it should only protect depositors and never be used to cover bank losses or shield bank managers, shareholders and creditors. It must also provide equal incentives throughout the Single Market to bank shareholders and managers with *ex-ante* funding and risk-based fees. Finally, it must entail some risk and funds pooling at EU level so as to be able to cushion shocks affecting a large cross-border bank.

The accumulation and pooling of funds would only start within the new system, and thus not affect accumulated insurance funds, in line with transitional arrangements proposed by Gros and Schoenmaker.¹² The management of insurance fund could be entrusted to the ESM, under instructions from the ECB supervisory function.

¹⁰ See VV. AA. *Overcoming too-big-to-fail: A Regulatory Framework to Limit Moral Hazard and Free Riding in the Financial Sector*, CEPS Paperback, CEPS, Brussels, March.

¹¹ The German Council of Economic Experts warned against the creation of a European-wide deposit insurance without prior establishment of a European resolution authority (VV. AA. *From the internal market to a banking union: A proposal by the German Council of Economic Experts*, in *VoxEU*, 12 November). Véron and Schoenmaker share our view that a banking union without a resolution authority and a federal deposit insurance would be incomplete and not credible (See VERON *The first step in Europe’s banking union is achievable, but it won’t be easy*, *VoxEU.org*, 29 October and SCHOENMAKER, *Banking union: Where we’re going wrong*, available at *voxeu.org*, 16 October).

¹² See GROS and SCHOENMAKER, *European Deposit Insurance: Financing the transition*, in *CEPS Commentary*, CEPS, Brussels, 6 September.

Under the supervisory approach that has been described, resolution would become a residual function that, under common rules preventing national authorities from making good on the losses incurred by shareholders and creditors, may well be left to the national jurisdiction of residence of the parent company. With the additional advantage of removing from the discussion questions of harmonization, let alone centralization, of bankruptcy rules.¹³

This, however, does not eliminate the need for a European banking resolution fund. Rather than covering losses emerging from liquidation, its task would be limited to providing capital, in case of need, to the ‘good bank’ carved out by (European) supervisors to preserve deposits, sound commercial loans and other assets, and worthy systemic functions relating to the payment infrastructure.¹⁴ This approach was notably shared by a 2010 Commission Communication on resolution funds.¹⁵ In view of its limited scope, such a fund would not have to be very large; its resources could be raised by means of a small surcharge over the deposit insurance fee and be managed by the ESM together with the deposit insurance fund.¹⁶

Two things should be clearly established in this regard. Firstly, the ESM should not normally be expected to cover losses stemming from individual bank insolvency, but only to provide time to ailing banks to restructure and come back to good health. On this, the ongoing discussion on ‘legacy assets’ appears misleading: the reference model for ESM intervention should be the US TARP

¹³ It must be stressed that, were the resolution authority to be supranational, the creation of this new authority could not be covered by Article 127 and would have to rely on a different legal basis.

¹⁴ See CARMASSI *et al.*

¹⁵ See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank, Bank Resolution Funds*, COM (2010) 254 final, 26.5.2010, Brussels, p. 3.

¹⁶ In order for the ESM to play the role we have envisaged on deposit insurance and resolution, its treaty should be amended so as to allow it to perform these functions also for banks of non-euro countries.

recapitalization scheme of October 2008, with cheap and plentiful equity injections that were later fully recovered by the US Treasury, and with hefty profits.¹⁷ To this issue I will come back shortly.

Secondly, in case of a systemic crisis affecting large segments of the banking system, a much larger fiscal back-up may well be needed; however, rather than by setting aside ex-ante large resources, the issue may be tackled by agreeing on a key for fiscal burden-sharing among Union member states (either all of them, independently of banks' location, or those directly implicated in the banking crisis), as was envisaged by Goodhart and Schoenmaker.¹⁸

The freshly published Commission proposal for the SRM courageously proposes to centralize all decisions entailing resolution of a banking institutions, regardless of who is in charge of ordinary supervision. Unfortunately, it also walks away from the FDIC model that has been discussed: under the proposal, all restructuring and resolution powers will be separated from ordinary supervision and will be entrusted to a new Resolution Authority, with the Commission taking up key powers in the decision to start resolution and implementing it – in close connection with its state aid legal framework and decision-making.

This proposal is likely to meet strong legal objections, since it is based on Article 114 of the TFEU – the legal basis of internal market harmonization legislation. Whether indeed this legal basis can cover the exercise of the very intrusive executive powers required for bank resolution is open question.

6. Under its founding treaty, the Euro zone Stability Mechanism may provide stability support to its member countries in financial difficulty in the form

¹⁷ The US Treasury has so far recovered \$267 billion from TARP's bank programs, \$22 billion more than the \$245 billion invested (US Treasury, *Troubled Asset Relief Program (TARP) – Monthly Report to Congress*, October 2012).

¹⁸ See GOODHART and SCHOENMAKER, *Fiscal Burden Sharing in Cross-Border Banking Crises*, in *International Journal of Central Banking*, Vol. 5, No. 1.

of loans, by purchasing their bonds in primary and secondary debt markets, by providing precautionary financial assistance in the form of credit lines, and by financing the recapitalization of financial institutions through loans. In June 2012, the Euro zone summit decided that the ESM should also be able to recapitalize banks directly, in order “to break the vicious circle between banks and sovereigns”.

The ministers of finance and the economy of the Euro zone have now agreed on the main features of a new ESM instrument for the direct recapitalization of euro area banks.¹⁹ The new ESM instrument will enter into force only after the SSM is effectively in place and the legislative proposals for the SRM and Deposit Insurance directives are finalized by Council and Parliament; in all likelihood, therefore, well into 2014. This accommodates widespread demands for a delay – not only by Germany – and is somehow also at variance with the urgency of the Euro zone summit decision last year. The truth is that, once again, as soon as financial markets tensions begin to ease, institution-building also slows down, and with it the reduction in market fragmentation.

Utilization of the new ESM instrument will be subject to strict conditions, in line with the instructions of the Euro zone summit. Accordingly, it will only be made available when the requesting member state cannot help its banks on its own without endangering the sustainability of its sovereign debt, aid is indispensable to the Euro zone financial stability, and the financial institution concerned is undercapitalized (in breach of CRD IV prudential requirements) and unable to attract sufficient capital from private sources. In order to preserve the top credit rating of the ESM, it has also been decided that the available funds under the new instrument must not exceed euro €60 billion – not an insignifi-

¹⁹ See EUROGROUP, *ESM direct bank recapitalization instrument – Main features of the operational framework and way forward*, Luxembourg, 20/6/2013 (www.eurozone.europa.eu)

cant sum, but hardly sufficient when there is a need to intervene for several banks and across several member states. It may be recalled that market participants apparently consider a ceiling that is double the amount consistent with the ESM's top rating.

The decision to grant the capital injection will be subject to thorough due diligence of the institution's balance sheet quality and loss-absorption capacity, in order to assess its continuing viability and need for restructuring. It will only proceed after an adequate capital contribution by shareholders (capital write-down) and creditors (debt conversion into equity or write-offs) of the beneficiary institution, in line with the proposed directive on resolution (discussed below). In addition, the requesting member state will be required to inject capital into the distressed institution as required to bring its common equity (CE Tier 1) up to its legal minimum (4.5% of risk weighted assets under the CRD IV rules), as well as more broadly to participate in the capital injection, alongside the ESM, for an amount equivalent to at least 20% of the total public contribution in the first two years, and 10% thereafter. These provisions entail that the ESM assistance does not cover "legacy" debts – one of the "red lines" drawn on the negotiating table by (potentially) creditor countries.

It is envisaged that the ESM will intervene by purchasing common equity (CET 1 capital) and will acquire strong rights of involvement in the institution's business decisions and even choice of management – while ensuring, as the text goes, "a careful balancing between influence by the ESM and the maintenance of independent commercial business practices", so as to leave open the possibility of a return of the institution to "market functioning".

The system for financial assistance to ailing banks is based on the broader foundation of the principles that have been agreed upon for the resolution of

ailing banks within the member states of the Union and that, once adopted as a directive, will guide national legislation in this matter.²⁰

Under the directive just agreed upon, all members states will be required to entrust their resolution authority with the power to sell part or all of a business; establish a bridge institution to manage the “good” activities of a bank; transfer impaired assets to an asset management vehicle (the “bad” bank); impose losses (bail-in) on creditors with an order of seniority, starting with shareholders and unsecured creditors.

Two main features are worth stressing in the final compromise. The first is that certain types of liabilities, including secured liabilities and covered bonds, would be permanently excluded from bail-in, while deposits would have preference status in the creditors’ pecking order, but would not be excluded. Insured deposits, however, will be made good by the deposit insurance system (assuming sufficient funds will be available).

This provision might make a run on deposits more likely, should a bank seem unable to stand on its own. It is also likely to encourage an increase in the “encumbered” share of banks’ assets (i.e. the share pledged as a guarantee for bond issuance), which can make the return to unsecured funding more difficult and “leave banks reliant on liquidity support by the ECB for longer than warranted”.²¹

The second feature worth noting is that national authorities maintain some discretion to exclude liabilities from bail-in for reasons such as the need to avoid contagion or to ensure the continuity of critical functions (interbank liabil-

²⁰ See ECOFIN, *Council agrees position on bank resolution*, 11228/13, PRESSE 270, Brussels 27 June 2013.

²¹ See EUROPEAN COMMISSION, *European Financial Stability and Integration*, Report 2012, Brussels, April p. 26.

ities and liabilities arising from participation in payment systems are always excluded).

On the whole, establishing common principles for the resolution of ailing banks is a necessary foundation of the banking union, in order to eradicate moral hazard from the system, and the proposed directive should therefore be welcome. However, the text that has come out of the frantic late-night negotiations in the ECOFIN Council seems to leave unwelcome uncertainty as to the real scope of the new rules in the different national jurisdictions, while the lack of depositor preference in the bail-in pecking order may result in destabilization.

As for direct recapitalization of banks by the ESM, the proposed system appears not only highly intrusive but it also places a considerable burden of aid to the failing institution on the member state, raising doubts about its ability to “break the vicious circle between banks and sovereigns”. It also displays a profound mistrust of anyone in need of assistance; hardly the remedy to restore confidence among market participants. The emphasis is on individual institutions, leaving little room to address a generalized need for strengthening bank capital as a result, for instance, of a protracted recession affecting banks economy-wide – as many believe is the case in the Euro zone today.²² The conditions imposed on the requesting member state and the distressed institution are very harsh, so that resorting to the new instrument will probably be delayed as long as possible; in all likelihood raising the eventual cost of the rescue.

A world of difference, in sum, from the approach taken in 2008 by Secretary Paulson of the US Treasury with his Capital Purchase Programme (CPP). The CPP was designed to bolster the capital of ailing institutions, in extremely adverse economic conditions, so as to release the flow of credit to the economy

²² See EU, IMF, *Global Financial Stability Report: Old Risks, New Challenges*, Washington, DC, April; BENINK and HUIZINGA, *The urgent need to recapitalize Europe’s banks*, VOX-EU, 5 June.

and restore confidence. To this end, the US Treasury initially committed \$250 billion, and eventually invested about \$205 billion, to provide capital to 707 financial institutions throughout the country. Against the capital injections, the Treasury received preferred (non-voting) stock yielding a 5% dividend for the first five years and 9% thereafter, but there was no deadline for the investment and little intrusion into the banks' business decisions. As of April 30, the Treasury has recovered more than \$222 billion from CPP from dividend income and repayments and expects to recover additional funds.

7. Banking union is an extraordinary step in the Road Map to a “genuine economic and monetary union”, comparable for its implications to the creation of the single currency. It must also be recognized that a lot has been achieved in its construction. Few would have believed one year ago that the Regulation establishing the SSM would already be in place and, altogether, also with remarkable quality.

And yet, the construction appears incomplete and, as is, not capable of reversing the fragmentation of financial markets that is threatening the economic recovery in the periphery of the euro zone and the very sustainability of sovereign debts. The principle that have been established for the resolution of banks and the intervention of the ESM in their recapitalization fall short of what is required for restoring confidence. Deposit insurance will remain at national level, albeit with harmonized principles. The SRM is not yet there, and the current Commission proposal will have confront considerable opposition. The fundamental problem of a credible fiscal back stop per the deposit insurance and resolution funds as not been tackled.

All in all, the fundamental mistrust between the euro zone member states that has prevented the construction of effective risk sharing arrange-

ments for sovereigns, has also impeded to travel the full way to banking union.
As a result, survival of the euro zone remains uncertain

THE REFORMS OF THE EUROPEAN
FINANCIAL MARKETS SUPERVISION.
THE DIFFICULT COORDINATION BETWEEN EU
AND MEMBER STATES

*Raffaele Lener and Edoardo Rulli**

ABSTRACT: *The financial crisis has forced the European institutions to approve structural reforms of the EU financial market which have had a profound impact on the supervisory architecture and affected the way in which the single European financial market is conceived. Following the establishment of the ESFS in 2011, the Commission has presented new proposals inspired by the report "Towards a genuine Economic and Monetary Union", which was drawn up just before the summer of 2012 by the President of the European Council Van Rompuy and which highlights the importance of establishing a supervisory mechanism tailored to the Euro area. Furthermore, the article takes into account the ongoing discussions on the introduction of an EU-wide system to manage and resolve bank crises so as to overcome the "too big to fail" myth.*

SUMMARY: 1. Introduction. - 2. New perspectives in European financial supervision. - 3. A hybrid supervisory system: Italy. - 4. From the crisis to the ESFS. - 5. ESFS, ESAs: tasks, powers and intervention in emergency situations - 6. Collaboration between Italian supervisory authorities and ESAs: a super-hybrid system? - 7. The Banking Union

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and the role of the EBA. - 8. The European Commission's proposal on recovery and resolution plans and concluding remarks.

1. Over the past three years, the financial crisis has forced the European legislator to approve structural reforms of the EU financial market regulation, which has had a profound impact on the supervisory architecture and, more in general, has affected the way in which the single European financial market is conceived.

The new financial supervisory system, which was introduced on 1 January, 2011, was the first of these radical reforms and, in certain respects, represents a radical change of approach with regard to supervision. However, shortly after the establishment of the European System of Financial Supervision (ESFS), the leaders of the European Union opened a new discussion on the topic of the Banking Union. The project was presented in late spring 2012 by President Van Rompuy in the report "*Towards a genuine economic and monetary union*"¹ and involves the establishment of a dual system at European level in the field of supervision of banks which would separate the prudential supervision of banks in the Economic and Monetary Union (EMU) from the prudential supervision of banks in EU member States which are not part of the EMU. The Von Rompuy report describes the project by listing the envisaged steps towards greater economic and monetary integration. They are referred to as the "building blocks" of the new EMU: a single banking supervision mechanism in the Euro area, an integrated budgetary framework, an integrated economic policy framework and a strengthened democratic dimension.

¹ See HERMAN VAN ROMPUY, *Towards a Genuine Economic and Monetary Union*, Brussels, 26 June 2012 EUCO 120/12, available at www.consilium.europa.eu

On the basis of this report, the European Commission has drafted a package of measures consisting of two proposals for Regulations² which, on the one hand, involve the creation of a single banking supervisory mechanism common to all the Euro countries under the responsibility of the ECB and, on the other hand, the amendment of Regulation 1093/2010 establishing the EBA, so as to coordinate the action and the tasks of the two authorities.

In addition to these innovations, there are ongoing discussions at an EU level on a new framework for the deposit guarantee schemes and a proposal - which is pending approval - on the creation of a resolution system for banks.

These new pieces of EU legislation, both *de iure condito* and *de iure condendo*, do not resolve the issue of the relationship between the national authorities and European authorities and, more specifically, the problem of how to allocate powers and responsibilities to the various levels of the new "government" of the European financial market.

2. The rationale for public oversight of financial markets is traditionally linked to the need to remedy the defects that prevent the market from operating as it should. In general terms, it is the prevailing opinion that financial supervision is necessary and should be carried out by public authorities in order to ensure both market stability and that market participants act in a fair manner. The first is usually referred to as "prudential supervision", while the second consists of monitoring the conduct of financial market operators, especially when

² See the proposal for a Council Regulation which would entrust the ECB with specific tasks concerning policies on the prudential supervision of credit institutions, COM (2012) 511 final, Brussels, 12 September 2012, and the 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) with regard to the interaction of said Regulation with the Regulation entrusting the European Central Bank with specific tasks concerning policies relating to the prudential supervision of credit institutions, COM (2012) 512 final, Brussels, 12 September 2012.

they enter into negotiations with retail investors. The two forms of public control have apparently different purposes, but in reality they pursue convergent objectives, both ensuring the stability of the market (including the prevention of systemic risks³) and protecting investors.

While the need for public supervision of the financial markets is now widely accepted, the manner in which the authorities' tasks, responsibilities and powers are allocated remains very different from country to country, even among EU member States. There are many different approaches to the role of the public authorities, their supervisory tools and the powers with which they are entrusted and many of the EU jurisdictions have modified or restructured their financial regulatory systems in the last ten years⁴. In addition to the problem of the *horizontal* coordination of the supervisory systems in the member States, the establishment of new EU authorities has introduced the new problem of *vertical* integration among national and EU regulators.

Starting from the national level, it is clear that no two countries regulate and supervise financial markets in the same manner. Nevertheless, scholars have identified the most widespread and common regulatory frameworks for financial market supervision, also known as "models of financial supervision", which can be divided into four different groups (or "approaches"): the institutional approach, the functional approach, the single supervisor approach, and the twin peaks approach. However, those approaches are merely archetypical models⁵ which are usually adapted and adjusted in each jurisdiction⁶. For that

³ See TURKINGKTON, *Financial Services Regulation - The Reform of the English System*, LUISS-CERADI Research Center for the Enterprise Law, 2004, p. 51

⁴ See GROUP OF 30, *The Structure of Financial Supervision - Approaches and Challenges in Global Marketplace*, Washington DC, 2008, p. 15, available at www.group30.org

⁵ See LLEWELLYN, *The Regulation and Supervision of Financial Institutions*, London, 1986, p. 16. See also BARRY, RIDER, YUTAKA, MACMILLAN, *Commercial law in a global context: some perspectives in Anglo-Japanese law*, Kluwer Law International, 1998, p. 72.

reason it is more useful to consider the different models of supervision as they are applied in practice in the various jurisdictions. Most EU countries adopt mixed or hybrid systems of supervision, which contain different features of the aforementioned archetypical models.

3. At first glance, the Italian legislator appears to have chosen the functional approach, because it has established and empowered different authorities, assigning different tasks and purposes to them irrespective of the type of entity or business subject to supervision. In particular, the Italian Consolidated Financial Act (Legislative Decree no. 58/1998) entrusted the Bank of Italy with the supervision of the stability of the financial system and made the CONSOB responsible for supervising the performance of investment services with a specific focus on transparency and fairness of the business practices adopted by market participants.

This approach was preferred to other possible models because it was the most popular system at the time when it was adopted⁷. The Italian legislator has not modified its original choice even though the majority of European jurisdictions have since adopted models (e.g. the single supervisor model) that are deemed to be better suited to the efficient supervision of an increasingly integrated market, in which there is a widespread tendency of financial intermediaries and investment firms to perform "multi-sector" activities. Although nowadays it is difficult to clearly distinguish between the three traditional financial sectors (banking, insurance and securities) and although financial intermediaries

⁶ See BALDWIN and CAVE, *Understanding Regulation*, Oxford, Oxford University Press, 1999; JORDANA LEVI-FAUR, *The Regulatory Reforms for the Age of Governance*, edited by Edward Elgar, Cheltenham, 2004; AVGERINOS, *EU Financial Market Supervision Revisited: The European Securities Regulators*, Jean Monnet Working Paper No. 7/03, 2003, p. 14.

⁷ See LENER R., *I mercati finanziari e il sistema di vigilanza*, in *Diritto dei mercati finanziari*, Saggi, ed. Lener R., 2011, p. 8.

belong to groups of companies that perform the whole range of financial activities, the Italian legislator has not passed any radical reforms. However, many minor amendments have been made to the main pieces of financial legislation affecting the Italian system in the distant and recent past.

Consequently, the Italian system of financial supervision is considered to be a good example of a *hybrid* system, in particular due to the, sometimes accidental, stratification of different features and tools largely as a result of imitation of other countries or the implementation of EU directives. In particular, sectors such as insurance and pension funds have undergone alterations and modifications.

However, at present, in Italy there are two main supervisory authorities: the Bank of Italy and the CONSOB. Pursuant to article 5 of the Italian Consolidated Financial Act, as amended by Legislative Decree no. 164/2007 implementing the MiFID (Directive 2004/39/EC) the two authorities have a joint responsibility to carry out supervisory tasks, but they are each required to pursue different objectives. In particular, article 5 states that the objectives of the supervision are as follows: “*a) the safeguarding of faith in the financial system; b) the protection of investors; c) the stability and correct operation of the financial system; d) competitiveness of the financial system; e) the observance of financial provisions*”. In this respect, the wording of the Consolidated Financial Act does not substantially differ from that of article 5 of the Italian Consolidated Banking Act (Legislative Decree no. 385/1993)⁸, which also lists the objectives of the su-

⁸ Article 5 of Legislative Decree 385/1993: “*The credit authorities shall exercise the supervisory powers they are granted with by this Legislative Decree, taking into account the sound and prudent management of the supervised entities, the overall stability, efficiency and competitiveness of the financial system and the compliance with the provisions regarding credit activities*”. However, the provision contained in the Legislative Decree 385/1993 is not addressed to investment firms, but to banks, groups of banks, payment institutions and electronic money institutions.

pervision to be carried out by the credit authorities with respect to banking activities⁹.

In its pursuit of such objectives, “*the Bank of Italy is responsible for risk containment, asset stability and the sound and prudent management of intermediaries*” (Article 5, paragraph 2 of the Consolidated Financial Act), while the “*Consob is responsible for the transparency and correctness of conduct*” (Article 5, paragraph 3 of the Consolidated Financial Act).

The Italian functional approach, however, contains several features that are typical of the "institutional approach". Thus, the supervision of banks – in the performance of their traditional banking activities – has been entirely entrusted to the Bank of Italy, while in the insurance sector, the control and supervision of insurance firms has been delegated to another entity, which to a certain extent now belongs to the Bank of Italy, known as IVASS¹⁰. Moreover, specific tasks in the banking sector are still delegated to the Ministry of Finance, and some powers over insurance firms still lie with the Ministry of Economic Development. Furthermore, a specific authority, COVIP, has been set up with the sole responsibility for supervising pension funds, which is a good example of the institutional approach in the context of a mixed system. Finally, another authority - the Italian Antitrust Authority (AGCM) – is responsible for all matters falling within the scope of competition rules.

The Italian case is certainly significant because of its complexity and due to the addition of layers of legislation over the time. Following the recent Euro-

⁹ See CAPRIGLIONE, *L'ordinamento finanziario verso la neutralità*, Padova, Cedam, 1994; G. MINERVINI, *La Banca d'Italia, oggi*, in *Banca borsa e Titoli di Credito*, 2006, I, p. 619; VELLA, *La riforma della vigilanza: tanto rumore per nulla*, in *Analisi giuridica dell'economia*, 2006, p. 117.

¹⁰ On 1 January 2013, the ISVAP was replaced by IVASS (Institute for the Supervision of Insurance Companies), which took on all its powers, functions and responsibilities. IVASS was established, pursuant to Decree Law of 6 July 2012 no. 95, in order to ensure greater integration of insurance supervision with banking supervision.

pean reforms that introduced the European System of Financial Supervisors (ESFS), the system of supervision which is headed by the three new European authorities (EBA, ESMA and EIOPA) and includes all the national authorities, any analysis of the supervisory system of an EU Member State must take into account the coordination of the national system with that of the EU.

4. In light of the foregoing, it is no longer possible to describe the powers of the authorities of each EU member State without taking into account the recently established European framework for financial supervision.

The shortcomings highlighted by the financial crisis have given the EU an opportunity to establish new authorities in order to mitigate the failures of the nationally-based supervisory models. This is a response to the market crisis which has seriously undermined the credibility of most of the national supervisory systems¹¹ and has forced the European institution to intervene. The objective of the ESFS is to solve the problems that have arisen from the fact that while, for the last twenty years, financial regulations have mainly been issued at an EU level, the same regulations have been applied, interpreted and enforced by the individual member States. The purpose of the reform is to establish a system which is based on high supervisory standards, applied in a consistent manner in all EU member States and consistently enforced for all market operators without jeopardizing the independence of national supervisors¹².

¹¹ See ENRIQUES, *Regulators' Response to the Current Crisis and the Upcoming Reregulation of Financial Markets: One Reluctant Regulator's View*, 30 U. Pa. J. Int. Law, 2009, p. 1147.

¹² See MONACI, *La struttura della vigilanza sul mercato finanziario*, Milano, 2007, p. 201. See also SCREPANTI, *La dimensione ultrastatale delle autorità indipendenti: i "sistemi comuni" europei e globali*, in *Riv. it. dir. pubbl. comunit.* 2009, 05, p. 913 and, in general, CASSESE, *Dalle regole del gioco al gioco con le regole*, in *Lo spazio giuridico globale*, 2003, p. 124.

5. On the basis of the proposals contained in the de Larosière report, and following an interesting consultation procedure with the operators¹³, the European Commission adopted a package of draft legislation, which was quickly approved and transformed into EU Regulations, with the aim of strengthening financial supervision in Europe. The Regulations provided for the establishment of the European Systemic Risk Board (ESRB) and for the creation of a European System of Financial Supervisors (ESFS), consisting of the existing national authorities supplemented by three new European Supervisory Authorities (ESAs), created through the transformation of the Lamfalussy committees CESR, CEBS and CEIOPS.

The European Systemic Risk Board (hereinafter, ESRB) was established by Regulation no. 1092/2010 of 24 November 2010¹⁴. It is a new body which has no legal personality and is responsible for conducting macro-prudential oversight at the level of the Union.

The Board has its headquarters in Frankfurt am Main and is part of the "European System of Financial Supervisors" (ESFS)¹⁵. The ESRB's institutional task is to prevent or mitigate systemic risks related to financial stability in the

¹³ The outcomes of the consultations are available at: ec.europa.eu. It is worth noting that the Italian government did not submit observations but from the Italian side the ABI (the Italian banks association) submitted a paper in favour of the new regulatory system supporting the idea (expressed also by the European Central Bank) of entrusting an independent division of the ECB with powers of micro-prudential supervision, based on Article 105, paragraph. 6 of the Treaty on the Functioning of the UE. The proposal, which at that time was not taken into sufficient consideration, is now on the table of negotiations for the Banking Union.

¹⁴ Regulation (EU) no. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board

¹⁵ Some concerns regarding the ESRB were also expressed by the House of Lords, European Union Committee, *The Future of Economic Governance in the EU: Report*, The Stationery Office, 28 March 2011, p. 48. In that report the House of Lords highlighted the risk deriving from the lack of clarity of the powers attributed to the ESRB stating that it is "... unclear how it would operate in practice." For a more optimistic view: WYMEERSCH, *Europe's new Supervisory System*, in *After the crisis: economic, financial and social*, Giuffré, 2010, p. 43.

European Union¹⁶. The ESRB does not have autonomous decision-making powers¹⁷ and may not take any action with direct effect in respect of Member States or the national supervisory authorities. Nevertheless, the ESRB is an innovation of great importance in the context of the reform of the European supervisory system: prior to the 2011 reform, there was no European body in charge of the macro-prudential oversight of the financial market.

According to some authors, the complex *governance*¹⁸ of the ESRB (which reflects the balance between the main bodies responsible for governance of the banking and financial system in the Union) is a threat to its effectiveness. Another aspect that has given rise to concerns is the strong link between the ESRB and the ECB; a link which could undermine the independence of the Board. Suffice it to say, for example, that it is the ECB that provides the ESRB with a secre-

¹⁶ Pursuant to Article 3 of the Regulation establishing the ESRB, the board: “*shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth*”.

¹⁷ The option not to provide the ESRB with autonomous powers was probably the result of a political compromise. Obviously, such a choice has been criticised by some authors. For an overview see BEGG *Regulation and Supervision of Financial Intermediaries in the EU: The Aftermath of the Financial Crisis*, JCMS - Journal of Common Market Studies, 2009, 47, p. 1107–1128. doi: 10.1111/j.1468-5965.2009.02037.x

¹⁸ The European Systemic Risk Board (ESRB) has: a General Board, a Steering Committee, a Secretariat, an Advisory Scientific Committee and an Advisory Technical Committee. The General Board takes the decisions necessary to ensure the performance of the tasks entrusted to the European Systemic Risk Board (ESRB). The General Board consists of the following members with voting rights: the President and the Vice-President of the European Central Bank (ECB); the Governors of the national central banks of the Member States; one member of the European Commission; the Chairperson of the ESAs (EBA, EIOPA and ESMA), the Chair and the two Vice-Chairs of the Advisory Scientific Committee (ASC), the Chair of the Advisory Technical Committee (ATC). Furthermore, the following parties are members without voting rights: one high-level representative per Member State of the competent national supervisory authorities (the respective high-level representatives will rotate depending on the item discussed, unless the national supervisory authorities of a particular member State have agreed on a common representative), the President of the Economic and Financial Committee (EFC).

tariat, pursuant to the decision adopted by the Council in COM/2009/500 issued under art. 127, para. 6, of the TFEU, which entrusts the ECB with specific tasks in the area of prudential supervision.

In order to carry out its macro-prudential oversight of the financial system, the ESRB collects and analyses information, identifies (and gives a scale of priority to) potential systemic risks. In that respect, the ESRB issues warnings where such systemic risks are deemed to be significant (the so-called “early warnings”) and, where appropriate, makes these warnings public. Furthermore, the Board can issue recommendations for remedial action in response to the risks identified.

When carrying out its tasks, the ESRB must cooperate with the ESAs and coordinate with the International Monetary Fund, as well as with the Financial Stability Board in all matters relating to macro-prudential oversight.

Of the above mentioned tasks, probably the ESRB’s most important function is to issue reports identifying potential imbalances in the financial system. Once the ESRB identifies imbalances, if they are deemed likely to increase systemic risks, then the Board may issue recommendations indicating the most appropriate remedies according to the circumstances.

Pursuant to Article 16 of the Regulation establishing the ESRB, these warnings and recommendations may be of a general or a specific nature and can be addressed to the Union as a whole or to one or more member States or even to one or more ESAs. Despite the importance of the warnings and recommendations, the ESRB cannot impose obligations upon member States or upon national supervisory authorities: it was conceived as a body that is based on the reputation of its members and it is only able to influence policy makers and supervisors by exerting moral suasion. The decision not to assign binding powers

to the ESRB was taken for political reasons¹⁹. Indeed, the de Larosière Report suggested that the ESRB should at least be given the power to impose penalties in the event that measures taken by member States, on the basis of a recommendation issued by Board, proved to be insufficient to prevent or mitigate the reported risks. The Commission's proposal, however, did not follow the suggestion by the de Larosière report²⁰. Recent proposals regarding the banking union appear to confirm that systemic risk prevention not only requires a form of strengthened coordination between the member States, but also requires the establishment of a competent body with specific binding powers. It is perhaps a risk to establish a body such the ESRB and to assign it such delicate tasks without assigning it anything more than *soft* powers.

The only provision that seems to confer “direct” powers upon the ESRB is contained in Article 17 of the Regulation which states that if a recommendation is addressed to the Commission, one or more Member States, one or more ESAs or one or more national supervisory authorities, the addressees are required to inform the ESRB (and the Council) of any actions undertaken in response to the recommendation and to provide adequate justification for any inaction. Such a provision implies that the addressees of ESRB recommendations cannot just ignore the risks reported by the ESRB but, according to the well-known “comply or explain” principle, must explain the reasons their inaction to the ESRB.

¹⁹ See FERRARINI - CHIODINI, *Nationally Fragmented Supervision Over Multinational Banks as a Source of Global Systemic Risk: A Critical Analysis of Recent EU Reforms*, March 2012. In *Rethinking financial regulation and supervision in times of crisis*, Ferrarini, Hopt and Wymeersch, eds., Oxford University Press, Forthcoming. Available at ssrn.com

²⁰ See EIFFINGER, *Defining and measuring risk systemic*, in Eijffinger and Masciandaro (ed.), *Handbook of Central Banking, Financial Regulation and EIFFINGER, Supervision: After the Financial Crisis*, Edward Elgar Publishing, 2011, p. 315. See also FERRAN AND ALEXANDER, *Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board*, November 4, 2010, University of Cambridge Faculty of Law Research Paper No. 36/2011. Available at ssrn.com or dx.doi.org

It is clear from an analysis of the provisions of the regulations establishing the three authorities EBA, ESMA and EIOPA (hereinafter the “Regulations”)²¹ that it was probably difficult to reach an agreement among the member States on the new legal framework for financial supervision²².

Unlike the ESRB, the three European Supervisory Authorities (ESAs) have legal personality under EU law (Article 5 para. 1 of the Regulations). This is certainly significant because it shows that the European legislator intended to establish the three entities as independent authorities. This choice also highlights the EU institutions’ aim to supersede the previous European legal framework which was based on voluntary cooperation among national authorities within the Lamfalussy committees. Whilst the granting of the legal personality is to be considered a major improvement on the Lamfalussy structure, other aspects of the 2011 reform immediately suggested that there was still a long way to go before a definitive organisation of the financial supervision in the EU could be achieved. For instance, the fact that the three authorities have their headquarters in the same places where the Lamfalussy committees used to have their headquarters (the EBA is in London, the EIOPA in Frankfurt and the ESMA in Paris), has been criticised by those who believe that bringing the ESAs together in the same place would have made them more effective and would, in any case, have given rise to greater integration of the supervisory structure²³. The deci-

²¹ The three regulations are the following: Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing the European Banking Authority (EBA); Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing the European Securities and Markets Authority (ESMA); and Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing the European Insurance and Occupational Pensions Authority (EIOPA).

²² See FERRAN, *Crisis-Driven EU Financial Regulatory Reform*, in VV. AA., *The regulatory aftermath of the global financial crisis*, Cambridge University Press, 2012; University of Cambridge Faculty of Law Research Paper No. 6/2012, p. 9, available at ssrn.com

²³ This solution was supported in particular by the rapporteur of the proposal establishing the *European Systemic Risk Board*. See, in this regard, GOULARD, *ESRB Report*, EP 438 496, Febru-

sion to maintain the headquarters of the old Lamfalussy committees is the result of a political agreement: member States probably opted for this compromise in order to avoid delays in the approval of the legislative package. This compromise is likely to be discussed in the future and the authorities may well be moved to different places. Indeed, the proposal for a banking union, for example, led to a new discussion on this matter. The fact that the ECB will be granted brand new supervisory powers and the risk that its competences may overlap with those assigned to the ESAs (in particular, to the EBA) have reopened the debate among scholars over the possible future evolutions of the EU supervisory system. It is a well-known fact that although the EU legislator has opted for a model of supervision which may be defined as an “institutional approach to oversight”, many authors still support the functional model of supervision which would lead to a reduction in the number of authorities and would definitely separate the supervisory tasks into two main areas: prudential supervision and fairness of operators’ conduct²⁴.

Like the ESRB, the ESAs have a complex governance. In accordance with article 6 of the Regulations, the main governing bodies of the ESAs are the Board of Supervisors²⁵, the Management Board, the President and the Executive Director. Significantly, the Regulations introduced the general rule that the Board of Supervisors must approve its decisions by a simple majority in accordance with the principle whereby each member has one vote (article 44 of the

ary 2010, 48-49, available at www.europarl.europa.eu. See also LANNON, *The Road Ahead after De Larosière*, CEPS Policy Brief, 2009.

²⁴See GOODHART and SCHOENMAKER, on ft.com/economistsforum of 13 March 2009. The UK has recently adopted this model by replacing the single supervisor with two main authorities. See FERRAN, *The Break-Up of the Financial Services Authority*, University of Cambridge Faculty of Law Research Paper Series No. 10/04, October 2010, available at ssrn.com

²⁵ Made up of the heads of 27 national authorities (where there is more than one national authority in a Member State, the authorities agree which of their heads will represent them), with one observer from the European Commission, from Norway, Iceland and Liechtenstein, a representative of the each of the other ESAs.

Regulations). This provision applies to all cases save for the approval of acts of a general nature (including those relating to the implementation of technical standards)²⁶.

Despite its limited scope, the provision is significant because it establishes the simple majority as a general decision-making rule, while qualified majorities are considered to be an exception. In order to understand just what an innovation this provision is, one only needs to compare it with the decision-making process of the Lamfalussy committees, where decisions had to be approved unanimously since qualified majorities were considered to be an exception and simple majorities were not even taken into account. This is an important change of perspective and it is no coincidence that this innovation was strongly criticised by some euro-sceptical observers who emphasised that the procedures for the adoption of decisions by financial supervisors do not fairly reflect the “market shares” of the member States in the European financial market²⁷.

Another important provision is set forth in article 75 of the Regulations, which states that third countries which have concluded agreements with the Union “*whereby they have adopted and are applying Union law in the areas of competence*” of the relevant ESA may take part in the work of the ESAs. Unlike the other provisions contained in the Regulations, which all relate to EU “internal” financial oversight, article 75 introduces the possibility to establish supervi-

²⁶ The ESAs will act by a qualified majority with reference to the binding technical standards (article 10 of the Regulations), relating to the implementation of the technical standards (article 15 of the Regulations) and when issuing guidelines and recommendations (article 16 of the Regulations).

²⁷ See OPEN EUROPE, *Shifting Powers: What the EU's Financial Supervisors will Mean for the UK and the City of London*, September 2010, in which the British think tank says that the provision was designed to the detriment of the interests of the UK, a country that represents more than 30 per cent of the European financial market and would, therefore, be entitled to have a stronger position in the decision-making process of the ESAs.

sory schemes than go beyond the EU²⁸. The impact of this provision is potentially very significant and it will be interesting to see how it will be applied²⁹.

As regards the ESAs' *accountability*, the authorities report to the European Parliament and the Council (article 3 of the Regulations). One of the tools available to the EU institutions to scrutinize the work of the ESAs is the authorities' obligation to transmit an annual report on their activities together with a multi-annual work program to the European Parliament, the Council, the Commission, the Court of Auditors and the European Economic and Social Committee by 15 June of each year. The Regulations provide that such documents must be made public. Furthermore, under article 50 of the Regulations, the Parliament and the Council are entitled to invite the chairperson of each of the ESAs "to make a statement". In such cases, the chairperson is also required to answer any questions made by the members of the Parliament (this is a fairly widespread practice in the European institutions which goes by the acronym "Q&A") and, if so requested by the Parliament, he or she will also have to prepare written reports on the main activities of his or her authority. Article 50 also states that the powers granted to the Parliament and to the Council must be exercised in accordance with the independence of the authority. The scope of this specification is not fully clear; since the Parliament and the Council only have the

²⁸ The idea of a financial supervision organized on a global scale has been discussed in the recent years of financial crisis. See STRAUSS KAHN, *National, European, or Global? The Future of Bank Regulation*, speech in Paris on 24 November 2009, available at www.imf.org.htm; PAN, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, in *Chicago Journal of International Law*, 2010, Vol. 11, 243-284, in Cardozo Legal Studies Research Paper No. 300, available at ssrn.com; BRUMMER, *How International Financial Law Works (and How it Does not)*, *Georgetown Law Journal*, Vol. 99, 2011, Georgetown Law and Economics Research Paper No. 11-15, available at ssrn.com

²⁹ The Commission has already sought ESMA's technical advice on the preparation of possible implementing acts concerning the equivalence between the legal and supervisory frameworks of certain third countries and Regulation No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

power to impose mere reporting obligations on the ESAs, this form of control would not appear to be sufficient to “limit” the independence of the ESAs.

In addition to the provisions that impose the reporting obligations which ensure that the authorities are subject to a democratic control, it is worth noting that the Regulations have introduced the principle of permanent consultation procedures with market participants. In order to facilitate consultation with stakeholders, the ESAs have established specific "Stakeholder Group(s)". Article 37 of the Regulations sets forth the procedure for the appointment of the members of the group (although the final decision lies with the Board of Supervisors, market participants may submit proposals).

The Regulations also established a Board of Appeal, before which the ESAs' decisions may be challenged. The Board, which is regulated by articles from 58 to 60 of the Regulations, is a joint body of the three ESAs. Significantly, the decisions of the Board of Appeal may be appealed before the Court of Justice of the European Union, in accordance with Article 263 of the TFEU. This means that the ESAs could be held liable for damages caused when carrying out their activities pursuant to Article 268 TFEU. Should such liability arise, it would be of a tortious nature which falls within the jurisdiction of the Court of Justice³⁰. The issue of liability arising from negligent supervision is a very sensitive one and there are important differences between the legal systems of the member States. For example, in Italy, according to recent Supreme Court case law, the financial supervisors (Consob) can be held responsible for negligent supervision.

In general terms, the main tasks entrusted to the ESAs consist of contributing to the establishment of “high-quality common regulatory and supervisory

³⁰ See DIJKSTRA, *Liability of Financial Regulators: Defensive Conduct or Careful Supervision?*, in *Journal of Banking Regulation*, 2009, 10, p. 269.

standards and practices”, in particular by providing opinions to the Union institutions and by developing guidelines, recommendations, and draft regulatory and implementing technical standards; and contributing “to the consistent application of legally binding Union acts”. These objectives aim to create a different approach to financial supervision which is referred to as the new “common supervisory culture” (article 8 of the Regulations) in order to prevent regulatory arbitrage and to guarantee a level playing field in international supervisory coordination.

In addition, each of the three authorities must, on the one hand, cooperate with the ESRB and, on the other, establish efficient forms of cooperation with national authorities (e.g. by identifying best practices and issuing recommendations). To achieve these tasks, the ESAs have been assigned a broad set of powers. The most relevant are the power to (a) develop and implement draft regulatory and technical standards by means of delegated acts under Article 290 and 291 of the TFEU in order to ensure consistent harmonisation in their respective areas of competence; and the power to (b) issue guidelines and recommendations addressed to all national authorities and all market participants. The ESAs may also address their opinions to the European Parliament, the Council, or the Commission, as provided for in article 34 of the Regulations. However, the greatest innovation compared to the previous regime regards the ESAs’ power to make individual decisions with regard to national authorities and financial market participants, although this power is limited to the specific cases envisaged by articles 17, 18 and 19 of the Regulations.

In addition, the ESAs may issue recommendations and guidelines addressed to national supervisors in accordance with article 16 of the Regulations. Upon receipt of general or individual recommendations, the national authorities have to make every effort to comply with the ESAs’ communications within two

months. In the event that the national authority decides not to comply, it has to state the reasons for its decision in accordance with the above mentioned "comply or explain" principle. In any event, where it does not comply, the ESAs may publish the reasons for the decision of the member State.

The power to draft binding technical standards and the relevant implementing measures envisaged by articles 10 and 15 of the Regulations is the most important regulatory tool granted to the ESAs. Until 2011, EU financial legislation was mainly implemented through directives which have resulted in a series of similar, but not identical, national regulatory regimes, while the technical standards drafted by the ESAs will be directly implemented at an EU level. The purpose of this change of regulatory perspective is to reduce national variations in financial regulation by limiting or even ruling out the possibility for regulatory competition and fostering joint supervision. However, once these technical standards are drafted by the ESAs, they do not immediately become "binding": in order for the drafts to be turned into EU regulations, they need the prior endorsement of the European Commission. The choice of the EU legislator to confer such a power on the ESAs, albeit subject to the prior approval of the Commission, is of great importance because it is the most progressive measure introduced by the Regulations and supersedes the scheme based on voluntary coordination previously "governed" by the Lamfalussy committees.

This decision-making mechanism falls under the definition of "delegation of powers"³¹. This legislative technique has given rise to concerns from time to

³¹ With the entry into force of the Lisbon Treaty, the European Union's legal acts are divided into legally binding acts and non-binding acts. Legally binding acts are divided into "legislative acts" (Article 288 TFEU) and "non-legislative acts", which in turn differ from "delegated acts" (Article 290 TFEU) and "implementing acts" (Article 291 TFEU). In this context, the acts of ESAs may become binding through a mechanism under which, as part of a delegation granted pursuant to Article 290 TFEU and 291 TFEU, the ESAs draft regulatory technical standards (or implementing measures) and send them to the European Commission for approval. Where approved, those technical regulations become EU regulations, directives or decisions and are

time, especially with regard to the coordination between the regulatory powers of the ESAs and the powers which remain with the national authorities³². As a matter of principle, it is, in fact, hard to imagine that the ESAs will refrain from regulating aspects which are not entirely “technical”; in practice, the drafting of binding technical standards is a competence that is likely to expand the ESAs’ influence beyond their area of competence, thereby affecting the competences both of the European legislator and of the Member States.

It is a well-known fact that the technique of the delegation of powers has been heavily influenced by the decisions of the EU Court of Justice and, in particular, by the so-called *Meroni doctrine*³³. European Union law does not allow the delegation of powers to European agencies or authorities because legislative powers can only be exercised by the Council and Parliament and, as a matter of principle, they may only be delegated to the Commission. Given this framework, in order to assign the ESAs the power to prepare the technical standards and the relevant implementing measures, the European legislator has identified a *sui generis* regulatory strategy. One of the recitals of the Regulations states that: “*There is a need to introduce an effective instrument to establish*

published in the Official Journal of the European Union. See ADAM and TIZZANO, *Lineamenti di Diritto dell’Unione europea*, Giappichelli, Torino, 2010, p. 188. See, in this regard, the opinion of Advocate General Mayras in Case 23/75 *Rey Soda* and judgment C-41/69, *Chemiafarma*.

³² In this respect, it is sufficient to recall that the EBA’s publishing of the results of its 2011 EU-wide stress test on 15th July 2011 gave rise to a heated debate. Conversely, a different approach was followed as regards the recent Commission Delegated Regulation (EU) No 152/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on capital requirements for central counterparties.

³³ See MERONI, *High Authority*, C-9/56. The Meroni doctrine sets out limits and conditions under which the Commission could delegate certain tasks to independent authorities which are not EU institutions (because not mentioned in the Treaties). The main conditions are as follows: delegation is only possible for those powers that the EU Commission is entitled to exercise; the delegation cannot include the possibility of delegating discretionary powers; the EU Commission has the power (and the duty) to supervise the activities carried out in relation to the delegated competence; the delegation cannot alter the “balance of power” of European institutions.

harmonised regulatory technical standards...” in financial markets. In order to establish these effective instruments, the European legislator has provided for a mechanism which overcomes the limitations imposed on the delegation of powers, by formally assigning competence to the Commission for acts which are, in fact, drawn up by authorities – i.e. the ESAs - which have no legislative powers. The mechanism works as follows:

- a) pursuant to article 10 of the Regulation, the European Parliament and the Council delegate power to the Commission to adopt regulatory technical standards by means of delegated acts under Article 290 TFEU;
- b) pursuant to article 11 of the Regulation, the power to adopt the regulatory technical standards referred to in Article 10 is conferred on the Commission for a period of 4 years from 16 December 2010 (and the delegation of power will be automatically extended for periods of identical duration, unless the European Parliament or the Council revokes it);
- c) the ESAs, in their respective areas of competence, are responsible for elaborating "draft" regulatory technical standards which “do not involve policy choices” (recital 22 of the Regulation);
- d) finally, once the Commission endorses the drafts, they become EU legally binding acts.

In practice, the system confers upon the European Commission a permanent delegated power to adopt legally binding acts which are not elaborated by the Commission itself but by “technical” authorities. The delegated power of the Commission appears to be, in this context, nothing more than a ratification power of the ESAs’ work³⁴. Notwithstanding the right not to endorse the drafts submitted by the ESAs, it is clear that the Commission has very little room for

³⁴ See ORATOR, *Everything under Control? The “way forward” for European agencies in the footsteps of the Meroni doctrine*, 2010, 35, *European Law Review*, p. 3-35.

manoeuvre when adopting these delegated acts. The Regulations seem to justify this aspect with the high degree of technical complexity of the standards, the elaboration of which is to be entrusted to bodies with specific technical skills in the supervision of the financial sector. This justification, however, is not entirely satisfactory and this decision-making process remains exposed to at least two different kinds of criticism. On the one hand, it seems to be in contrast with the very rationale of the reform of the European supervisory framework: the need for EU member States to strengthen the supervision of financial markets may be frustrated by the fact that the European authorities are equipped with a power that is conditional (upon the Commission's endorsement). On the other hand, because the authorities are not expressly recognised by the Treaties, it may be argued that the powers were assigned to the ESAs through a questionable process. This paradox was noted by some legal scholars both before and after the reform³⁵. The issue has not gone away and it is reasonable to argue that, sooner or later, the Court of Justice will have the chance to rule or pass judgment on the matter.

In addition to the possibility of drafting technical standards, the Regulations provide (article 17) the ESAs with some specific *enforcement tools*. In particular, ESAs may send recommendations to national authorities on specific issues and, if necessary, take decisions with direct effects on individual financial institutions in order to correct breaches or non-applications of Union law. The purpose of these tools is to limit the discretion of national authorities in the application of European regulations and technical standards. This power is to be regarded as a power of last resort, which implies that a national authority's ac-

³⁵ See AVGERINOS, *Essential and Non-essential Measures: Delegation of Powers in EU Securities Regulation*, 2002, 8 *European Law Journal*, p. 269-289; VERHELST, *What if the new financial framework Supervision Proves insufficient?*, TGAE Rapport III, Part 2, Economic governance and financial regulation, p. 127.

tion did not comply with EU law, and which may be exercised “*where it is necessary to remedy in a timely manner such non compliance in order to maintain or restore neutral conditions of competition in the market or ensure the orderly functioning and integrity of the financial system*”.

This power of substitution of the ESAs – which also allows the EU authorities to adopt individual decisions addressed to market participants in order to restore compliance with EU law – is a new feature introduced by the 2011 reform. The Regulations expressly state that these direct decisions of the ESAs “*shall prevail over any previous decision adopted by the competent authorities on the same matter*”. The power to enforce compliance with EU law appears, at first sight, more important than it is in practice because, even in this case, it can only be exercised once the Commission has issued an opinion (article 17, para. 4)³⁶.

A potentially significant power is granted to the ESAs by article 18 of the Regulations. The provision, named “*action in emergency situations*” states that in the case of “*adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union*”, the ESAs have to facilitate and coordinate any actions undertaken by the national supervisory authorities. Whilst the “*emergency situation*” has to be previously certified by the Council, which will adopt a decision determining whether such emergency situation exists, the provision gives the ESAs an important role. In addition to coordinating the national authorities the ESAs may, in the case of inaction by the national supervisors, adopt individual decisions addressed to financial market participants requiring them to take any action needed to comply with their obligations under that leg-

³⁶ In this sense, see the comments in two reports to the European Parliament, which suggested “*skipping*” the passage through the Commission: GARCIA, *EBA Report*, PE225 and GIEGOLD, *ESMA Report*, PE438.409, February 2010.

isolation, including the cessation of any practice³⁷. Once again, a European authority (the ESAs) is empowered to replace a national authority. However, unlike the power referred to in article 17, in this case once the emergency situation has been "certified" by the Council, ESAs may act directly without the need to obtain the endorsement (or the opinion) of the European Commission³⁸.

The Regulations establishing the ESAs (article 19) also introduce a mechanism for resolving disputes between national authorities. The disputes referred to in the provision are those which may arise when a national supervisor disagrees on "*the procedure or content of an action or inaction of a competent authority of another Member State*". The aim of this tool is to ensure that the relevant national supervisors take into due account the interests of other member States as well as the soundness and stability of the European system as a whole³⁹.

The possibility for the EU level to settle disagreements between national authorities is not new. Prior to the establishment of the ESFS, such a task was already carried out by the Lamfalussy committees⁴⁰. Compared to the power assigned to the Lamfalussy committees, however, the mediation power conferred upon the ESAs is certainly more effective: in addition to the traditional non-

³⁷ With respect to the definition of emergency situation and to the scope of this power, on 18 January 2011 ESMA published a report (ESMA/2001/26) (started by the CESR in 2010) on the importance of contingency powers in addressing emergency situations. The report is available at www.esma.europa.eu

³⁸ Although a risk of overlap with the power contained in article 17 exists. This is the opinion of FERRAN, *Understanding the New Institutional Architecture of EU Financial Market Supervision*, University of Cambridge Faculty of Law Research Paper Series No. 29, may 2011.

³⁹ See the Explanatory Memorandum of the European Commission COM(2009) 576 final, Brussels, October 26, 2009.

⁴⁰ By way of example, see with regard to voluntary mediation the *Protocol on Mediation mechanism* prepared by the CESR, CESR/06-286b, August 2006. On this issue, see also WYMEERSCH, *The Institutional Reforms of the European Financial Supervisory System*, an Interim Report, January 25, 2010, Ghent Univ. Financial Law Institute Working Paper No. 2010-01, available at ssrn.com, p. 15.

binding mediation responsibilities, the ESAs have a binding mediation tool which can be activated in accordance with article 19, paragraph 3, of the Regulations, which states that “*if the competent authorities concerned fail to reach an agreement within the conciliation phase*” [...], the ESAs may [...] “*take a decision requiring them to take specific action or to refrain from action in order to settle the matter, with binding effects for the competent authorities concerned, in order to ensure compliance with Union law*”. From a political point of view, the creation of a binding mechanism to resolve disputes among national supervisors represents a significant advancement. It implies that the ESAs are deemed to be able to impose their interpretation of EU financial market law on national authorities, including in fields in which the national supervisors have discretion. With respect to binding mediation, there are several unanswered questions. First, it is debatable whether it will prove to be more effective *in practice* than the mediation procedures carried out under the Lamfalussy regime. Secondly, it would be worth analysing the consequences of such power on market participants: binding mediation decisions are likely to by-pass the national authorities in cases in which they disagree, so that ESAs’ decision may indirectly affect market participants. Although this possibility exists, it seems to have little practical relevance. It is, in fact, difficult to imagine that any disagreement between authorities could reach the point where the ESAs are forced to by-pass national authorities in application of the procedure set out under article 19 of the Regulations, which may only be enacted if a national supervisor opposes a mediation decision issued by the ESAs. Such an event would give rise to a scenario that could undermine the integrity of the supervisory system as a whole.

6. The picture outlined above shows that the establishment of new bodies at a European level has affected the relationship between national and Eu-

ropean authorities. Actually, the newly established authorities are expected to have an increasingly important impact on national supervisors' activities, both because the ESAs are continuously drafting technical standards and because they are already interpreting EU financial law provisions.

Coming back to the Italian financial legal system, although the legislative and regulatory provisions in force in the field of supervision have not been radically amended or revised, some major changes of perspective have already left a mark on the Italian Consolidated Financial Act as well as on the Italian Consolidated Banking Act. It is mostly a matter of minor formal amendments to the definitions contained therein, which however affect the interpretation of the relationship between the Bank of Italy and the CONSOB, on the one hand, and the ESAs on the other. There is a risk, however, that in the course of this transitional phase of gradually increasing integration between the European and national levels, some problems of coordination among jurisdictions could arise. The Regulation of the European Parliament and of the Council on short selling and credit default swaps can be regarded as a good example of this complex matter. It is a good example because both short selling and credit default swaps are areas with respect to which the European legislator has provided the ESMA with specific competences. This choice dates back to 2010 and it was contained for the first time in the *"Proposal for a Regulation of the European Parliament and of the Council on short selling and credit default swaps"*⁴¹ and, subsequently, formalised with the EU Regulation of the European Parliament and of the Council no. 236 of 14 March 2012, which came into force on 1 November 2012. The first delicate issue concerns the very definition of "short selling". Short selling is the sale of a security that the seller does not own, although the seller will subsequently need to buy the security in order to be able to deliver the security to

⁴¹ European Commission Communication no. 482/2010.

the buyer. Short sales can be divided into two types: “covered short sales”, where the seller has borrowed the securities, or made arrangements to ensure they can be borrowed, before the short sale; and “naked” or “uncovered short sales”, where the seller has not borrowed the securities at the time of the short sale, or ensured they can be borrowed⁴².

What are the purposes of short selling? First of all, it is a tool used by intermediaries as a medium for their business. It is widely recognized that short sales increase market efficiency especially because they can help in regulating prices, in particular in the case of financial instruments which appear to be overvalued. Furthermore, short selling allows investors to realise capital gains, even on falling markets, but also to protect their portfolio by hedging. Moreover, it is a widely used instrument for leverage purposes. Nevertheless, short sales may also to a certain extent affect the proper functioning of the market, because they allow the exchange of instruments which may ultimately not be delivered to the buyer. In the course of the financial crisis and, in particular, since the end of 2008, some EU member States have adopted emergency measures to restrict or ban short selling for some categories of financial instruments (for limited periods of time)⁴³. These authoritative interventions were

⁴² See AVGOULES, *The Vexed Issue of Short Sales Regulation and the Global Financial Crisis*, in *Law Reform and Financial Markets*, Edward Elgar Publishing, 2011, 71-110. Consistent is the opinion of the IOSCO *Technical Committee, Regulation of Short-Selling - Consultation Report*, Appendix III, on 24 March 2009. See also AVGOULES, *A New Framework for the Global Regulation of Short Sales: Why Prohibition is Inefficient and Disclosure Insufficient*, *Stanford Journal of Law, Business, and Finance*, Vol. 16, No. 2, 2010, available at ssrn.com.

⁴³ See the Opinion of the European Economic and Social Committee on the "Proposal for a Regulation of the European Parliament and of the Council on short selling and credit default swaps" COM (2010) 482 final - 2010/0251 (COD) 2011 / C 84/07: " *The short selling of equity securities of financial institutions has been banned in the UK and other countries as a reaction to the collapse of the market after the failure of Lehman. In response to the sovereign debt crisis of Greece, the German authorities have banned the short selling of equities of certain German financial institutions, of euro area sovereign debt and CDS positions "naked" in that debt. In the regulation, in the context of the revision of the financial regulation and supervision, the Commission proposes a single regulatory framework, under the coordination of ESMA (the Eu-*

deemed necessary based on the conventional wisdom that, in times of financial instability, short sales are likely to exacerbate the downward spiral in the prices of financial instruments, to the extent that they could even create systemic risks. However, experience has shown that measures taken at a national level by the authorities of the single member States are unlikely to be effective. The purpose of the European Regulation in this area is, therefore, to establish a common legal framework in relation to short selling.

The other important issue taken into account by the Regulation are credit default swaps (CDS), derivative instruments in which the seller agrees to compensate the buyer in the event of a default of the referenced sovereign instrument, in return for an annual fee. CDS are widely regarded as a form of insurance against the credit risk and, with specific respect to sovereign debt instruments, they are regarded as a form of coverage against the default of a sovereign debt. Now, CDS were regulated in the same piece of legislation because on cash markets, in addition to short sales, a net short position can also be achieved by the use of derivatives, including CDS. For example, if an investor buys a CDS without being exposed to the credit risk of the underlying bond issuer (a so-called "naked CDS"), the investor will gain from the rise of credit risk (or from the default of the bond issuer). This is economically equivalent to short selling the underlying bond⁴⁴.

This being the framework, Regulation 236/2012 contains a number of provisions that grant the ESMA the responsibility of ensuring consistent compliance by market participants and enforcement by competent national authorities with specific respect to transactions having cross-border effects. Furthermore, the ESMA is assigned the power to issue binding technical standards to regulate

ropean Securities and Markets Authority), for the management of short selling and CDS across the EU ... "

⁴⁴ The economic equivalence is contained in Regulation (EU) 236/2012, in recital (14).

the matter and to intervene directly, including by temporarily limiting short sales, where there is a threat to the proper functioning or to the integrity of financial markets, in cases in which the measures taken at a national level do not appear to be sufficient (article 28). Apart from the powers specifically granted to ESMA, the purposes of Regulation 236/2012 are to increase the transparency of short positions held by investors in certain financial instruments and ensure member States – and the ESMA - have clear powers to intervene in exceptional situations to reduce risks to financial stability and market confidence arising from short selling and credit default swaps. The introduction of this regime of transparency in the market of short sales implies the possibility to restrict – in a less discretionary manner – the uncovered short selling of certain financial instruments and of sovereign debt. The choice of the European legislator is, therefore, quite clear: instead of introducing prohibitions or bans in the area of short selling, it has preferred to impose transparency rules designed to allow the market and the financial supervisors to get a clearer perception of the phenomenon. This option recognises the validity of the theories that see short sales as a tool that contributes to market efficiency and not just an instrument used for speculative purposes that affects market integrity⁴⁵.

Based on these assumptions, on the one hand, Regulation 236/2012 imposes a series of obligations to provide the market with adequate information and, on the other, it establishes a residual power to impose restrictions on the possibility of carrying out naked short sales under certain circumstances. Some

⁴⁵ See AVGOULEAS, *Short sales regulation in seasoned equity offerings: what are the issues?*, in *Corporate Law and Finance in the UK and EU*, Oxford: Oxford University Press, 2011, p. 117. In this context, it should be noted that some studies show that short selling helps to facilitate - and makes more efficient - the mechanism for determining prices of financial instruments. See JONES and LAMONT, *Short Sale Constraints and Stock Returns*, in *Journal of Financial Economics*, 66, 2002, p. 207; VV. AA., *Efficiency and the Bear: Short Sales and Markets Around the World*, *Journal of Finance*, 62, 2007, p. 1029.

of the measures introduced by Regulation are not “new”, at least not for all the legal systems of the member States. The most important innovation brought by the Regulation is the introduction of a set of common rules aimed at harmonising certain provisions already in force in some member States, including - and especially - through the specification of the tasks of the national supervisory authorities and ESMA. With respect to transparency, the Regulation requires that the “significant” short positions in shares are disclosed to supervisors and, in some cases, to the market. The concept of "net short position" is, of course, a relative concept: in order to assess whether an investor is in a specific “position”, it is necessary to take into account his position as compared to the capital of the issuer.

However, not all net short positions must be disclosed to the market and this is the reason why the Regulation uses the term "significant" and introduces the above mentioned model of compulsory notification structured on two levels⁴⁶. At the first level, the net short positions are to be confidentially disclosed to the relevant supervisory authorities, in order to allow for the identification of short selling and, if necessary, to investigate any sales that appear to be improper or are likely to give rise to systemic risks. At the second level, the net short positions are to be disclosed to the market in order to provide useful information to all participants (articles 5 and 6).

In addition to the reporting obligations to the authorities, the Regulation introduces a number of restrictions on so-called "naked" short selling. The re-

⁴⁶ In this respect, when an investor holds a short position equal to 0.1% of the relevant issued financial instrument, he must notify the supervisors, while the obligation to disclose a net short position to the market becomes effective when the investor exceeds the threshold of 0.5%. In order for this provision to become effective the Regulation also sets out the technical details of how to calculate those net short positions, including how net short positions should be calculated by different funds managed by the same fund manager, or by different entities within a group company.

restrictions are justified on the basis of the widespread belief that speculative transactions are carried out through naked short selling, which may also be aimed at bringing down the prices of specific financial instruments. Nonetheless, the European legislator did not ban naked short selling, nor did it ban naked short selling on sovereign debt; it merely limited the possibility of carrying out such transactions to cases in which certain conditions are met.

It is worth noting that the only ban essentially introduced by the Regulation (albeit with some exceptions) consists of the prohibition on having an uncovered sovereign CDS position⁴⁷. The rationale for this prohibition is the desire to avoid downward speculation against the sovereign debt of a member State. Since during the most recent phases of the crisis speculators have shown a predilection for coordinated actions to the detriment of a State, it might have been appropriate to provide a more effective mechanism for consultation between the authorities so as to ensure greater coordination with regard to the imposition as well as the suspension of the restrictions.

It is, however, uncertain whether ESMA will be able to effectively and promptly exercise its powers in the event of breaches by the market operators that are not censured by the competent authorities at a national level. An initial answer to this question was given by the European legislator when it granted the ESMA powers of coordination (article 27) and of direct intervention in the event of exceptional circumstances (article 28); however, in practice, the issue remains unresolved. Indeed, it is the very concept of “exceptional circumstances” which is not entirely clear and is, in any event, questionable. The distinction

⁴⁷ A sovereign CDS position is uncovered where the sovereign CDS does not serve to hedge against the risk of default of the issuer where the person has a long position in the sovereign debt of that issuer to which the CDS relates; or the risk of decline in the value of the sovereign debt where the person holds assets or is subject to liabilities the value of which is correlated to the value of the sovereign debt.

between ordinary and exceptional circumstances depends on discretionary assessments and may give rise to disputes among national authorities and among the latter and the ESMA. The issue has no easy solution because it concerns the harmonisation of rules governing a phenomenon with a highly technical content in countries with different legal traditions.

Returning to the Italian case, the risk of conflict between the new European provisions and the Italian existing legal framework exists. The very concept of "short position", for example, is almost unknown to Italian jurists: it can only be obtained by reference to financial jargon which, of course, has nothing to do with the Italian legal tradition.

The first difficulty, therefore, lies in the very "definition" of the phenomenon. The problem is mitigated by the attribution of supervisory responsibilities to a competent authority (CONSOB, in the Italian case) that certainly has sufficient technical knowledge on the matter (while it remains to be established how an *ex-post* evaluation of the phenomenon will be carried out before the judicial authorities and courts in general).

The introduction of a European regulation on short selling and CDS has also led Italy to make some legislative changes. In particular, a new article – article 4-*ter* – has been introduced to the Consolidated Financial Act, whose purpose is to allocate supervisory tasks to the competent authorities in accordance with Regulation no. 236/2012. Under such provision, while ESMA is the competent authority at a European level, at a national level the Ministry of the Economy and Finance, the Bank of Italy and the CONSOB are all "competent national authorities" and carry out their respective tasks pursuant to a scheme which is not easy to understand.

The CONSOB is the authority competent to receive notifications, to implement some of the measures and to exercise the powers contained in the

Regulation no. 236/2012. In particular, the CONSOB is required to exchange information with the other national supervisors as well as with the ESAs. However, with reference to sovereign debt, the powers to impose temporary restrictions on short sales and CDS transactions are exercised by the Ministry at the proposal of the Bank of Italy (having informed the CONSOB, which is entitled to express its opinion). Furthermore, for the purpose of exercising their respective tasks and the functioning of this mechanism, the CONSOB and the Bank of Italy are allowed to use the powers contained in article 187-*octies* of the Consolidated Financial Act (e.g. request information, organise inspections, impose seizures).

7. When discussing the role of the ESRB, we referred to the recent proposals of the European Commission in relation to new banking prudential supervision. The European debate has been inspired by the report "Towards a genuine Economic and Monetary Union"⁴⁸, which was drawn up shortly before the summer of 2012 by the President of the European Council Van Rompuy in collaboration with the Presidents of the European Commission, the Euro Group and the ECB.

The purpose of the European institutions is to take into proper account the challenges that the Economic and Monetary Union (EMU) is facing. Notwithstanding the 2011 reform, the report showed that the Euro area is still diverse and non-coordinated national policies⁴⁹ have effects that "*quickly propagate to the euro area as a whole*". The report proposes a vision for the EMU based on four pillars: an integrated financial framework to ensure financial stability in

⁴⁸ See report by President H. VAN ROMPUY to the European Council, *Towards a genuine economic and monetary union*, June 26, 2012. Available at www.consilium.europa.eu

⁴⁹ See MICOSSI, *Survey of Community acts relating to the examination n. COM (2012) 280, n. COM (2012) 511 and n. COM (2012) 512, concerning the settlement of the crisis and prudential supervision of credit institutions*, Hearing of the Assonime Director General before the Italian Senate, Rome, 6 November 2012.

particular in the Euro area and minimise the cost of bank failures to European citizens; an integrated budgetary framework to ensure sound fiscal policy making at the national and European levels, encompassing coordination, joint decision-making, greater enforcement and commensurate steps towards common debt issuance; an integrated economic policy framework compatible with the smooth functioning of EMU; a higher level of democratic legitimacy and accountability of decision-making within the EMU. These four “building blocks” are deemed to be necessary for long-term stability in the EMU, but of course they require a lot of further work, including possible changes to the EU treaties. For the time being the instrument through which the goal of greater and better financial integration may be pursued is to entrust the prudential supervision of banks to the ECB (on the basis of the provision contained in article 127, para. 6, TFEU)⁵⁰. This is an important first step towards what has been called the “banking union”, the two other pillars of which are the creation of a European deposit guarantee scheme and the introduction of standard procedures for the resolution of banking crisis occurring in the Euro area.

The initial package⁵¹ of measures relating to prudential supervision is divided into two proposals for regulations which provide for the creation of a single system of supervision under the responsibility of the ECB (Single Supervisory Mechanism or SSM) and for the necessary amendments to Regulation 1093/2010 establishing the EBA. This second intervention is required in order to

⁵⁰ See Articles 127(1) and 282(2) of the Treaty and Article 2 of the Statute of the ESCB.

⁵¹ On 12 September 2012, the European Commission presented a package of proposals for the creation of the banking union which consists of: (I) A communication entitled “*A Roadmap to the EU banking*” (COM (2012) 510); (II) a regulation entrusting the ECB with specific tasks concerning the prudential supervision of credit institutions (COM (2012) 511), (III) a regulation amending Regulation no. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) with regard to the interaction of the said regulation with regulation entrusting the ECB specific tasks (COM (2012) 512).

precisely define the scope of the powers attributed to the EBA so as to avoid overlaps of tasks and competences with the ECB.

With regard to the scope of the SSM, the Commission proposed the transfer of supervision over banks established in the Euro area to the European level. In particular, the ECB would carry out its tasks within the single supervisory mechanism made up of the ECB and national supervisory authorities. Such a structure aims to provide consistent supervision across the Euro area, having recourse to a centralised system which takes advantage of the know-how of national supervisors. The ECB will therefore become the supervisor of last resort in the field of prudential supervision. Contrary to other systems of European cooperation, under the framework of the proposed banking union the ECB will have more incisive powers of coordination of national authorities. Although the supervision over banks will not be *directly* carried out by the ECB – because such an option would have constituted an excessive compression of the powers of national authorities and would have made the ECB’s new tasks extremely difficult⁵² - the ECB will have the ultimate responsibility for the new supervisory system. Moreover, it can be assigned direct supervisory tasks with respect to *the most significant banks*⁵³.

As for the member States which are not part of the Euro area, the Commission has considered whether they might adhere to the SSM on the basis of an *opt-in* mechanism that would allow their national authorities to establish a "close cooperation" between the ECB (article 6 of the proposal for COM (2012) 511).

⁵² This idea is shared by the ECB itself, which in its opinion of 27 November 2012 (CON/2012/96) on the proposal for a Regulation of the Council on entrusting the European Central Bank with the prudential supervision of credit institutions.

⁵³ See MERSCH, Member of the Executive Board of the ECB, at the seminar “Auf dem Weg zu mehr Stabilität – Ein Dialog über die Ausgestaltung der Bankenunion zwischen Wissenschaft und Praxis“ organised by Europolis and Wirtschaftswoche, Berlin, 5 April 2013.

In the event that they decide to opt in, the non-Euro member States will, however, have a slightly different position from that of Euro area countries because they will only have limited rights to participate in the decision-making process and, in any case, the ECB will keep its power to unilaterally exclude them from the common mechanism of supervision where they do not comply with their obligations.

The package of proposals meets some needs that emerged during the most recent global financial crisis; a financial crisis which hit the private sector but which, in some Member States, also became a public finance crisis. According to Brussels, the extension of the crisis to the public sector was made possible by *inter alia* the discrepancy between the centralisation of monetary policy powers at EU level on the one hand and the fragmentation of prudential supervision over the banking system - which remained the exclusive competence of the member States of the Euro area - on the other⁵⁴. In order to overcome this paradox, the institutions of the European Union and, in particular, the Euro Group have decided to concentrate the powers of micro-prudential oversight at the level of the Euro area, assigning the new task to the ECB.

Based on these assumptions, the Commission has decided, on the basis of an opinion shared by the ECB itself, to take action "*to break the link between sovereign debt and bank debt and the vicious circle which has led to over €4,5 trillion of taxpayers money being used to rescue banks in the EU*"⁵⁵.

⁵⁴ On the causes of the contagion between private and public debt, there is a big debate in economic literature. There are scholars, however, who do not agree with the view that the banking union will be an appropriate tool to stabilise the euro area. This thesis is based on the assumption that public debts in the EU were not created by banking crises (except perhaps in the case of Ireland), but rather by the previous existence of excessive public debt in some countries of the EU. See SARCINELLI, *L'Unione Bancaria Europea E La Stabilizzazione Dell'Eurozona* (The European Banking Union and the Stabilization of the Eurozone), in *Moneta e Credito*, Vol. 66, No. 261, pp. 7-42, 2013. Available at ssrn.com

⁵⁵ See COM (2012) 510 final, p. 3.

The proposed measures represent a further response to the persistent financial crisis, but this time the approach appears to be more practical and, hopefully, more effective: the European institutions are betting on the stability of the banking system as a tool that will confer credibility and integrity on the whole financial system. There are, however, some critical aspects.

First of all, the proposed reform will come into force just over a year after the establishment of the ESAs. This would appear to reveal at least a failure of the supervisory reform that came into force in 2011. This failure is probably related to the technique of the delegation of powers (according to which the EBA's regulatory powers must be adopted by the Commission in order to become effective). From this point of view, the proposed SSM regulation will be different since the ECB enjoys regulatory powers under article 132 of the TFEU and article 34, para. 1, of the Statute of the ESCB. In this respect, the ECB will have more weapons: as an institution of the Union (unlike the EBA), it will have more opportunities to issue directly binding acts or decisions.

Secondly, as other papers have highlighted, there is no proof that the centralisation of supervisory activities is the best tool to limit moral hazard and excessive risk-taking by banks. As a matter of fact, supervision alone is not sufficient to ensure the proper functioning of an integrated banking system and requires the establishment of a common framework for deposit guarantees and for bank crisis resolutions. This second aspect will be discussed below, taking into account the ongoing discussion at the EU level.

The creation of the banking union is part of the wider process of completing the European program of reforms for the single financial market, which also include the setting out of a *Single Rulebook*⁵⁶ on banking and financial regula-

⁵⁶ In June 2009, the European Council called for the establishment of a "*European single rule book applicable to all financial institutions in the Single Market*". The single rule book aims to

tion. In Communication COM (2012) 510 final accompanying the new set of proposals, the European Commission has identified a number of priorities or, to use the language of the Brussels' legislator, three "areas of specific relevance" for the EU banking industry, which are as follows:

I) the definition of "stronger" prudential requirements for banks (CRD4⁵⁷). In this respect the Commission has launched the implementation process for the new global standards on bank capital and liquidity⁵⁸. An initial approval of the package was expressed on 27 March 27 2013 by the COREPER⁵⁹, which set in motion the process of implementation of the new standards set by Basel IV;

II) the setting up of a new Deposit Guarantee Schemes (DGS) to replace (or adapt) the existing one which provides for a harmonised guaranteed thresh-

provide a single set of harmonized prudential rules which institutions throughout the EU must respect.

⁵⁷ Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (Text with EEA relevance) COM (2011) 0452.

⁵⁸ Which will affect banks and investment firms, which will have to provide their own capital to be of a higher quantity, and also of a better "quality", in order to ensure their ability to absorb losses. This is referred to as a "capital buffer" as an additional protection against loss. The new measures, however, do not only refer to the capital requirement, but also extend to the methods of cash flow management (in order to maintain the availability of sufficient liquidity in the short and long term); compliance with the maximum amount of assets that banks and investment firms will be able to acquire in relation to their capital (leverage ratio); the obligation to acquire more capital if they intend to market complex financial derivatives.

⁵⁹ If the proposals are approved by the European Parliament, a series of measures will come into force in accordance with a predetermined time schedule,: by December 2014, at least 4.5% of the assets of a bank will be made up of its ordinary shares plus reserves. In addition, banks must accumulate an additional protective wall of 3.5% formed by the so-called "conservation buffer" and other equity instruments. As regards liquidity, CRD IV introduces requirements which will come into effect in 2015, after an initial period of experimentation. In practice, banks will be required to hold sufficient cash on hand to be able to cover all the exits in a period of thirty days in severe financial stress. The thirty-day period is a guarantee for both the bank and for the European institutions which would have enough time in a crisis to devise solutions such as emergency loans and bailouts. The key index will be represented by the Liquidity Coverage Ratio , which will be raised from 60% in 2015 to 100% in 2018, which means the percentage of the sum to be held and liquidated within thirty days.

old of Euro 100,000 per depositor. In particular, the new scheme should imply the creation of a deposit guarantee consisting of contributions from the same banks and a mandatory borrowing facility between national schemes within certain fixed limits;

III) the creation of a mechanism for the recovery and the resolution of banks, in relation to which the Commission has presented a proposal for a directive⁶⁰ containing common rules that will enable the supervisory authorities of the member States to prevent the occurrence of banking crises and, in the event of a crisis, to manage failures in an effective way (the Single Resolution Mechanism, SRM).

The Council proposal for a regulation on the establishment of a single supervisory mechanism, as subsequently amended by the European Parliament⁶¹ provides for the transfer of certain EU-wide supervisory tasks and for coordination powers among national supervisors. Certain aspects of the scope of the powers of the ECB are still under discussion since the line of demarcation between the area of competence of the ECB and the area of competence of the national authorities has not been definitively established. Furthermore, as mentioned, the scope of application of the new banking supervision rules will be to a certain extent "mobile" where one considers that the very definition of "participating member State" means: *"a Member State whose currency is the euro or a Member State whose currency is not the euro which chooses to participate in the SSM"*.

⁶⁰ Proposal for a Directive of the European Parliament and of the Council establishing a framework for recovery and resolution of the crisis of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/CE, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EU and Regulation (EU) No. 1093/2010 - Brussels, 6.6.2012 COM (2012) 280 final 2012/0150 (COD).

⁶¹ Report on the proposal for a Council Regulation entrusting the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions (COM (2012) 0511 - C7-0314/2012 - 2012/0242 (CNS)).

Whilst retaining the ultimate responsibility for supervision, the ECB will primarily perform its tasks by ensuring cooperation among national banking regulators. This structure, which perhaps seeks to replicate the experience of the European System of Central Banks (ESCB), would in the intention of the EU legislator allow the ECB to pursue the objectives of establishing strong and uniform supervision in the whole Euro area (extendable on the basis of potential *opt-ins* by other Member States), making use of the already existing competences and powers of national supervisors. In this respect, it is significant that the proposal calls for an higher level of “quality” in the use of the existing supervisory tools.

However, in order to achieve this higher level of quality of coordinated supervision, in addition to the activation of an effective mechanism of cooperation between national authorities and the ECB, it is also important to identify some, limited, supervisory tasks that should be granted exclusively to the ECB.

In this regard, the proposal provides (article 4) that, in accordance with the relevant provisions of Union law, and in accordance with the single rulebook and single supervisory handbook prepared by EBA, the ECB will have exclusive competence in a number of “classical” tools of prudential supervision. In particular, the ECB shall be exclusively competent to carry out, for prudential supervisory purposes, the following tasks in relation to all credit institutions established in the participating Member States: *“(a) to authorise credit institutions and to withdraw authorisation of credit institutions; (b) to assess applications for the acquisition and disposal of holdings in credit institutions; (c) to ensure compliance with any Union acts imposing prudential requirements on credit institutions in the areas of own funds requirements, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on those matters; (d) only in the cases specifically set out in Union acts, to set higher prudential requirements*

and apply additional measures to credit institutions; (e) to impose capital buffers to be held by credit institutions in addition to own funds requirements referred to in (c), including setting countercyclical buffer rates and any other prudential measures aimed at addressing systemic or macro-prudential risks in the cases specifically set out in Union acts; (f) to apply requirements specifically set out in Union acts for credit institutions to have in place robust governance arrangements, processes and mechanisms and effective internal capital adequacy assessment processes; (g) to determine whether the arrangements, strategies, processes and mechanisms put in place by credit institutions and the own funds held by these institutions ensure a sound management and coverage of their risks, and on the basis of that supervisory review to impose on credit institutions specific additional own funds requirements, specific publication requirements, specific liquidity requirements and other measures in the cases specifically set out in Union acts; (h) to carry out supervisory stress-tests on credit institutions to support the supervisory review subject to appropriate coordination with EBA, and where appropriate publish the results of the tests; (i) to carry out supervision on a consolidated basis over credit institutions' parents established in one of the participating Member States, including over financial holding companies and mixed financial holding companies, and to participate in supervision on a consolidated basis, including in colleges of supervisors, in relation to parents not established in one of the participating Member State; national competent authorities will participate in colleges of supervisors as observers under the lead of the ECB; (j) to participate in supplementary supervision of a financial conglomerate in relation to the credit institutions included in it and assume the tasks of a coordinator where the ECB is appointed as the coordinator for a financial conglomerate in accordance with the criteria set out relevant Union law; (k) to carry out supervisory tasks in relation to early intervention where a credit institution does not

meet or is likely to breach the applicable prudential requirements, including recovery plans and intra group financial support arrangements”.

The ECB will also have the necessary powers of inspection and the power to enforce its decisions (including sanctions).

Which powers will stay with the national supervisors? In addition to powers which have not expressly been transferred to the ECB⁶², they will be required to perform tasks related to the preparation and to the enforcement of ECB decisions. National authorities will also continue to carry out their supervisory duties (the so-called “day-to-day verifications” of credit institutions) thereby exploiting the advantages of their position of greater proximity to banks (as well as the experience of their staff)⁶³. Among the powers which will be transferred to the ECB, it was particularly interesting that the central bank was assigned the power to grant and revoke authorisations to credit institutions, a power which is traditionally attributed to national authorities. By way of example, from an Italian perspective, the issues relating to banking authorisations bring to mind the long-lasting doctrinal debate that started with the Banking Act of 1926 and was only concluded when the Consolidated Banking Act came into force in 1993, after many reforms and, in particular, following the one introduced by Presidential Decree (DPR) no. 350/1985. Article 1, para. 2 of the aforementioned Decree introduced the principle that the authorisation to carry

⁶² Those tasks should include: (I) the power to receive notifications from credit institutions in relation to the right of establishment and the free provision of services, (II) to supervise bodies which are not covered by the definition of credit institutions under Union law but which are supervised as credit institutions under national law, (III) to supervise credit institutions from third countries establishing a branch or providing cross-border services in the Union, (IV) to supervise payments services, to carry out day-to-day verifications of credit institutions, (V) to carry out the function of competent authorities over credit institutions in relation to markets in financial instruments and the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

⁶³ See SIGNORINI, *L’unione bancaria*, hearing of the Central Director for the Banking and Financial Supervision of the Bank of Italy, Roma, Camera dei Deputati, Commissione VI della Camera dei Deputati (Finanze), November 22, 2012.

out banking activities had to be a non-discretionary and legally binding measure⁶⁴ so that if a bank applying for authorisation met all the statutory conditions, the Italian authorities could not withhold the authorisation.

However, the national authorities will continue to formally exercise the power of authorisation once this power has been transferred to the ECB, which may carry out an ultimate control. This implies the setting up of a system of “supervision of the supervision” which, as it is reasonable to imagine, may well compress the residual authorising powers of the national authorities, which may become nothing more than operative units of the ECB. In other words, there is a risk that the ECB could develop an implicit (or explicit) tendency to form uniform operational standards in the exercise of national powers, which would result in a betrayal of the noble intention to centralise supervisory responsibilities while maintaining the advantages arising from the fact that they are carried out in greater proximity to the banks.

Similar considerations can be made with regard to the power to assess applications for the acquisition and disposal of holdings in credit institutions, and with regard to many other powers in relation to which it will be necessary to coordinate jurisdictions with more than one supervisory authority having different tasks and competences. This is the case of Italy, and also of France and Spain, where there are different supervisory authorities and, in particular, the authorities with a specific responsibility for the securities market⁶⁵ are different from the banking regulators. Moreover, the coordination in the field of acquisition and disposal of holdings and interests in credit institutions will have to take into account the existence of antitrust law provisions and, in particular, the role of independent antitrust authorities.

⁶⁴ See COSTI, *L'ordinamento bancario*, 2012, p. 325.

⁶⁵ By way of example, consider the Autorité des marchés financiers (AMF) in France, the CONSOB in Italy and the Comisión Nacional del Mercado de Valores (CMNV) in Spain.

Lastly, it will be extremely difficult to fairly and efficiently coordinate the ECB's power to impose penalties with the respective powers of the national authorities. Aside from the obvious danger of overlaps, the most complex aspect in coordinating the two levels may arise with respect to the *ex-post* judicial protection against the penalties imposed by the authorities and, in particular, to the consequent potential conflict of jurisdictions between national and European levels. The issue of judicial protection of banks remains open: it will in any case be difficult to obtain uniform decisions in similar cases given the differences among the various national legal systems. The problem is made even more challenging by the thorny issue of the genetic differences between legal systems that only have a single jurisdiction and legal systems (such as the French or the Italian one) that have a dual jurisdiction (civil or administrative) based on whether the right or interest that the bank claims has been harmed can be defined as a *diritto soggettivo* or *interesse legittimo*.

The European institutions' aim is to entrust the ECB with the new prudential oversight over all Euro area banks so that a single set of rules will apply to the single (Euro) banking market. It was the European Commission's intention that the supervisory mechanism would come into force gradually but rapidly. According to the original step plan, the ECB should already have been authorised to carry out some of the new tasks on 1 January 2013. Furthermore, the plan was to entrust the ECB with the supervision of the most significant credit institutions as of 1 July 2013 and, of all other banks, from 1 January 2014. However, the discussions among the members of the Euro Group are still ongoing and no final agreement has been reached yet. Under the political agreement reached in December 2012 at the Ecofin meeting, followed by the discussions of the European Summit held in Dublin on 13 and 14 April 2013, the power to su-

pervise all banks in the Euro area was due to be transferred to the ECB on 1 March 2014.

The declarations of principle accompanying the proposals of the Commission on the Banking Union state that the ECB will have to cooperate with the EBA. The Commission may have wanted give an air of normality to something which is not at all normal. Indeed, the proposal for the establishment of the Banking Union shows - at least - some imperfections in the design of the ESFS which was launched in 2011 with the establishment of EBA, ESMA, EIOPA and ESRB.

Since the application of the new rules is expected to be “geographically flexible”, partly due to the *opt-in* mechanism, there is a serious risk that the tasks of the EBA and of the ESRB will overlap with the new competences of the ECB; a risk which certainly demonstrates the partial inadequacy of the recent reform that introduced the ESFS.

As mentioned, the powers attributed to the ESRB essentially consist of a power of recommendation and early warning with respect to systemic risk. The ESRB does not have any binding powers (except for the possibility to impose reporting obligations under the comply or explain mechanism, which is, however, a power that does not go beyond moral suasion). The new powers of the ECB will directly affect macro-prudential policies and their implementation and, at least as far as the countries of the Euro area are concerned, the ESRB is likely to benefit from ECB powers in carrying out its own tasks. It will be therefore necessary for the ESRB to reflect on the implications of the Banking Union and, in particular, of the SSM on its own work. The Commission’s proposal appears to be imply that the ECB will have exclusive competence within the euro area “to set counter-cyclical buffer rates and any other measures aimed at addressing sys-

*temic or macro-prudential risks in the cases specifically set out in Union acts*⁶⁶. The issue whether the ESRB will also enjoy of some sort of endorsement by the ECB remains, at this stage, open to debate. However, the proximity (including the physical proximity) of the two bodies may either lend the ESRB a higher degree of credibility or it may simply be replaced and end up without any substantive role⁶⁷. It remains to be seen whether the ESRB will become more independent from the ECB or whether it will be kept as “a lean institution, in charge of coordination among Euro area countries and other EU countries, and among central banks and supervisory authorities not represented in the SSM”. The debate is in its early stages. Much will depend on how many EU countries join the SSM⁶⁸.

There is an even more evident risk of overlaps of competences between the ECB and the EBA. It is no coincidence that, in this regard, the European Commission has constantly reiterated that, following the approval of the Banking Union, the role of EBA will be similar to its current role, with – apparently – no clashes with the powers granted to the ECB: “...to avoid fragmentation of the internal market following the establishment of the single supervisory mechanism, the proper functioning of the EBA needs to be ensured. The role of the EBA

⁶⁶ See DRAGHI, *ESRB hearing before the Committee on Economic and Monetary Affairs of the European Parliament*, Introductory statement by the Chair of the ESRB, Brussels, October 9, 2012.

⁶⁷ See LANNOO, *The Roadmap to Banking Union: A call for consistency*, CEPS Commentary, August 3, 2012, p. 5. The issue has also been taken into account by the ESRB which has planned a review of its mission and organisation in the course of 2013. Three members of the ESRB Steering Committee – Stefan Ingves, Chair of the Advisory Technical Committee, André Sapir, Chair of the Advisory Scientific Committee, and Vítor Constâncio, Vice-President of the ECB – will examine the functioning of the ESRB in light of the forthcoming Banking Union.

⁶⁸ See PANETTA, *Macroprudential tools: where do we stand?*, Remarks by the Member of the Governing Board of the Bank of Italy Luxembourg Banque Centrale du Luxembourg - Presentation of the 2013 Financial Stability Review, May 14, 2013, p. 9.

*should therefore be preserved in order to further develop the single rulebook and ensure convergence of supervisory practices over all EU*⁶⁹.

Some problems, however, have not been resolved. As a general remark, it is worth mentioning that the EBA, as an EU-wide authority, has to ensure the effective functioning of the single market. Many commentators and institutions of EU member States have highlighted the issues of how such a newly-established body will interact with such an important and powerful institution as the ECB and, in particular, how the EBA will be able to remain effectively independent⁷⁰.

As for the specific issues which potentially affect the coordination between EBA and ECB, under the new regime, the ECB will be entitled to carry out supervisory stress tests to support the supervisory review, and carry out supervision on a consolidated basis. Such stress tests are supervisory tools which are also used by national authorities to assess the stability of individual banks and which, since 2011, have also been carried out by the EBA. Although the SSM proposal does not provide that the ECB stress tests will replace the stress tests carried out by the EBA, it would be useful to precisely identify the area of competence of the two authorities in order to avoid duplications and conflicts on a politically delicate matter such as the stress tests of banks.

Another potential problem of coordination regards the supervision of banks with cross-border operations in the member States both in the Euro area and non-Euro area. The Commission proposal envisages that the day-to-day supervision of cross-border banks will be carried out by national supervisors. As in the current situation, the home supervisor and the host supervisors of other

⁶⁹ See COM(2012) 512 final, p. 3

⁷⁰ The UK Parliament has been discussing the matter. See EUROPEAN BANKING UNION, *Key issues and challenges - European Union Committee Contents*, January 20, 2013. Available at www.publications.parliament.uk

Member States (where the bank establishes branches or subsidiaries or provides cross-border services) will have to coordinate their actions. With the creation of the SSM, however, many supervisory tasks in the Euro area will be assigned to the ECB for all Member States concerned. Once the new structure is in force, the ECB will also perform some of the functions traditionally attributed to home States. Although the EBA has never had powers relating to direct supervision of banks in this respect, it has drafted (and will continue to draft technical standards applicable by all member States' supervisors. In this context, will the ECB follow the rules and the standards prepared by the EBA or will it develop its own practice (with the risk of creating a double regime of supervisory standards that is different for Euro and non-Euro member States)? The question has no answer for the time being.

On the other hand, the EBA will preserve its role of creating a single rulebook for financial services in the European Union. The Commission also expressly requested that the EBA develop a "Single Supervisory Handbook" to complement the EU's single rulebook and ensure consistency in bank supervision across the 27 countries of the single market. The purpose of the Single Supervisory Handbook is to overcome the current single market fragmentation which is also a consequence of the different supervisory approaches and practices of the various member States.

Another unresolved issue relates to the representation and voting rights of the member States within EBA Board of Supervisors (the decision-making body of the authority). As described above, as a matter of principle, SSM decisions are currently approved by a simple majority of the members (i.e. all member States) of the Board of Supervisors; however, there are decisions which are subject to approval by larger majorities. The Banking Union package of measures will not amend the composition of the Board of the EBA, but it will

empower the ECB to coordinate the positions of the Euro area Member States when they participate on the Board of the EBA. This choice, which appears to be reasonable, has obviously generated concerns among non-Euro countries, who fear that they will constantly be in a minority on the EBA Board. The issue is under discussion and has so far been one of the major obstacles to the approval of the legislative package.

8. On 6 June 2012, the European Commission presented a draft directive⁷¹ for the regulation of banking crisis. The proposal aims to provide the competent national authorities with effective tools and powers to manage bank crises by safeguarding financial stability and minimising taxpayers' exposure to losses arising from banking insolvencies⁷² (hereinafter Recovery and Resolution Directive or RRP). The matter is relatively new, although the need to introduce a supranational regulation of the bank crises had already been flagged up by the Cross-border Bank Resolution Group (CBRG), which was established by the Basel Committee in 2007⁷³.

⁷¹ On May 2013, 29 the Presidency of the EU Council published its latest "Compromise Proposal", Inter-institutional 2012/0150 (COD).

⁷² Proposal for a directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No. 1093/2010 {COM (2012) 280 final} {SWD (2012) 167 final}

⁷³ Basel Working Group named Cross-border Bank Resolution Group (CBRG) was set up in December 2007 for the purpose of studying the resolution of cross-border banks. It issued its report and recommendations in December 2009. Available at www.bis.org. The matter of bank recovery and resolution planning was, however, already under discussion even before 2007. By way of example, consider the United States with the "resolution arrangements" of the Dodd-Frank Act. In Europe as well, some Member States (UK, Spain, Germany, Sweden) have adopted bank recovery and resolution systems comparable to the one which European institutions intend to approve. See also GUYNN, *Are bailouts inevitable?*, 2012, 29 Yale Journal on Regulation, p. 121-154.

The Commission's proposal was based on the recommendations of the Financial Stability Board (FSB), which were approved by the G20 in 2011⁷⁴ and aims to approve common European standards to manage and "solve" the crises of entities operating in the banking and financial market ("all credit institutions" and "certain investment firms")⁷⁵. In addition to a set of harmonised rules, the objective of the European legislator is to create a mechanism for enhanced co-operation among member States which will allow the recovery and the resolution of banks to be financed – and this is the first fundamental innovation – by funds set up by the banks themselves.

Moreover, the RRP directive intervenes on a issue – bank insolvency – which is poorly harmonised at European level. In fact, the legal systems of the member States regulate the matter in very diverse ways. Indeed, the insolvency (or quasi-insolvency) procedures adopted by the single member States are very different with respect to timing, nature (e.g. whether they are court-led or take place as out-of-court settlements) and, in general, applicable provisions.

Sometimes the differences regard the type of entity in a state of insolvency: the procedures and methods of managing the crises of economic operators are often different from those affecting individuals (e.g. in most countries the insolvency of commercial companies is tackled differently from the procedure that applies to natural persons). Furthermore, some jurisdictions, such as

⁷⁴ Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, 2011, available at www.financialstabilityboard.org. The lack of a bank resolution system had already been stressed in The high level group on financial supervision in the EU – Report, 25 February 2009, ec.europa.eu: "*The lack of consistent crisis management and resolution tools across the Single Market places Europe at a disadvantage vis-à-vis the US and these issues should be addressed by the adoption at EU level of adequate measures*".

⁷⁵ The scope of the proposal is identical to that of the Capital Requirements Directive (CRD), which harmonised banking legislation and introduced the Basel II framework in the EU. Although the preliminary discussions related only to banks, certain investment firms needed to be included in the framework, as the recent crisis showed that their failure could have serious systemic consequences.

Italy, provide specific insolvency or pre-insolvency procedures for specific types of entities that carry on specific types of economic activities (for example, in the Italian case, the traditional insolvency procedure “*fallimento*” does not apply to banks, which in case of insolvency undergo a different procedure named “*liquidazione coatta amministrativa*”).

In light of these national peculiarities, the current European insolvency regulatory framework is rather poor and, in any case, deeply fragmented. Moreover, this fragmentation has certainly not been superseded by the existing provisions of Regulation (EC) No. 1346/2000 establishing a common framework for insolvency proceedings in the EU or by Directive 2001/24/EC⁷⁶ on the reorganisation and winding up of credit institutions, which basically maintained the exclusive competence of the member State of origin in respect of the bankruptcy of banks (and insurance companies). The only really supranational tool currently in force is linked to certain well-known EU law principles, since previously-implemented directives have established the need for mutual recognition by the member States of winding-up proceedings and of their effects in the European Union.

Like the proposals on the deposit guarantee scheme and on the SSM, the need for action in the field of bank crises and insolvency is further justified by recent experience. In particular, the proposed harmonisation of the rules on recovery and resolution of banks is based on the idea of establishing a EU common framework that will enable national authorities to use consistent tools to manage the crises of banks and large financial intermediaries, especially in cases in which the crisis may have adverse cross border effects. There can be no

⁷⁶ Directive 2001/24/EC of the European Parliament and the Council of 4 April 2001 on the Reorganisation and winding-up of credit institutions (OJ L 125, 5.5.2001); Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the Reorganisation and winding-up of insurance Undertakings (OJ L 110, 20.4.2001).

doubt that since 2007, the crises of some major banking groups have had a negative impact on the public finances of many member States. The lack of adequate tools to prevent and manage banking crises has forced several member States to bail out certain credit institutions and investment firms (in accordance with to the “too big to fail” principle) in order to stem the liquidity crises arising from their excessive exposure to debt. The use of public financial resources – the preparatory documentation of the Directive refers to the costs borne by “taxpayers”⁷⁷ – has long been justified by the fact that the failure of large banks and financial intermediaries could have caused significant systemic damage to the financial system as a whole. For this reason, in many cases, member States had no other choice but to finance bank bailouts by using taxpayers’ money. The proposal for a Directive on banks’ recovery and resolution plans represents the main response to this issue. The European institutions have essentially proposed the establishment of a mechanism that would allow the competent authorities of the member States, in collaboration with the European level authorities (which will be the EBA⁷⁸, but which according to initial proposals could have been a “European Deposit Insurance and Resolution Authority” entitled to manage the deposits guarantee scheme), to jointly carry out resolution tasks. The

⁷⁷ The Commission staff working document - Summary of the impact assessment accompanying the Proposal for a Directive COD 2012/0150 states that: *“Between October 2008 and October 2011, the Commission approved € 4.5 trillion (equivalent to 37 % of EU GDP) in state aid measures to financial institutions, of which € 1.6 trillion (equivalent to 13 % of EU GDP) was used in 2008-2010. Guarantees and liquidity measures account for € 1.2 trillion, or roughly 9.8 % of EU GDP. The remainder went towards recapitalisation and impaired assets measures amounting to € 409 billion (3.3 % of EU GDP). Budgetary commitments and expenditure on this scale are not sustainable from a fiscal point of view, and impose a heavy burden on present and future generations. Moreover, the crisis, which started in the financial sector, pushed the EU economy into a severe recession, with the EU’s GDP contracting by 4.2 %, or €0.7 trillion, in 2009”.*

⁷⁸ On 11 March, the EBA launched a consultation on Draft Regulatory Technical Standards (RTS) on the content of recovery plans. In doing so, the EBA has started the preparatory work for the implementation of the Recovery and Resolution Plan Directive (RRP) currently being discussed by the EU legislators.

RRP proposal assigns specific powers to national and European authorities thereby providing a proper legal framework that would prevent banking crises and manage any crises which prove to be inevitable. As regards the national level, according to a well-established legislative technique, the Directive does not specify which entity should be identified as the “resolution authority”: each member State will, therefore, be free to designate the national central bank or another supervisory authority.

This is an important choice which requires member States to assess whether it is more efficient to assign the power of resolving bank crises to the same entity that is responsible for the supervision of banks or if it is more convenient to set up an *ad hoc* resolution authority. In fact, in the event that supervision and resolution were allocated to the same authority, this would generate an “economy of scale” which would enable the competent authority to have a complete picture of the situation of the banks subject to its supervision. On the other hand, however, in the absence of adequate measures of internal organisation, the supervisor’s power - and thus its use of significant margins of discretion - might prove to be too broad and pervasive. It is worth noting that both choices have recently been applied in practice. In particular, the UK Banking Act 2009 created a Special Resolution Regime (SRR) which gave the Bank of England a leading role in implementing bank crisis resolution⁷⁹ while in the United States the resolution authority is separate from the central bank (as resolution powers are granted to the Federal Deposit Insurance Corporation or FDIC).

⁷⁹ Although SRR powers are exercised by a “Special Resolution Unit”, the power is essentially attributed to the Bank of England. The SRR powers allow the authorities to: transfer all or part of a bank’s business; transfer all or part of a bank’s property to a bridge bank - a subsidiary of the Bank of England – pending a future sale; place a bank into temporary public ownership; apply to put a bank into the bank insolvency procedure; apply for the use of the bank administration procedure to deal with a part of a bank that is not transferred and is instead put into administration.

This issue must also be taken into account in relation to the cross competences that will arise from the implementation of the RRP. Once the SSM has entered into force, the ECB will have the power to revoke banking licenses and authorisations: this power is likely to be exercised in conjunction with the resolution powers that will be granted to the EBA. The coordination of these powers, and the possibility that in the future an *ad hoc* resolution authority will be established, leave some unresolved issues which might need to be expressly regulated by the European institutions⁸⁰.

In addition to granting new powers to the EBA and providing criteria for identifying national resolution authorities, the RRP – subject to last minute amendments – will provide supervisors with powers that will allow them to adopt three main categories of measures: (a) preparatory steps and plans to minimise the risks of potential problems (preparation and prevention tools); (b) powers to stop a bank's deteriorating situation at an early stage in order to prevent insolvency (early intervention powers); and (c) measures for bank crisis resolution (resolution tools).

Appropriately, the European legislator starts with crisis prevention. The RRP proposal outlines a system of “preparation and prevention” measures regulated by articles 3 to 13 of the version about to be approved⁸¹.

To that end, as mentioned, the first objective of the bank recovery and resolution framework will require member States to confer resolution powers on one or more administrative authorities to ensure that the objectives of the RRP framework “*can be delivered in a timely manner*”⁸². In order to guarantee

⁸⁰ See FERRAN - BABIS, *The European Single Supervisory Mechanism*, University of Cambridge Faculty of Law Research Paper No. 10/2013, p. 8. Available at ssrn.com or dx.doi.org

⁸¹ See COM (2012) 280

⁸² See COM (2012) 280, *Detailed explanation of the proposal*, p. 9.

the prevention of bank failures both national authorities and banks must be prepared in advance to manage possible adverse developments.

With specific regard to the prevention and preparatory measures to be taken by the national authorities, the proposal specifies that the latter should be granted suitable tools so that they may carry out their role of preventing banking crises in a timely and flexible manner. This implies the provision of sufficient resources which will have to be collected in special funds created by the banks themselves in order to minimise the taxpayer's exposure to their potential losses⁸³. The resolution funding mechanism is regulated by articles 90 to 99 of the proposal, which lay down rules involving a combination of *ex ante* and *ex post* contributions which are supplemented, where needed, by borrowing facilities from financial institutions or the central bank. With regard to the preparatory measures in the strict meaning of the term, the European Commission has established a framework (articles 3 to 12) which provides that banks, certain investment firms and groups have an obligation to draw up and maintain a recovery plan⁸⁴ and a resolution plan⁸⁵.

Recovery plans are documents that will be prepared – and constantly updated – by the banks and the investment firms subject to the application of the CRD. These plans will provide for measures that may be taken by the relevant bank or firm to restore their financial position following a “significant deterioration”. As regards the legal nature of recovery plans, the RRP proposal states that

⁸³ According to documentation accompanying the proposal: *“In order to ensure that some funds are available at all times, and given the pro-cyclicality associated with ex post funding, a minimum target fund level is set, to be reached through ex ante contributions in a time span of 10 years. Based on model-calculation, an optimal minimum target fund level is set at 1% of covered deposits.”*

⁸⁴ As provided for in Articles 5(1) and 7(1).

⁸⁵ As provided for in Articles 9(1) and 11(1).

they shall be considered as “governance arrangements”⁸⁶ and, therefore, as tools that will be part of the traditional set of corporate governance tools without fully coinciding with the latter. This approach suggests that recovery plans will be drafted during the "physiological" course of a bank's business, which must take into account all possible measures to cope with potential future crises and, therefore, provide measures to manage possible "pathological" periods in its business.

However, it is not entirely clear when exactly the measures envisaged by a recovery plan must be implemented. The RRP proposal refers to the concept of "significant deterioration" of the financial situation of a bank or firm. The lack of any further definition of the concept of significant deterioration is noteworthy: the Commission has probably steered clear of any strict definitions to prevent problems of coordination with the traditional definitions of insolvency (or pre-insolvency status) used in the member States. Indeed, the exact moment in which an insolvency status arises is defined differently at a national level⁸⁷ and an excessively detailed definition of “significant deterioration” would have prevented national legislators from implementing the RRP's provisions in a sound and rational manner.

⁸⁶ For the meaning of this expression see Article 22 of Directive 2006/48/EC: “1. Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures. 2. The arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and proportionate to the nature, scale and complexity of the credit institution's activities...”.

⁸⁷ The phenomenon is diversely described in the legal systems of the member States. By way of example, reference can be made to the Italian concepts of “insolvenza” and “sovraindebitamento”, or to the various stages of the concept of insolvency in German law (insolvency or “Zahlungsunfähigkeit” under article 17 of InsO, the danger of insolvency or “Drohende Zahlungsunfähigkeit” under article 18 of InsO and excessive indebtedness or “Überschuldung” under article 19 of InsO).

The proposed Directive also includes detailed "*information to be included in recovery plans*", which is listed in Section A of the annex to the proposal. This constitutes the minimum content⁸⁸ of the plan, which must include a series of measures ranging from the "*...key elements of the plan, strategic analysis, and summary of overall recovery capacity*" to the "*...measures necessary to maintain the continuous functioning of the institution's operational processes...*", taking into account delicate aspects such as the possible "*...arrangements to facilitate the sale of assets*".

⁸⁸ The recovery plan will include the following information: "(1) A summary of the key elements of the plan, strategic analysis, and summary of overall recovery capacity; (2) a summary of the material changes to the institution since the most recently filed recovery plan; (3) a communication and disclosure plan outlining how the firm intends to manage any potentially negative market reactions; (4) a range of capital and liquidity actions required to maintain operations of, and funding for, the institution's critical functions and business lines; (5) an estimation of the timeframe for executing each material aspect of the plan; (6) a detailed description of any material impediment to the effective and timely execution of the plan, including consideration of impact on the rest of the group, customers and counterparties; (7) identification of critical functions; (8) a detailed description of the processes for determining the value and marketability of the core business lines, operations and assets of the institution; (9) a detailed description of how recovery planning is integrated into the corporate governance structure of the institution as well as the policies and procedures governing the approval of the recovery plan and identification of the persons in the organisation responsible for preparing and implementing the plan; (10) arrangements and measures to conserve or restore the institution's own funds; (11) arrangements and measures to ensure that the institution has adequate access to contingency funding sources, including potential liquidity sources, an assessment of available collateral and an assessment of the possibility to transfer liquidity across group entities and business lines, to ensure that it can carry on its operations and meet its obligations as they fall due; (12) arrangements and measures to reduce risk and leverage; (13) arrangements and measures to restructure liabilities; (14) arrangements and measures to restructure business lines; (15) arrangements and measures necessary to maintain continuous access to financial markets infrastructures; (16) arrangements and measures necessary to maintain the continuous functioning of the institution's operational processes, including infrastructure and IT services; (17) preparatory arrangements to facilitate the sale of assets or business lines in a timeframe appropriate for the restoration of financial soundness; (18) other management actions or strategies to restore financial soundness and the anticipated financial effect of those actions or strategies; (19) preparatory measures that the institution has taken or plans to take in order to facilitate the implementation of the recovery plan, including those necessary to enable the timely recapitalisation of the institution".

Recovery plans run the risk of becoming very long and complex documents, a circumstance that will require significant standardisation by the banks' management, advisers and the national authorities. In particular, the latter will play a fundamental role as the proposed Directive provides that competent national authorities have to review recovery plans and assess whether each plan meets the requirements set out in the Directive according to the following criteria: *“(a) the implementation of the arrangements proposed in the plan is reasonably likely to maintain or restore the viability and financial position of the institution or of the group, taking into account the preparatory measures that the institution has taken or has planned to take; (b) the plan and specific options within the plan are reasonably likely to be implemented effectively in situations of financial stress and without causing any significant adverse effect on the financial system, including in the event that other institutions implemented recovery plans within the same time period”*.

National authorities will also have the responsibility of assessing if there are “material deficiencies” in a recovery plan, or potential impediments to its implementation. If that is the case, they will have to notify the relevant bank or firm (or group) and ask it to submit, within three months, a revised recovery plan demonstrating how these deficiencies or impediments have been addressed. This is just an example of the noteworthy powers which will be granted to national authorities. However, with great powers comes great responsibility and there is a risk that the power to assess recovery plans may give rise to liability in the event of negligent evaluation⁸⁹.

Resolution plans are documents drafted by the national authorities for each bank or firm (that is not part of a group subject to consolidated supervision

⁸⁹ Moreover, the EBA is required to draft technical standards within twelve months of the date of entry into force of the RRP Directive. It is expected to enter into force by the end of 2013.

pursuant to articles 125 and 126 of Directive 2006/48/EC) which enable any measures to be taken more quickly, more efficiently and more effectively, with the aim of reducing or limiting the costs of a bank failure. These plans must take into account a wide range of scenarios including *“that the event of failure may be idiosyncratic or may occur at a time of broader financial instability or system wide events”* (article 9). Once drafted, resolution plans must be reviewed and updated at least once a year and following any changes in the business of the relevant bank or firm that could require amendments to the plans. As regards the contents of these documents, the draft RRP directive lists the information that has to be included⁹⁰, all of which relates to the resolution of banks (tending

⁹⁰ The resolution plan will set out options for applying the resolution tools and resolution powers referred to in Title IV to the institution. It will include: *“(a) a summary of the key elements of the plan; (b) a summary of the material changes to the institution that have occurred after the latest resolution information was filed; (c) a demonstration of how critical functions and core business lines could be legally and economically separated, to the extent necessary, from other functions so as to ensure continuity upon the failure of the institution; (d) an estimation of the timeframe for executing each material aspect of the plan; (e) a detailed description of the assessment of resolvability carried out in accordance with paragraph 2b and Article 13; (f) a description of any measures required pursuant to Article 14 to address or remove impediments to resolvability identified as a result of the assessment carried out in accordance with Article 13; (g) a description of the processes for determining the value and marketability of the critical functions, core business lines and assets of the institution; (h) a detailed description of the arrangements for ensuring that the information required pursuant to Article 10 is up to date and at the disposal of the resolution authorities at all times; (i) an explanation by the resolution authority as to how the resolution options could be financed without the assumption of any extraordinary public financial support; (j) a detailed description of the different resolution strategies that could be applied according to the different possible scenarios; (k) a description of critical interdependencies; (l) an analysis of the impact of the plan on other institutions within the group; (m) a description of options for preserving access to payments and clearing services and other infrastructures; (n) a plan for communicating with the media and the public; (na) the minimum requirement for own funds and eligible liabilities required pursuant to Article 39(1) and a deadline to reach that level, where applicable; (naa) where applicable, the minimum requirement for own funds and contractual bail-in instruments pursuant to Article 39(1), and a deadline to reach that level, where applicable; (nb) a description of essential operations and systems for maintaining the continuous functioning of the institution’s operational processes; (nc) and a description of the impact on employees of implementing the plan, including an assessment of any associated costs”*.

to avoid social costs, on the one hand, and preserve financial stability on the other).

The singularity of these plans lies in the balancing of the different and conflicting interests that usually arise from the crisis of large banks: the interest of the entity and its shareholders, the creditors' interest and the general interest in safeguarding the soundness and the stability of the financial system. These plans will achieve this balance, which as recent experience has demonstrated is extremely difficult in practice, by minimizing the exposure of taxpayers - and therefore of public finance - to losses arising from the financial support given to failing banks.

As with the recovery plans, the resolution plans must be drawn up during the ordinary course of business of the relevant bank or firm by the competent national authority (i.e. the resolution authority, in cooperation with the bank supervisor where the two entities do not coincide) and has to contain all possible options for the resolution of crises, including by considering various scenarios and taking into account measures that will limit the spread of systemic risk.

Significantly, when drafting such plans, the resolution authority will be allowed to influence the organisation of banks and firms: in the event that a major impediment to the resolution of the crisis of an entity or of a group is detected by the authority, it will be entitled to impose on the relevant bank or firm the obligation to adopt appropriate measures to facilitate the resolution of the crisis (articles from 14 to 16). To that end, the national authority may even ask a bank, *inter alia*, to make changes to its legal or operational structure or to ensure that certain functions are separated from other functions. It is a fact that these powers and other similar powers contained in the RRP directive will allow national authorities to have a profound influence on the business of a bank including by modifying its business organisation.

As with the recovery plans, the EBA will have to draft and develop technical standards to ensure that the envisaged rules are applied consistently in all European member States.

Furthermore, a preventive tool of particular note is the “*voluntary intra-group financial support agreement*”, which will enable financial groups to transfer assets between entities when one member of a group suffers financial difficulties. According to the RRP proposal, these agreements must also, under certain circumstances, be submitted to the national authorities for verification and to shareholders for approval. This tool is interesting because it represents the “codification” of an existing practice that has always posed problems of coordination among the member States’ legal systems as they regulate the delicate matter of intercompany loans in different ways⁹¹.

Early intervention powers are intervention tools that will be granted to national authorities in order to prevent and correct the financial problems of banks and firms and to safeguard the effectiveness of crisis management. Among the powers that will be conferred upon the authorities, apart from the possibility to adopt a large variety of minor corrective measures, will be the possibility to appoint a special manager to stop the mismanagement of banks and to implement the identified corrective measures.

The authoritative power to appoint managers to replace bank directors in all European legal systems and is quite familiar to many European countries, in particular to Italy where there is a similar administrative procedure (*amministrazione straordinaria*) that applies to Italian banks and is regulated by the Italian Consolidated Law on Banking.

⁹¹ The issue concerns the interpretation of the legal nature of the intercompany loans, which is not consistent across Europe. A recent ruling in the UK has determined that such intra-group debts are not considered loan relationship *MJP Media Services Ltd v. Commissioners for HMRC*, No. A3/2011/2831 (UK Ct. App November 28, 2012), other jurisdictions have a completely different approach towards the matter.

In cases in which such measures prove to be insufficient and the deteriorated financial situation of a bank is verging on irreversible insolvency, the resolution authorities will have access to wide-ranging resolution powers. The RRP Directive proposal provides that the national authorities will be entitled to exercise voting rights in lieu of the shareholders, take control of the management body and even proceed with the transfer of the business of banks and firms.

Under articles from 31 to 64, the RRP Directive lists and describes these “*resolution tools and powers*”. The major resolution tools are defined as follows: the “sale of business tool”, the “bridge bank tool”, the “asset separation tool” and the “bail-in tool”.

The “sale of business tool” confers upon resolution authorities the possibility to sell banks and firms as a whole, but also a part thereof (single assets and/or liabilities) without previously requesting the shareholders’ consent. The “bridge bank (or institution) tool”, will allow the creation of a company wholly owned by one or more public authorities whose purpose will be to temporarily carry out the business and subsequently to sell the latter as soon as market conditions so allow. The purpose of the “asset separation tool” will be to grant resolution authorities the power to transfer only “certain” assets to a specific purpose vehicle so that assets and liability are separated and at least part of the business of the failed bank can be placed on the market again.

The most significant measure, however, is certainly the “bail in tool”, an instrument that will allow the resolution authorities to convert the debts of banks into equity. This is an extreme measure which presents risks of conflicts with the statutory principles of many European member States. The rationale of this tool is that bank losses should be borne by shareholders and creditors and not by taxpayers. Although, as a matter of principle, this approach appears to be correct, it cannot be denied that the decision to impose losses on shareholders

and to turn creditors into shareholders without their consent is likely to give rise problems that will not be easily treated and resolved. Once again, the EBA will play an important role through the preparation of guidelines and technical standards. In this case, the EBA will have to take care when addressing problems arising from the use of any particular resolution tool in the case of cross-border crises, especially since it is the EBA that will handle any potential controversies between banks and supervisors in its role as binding mediator.

Another important aspect concerns the role of the European Commission in the banking resolution process. Like the ESAs, the EU level resolution authorities (the EBA or the different Resolution Authority to be established) are not “institutions” of the EU under the Treaties and, within the current legal framework, are not entitled to decide on matters related to the resolution of a bank. In this respect, the Commission has suggested that the power to issue decisions on bank crisis resolution lies with the Commission itself (although any such a decision would be taken following the input of the Single Resolution Authority, which in the event of future amendments to the Treaties may be turned into a EU institution). If that is the case, in the event of a bank crisis that triggers a resolution, the SRM should work as follows: (I) the ECB notifies the Single Resolution Authority, the Commission and the national level authorities that a bank is failing; (II) the Single Resolution Authority carries out the required assessments and proposes the measures to be adopted to the Commission; (III) the Commission adopts the relevant decision and assigns the powers to execute it to the Single Resolution Authority .

The above mentioned framework will have to be properly coordinated with the national statutory provision. For that reason, the Directive will gradual-

ly introduce these new provisions to national legislations⁹². Meanwhile, member States will have to study adequate solutions to solve the problems of coordination of the RRP framework with the parts of the national laws which will be affected by the implementation of the directive, especially bankruptcy and corporate law. From a corporate perspective, the impact of some resolution tools and powers on shareholders' (and creditors') rights is of great interest and raises great concerns⁹³. As regards shareholders, the issue is how and to what extent a bank crisis can determine such a strong limitation of their administrative and property rights. Furthermore, the issue is complicated by the fact that the decision to use a specific resolution power will be made by public authorities in pursuit of the general interest (the stability of the financial system) disregarding the individual interest of the specific investor. Although financial stability may be considered a higher value than individual interests, from a constitutional law standpoint this matter may become critical. As for the creditors, the issue is even more complex, because the use of the resolution tools (in particular the above mentioned bail-in tool) involves the transformation of a stakeholder linked to a bank on the basis of a credit-debt relationship into an "investor" against his will and without any previous consent.

⁹² The implementation, according to the proposal, will take place progressively: the most of the Directive is to be transposed by 1 January 2015, while the bail-in mechanism will be introduced on 1 January 2018.

⁹³ See BABIS, *Bank Recovery and Resolution: What About Shareholder Rights?*, University of Cambridge Faculty of Law Research Paper No. 23/2012, September 6, 2012. Available at ssrn.com and dx.doi.org and HÜPKES, *Special bank resolution and shareholders' rights: balancing competing interests*, *Journal of Financial Regulation and Compliance*, 2009, 17, p. 282.

THE NEW INSTITUTIONAL STRUCTURE OF EBA

*Vincenzo Troiano**

ABSTRACT: In September 2012 the European Commission passed two proposals for regulations aimed, overall, at assigning to the ECB tasks and responsibilities of prudential supervision over credit institutions in the context of a newly instituted single supervisory mechanism, and at making certain consequent amendments to the regulation which established the EBA. The paper analyzes the initiatives of the European Commission as well as their subsequent amendments from the standpoint of EBA's role and functions and of the organizational complex to which it belongs (the ESFS), evaluating how the overall structure envisaged just a few years ago with the creation of the three sector-specific EU regulatory authorities will change with respect to the banking sector and what the substantive role of the EBA may be going forward under the new regulatory framework.

SUMMARY: 1. Introduction. - 2. EBA and ESFS under their current structure. – 3. Current trends and state of the art. 4. Matters for analysis: overall structure, objectives pursued, instruments, governance. 5. Conclusions.

1. The two proposals for regulations adopted by the European Commission in September 2012 – the first of which is aimed at assigning to the ECB (with reference to the Euro area) tasks and responsibilities of prudential supervision over credit institutions in the context of a newly instituted single supervi-

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sory mechanism¹, and the second of which is aimed at making certain consequent amendments to the regulation which established the EBA² – constitute steps in a broader process geared toward ultimately achieving a true economic and monetary union, in this case deepening the internal market for banking services. The driving force underlying this new structure is, *inter alia*, the need to attenuate the link between the solidity of credit institutions and the state in which they are established³.

These initiatives, if analyzed from a standpoint of the role and functions of the EBA and the organizational complex to which it belongs (the European System of Financial Supervision or a segment of such system concerning the banking system), allow us to analyze how the overall structure envisaged just a few years ago with the creation of the three sector-specific EU regulatory authorities will change with respect to the banking sector, and not only from just a purely formal standpoint. More specifically, such initiatives allow us to examine

¹ See EUROPEAN COMMISSION, *Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*, Brussels, 12.9.2012, COM(2012) 511 final.

² See EUROPEAN 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*, Brussels, 12.9.2012, COM(2012) 512 final.

³ In such regard, whereas no. 5 of the Commission's Proposal COM(2012) 511 final, expressly indicates that "[t]he solidity of credit institutions is in many instances still closely linked to the Member State in which they are established. Doubts about the sustainability of public debt, economic growth prospects, and the viability of credit institutions have been creating negative, mutually reinforcing market trends. This may lead to risks for the viability of some credit institutions as well as for the stability of the financial system, and may impose a heavy burden for already strained public finances of the Member States concerned. The problem poses specific risks within the euro area where the single currency increases the likelihood that negative developments in one Member State can create risks for economic development and the stability of the Euro area as a whole". See, CAPRIGLIONE and SEMERARO, *Financial crisis and sovereign debt. The European Union between risks and opportunities*, available at ssrn.com

what the substantive role of the EBA may be going forward under the new regulatory framework⁴.

In this paper, I will briefly touch upon the features characterizing the system currently in force, and then will move onward to consider separately, on matters relevant to this discussion, the proposed changes to the current institutional structure of the EBA and attempt to formulate a few initial summary considerations on the system now under development.

This analysis has been conducted on the basis of the documents issued in May 2013, which set forth the amendments to the texts published by the Commission and approved by the European Parliament as part of their respective legislative procedures (the ordinary one with regard to the draft regulation on the EBA and the special one with regard to the draft regulation on the ECB)⁵.

2. As we all know, starting on 1 January 2011, the top-level organization of the European financial system is structured through three supervisory authorities – which were established through the adoption of separate Regulations which are very similar in wording – in charge of, respectively, the banking sector (the EBA), financial markets and instruments (the ESMA), insurance and

⁴ See in the scholarly doctrine, with reference to the abovementioned Commission's proposals, WYMEERSCH, *The European Banking Union, a First Analysis*, in *Financial Law Institute Working Paper Series*, WP 2012-07, available at ssrn.com; FERRAN and BABIS, *The European Single Supervisory Mechanism*, in *University of Cambridge Legal Studies Research Paper Series*, No. 10/2013, available at ssrn.com

⁵ The reference is to the documents of the European Parliament setting forth: *Amendments adopted by the European Parliament on 22 May 2013 on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions* (PT_TA(2013)0213) and *Amendments adopted by the European Parliament on 22 May 2013 on the 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* (PT_TA(2013)0212).

occupational pensions (the EIOPA)⁶. Such authorities are sided by the European Systemic Risk Board (the ESRB) which has been entrusted macro-prudential supervisory tasks. The authorities and the ESRB comprise, together with the member states' supervisory authorities, the European System of Financial Supervision (ESFS). The latter is in charge of ensuring that the provisions applicable to the sector are implemented adequately and are capable of preserving stability and trust in the entire financial system, while ensuring the sufficient protection of consumers of such services⁷.

The overall approach, which also draws upon the results of the Larosière report issued in 2009, distinguishes between macro-prudential supervision and micro-prudential supervision, assigning only the latter to the three newly established authorities for the individual sectors; it distinguishes regulation from supervision over financial institutions, the latter remaining entirely entrusted to the national authorities.

Consequently, a model is developed that is a network-based structure or, if you prefer, a system of networks, underscoring the three sector-specific segments identifiable within the ESFS, respectively, for banks, finance and insurance, built on a nexus linking the three specialized European agencies and their respective competent national authorities⁸.

⁶ The reference is to, respectively, Regulation (EU) no. 1093/2010 of 24 November 2010, whereby the European Banking Authority was established; Regulation (EU) no. 1095/2010 of 24 November 2010, whereby the European Securities and Markets Authority was established; Regulation (EU) no. 1094/2010 of 24 November 2010, whereby the European Insurance and Occupational Pensions Authority was established.

⁷ In the scholarly doctrine, see, among others, WYMEERSCH, *The reforms of the European financial supervisory system - an overview*, in *European Company and Financial Law Review*, Volume 7, July 2010; PELLEGRINI, *L'architettura di vertice dell'ordinamento finanziario europeo: funzioni e limiti della supervisione*, in *RTDE*, no. 2/2012, p. 2 et seq.

⁸ See GUARRACINO, *Supervisione bancaria, europea. Sistema delle fonti e modelli teorici*, Padua, 2012, p. 34 ff.

The integration, effectiveness and, more generally, the successful outcome of the envisaged structure, is based upon the principle of fair and loyal cooperation between the authorities in question, which is specifically highlighted in the Regulations. Such regulations specify that the parties taking part in the ESFS must cooperate with full mutual trust and respect, specifically with a view to ensuring an exchange of useful and reliable information⁹.

As part of the general objectives assigned to the ESFS, the action on the part of the European Authorities (and therefore the EBA) – has the goal of *protecting the public interest*, contributing toward ensuring short-term, medium-term and long-term stability of the financial system, for the benefit of the European Union's economy, its citizens and its businesses.

The Authorities' objectives are focusing on certain key areas: (I) improving the *functioning of the internal market*, with the aim of attaining a level of *regulation and supervision* that is appropriate, effective and uniform; (II) ensuring the *integrity, transparency, efficiency and proper functioning of the markets*; (III) reinforcing the *international coordination* on matters of regulatory oversight; (IV) boosting the protection of *consumers*.

Functions and tools attributed to the Authority as well as *governance* rules are instrumental to these goals.

As regards functions and tools, *regulation* (which consist in the power to develop draft regulatory technical standards and implementing technical standards), *guidance and recommendations* (which consist in the issue of guidelines and recommendations), and *decision-making* functions (e.g., interventions in emergency situations and resolution of controversies between European authorities in cross-border situations) as well as the more general tasks of collaboration, coordination and control, are of particular relevance.

⁹ See on the banking sector art. 2, par. 4, Regulation (EU) no. 1093/2010.

Governance as well, which is essentially articulated on the Board of Supervisors, the Management Board and the Chairman, takes on an operational and functional role within the overall plan under discussion¹⁰. In particular, with regard to the Board of Supervisors, composition of the board and decision-making mechanisms would suggest a model which, essentially, envisages a prominent position, in a condition of almost equality basis, held by the heads of all of the national public authorities competent for the supervision of credit institutions in each member state. The principle of a simple majority is replaced by that of qualified majority (as defined in the EU Treaty in art. 16.4 and in the transitional provisions) for decisions of key importance, such as, for example, on the matter of regulatory and implementing technical standards, guidelines and recommendations, powers of intervention; situations in which minorities would have a blocking power are limited¹¹. The *independence* principle, which calls for the objective pursuit of the exclusive interest of the Union considered as a

¹⁰ The EBA's *Board of Supervisors* is composed of (I) the head of the national public authority competent for the sector in each member state, and of (II) a Chairman (appointed by the Board of Supervisors), a representative of the Commission, a representative of the ECB, a representative of the ESRB and one representative for each of the other two European supervisory authorities. Voting rights rest only with the members under point (I). The Board of Supervisors makes all *decisions* and issues the *opinions*, on matters for which the Authority exercises responsibilities and powers, in accordance with the provisions of chapter II of the relevant regulation.

The *Management Board* of the Authorities is comprised, in turn, of a Chairman and six members appointed from voting members of the Board of Supervisors. It is expressly envisaged that the composition of the Management Board must be *balanced and proportionate*, and must reflect the EU considered as a whole. The responsibilities of the Management Board range from matters concerning the Authority's financial statement matters to its personnel policies, and the preparation of its annual and long-term programs of works. It passes resolutions and makes its decisions with a majority vote on the part of members in attendance, with each member having only one vote.

¹¹ See on these points TROIANO, *Interactions between EU and National Authorities in the New Structure of EU Financial System Supervision*, in *Law and Economics Yearly Review*, no. 1/2012, p. 110 ff.

whole, is formally entrusted with the task of neutralizing the possible temptation to cultivate (or protect) national interests at the EU level.

Considered in its entirety, the regulatory framework set forth in the 2010 institutive sources – despite the terminology used: supervisory authority – does not assign to the European Authorities, and name EBA, functions of direct supervision over intermediaries, but rather tasks involving the development of the regulatory framework within the scope of which the actual performance of supervisory tasks will be envisaged; ensuring that they operate in accordance with uniform practices; discouraging any non-conforming actions in the application of EU law. As already mentioned, the supervisory functions continue to rest with the national authorities.

3. This is the picture, as originally envisaged. What has followed belongs to administrative praxis and financial chronicles: structural and operational reinforcement, the creation of more or less formalized links with national authorities; in the banking sector, the onerous performance of stress tests, and so forth.

As structured, the ESFS constitutes an intermediate step in the process aimed at identifying an optimal structure for regulation and supervision at European level.

The very same sources that have established the Authorities and the System clearly acknowledge this.

The EBA regulation like those of the other European supervisory authorities, contains a review clause pursuant to which upon the initial entry into force by January 2014 and then every three years, the Commission will have to publish a report on the effectiveness of the system put in place. The report will have to examine the level of convergence reached in regulatory supervisory practices

and whether it may be advisable to initiate prudential supervisory action and, if so, whether such action should be taken separately or through a single supervisory authority. A similar assessment should be made on whether or not to assign to the authorities in question tasks involving the direct supervision of pan-European institutions.

Over the brief time span of just a few years, evolutionary trends have emerged which would appear to change the internal symmetry of the structure of the ESFS (the three sector-specific areas; the European sector-specific authority; the micro-prudential supervision assigned entirely to the national authorities).

On the one hand, we have examples of expansion of prerogatives of certain of the authorities in question – reference is made to the ESMA – which have, in addition to regulatory-type responsibilities, direct supervisory tasks: this applies in the case of supervision over rating agencies¹² and with regard to trade repositories in the European Union¹³.

On another front, and this is the matter at hand for purposes of this paper, in the banking sector, we are witnessing a process of centralization of responsibilities on supervisory matters at the European level, giving rise to an architecture which we could refer to as “dual-hub”, with one hub concentrated within the EBA, for regulatory matters, and the other (at least as regards the Euro area) concentrated within the ECB, for micro-prudential supervisory matters. The EBA remains connected to national supervisory authorities, but the system

¹² See Regulation (EC) no. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, as amended by Regulation (EU) no. 513/2011 and by Regulation (EU) no. 462/2013.

¹³ See Regulation (EU) no. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

is more composite, since now an EU level institution is in place which is directly responsible for micro-prudential controls over credit institutions.

This change in the overall system must necessarily translate into a separate and distinct consideration of the banking sector with respect to the others, with a forward-looking approach envisaging the possible development and modification of the sources which established the three European supervisory agencies. Essentially, at the recent public hearing organized by the European Commission in view of the implementation of the 3-year review clause envisaged under the three regulations¹⁴, the discussions related to the banking sector focused in large part on the issue of the future relationship between the EBA and the ECB; and the foregoing concerns the management of their respective prerogatives and responsibilities (and possible overlapping of the same), as well as an analysis of the new mission which the European agency would effectively pursue under the new structure.

Going back to the set of legislative proposals presented by the European Commission last September, it is common knowledge that the transfer of banking supervisory tasks to the European level, is part of a broader scheme which, through the realization of a common system of deposit protection and an integrated European system for the management of banking crises, should reassure citizens and the markets of the fact that the prudential rules will be applied consistently for all banks and that banks facing difficulties will be restructured or closed, thereby minimizing costs for taxpayers¹⁵. The preparation of EC systems

¹⁴ See EUROPEAN COMMISSION, *Financial Supervision in the EU*, Public Hearing, 24 May, 2013, Brussels.

¹⁵ See CAPRIGLIONE, *Mercato Regole Democrazia. L'UEM tra euroscetticismo e identità nazionali*, Torino, 2013, p. 72 et seq.; PAVLOVA, *The Proposals for a Single Supervisory Mechanism for Banks in the Euro Area are an Important Step in Strengthening the Economic and Monetary Union*, January 2013, available at ssrn.com; VALIANTE, *Last Call for a Banking Union*

for rescuing enterprises in distress is tied to a prior centralization of supervisory and preventative activities¹⁶.

Under the new regulatory framework, from a forward-looking standpoint, the ECB is assigned – under the mechanism of a single supervisory mechanism – a broad range of tasks of control over credit institutions in the member states of the Euro zone. In this context and in order to avoid market fragmentation, it is necessary to ensure the proper functioning of the EBA, and to preserve its role so as to further develop the single body of rules and ensure convergence of supervisory practices throughout the European Union. The draft regulation concerning the EBA is aimed at introducing specific amendments to the contents of the act establishing the same, following the forward-looking approach referred to above.

During the legislative process, the Commission's proposal turned out to be broadly amended and supplemented. At present, as already mentioned, a text is available which incorporates the amendments approved by the European Parliament on 22 May 2013.

4. The regulatory framework under development may be examined from several different perspectives. For purposes of this paper, it may be advisable to bunch together certain considerations related to (I) the overall structure being developed; the implications with regard to (II) the objectives; (III) the instruments and (IV) the *governance* of the EBA.

in the Euro Area, August 2012, available at ssrn.com; MAYER, *A Copernican Turn for Banking Union*, in *Economic Policy, CEPS Policy Brief*, July 2013, available at www.ceps.be

¹⁶ See GUARRACINO, *Dal meccanismo di vigilanza unico (SSM) ai sistemi centralizzati di risoluzione delle crisi e di garanzia dei depositi: la progressiva europeizzazione del settore bancario*, in *RTDE*, no. 3/2012, p. 199.

As already mentioned, the EBA is essentially a regulatory agency and does not perform direct supervisory tasks. On the contrary, the ECB has been assigned direct tasks, in the forms envisaged under the regulation now under development, related to supervision over credit institutions.

Such distinction justifies the consideration that the single supervisory mechanism does not affect the EBA's current responsibilities¹⁷. Similarly, the fact that the EBA is not part of the single supervisory mechanism (which, under the definition given by the draft regulation on the ECB is a system of financial supervision comprised of the ECB and the national authorities in charge of supervision of credit institutions in the member states)¹⁸ is also justified through this over-arching distinction. On the other hand, the ECB, as a supervisory authority, will become a part of the ESFS and is qualified as a competent authority in the context of the draft regulation concerning the EBA¹⁹ (bearing in mind that it is currently a member of the Board of Supervisors within EBA).

As for the complementary nature and points of nexus linking the functions assigned to the EBA and the ECB, respectively, there certainly exist areas in which the distinctions between their respective roles and the various coordination modalities will call for particular attention: take, for example, the matter of stress tests, as well as the matter of international relations.

In any case, at the systemic level, the assignment of specific functions to the ECB on prudential supervision has been seen as a scheme which must not, in any way, pose an obstacle to the full realization of the internal financial services market. This leads to the need, which is stressed time and time again in the draft regulations, to maintain and even to reinforce all of the prerogatives and

¹⁷See (PT_TA (2013) 0212), whereas no. 4.

¹⁸ See (PT_TA (2013) 0213), art. 2, par. 1, n. 6-*quater*.

¹⁹ See (PT_TA (2013) 0212), art. 1, par. -1 *bis*.

tasks already assigned to the EBA with reference to all of the member states, in order to further ensure the integrity of the European Union and the thorough and proper functioning of the internal market²⁰.

As for the relationship that may be established between the regulatory and supervisory functions, this is certainly not the time or place to address in detail the matter of the distinctions and contiguities between the two components, especially if we drag along with us the conceptual schemes deriving from our national tradition which see in the so-called informative, inspective and regulatory supervision elements of a single set of instruments entrusted to the authority having supervisory functions²¹.

Certainly, in many cases, the developments in the regulations stem from the exercise of supervisory activities: this was the basis underlying the original structure of EBA's governance with the exponential role assigned to the heads of the national supervisory authorities within the Board of Supervisors. Within this system, the ECB's new role has a peculiar structure, through a provision set forth in the ECB draft regulation pursuant to which *if necessary*, the latter contributes, performing any participatory role, in the preparation of the draft regulatory and implementing technical standards by the EBA and may *request the latter to focus its attention* on the need to submit to the Commission drafts which amend the regulatory and implementing technical standards currently in force (which amounts to a sort of reporting power)²².

On another front, the separate areas of intervention assigned to the EBA and the ECB, respectively, are plain to see. The EBA enjoys a scope of intervention which spans the entire European Union (specifying that even the ECB will

²⁰ See (PT_TA (2013) 0212), whereas no. 4 octies.

²¹ See, in the scholarly doctrine, COSTI, *L'ordinamento bancario*, Bologna, p. 527 ff.

²² See (PT_TA (2013) 0213), art. 4, par. 3.

clearly have to comply with the acts and rulings issued by the EBA under the scope of its responsibilities)²³, since the ECB will exercise the prerogatives assigned to it under the draft regulation vis-à-vis credit institutions located in countries belonging to the Euro zone and those that will establish a close cooperation. Likewise, responsibilities on the regulation of the EBA will not be limited to prudential matters, since they may also concern any other matter falling under the scope of application of the sector-specific directives indicated in its institutive regulation.

The draft regulation does not set forth a new list of objectives of the EBA's action. It does, however, include in addition to the original list the task of preparing a European supervision handbook for credit institutions, aimed at identifying the best supervisory practices adopted in the territory of the European Union on the matter of methodologies and processes, so as to ensure compliance with a series of basic international and EU principles. The draft regulation on the EBA itself specifies that it must involve a non-binding text for the single national authorities (which, however, will have to use it) and which must not be limited to the exercise of prudent oversight. On the contrary, the use of the handbook should be considered a significant instrument in the assessment of the convergence of supervisory practices and for the *peer reviews* performed in accordance with the regulation itself²⁴. The matter of homogenization of regulatory practices and lasting albeit declining national discretionary powers constitutes a crucial aspect of the phase involving the actual realization of an integrated internal market: the preparation of a *handbook* of best practices and methodologies, albeit having the characteristics and limits referred to above with regard to the binding nature of the instrument, does indeed lean in the di-

²³ See (PT_TA (2013) 0212), art. 4, par. 3.

²⁴ See (PT_TA (2013) 0212), whereas 4 *quater*.

rection of a more incisive pursuit of the objective in question. From another standpoint, what will also need to be closely considered are the effects deriving from the co-existence of such new prerogative assigned to the EBA and the provisions pursuant to which the ECB may pass regulations, to the extent necessary to organize or specify the methods to be followed to perform the tasks assigned to it²⁵.

In addition to the objectives pursued by the EBA, as confirmed and supplemented, there is also an undeclared objective that is implicit within the entire structure: to create a regulatory system that is homogeneous among member states participating in and not participating in the single supervisory mechanism. The principle underlying the institution of the EBA, from the very outset, has been to contribute toward harmonizing supervisory policies and practices through the member states of the EU. The fact that certain member states have created a single supervisory mechanism does not, *per se*, change this objective (which still remains that of harmonizing supervisory policies within the EU) but effectively changes the methods to be followed in pursuing this goal, by grafting onto the convergence dynamics of the individual countries the convergence of blocks of countries (participating in as opposed to not participating in the single supervisory mechanism and among these, a pre-eminent position most certainly is attributable to the United Kingdom).

Therefore, without prejudice to the form, the unexpressed substance which marks the very function that may in the future constitute the most original contribution on the part of the EBA is precisely that of building a point of convergence and harmonization at the regulatory and methodological level in the exercise of functions, between these two aggregation hubs. Elements sup-

²⁵ See (PT_TA (2013) 0212), art. 4, par. 3.

porting this implicit objective may be found where it is indicated that the Authority, in exercising its functions, must operate in the interest of the *entire* European Union (underlining the term “entire”)²⁶; that no *group* of member states must be discriminated against as a market for financial services²⁷ and the Authority must fully take into account the various types of credit institutions, their different sizes and business models²⁸. Even the governance interventions to which we shall return later, may be construed from this perspective.

From this standpoint, we can also glean the potential future developments in the structure under consideration (this also emerges clearly from the transitional provisions of the draft regulation): the governance presumes the existence of blocks, and regulates it by taking a snapshot of the current and envisaged future structure; it presumes revisions depending upon the future development of the level of participation in the single supervisory mechanism²⁹.

It goes without saying that in a scenario in which we had uniform participation of countries in both the ESFS and the single supervisory mechanism, there would be implications at the level of the overall organization of the top-level European bodies.

Essentially, we see a fine-tuning, but not a supplementation of the instruments through which the authority pursues its objectives.

In this context, the promotion of homogeneity in data gathered by the various national authorities (referred to as “data collection”) plays a key role. This is an aspect that is not particularly stimulating from a standpoint of a system-wide analysis, but is of crucial importance with regard to the method and concrete feasibility of the objectives assigned to the EBA.

²⁶ See (PT_TA (2013) 0212), art. 1, par. -1.

²⁷ See (PT_TA (2013) 0212), whereas 10 *bis*.

²⁸ See (PT_TA (2013) 0212), art. 1, par. 1 *bis*.

²⁹ See (PT_TA (2013) 0212), art. 1, par. 8 *sexies*.

Indeed, any lack of homogeneity in the methods through which the authorities process requests for information originating from the EBA could constitute, at a substantive level, a harsh obstacle to the development of initiatives resting with the European authority, since it would undermine from the very outset the comparability of data and therefore the comparability of any assessment to be made on the basis of such data.

The draft regulation allows the EBA to request that the information be provided to it in predetermined formats and on comparable forms that have been approved by the Authority itself³⁰.

As already mentioned, the ESFS is based upon the principle of fair and loyal cooperation among its members (including the competent authorities, the ECB and the EBA) aimed at ensuring a mutual exchange of useful and reliable information.

The revision to the EBA regulation, in further expressing this principle, provides that information provided by the competent authorities must be accurate, consistent, complete and timely.

If, moreover, the information turn out not to be accurate or complete or not provided in a timely manner, the EBA may, under certain conditions, directly contact the financial institutions in question and, in such context, must receive collaboration on the part of the competent authorities involved (the same which had been initially under a duty to provide the information in question)³¹.

The revision of the governance mechanisms has been conceived as the fundamental instrument to maintain an internal operating an functional structure of the EBA in an institutional context which changes on account of the sim-

³⁰ See (PT_TA (2013) 0212), art. 1, par. 4.

³¹ See (PT_TA (2013) 0212), art. 1, par. 4.

ultaneous assignment to the ECB of the powers on the matter of prudential supervision of credit institutions.

Considered in their entirety, the proposed amendments tend to attribute relevance to the fact that some of the members states participate in a single supervisory mechanism and others do not.

With respect to the Management Board, changes are made concerning the composition of the board, while the rules of functioning and duties and responsibilities remain unchanged. It is envisaged that at least two members be representatives of states which do not take part in the single supervisory mechanism³². The criterion of balanced and proportionate composition of the body is specified through the introduction of minimum guaranteed quotas to *representatives* of certain countries. Evidently, the principle on functional independence that requires the members of the Management Board to act in a completely objective manner and in the exclusive interest of the European Union *as a whole* is not considered sufficient, and attention is focused on the substantive aspect of relationships of relative strength that can be established within the body.

As regards the Board of Supervisors, the proposed amendments concern the decision-making process and, in other words, the board's voting modalities while, essentially, the composition of the body is left untouched (as is the identification of the members holding voting rights), with the sole specification that the representative of the ECB – considering the institutional amendments concerning the latter – is appointed by the supervisory board of the ECB itself³³.

On this point, it should be noted that the original draft regulation on the ECB envisaged among the tasks assigned to the ECB the task of coordinating and

³² See (PT_TA (2013) 0212), art. 1, par. 8.

³³ See (PT_TA (2013) 0212), art. 1, par. 5 and 7.

expressing, on the matters referred to in the draft ECB regulation (and therefore prudential supervision), the common position of the representatives from competent authorities of the member states participating in the single supervisory mechanism within the Board of Supervisors of the EBA³⁴. This indication, which was also reflected in one of the whereas of the draft EBA regulation (no. 3), now appears to have been overcome.

However, the deletion of the provision leaves open the substantive issue underlying the same (and, in other words, the consistency of the positions of countries participating in the single supervisory mechanism) and which justified, at the substantive level, the revisions to the voting mechanisms³⁵. The general clause set forth in art. 5 of the draft ECB regulation assigns to the latter responsibility for the effective and consistent functioning of the single supervisory mechanism: this is a structural rule which can serve as a basis for pursuing the above-mentioned requests. The provision of the draft EBA regulation which, on the matter of the independence of the voting members of the Board of Supervisors, leaves intact the tasks assigned to the ECB, could be read in the same light³⁶.

The intervention in the decision-making process of the Board of Supervisors is based upon the consideration that the system currently in force (simple majority or qualified majority of the voting members, as the case may be) would not be entirely suitable, in the context that would arise with the creation of the single supervisory mechanism, to ensure that decisions made always reflect the interests of the EU considered in its entirety³⁷.

³⁴ See COM (2012) 511 final, art. 4, par. 1(l).

³⁵ See COM (2012) 511 final, report, p. 4.

³⁶ See (PT_TA (2013) 0212), art. 1, par. 6.

³⁷ See (PT_TA (2013) 0212), whereas no. 6.

The methods and the orientation of the intervention on decision-making mechanisms have certainly changed in the context of the legislative process which followed the Commission's submission of the draft regulation.

The original text of the proposal took into consideration only some of the matters for which the current regulation provides for decisions to be made with the simple majority mechanism and, in particular, situations involving breach of EU law and resolution of cross-border disputes pursuant to arts. 17 and 19 of the EBA regulation. For these situations, the preferred option – which would preserve the integrity of the internal market by avoiding, simultaneously, a risk of paralysis in decision-making processes - consisted in assigning decision-making responsibilities to the so-called independent group of experts (see below), providing that the decisions proposed by such group are considered passed when they are not rejected by a simple majority, with a vote on the part of at least three members that take part in the single supervisory mechanism and at least three members that do not take part in such mechanism³⁸.

The current text changes the above-described structure. As for decisions on matters related to the breach of EU law and mediation (those just mentioned above), a mechanism is established now which involves a “dual simple majority”, through which decisions by the group of independent experts are considered passed with a simple majority of both countries participating in the single supervisory mechanism and countries which do not participate in such mechanism³⁹.

The composition of the group of independent experts is also revisited significantly: in the structure most recently proposed, the body would be comprised of the chairman of the Board of Supervisors and another six members

³⁸ See COM (2012) 511 final, art. 1, par. 7.

³⁹ See (PT_TA (2013) 0212), art. 1, par. 7.

who are not representatives of competent authorities involved in the breach or the dispute in question⁴⁰.

However, the most important issue is that now the new structure would have an impact on the rules on decisions for which the regulation provides for the adoption of measures and decisions with a qualified majority⁴¹. For these situations, it is now envisaged that the above-mentioned qualified majority would have to include at least a majority of the countries taking part in the single supervisory mechanism and the majority of the countries which do not take part in such mechanism⁴².

It remains to be analyzed whether these complex voting mechanisms will actually be sufficient to enable the Authority to pass decisions that are put to it in a timely and effective manner, and therefore overcome the above-mentioned risk of paralysis.

What is certain for now is that the text pending approval provides for specific consequences in the event that the number of member states which do not take part in the single supervisory mechanism were to fall to four⁴³.

4. In conclusion, the draft regulations under discussion certainly create, in the banking sector, a peculiar governance structure as compared with the one currently in place for the remaining financial sectors, for which the ESFS had been conceived on a unitary basis.

The methods through which, in the new structure, the ECB's position will take action on the prior network-based structure of the banking segment of such system have not yet been thoroughly defined.

⁴⁰ See (PT_TA (2013) 0212), art. 1, par. 5.

⁴¹ See *supra*, paragraph. 2.

⁴² See (PT_TA (2013) 0212), art. 1, par. 7.

⁴³ See (PT_TA (2013) 0212), art. 1, par. 7 and 8 *sexies*.

Similarly, the lapse of the express assignment of a role coordinating the positions of countries participating in the single supervisory mechanism, which the Commission's original proposal assigned to the ECB, casts a different light on the very same changes to the governance mechanisms of the EBA.

From this perspective, the EBA's original functions are now coupled with an implicit objective consisting in guaranteeing (safeguarding differences in business models and characteristics of intermediaries operating throughout the EU) convergence and harmonization, at the regulatory level and with regard to methods followed in the exercise of supervisory functions, between aggregation hubs (of countries participating in the single supervisory mechanism and those that do not participate to such mechanism).

The overall structure is subject to dynamic developments that may well diverge from its current structure. The development over time of the composition of the group of countries participating in the single supervisory mechanism will inevitably impact upon the preservation of the system which would be introduced, based upon the current proposal. Regardless of this, the clause for re-examination set forth in the draft ECB regulation expressly entrusts to the Commission – for the first time at the end of December 2015 and then every three years – the task of assessing the functioning of the single supervisory mechanism under ESFS and the interaction between the ECB and the EBA, and, where appropriate, of formulating accompanying proposals⁴⁴.

It is more than likely that even the current step in the process constitutes merely an intermediate step, as the process has yet to reach a final point of stabilization.

⁴⁴ See (PT_TA (2013) 0213), art. 26.

ROLE AND POWERS OF THE ECB AND OF THE EBA IN THE PERSPECTIVE OF THE FORTHCOMING SINGLE SUPERVISORY MECHANISM

Francesco Guarracino*

ABSTRACT: *The recent inter-institutional agreement on the content of the two regulations aimed to establish a European single supervisory mechanism supervision on credit institutions and to amend the current legislative framework of the EBA gives substance to the prospect of having soon a more centralized system of prudential regulation and supervision in respect of banks and other financial institutions. The present work focuses in particular on the role and the powers of the two authorities at the heart of this architecture, the ECB and EBA.*

SUMMARY: 1. Introduction. – 2. Towards a new arrangement of prudential supervision. – 3. Tasks and tools of the ECB. – 4. The legal basis. – 5. Amendment to the EBA regulation – 6. Concluding remarks.

1. As a result of the compromise reached in the interinstitutional negotiations with the Council and the Commission (the so-called “trilogue”⁴⁵), on 22

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⁴⁵ See Rule 70 of the European Parliament’s Rules of Procedure.

According to the current paragraph 5 of Rule 70, «if the negotiations lead to a compromise, the committee responsible shall be informed without delay. The agreed text shall be submitted to the committee responsible for consideration. If approved by a vote in committee, the agreed text shall be tabled for consideration by Parliament in the appropriate form, including

May 2013 the European Parliament in plenary sitting adopted the agreed amendments both on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM (2012) 0511)⁴⁶ and the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 which establishes the European Banking Authority (COM (2012) 0512).

The first one aims to create a single supervisory mechanism (SSM) on credit institutions established in Member States which have the euro as their currency (opened, to the extent possible, to all Member States wishing to participate⁴⁷), the second one to amend the regulation on the EBA accordingly. They will set the first pillar of the new European Banking Union.

The original idea was discussed at the informal dinner of the members of the European Council held on 24 May 2012⁴⁸ and further developed in the report for the subsequent meeting of the European Council⁴⁹, which set out a vision for the future of the Economic and Monetary Union and claimed the need of a single European banking supervision system.

compromise amendments. It may be presented as a consolidated text provided that it clearly displays the modifications to the proposal for a legislative act under consideration».

⁴⁶ The final compromise text, agreed in COREPER on April 18, 2013, can be downloaded from the Public register of Council documents website register.consilium.europa.eu

⁴⁷ See Article 6 of the consolidated text, headed “Close cooperation with the competent authorities of participating Member States whose currency is not the Euro”.

⁴⁸ See President of the European Council H. VAN ROMPUY, *Remarks following the informal dinner of the members of the European Council*, Brussels, 24 May 2012, EUCO 93/12, Presse 215, PR PCE 78.

⁴⁹ See President of the European Council H. VAN ROMPUY, *Towards a genuine Economic and Monetary Union* - Brussels, 26 June 2012, EUCO 120/12, Presse 296, PR PCE 102.

The report was prepared by the President of the European Council, in cooperation with the Presidents of the Commission, the Eurogroup and the European Central Bank.

The legislative proposals were finally presented by the Commission on 12 September 2012, under different legislative procedures accordingly to respective legal bases.

In particular, the proposal for introducing targeted amendments to the Regulation (EU) No 1093/2010 on the EBA is to be adopted in accordance with the ordinary legislative procedure, ex-codecision procedure, under Article 294 TFEU, which means that the European Parliament acts as co-legislator on an equal footing with the Council. Conversely, the proposal for conferring prudential supervision tasks on the European Central Bank is subject to a special legislative procedure (Article 289, paragraph 2, TFEU), namely the one provided for by Article 127, paragraph 6, TFEU⁵⁰ which is a consultation procedure: because of that, the European Parliament is simply asked to give its advisory opinion⁵¹ without having a right of veto⁵².

Nevertheless, the two proposals, obviously linked to one another, have been treated as a single package, in a logic of co-decision. In any case, the European Parliament's role of co-legislator in amending the regulation on the EBA is a powerful lever to remain in control over the other legislative project.

⁵⁰ Article 127(6) says: («The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings»).

⁵¹ However, according to the settled case-law of the Court of Justice, «the requirement to consult the European Parliament in the legislative procedure, in the cases provided for by the Treaty, means that it must be consulted again whenever the text finally adopted, taken as a whole, differs in essence from the text on which the Parliament has already been consulted, except in cases in which the amendments substantially correspond to the wishes of the Parliament itself» (COURT OF JUSTICE, 11 November 1997, Case C-408/95 *Eurotunnel SA and others v. SeaFrance*, ECR I-6316 paragraph 46).

⁵² Instead of it, the Parliament has a “power of delay”: KARDASHEVA R., *The Power to Delay: The European Parliament's Influence in the Consultation Procedure*, JCMS: Journal of Common Market Studies, 2009, 47: 385–409.

In the mentioned session held on 22 May 2013 the European Parliament, after voting on their content, postponed the final vote on both the legislative resolutions and the matter was referred back to the committee responsible for reconsideration pursuant to Rule 57(2), second subparagraph, of the Rules of Procedure of the European Parliament, upon proposal of the two *rapporteurs*⁵³.

The reason for the postponement was twofold. On the one hand, before the final vote the European Parliament pursued a clear inter-institutional agreement with the ECB on democratic accountability and transparency of the ECB itself. On the other hand, the Council had not been yet able to reach a formal unanimous agreement on the final regulation on the SSM because of the need of the German Minister of Finance to obtain previous authorization from his Parliament. Postponing also the vote on the new regulation on the EBA would have thus allowed the European Parliament “to have an ace in the hole against the Council”⁵⁴.

According to the EP draft agenda, the vote in plenary session is scheduled on 10 September 2013.

Meanwhile, on 13 June the German Bundestag approved the law needed to create the conditions for a formal approval of the German representative in

⁵³ The Rule 57 relates to the adoption of amendments to a Commission proposal. Its second paragraph, first subparagraph, states that, «if the Commission announces that it does not intend to adopt all Parliament's amendments, the rapporteur of the committee responsible, or else the Chair of that committee, shall make a formal proposal to Parliament as to whether the vote on the draft legislative resolution should proceed. Before submitting this proposal, the rapporteur or Chair of the committee responsible may ask the President to suspend consideration of the item», while the second subparagraph adds that, «if Parliament decides to postpone the vote, the matter shall be deemed to be referred back to the committee responsible for reconsideration».

⁵⁴ This is an unofficial translation of what was said by the *rapporteur* M. Thyssen at the Committee on Economic and Monetary Affairs meeting held in the afternoon of April 24, 2013 (video stream available on the website of the EP).

the European Council on the proposal on the SSM ⁵⁵, removing the main obstacle from finalizing the legislative procedures.

Therefore, at this stage there should be no further significant changes in the texts agreed in the interinstitutional dialogue and this allows, with a certain tranquility, to examine some aspects of the future European banking union.

More in detail, the purpose of this work is to investigate the respective area of competence of the EBA and of the ECB, after it has been finally clarified that «the ECB should carry out its tasks ... without prejudice to the competence and the tasks of the other participants within the ESFS» (as stated by recital 24 of the draft Council regulation on the ECB) and also that «the European Banking Authority (EBA) should therefore maintain its role and retain all its existing powers and tasks: it should continue developing and contributing to the consistent application of the single rulebook applicable to all Member States and enhancing convergence of supervisory practices across the whole Union» (see recital 8 of the draft regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010).

For the sake of simplicity, in the following pages the abbreviated forms “*draft regulation on the SSM*” and “*draft regulation on the ECB’s new tasks*” are for “*draft Council regulation on conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*” and the abbreviated form “*draft regulation on the EBA*” is for “*draft regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing the European Banking Authority*”.

2. As for micro-prudential supervision, the legislation on the European Supervisory Authorities within the European System of Financial Supervision

⁵⁵ www.bundestag.de

(ESFS) introduced by the Regulations (EU) No. 1093, 1094 and 1095 of 24 November 2010⁵⁶ addressed primarily the critical issue of regulatory convergence.

It was a reform aimed to remedy the persistent inconsistencies of supervisory rules and practices at national level, which derived from the options, exceptions and exemptions often granted to the Member States in transposing EU law on banking and financial services, both at the first and the second level of the so-called Lamfalussy process (respectively concerning framework principles and technical implementation measures)⁵⁷ - hence the idea to develop an actual body of common rules for the European single market (a single rulebook), mainly through the use of regulations instead of directives, when possible, in the establishment of the legislative framework and the adoption of a new method for setting up regulatory and implementing technical standards to be used consistently by domestic supervisory authorities in their activities⁵⁸.

In this respect, in the banking sector the Regulation n. 1093/2010 entrusted several important tasks to the EBA (to draft binding regulatory and implementing technical standards; to issue guidelines and recommendations on the application of Union law; to settle disagreements between national authori-

⁵⁶ A fourth regulation adopted in the same date, regarding the macro-prudential oversight, establishes the European Systemic Risk Board (ESRB), which is another component of the European System of Financial Supervision: see Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board.

⁵⁷ The Lamfalussy process is a four-level regulatory approach for the adoption and implementation of financial services regulation which should allow the European Union to respond rapidly and flexibly to developments in financial markets. It is named by Alexander Lamfalussy, former president of the European Monetary Institute and chairman of the committee which proposed this new approach (see *Final report of the Committee of Wise Men on the Regulation of European Securities Market*, Brussels, 15 February 2001). For an extremely concise and up-to-date overview of this topic, see KOLASSA, *Financial Services: the Lamfalussy process and the development of European supervisory authorities*, in Fact Sheet on the European Union 2013, available at www.europarl.europa.eu

⁵⁸ See COMMUNICATION FROM THE COMMISSION “*European financial supervision*”, COM (2009) 252 final, Brussels, 27 May 2009, pag. 3 s., 8 ff.

ties in cross border situations, etc.) and, under certain circumstances, empowered it to take individual decisions addressed both to competent national authorities and financial institutions. However, the reform did not deal with the issue of allocation at national level of supervision functions, distributed across the nodes of a network of domestic authorities⁵⁹ whose core was the EBA.

The draft regulation on the ECB's new tasks operates on this latter aspect, subverting the current system structure. At least for the Member States whose currency is the euro, in fact, the creation of the SSM determines a transfer of key supervisory functions from local to European level, directly to the ECB or under its leading role, whether or not those functions are given to national central banks of the interested Member States. In this way, in the sector of credit institutions the cornerstone of the European regulation (the EBA) will be joined by another for the European supervision (the ECB), finally breaking the original symmetry between the three networks of authority that currently make up the micro-prudential segment of the ESFS.

The reasons behind these changes can be easily found in the most recent phase of the current financial and economic crisis.

When in 2007-2008 the first wave of the financial crisis, started in the USA and swiftly spread to Europe, exposed shortcomings in the areas of cooperation, coordination, consistent application of Union law and trust between na-

⁵⁹ Policy network systems, generally intended as non-hierarchical structures for cooperation and exchange of information among institutional actors (e.g., national regulatory bodies), have often found room into European law. However, because of dysfunctions of horizontal self-coordination, networks are sometimes organized around a subject playing a lead or a synthesis role: the EU Commission itself, agencies, authorities or other entities.

On this subject see, *inter alia*, CRAIG, *Shared Administration and Networks: Global and EU perspectives*, in Oxford Legal Studies Research Paper n. 6/2009 (also published in ANTHONY-AUBY-MORISON-ZWART, *Values in Global Administrative Law, Essays in Honour of Spyridon Flogaitis and Gerard Timsit*, Oxford, Hart Publishing, 2011, pag. 81 ss.); BÖRZEL, *What's So Special about Policy Networks? An Exploration of the Concept and Its Usefulness*, in *Studying European Governance, European Integration online Papers (EIoP)*, Vol. 1 (1997) n. 16, available at the web address www.eiop.or.at

tional supervisors, proving that the then existing system of cooperation between national authorities was insufficient as regards financial institutions operating across borders ⁽⁶⁰⁾, a major role was assigned by the EU legislators to the promotion of cooperation between the national authorities and to the strengthening of the colleges of supervisors (referred to in Directive 2006/48/EC). Pursuant to art. 21 reg. 1093/2010 and according to recital 36, the EBA was assigned the task of contributing to promoting and monitoring the efficient, effective and consistent functioning of the colleges of supervisors; it would have fostered the coherence of the application of Union law among them and played a leading role in ensuring the consistent and coherent functioning of these colleges for cross-border financial institutions across the Union. As for systemic risk, an European Systemic Risk Board was established for the macro-prudential oversight of the financial system within the Union⁶¹.

However, in the euro area a subsequent combination of banking crisis and sovereign debt crisis created a dangerous vicious circle that threatened the stability and even the survival of the single currency⁶² Not only did it call for de-

⁶⁰ See the conclusions of the high level group of expert, set up in October 2008 by the President of the EU Commission and chaired by the former Governor of the Banque de France, Jacques de Larosière, which had been requested to make proposals to strengthen European supervisory arrangements covering all financial sectors, with the objective to establish a more efficient, integrated and sustainable European system of supervision: in its final report, the Group highlighted the inability to coordinate and collaborate with each other shown by national authorities (see THE HIGH-LEVEL EXPERT GROUP ON FINANCIAL SUPERVISION IN THE EU, *Report*, Brussels, 25 February 2009, pag. 10 s. points 28-29, pag. 41 point 159, Annex IV, pag. 75).

See now recitals 1 and 33 of the Regulations (EU) No. 1093/2010 and No. 1095/2010 on the EBA and the ESMA and recitals 1 and 32 of the Regulations (EU) No. 1094/2010 on the EIOPA. The three Regulations above followed the conclusions

⁶¹ See Regulation (EU) No 1092/2010 cit.

⁶² See *inter alia* ENRIA A., *The crisis in Europe, the impact on banks and the authorities' response*, *Lectio Magistralis* at the University of Trento, 20 February 2013, p. 3: «following the first wave of bail-outs by national governments, banks started to be assessed by market participants on the basis of the credit standing of the sovereign providing them with the safety net and of the amount and quality of their sovereign exposures. This generated an inextricable link

linking banks and sovereigns, but it brought back to the fore the dilemma between upgrading the European institutional architecture and downgrading market integration⁶³.

One of the lessons of the present stage of the crisis has been that mere coordination between national supervisors is not sufficient and, therefore, the integration of supervisory responsibilities should be enhanced (recital 4 of the draft regulation on the ECB's new tasks).

Moreover, a single supervisory system can play an essential role to reach political consensus on sustaining financially domestic banks with common funds: in 2009, talking about the European System of Financial Supervisors (at that time still a proposal), the Commission clarified that leaving to national supervisors the responsibility for the supervision of individual entities reflected that the financial means for rescuing financial institutions had remained at the Member State level and with national tax payers⁶⁴; by contrast, pooling resources from Member States for case of crisis calls for a joint supervision, because foreign banks could carry risks that can fall on taxpayers of other Member States⁶⁵.

To discuss the reason for which the leading role in the SSM is being given to the ECB, rather than to the EBA or to a new agency, would exceed the scope

between the banks and their sovereign, creating a harmful negative circularity: (a) large (or less large, but numerous) financially-stressed banks burdened sovereigns which were expected to bail them out (the case of Ireland or Spain), while (b) financially-stressed sovereigns impacted their banks' market presence and credit fundamentals (the case of Greece, Portugal, and Italy)».

⁶³ See HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR, *Final report*, Brussels, 2 October 2012, pag. 107 (so-called *Liikanen report*, after the name of the chairman of the high level expert group).

⁶⁴ See COMMUNICATION FROM THE COMMISSION, *European financial supervision*, COM (2009) 252 final, *op. cit.*, p. 9.

⁶⁵ See what Volker Wissing (German Liberal Free Democrats) told about the Bundestag vote on the SSM regulation, referring to German taxpayers at www.bundestag.de

of this paper⁶⁶. Anyway, it can be observed that recital 11 of the draft regulation on ECB's new tasks sets forth that «as the Euro area's central bank with extensive expertise in macroeconomic and financial stability issues, the ECB is well placed to carry out clearly defined supervisory tasks with a focus on protecting the stability of Europe's financial system». Furthermore, not only in many Member States are central banks already responsible for banking supervision (as recital 11 reminds), but in the Eurozone the same mandate given to the European System of Central Banks by the TFEU associates monetary policy with financial system stability and macro-prudential supervision, therefore translating into positive law some of the conclusions of the theoretical debate on this matter (see art. 127, paragraphs 5 and 6 TFEU).

This said, it is high time to have a closer look at the Single supervisory mechanism and the division of tasks between the ECB and the national supervi-

⁶⁶ On this issue, shortly after the presentation of the two Commission proposals on 12 September 2012, see GUARRACINO, *Supervisione bancaria europea. Sistema delle fonti e modelli teorici*, Cedam, Padova 2012, pp. 141-150, 158 ff., and references therein; GREEN, *The Relationship between Micro-Marco-Prudential Supervision and Central banking*, in VV. AA. *Financial Regulation and Supervision. A post-crisis analysis*, Oxford University Press, Oxford, 2012, pp. 57 ff.

The opportunity to entrust central banks also with prudential supervision of credit institutions is a question debated for a long time: GOODHART and SCHOENMAKER, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, Oxford Economic Papers, New Series, vol. 47(4), 1995, pp. 539 ff.

A recent empirical study on a sample of fifty central banks has showed that more than half of them (thirty-one) also carry out banking supervisory tasks (nineteen in emerging economy countries and twelve in advanced economy countries), while nearly everywhere payment systems oversight was entrusted to central banks: NEIR-OSIŃSKI-JÁCOME-MADRID, *Towards Effective Macroprudential Policy Frameworks: An Assessment of Stylized Institutional Models*, IMF Working Paper WP/11/250, Washington, 2011, pp. 7 ff. (States' chart at p. 43).

Several years ago, the European Central Bank pleaded the cause of giving prudential supervision on individual institutions to national central banks rather than to apposite authorities, claiming the existence of a close correlation between prudential supervision on financial intermediaries (especially if systemically important) and assessment of risks for the financial system as a whole: see ECB, *The role of central banks in prudential supervision*, 2001, which expressed the position of the Governing Council of the ECB on the ongoing discussions on the reorganisation of the supervisory structures in some euro area countries (the full document can be downloaded from the ECB website at www.ecb.int)

sory authorities within it, assuming that the draft text adopted by the European Parliament on 22 May 2013 will be finally approved without further major changes.

3. The Single supervisory mechanism is an European system of financial supervision composed by the ECB and the national authorities of participating Member States which are empowered to supervise credit institutions.

The ECB is responsible for the effective and consistent functioning of the SSM, while the national competent authorities are responsible for assisting the ECB in the preparation and implementation of any act relating to the exercise of its supervisory tasks.

If the new powers conferred to the ECB make it the lead banking supervisor, however the European Central Bank is not *the* single supervisor, since that role belongs to the SSM as a whole.

In this regard, the actual version of the draft regulation on the ECB's new tasks significantly differs from the original proposal of the Commission.

As a matter of fact, according to the latter the ECB would have been the only authority really in charge of prudential supervision on credit institutions established in the participating Member States, because (a) the ECB would have been exclusively competent to carry out all the key supervisory tasks referred to in Article 4; (b) for the purposes of carrying out those tasks, the ECB would have been considered, without any exception, the competent / designated authority in the participating Member States in accordance with the relevant acts of Union law and have had the powers and obligations which competent /designated authorities have under those acts; (c) the ECB would have had jurisdiction on all credit institutions established in participating Member States (approximately 6,000 banks), irrespective of their business model or size, after a rather short

phasing-in period (1 year) in which the ECB would have only supervised European systemically important banks⁶⁷; (d) national supervisory authorities, called on assisting the ECB with the preparation and implementation of any acts related to those tasks on its request and under the framework and conditions set up by the ECB itself, would have only kept the responsibilities and related powers to carry out supervisory tasks not assigned to the ECB.

That is not true anymore. Article 4 of draft regulation, as amended, is still titled “Tasks conferred on the ECB” and still affirms that «the ECB shall be exclusively competent to carry out the following tasks in relation to all credit institutions established in the participating Member States», but it must be read in conjunction with Article 5, now titled “Cooperation within the Single Supervisory Mechanism”, that regulates the division of tasks between the ECB and the national competent authorities within the SSM. The result is a complex set of provisions, which reflects the political compromise on the role of the SSM, the tasks to be carried out by the ECB and those conferred to the national supervisors.

The current drafting is not a model of clearness, simplicity and conciseness and it has many internal cross-references, so that the tasks, responsibility and powers of institutions in the different situations referred to are not immediately and easily recognisable, as instead the Committee on Legal Affairs specif-

⁶⁷ To support that, it was pointed out that «recent experience shows that smaller banks can also pose a threat to financial stability» (see recital 13 of the original proposal, COM (2012) 511 final cit.); moreover, it was argued that «a two-tier system, where a subset of banks would be subject to ECB supervision while others would remain under full national responsibility would introduce significant asymmetries within the same country and is inherently unstable: depositors and banks could easily move to the segment that is perceived to be safer. This would increase volatility risks and make parts of the banking sector less, rather than more stable» (see *Commission proposes a package for banking supervision in the Eurozone – frequently asked questions*, MEMO/12/662, Brussels /Strasbourg, 12 September 2012, p. 2).

ically called for⁶⁸. Furthermore, it should be noted that the role and powers of the ECB are significantly reduced when the participating Member State is a State that does not have the euro as its currency. This will be discussed later.

What follows from a combined reading of Articles 4 and 5, as well as of Articles 1 (second and fifth paragraph), 13, 13 bis and 14, is that⁶⁹:

- Article 4 identifies the micro-prudential supervisory functions of interest to ensuring a coherent and effective implementation of the European Union's policy on prudential supervision of credit institutions, which are, thus, assigned to the SSM as a whole;
- among them, some tasks of the utmost importance always fall within the exclusive competence of the ECB in relation to all credit institutions established in the participating Member States, namely those referred to in Article 4, paragraph 1, lett. a) and b), which are: to authorise credit institutions and to withdraw authorisations of credit institutions subject to the certain provisions set up in Article 13; to assess applications for the acquisition and disposal of qualifying holdings in credit institutions, except in the case of a bank resolution, subject to the certain provisions set up in Article 13 bis.

Also the task indicated in Article 4, paragraph 1, lett. j), should exclusively belong to the ECB, because it is never referred to in provisions regarding competence and responsibility of national authorities (above all, in Article 5, paragraph 4 quinquies, first subparagraph) - the task is «to participate in supplementary supervision of a financial conglomerate in relation to the

⁶⁸ See COMMITTEE ON ECONOMIC AND MONETARY AFFAIR (rapporteur M. Thyssen), *Report on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM (2012) 0511- C7-0314/2012 – 2012/0242(CNS))*, 3 December 2012, Annex II, p. 68.

⁶⁹ The numbering adopted here (bis, ter, quater...) is that used in the French and Italian language versions of the draft regulation; English and German texts use a different system (b, c, d... etc).

credit institutions included in it and assume the tasks of a coordinator where the ECB is appointed as the coordinator for a financial conglomerate in accordance with the criteria set out in relevant Union law».

As for the authorisation of credit institutions, the ECB carries out its task upon a proposal by the relevant national competent authority, which assesses compliance with the relevant conditions set out by national law, while on withdrawal of authorisation the ECB can decide either upon a proposal by the relevant national competent authority or after consultations with it⁷⁰ (see Article 13); finally, also the assessment of acquisitions of qualifying holdings is made upon a proposal by the relevant national competent authority (see Article 13 bis);

- the remaining tasks listed in Article 4 are exclusively assigned to the ECB, as a rule, only with regard to: (a) credit institutions (or branches of them, when the sole branch is established in a participating Member States), financial holding companies or mixed financial holding companies “*of significant relevance*” (according to the assessment criteria laid down in Article 5, paragraph 4 ter, first subparagraph, banks and institutions with total assets exceeding 30 billion euro or more than 20% of the gross domestic product of the Member State of establishment are generally considered significant); (b) the three major credit institutions of each participating Member States, regardless of the size, importance or cross-border significance of those institutions; (c) credit institutions for which public financial assistance has been requested or received directly from the EFSF (the European Financial Stability Facility) or the ESM.

⁷⁰ This is because, as noticed in recital 14, Member States may currently provide for further conditions for authorisation and cases for withdrawal of authorisation.

It is noteworthy that a national authority can consider an institution of significant relevance with respect to the domestic economy even if that institution doesn't meet the criteria above; in that case, the final decision is up to the ECB (Article 5, paragraph 4 ter, first subparagraph, second indent point (III));

- those tasks are instead conferred to the national competent authorities in the case of less significant institutions. Nevertheless, this happens within the SSM and under the leading role of the ECB, which means that the national authorities adopt all relevant supervisory decisions, but the ECB can issue binding regulations, guidelines or general instructions to them, according to which their tasks are to be performed and supervisory decisions are to be adopted (Article 5, paragraph 4 quater, first subparagraph, lett. (a)).

Moreover, those tasks can be always taken by the ECB upon itself in regard to one or more institutions (see Article 5, paragraph 4 quater, lett. (b): «when necessary to ensure consistent application of high supervisory standards, the ECB may at any time, on its own initiative after consulting with national authorities or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions referred to in paragraph 4b ...»);

- finally, all the other prudential supervisory functions, not listed in Article 4 or referred to in whatsoever provision which could confer tasks or powers to the ECB or national authorities within the SSM, remain outside the Single supervisory mechanism and national authorities are exclusively in charge of them (see Article 1, fifth paragraph).

A list of these tasks can be found in recital 22: «the power to receive notifications from credit institutions in relation to the right of establishment and the free provision of services, to supervise bodies which are not covered by

the definition of credit institutions under Union law but which are supervised as credit institutions under national law, to supervise credit institutions from third countries establishing a branch or providing cross-border services in the Union, to supervise payments services, to carry out day-to-day verifications of credit institutions, to carry out the function of competent authorities over credit institutions in relation to markets in financial instruments, the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and consumer protection».

It must be added that great attention is paid to the matter of safety and financial soundness of credit institutions and to measures aimed at addressing systemic or macro-prudential risk, which results in more tasks and tools for the ECB. Particularly, with regard to systemic risk the ECB may apply higher requirements for capital buffers to be held by credit institutions than those applied by the national competent or designated authorities of participating Member States (Article 4 bis, paragraph 2); with regard to safety and soundness of single institution the ECB has the power to require any credit institution, financial holding company or mixed financial holding company to adopt appropriate measures, including specific additional own funds requirements, use of net profits to strengthen own funds, restriction or limitation of business, operations or network of institutions, divestment of activities that pose excessive risks, reinforcement of the arrangements, processes, mechanisms and strategies, and so on (Article 13 ter).

In order to carry out its tasks, the ECB is provided by the draft regulation with specific powers of investigation (Articles 9-12) and supervision (Articles 13-14), as well as with all the powers which competent and designated authorities have under the relevant Union law unless otherwise provided for (Article 8). It may impose administrative pecuniary sanctions, under certain conditions (Article

15), and even remove at any time members from the management body of credit institutions who do not fulfil the requirements set out in the relevant Union law and the national legislation transposing Directives and exercising options given by Regulations (Article 13 ter, paragraph 2, lett. (m)).

Its investigation powers enable the ECB to require credit institutions, financial companies, persons belonging to them and third parties to whom they have outsourced functions or activities to provide, also at recurring intervals, all necessary information (Article 9); it may examine the books and records of the aforementioned legal and natural persons, obtain written or oral explanation from them or their representative or staff, interview any other person who consents to be interviewed for the purpose of collecting information (Article 10). Furthermore, the ECB is entitled to conduct on-site inspections through its own officials and officials of the national competent authority of the Member State where the inspection is to be conducted (these last officials have the right to participate in Article 11).

If an on-site inspection requires authorisation by a national judicial authority, the latter may only control the authenticity of the decision of the ECB and the proportionality of the coercive measures envisaged. It cannot review the necessity for the inspection nor demand to be provided with the information on the file of the ECB (Article 12; according to it, only the EU Court of Justice has the power of judicial review of the lawfulness of the ECB's decision).

As for the specific supervisory powers given to the ECB, it has already been told of its tasks in regard to authorisation of credit institutions and withdrawal of it (Article 13) and assessment of acquisitions of qualifying holdings as well (Article 13 bis).

Returning to the issue of the participation in the SSM of Member States which do not have the euro as their currency, the ECB may fulfill the tasks laid

down in Articles 4 and 4 bis also in relation to credit institutions established in that Member State only if a “close cooperation” between the ECB and the national competent authority of such Member State has been established in accordance with Article 6.

It is up to the Member State to request to enter into a close cooperation with the ECB, in which case it has to ensure that its national competent authority or national designated authority will abide by any guidelines or requests issued by the ECB. In this respect, the Member State has to approve in advance the legislation needed to oblige its national authority to adopt any measure in relation to credit institutions requested by the ECB.

However, under no circumstance could the ECB directly take any supervisory decisions with regard to credit institutions established in a Member State whose currency is not the euro nor oblige its national authority to do something.

As a matter of fact, despite the commitment that the Member State has taken on with its request to establish a close cooperation, in the close cooperation system the ECB can only address instructions to the national competent authority and if the latter does not comply, even after a warning issued to the concerned Member State, the ECB cannot take any measure but suspending or terminating the close cooperation with that Member State (Article 6, paragraphs 1, 5 and 5 bis).

On the other hand, a non-euro area Member State which has entered in a close cooperation with the ECB has the right to dispute the draft decisions of the Supervisory Board established in the ECB⁷¹ (although each national authority

⁷¹ The Supervisory Board is a new internal body of the ECB, specially established to undertake the planning and execution of the tasks conferred upon the ECB within the SSM. It carries out preparatory works and proposes to the Governing Council of the ECB draft decisions. The Su-

has its representative in the Supervisory Board) as well as the objections of the Governing Council of the ECB to the draft decisions of the Supervisory Board. According to the case, finally the Member State may decide not to be bound by the ensuing final decision on the matter or decide to terminate the close cooperation with immediate effect (see Article 6, paragraphs 5 quarter and 5 quinquies).

The rationale for these provisions is to balance the fact that participating Member States which do not use the single currency are in the minority within the Supervisory Board (whose decisions are taken by a simple majority of its members: Article 19 paragraph 1 sexies) and are not present in the Governing Council.

Even though the solution devised for the participation of Member States whose currency is not the euro could seem questionable, it should be born in mind that in the Treaties there are some rules which can be applied only to euro area Member States and it must also be considered that excluding any possibility of voluntary participation in the SSM by those Member State would have been an even worse solution. This leads directly to the examination of the legal basis of the SSM.

4. The legal basis adopted for giving prudential supervision tasks on credit institutions to the ECB is Article 127, paragraph 6, TFEU.

It opens the chapter dedicated to the monetary policy of the Union, which is conducted by the ECB together with the national central banks of the Member States whose currency is the euro (the so-called Eurosystem) pursuant

pervisory Board includes one representative of the national authority competent for the supervision of credit institutions in each participating Member State.

to Article 282, paragraphs 1 and 4, TFEU and does not concern the non-euro area countries.

Article 127 enumerates the basic tasks to be carried out through the European System of Central Banks (more precisely, the Eurosystem, as the subset of the ESCB which conducts all the tasks involved in the single currency): to define and implement the monetary policy of the Union; to conduct foreign-exchange operations; to hold and manage the official foreign reserves of the Member States; to promote the smooth operation of payment systems.

However, it also contains two provisions broadening the horizon of the ESCB well beyond the boundaries of monetary policy in the proper sense.

On the one hand, paragraph 5 states that «the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system»; on the other hand paragraph 6 provides that «the Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings».

These provisions lead to some considerations.

One is that, by explicit mandate conferred by paragraph 5, the European System of Central Banks has a jurisdiction that is extended to macro-prudential policy (stability of the financial system) and to micro-prudential policy as well (prudential supervision of credit institutions). This jurisdiction is not exclusive, because Article 127 paragraph 5 makes use of the verb “to contribute”, that means to give help, to take part in something doing also by others, and uses it with reference to policies "pursued by the competent authority", that means

assuming and acknowledging that someone else than the ESCB is legally entitled of those functions⁷². The provision of Article 127, paragraph 5, does not specify in which way the ESCB should contribute to the conduct of policies on prudential supervision of credit institutions and stability of the financial system, seeming to leave space open to different modulations, as long as the legal principles of subsidiarity and proportionality are respected. However, in its chapter on prudential supervision the Statute of the ESCB and the ECB, laid down in the Protocol (n. 4) attached to the Treaties, gives the ECB a mere advisory role in this regard (see⁷³ Article 25, paragraph 1)⁷⁴.

Another consideration is that, as seen before, the jurisdiction of the ESCB may be further extended by a legislative act entrusting it with specific tasks concerning prudential supervision (Article 127, paragraph 6, TFEU; Article 25, paragraph 2, Statute ESCB/ECB), which makes the ECB not just involved in, but also entitled of the related functions and, thus, needs to be approved unanimously by the Council. It must be a conferment of “specific” tasks, *id est* of powers strictly identified and determined. However, it is doubtful that the adjective “specific” makes it necessary to observe a given quantitative limit, which would not be easy, nor perhaps possible, to identify (except for the extreme case of a

⁷² The European System of Central Banks, unlike the entities, which compose it (the European Central Bank and the national central banks), has no legal personality, no capacity to act and no decision-making bodies of its own: see SCHELLER, *The European Central Bank. History, role and functions*, 2nd revised edition, ECB, Frankfurt am Main, 2006, pag. 42

⁷³ According to it, «the ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Union legislation relating to the prudential supervision of credit institutions and to the stability of the financial system».

⁷⁴ These rules are the result of a compromise reached with specific reference to supervisory functions and financial stability at the time of the establishment of the ECB. It should be noted that the first draft of the Statute of the ESCB proposed to provide the ECB also with another task: «to participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system» (text after SMITS R., *The European Central Bank. Institutional Aspects*, the Hague, 1997, pag. 335, note 75).

total depletion of national supervisory functions). Rather, the rule seems to prohibit the assignment of competences through vague, generic or indeterminate formulas that, in a subsequent interpretation, could lead to an alteration of the equilibria agreed, betraying ex post the will of the Member States entrusted to the unanimous vote of the Council.

In literature, the wording of that provision is doubtless seemed to allow the transfer to the ECB of tasks such as, for example, the issuance of authorisations and the supervision of intermediaries, with assumption of the role of competent authority at the European level⁷⁵. On the contrary, some concern has been raised about the exact area of the entities (in addition to credit institutions) that may be subjected to the supervisory powers of the ECB, due to the difficulty of finding a reliable criterion for identifying the “other financial institutions” to which the provision of the Treaty makes a generic reference⁷⁶.

Finally, the enabling clause in Article 127, paragraph 6, TFEU was introduced to allow the reorganization of the architecture of prudential supervision in the Eurozone without the need to modify the Treaties and in fact it is well suited for this purpose, as to become the legal basis for the leading role of the ECB within the SSM, but it should not be forgotten the different legal position of the Member States which do not use the single currency.

5. The establishment of the single supervisory mechanism is not intended to affect role and tasks⁷⁷ entrusted to the EBA by the Regulation (EU) No. 1093/2010, which are indeed strengthened.

⁷⁵ SMITS R., *The European Central Bank, op. cit.*, p. 358

⁷⁶ *Ibidem*.

⁷⁷ For an in-depth analysis of the tasks and powers conferred on the EBA by Regulation (EU) No. 1093/2010, see GUARRACINO, *Supervisione bancaria europea, op.cit.*, pp. 66-131.

The amendments to the two legislative proposals have definitely clarified this matter.

In this regard, the new recital n. 4 of the draft regulation on the EBA expressly affirms that the EBA «should ... maintain its role and retain all its existing powers and tasks», namely developing and contributing to the consistent application of the single rulebook and enhancing convergence of supervisory practices, and the amended recital n. 5 points out that it should carry out its tasks in relation to the ECB «in the same manner as in relation to the other competent authorities».

Even more clearly, the draft regulation on the ECB states that «the ECB shall carry out its tasks without prejudice to the competence and the tasks of EBA, ESMA, EIOPA and the ESRB» (Article 3, paragraph 1 ter) and takes care of clarifying that the ECB «shall in particular be subject to binding regulatory and implementing technical standards developed by EBA and adopted by the Commission in accordance with Article 10 to 15 of Regulation 1093/2010, to Article 16 of that Regulation on Guidelines and Recommendations, and be subject to the provisions of the EBA regulation on the European supervisory handbook developed by the EBA in accordance with that Regulation. The ECB may also adopt regulations only to the extent necessary to organise or specify the modalities for the carrying out of those tasks» (Article 4, paragraph 3, second subparagraph; see also on these themes Article 4, paragraph 1 lett. (g), and Article 7)

However, according to Article 4, paragraph 3, fourth subparagraph, of the draft regulation on the ECB, the European Central Bank may contribute “*in any participating role*” to the development of draft regulatory technical standards or implementing technical standards by the EBA, which means letting the door open to new possible developments of their *de-facto* roles.

In brief, prudential supervision and prudential regulation remain separate, the first entrusted to the SSM, the other to the EBA.

Therefore, the amendments to Regulation (EU) No. 1093/2010 proposed in the draft regulation on the EBA are of limited significance. Mostly they change the wording of previous rules in order to clarify or improve some aspects of the text, or reflect the need to adapt certain provisions to the fact that the EBA must carry out its tasks also in relation to the ECB. Nonetheless, there are at least two important novelties.

The first consists in an extension of the tasks assigned to the EBA. The draft regulation on the EBA acknowledges the utmost importance to the issue of uniformity of supervisory practices⁷⁸, that retains its relevance in a context in which the participation in the SSM is not mandatory for all the Member States. In effect, even a single set of harmonised prudential rules (the single rulebook) could not be sufficient to avoid fragmentation of the single market and regulatory arbitrage when different handbooks and supervisory approaches still exist between Member States⁷⁹. As a consequence, according to the new provisions of Article 8, paragraph 1, lett. (a) bis, and of Article 29, paragraph 2, second subparagraph, of the Regulation (EU) N. 1093/2010, the EBA is also requested to develop a “European supervisory handbook”, which should identify the best practices with regard to supervisory methodologies and processes, covering all matters within the remit of EBA (including to the extent applicable the areas of consumer protection and efforts against money laundering, which are, on the contrary, beyond the boundaries of the SSM), as clarified by recital n. 4 quater. The same recital points out the two main distinguish features of the European

⁷⁸ See, *inter alia*, the following new or amended articles of the Reg. (EU) No. 1093/2010: Article 8, paragraph 1 lett (a) bis; Article 20 bis; Article 21, paragraph 1; article 29, paragraph 2.

⁷⁹ See COMMUNICATION FROM THE COMMISSION, *A Roadmap towards a Banking Union*, COM(2012) 510 final, Brussels, 12 September 2012, p. 5.

supervisory handbook, namely its not legally binding nature and its use as a significant element in the assessment of the convergence of supervisory practices and for peer review analyses of competent authorities.

The second novelty concerns the governance of the EBA. Under the current majority rule laid down in Article 44 of the Regulation (EU) No. 1093/2010, the national supervisory authorities of Member State participating in the SSM would have a decisive structural influence upon the decisions of the Board of Supervisors of the EBA, a result opposed by non-euro Member States. On the other hand, introducing the unanimity rule would make it extremely difficult to take decisions. As a result, it has been agreed to change the voting modalities within the Board of Supervisors, so that now the amended Article 44 requires that, whether the request majority for a certain decision is simple or qualified, it must include at least a simple majority from SSM members and a simple majority from non SSM members.

Finally, it is worth mentioning that the draft regulation highlights the need to provide the EBA with the appropriate financial and human resources to properly perform the tasks entrusted to it (see recital n. 10 ter).

6. There is no doubt that the new single supervisory system and the changes to the Regulation (EU) No. 1093/2010 on the EBA, particularly with respect to its governance, are the result of a political compromise which in some ways seems simplistic. However, it should not be forgotten that the Treaty on the Functioning of the European Union requests unanimity in the Council to confer specific prudential supervisory tasks upon the ECB, providing each Member State with a strong negotiation power.

Besides this, any reform within the existing constitutional framework can not ignore limitations imposed by compliance with the Treaties in force.

In this regard, not only does the legal basis provided by Article 127, paragraph 6, TFEU for transferring prudential supervision tasks to the ECB set limits of substantial nature, since it refers to conferring of “specific tasks”, but it suffers from the major split between euro and non-euro area Member States of the European Union. The compromise reached on the establishment of the SSM stands almost on the border of these limits.

As a matter of fact, few years ago the assignment to the EBA of the task of developing draft regulatory and implementing technical standards to be adopted by the Commission already involved a stretching of the Treaty to its limits. Since in the making of those non-legislative rules the EBA plays an essential role, it substantially exercises a regulatory power. In effect, by subordinating the adoption of regulatory and implementing technical standards to coordination between the Commission and the EBA, the Regulation substantially states that no technical standards can be adopted in case of whole contrast between the EBA and the Commission on its content (see, briefly, Reg. (EU) No. 1093/2010, recital n. 23: the draft regulation prepared by the EBA « should be subject to amendment only in very restricted and extraordinary circumstances» and «the Commission should not change the content of the draft regulatory technical standards prepared by the Authority without prior coordination with the Authority»). In this way, bypassing the well known constraints imposed by the Treaties and the EJC’s case law on transferring or delegation of powers to European agencies, the Regulation (EU) No. 1093/2010 has introduced a joint use of powers delegated to the Commission under Articles 290 and 291 TFEU, as the Commission basically performs controlling and final formalizing tasks on the

technical standards prepared by the EBA⁸⁰ (hence the concerns expressed by the Commission itself about this issue ⁸¹).

Further steps towards a closer integration would require a revision of the Treaties, but this will depend also on the outcome of the reform process underway.

⁸⁰ See GUARRACINO, *Supervisione bancaria europea, op.cit.*, pp. 91 ff., in part. pp. 102 ff.

⁸¹ See the *addendum* from the General Secretariat of the Council, n. 15647/10 ADD 1 of the 10 November 2010 (Inter-institutional File 2009/0142(COD), referring to the original proposal of regulation for establishing the EBA), which reports the following *Commission Statement in relation to Articles 290 and 291 TFEU*: «As regards the process for the adoption of regulatory standards, the Commission emphasises the unique character of the financial services sector, following from the Lamfalussy structure and explicitly recognised in Declaration 39 to the TFEU. However, the Commission has serious doubts whether the restrictions on its role when adopting delegated acts and implementing measures are in line with articles 290 and 291 TFEU» (register.consilium.europa.eu)

TOWARDS A NEW REGULATORY FRAMEWORK FOR BANKING RECOVERY AND RESOLUTION IN THE EU

*Simone Mezzacapo**

ABSTRACT: The aim of this article is to provide an analysis of the main elements and principles of the new EU regulatory framework for recovery and resolution of ailing firms that is going to be developed as part of the establishment of the more integrated *financial framework* making up the so-called *EU Banking Union*. Specific relevance is given to the analysis of the impact of such new *EU resolution framework* on State aid control in the financial sector. Indeed, so far State aid rules have served also as a contingent de facto EU-wide resolution framework, while the European Commission has acted as a de facto crisis-management and resolution authority at EU level. However, the scale and severity of the crisis of the EU financial sector have shown the importance of establishing a specific and comprehensive EU framework for resolving failing financial institutions. In this respect, the proposal for a “Bank Recovery and Resolution Directive” (BRRD) seems to confirm the idea that the EU is resolutely and formally moving towards a harmonized “non-zero failure approach” to crisis management in the financial sector based on the paradigm that no financial institutions shall be unconditionally protected from an orderly market exit and the overarching policy principle of “more bail-in, less bail-out”. Indeed, all the crisis management tools, measures and arrangements envisaged in the BRRD proposal are essentially aiming at avoiding financial instability, and minimizing costs for tax payers. The most debated resolution tool is the so-called “bail-in” tool, allowing resolution authorities the power to write-down

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the claims of unsecured creditors of a failing institution and to convert debt claims to equity. In order to enhance cooperation and overcome the fragmentation existing among EU Member States in the field of crisis management of financial intermediaries the BRRD proposal envisages the establishment of a system of "Resolution colleges". Nevertheless, considering that once the *Single Supervisory Mechanism* (SSM) is in place a more integrated EU institutional framework will be even more needed also for recovery and resolution, the Council supported the Commission's initiative to also establish a *Single Resolution Mechanism* (SRM) and a *Single Bank Resolution Fund* (SBRF). The scope of the SRM's jurisdiction shall be limited to Member States participating in the SSM. Additional cooperation mechanisms and institutional arrangements with national resolution authorities in non-participating Member States will need to be implemented to maintain the level playing field in the EU internal market. Under the latest Commission proposal, such SRM shall consist of uniform rules and procedures to be applied by the *Single Resolution Board* (SRB) – a newly established EU Agency with legal personality – together with the Commission and the resolution authorities of the participating Member States. The SRB will own, administer and use for resolution purposes a newly established SBRF financed by contributions levied on the banking sector. The SRB will normally prepare decisions to initiate the resolution of banks which shall however be adopted only by the Commission. In this respect, it appears that this decision making process of the SRM has been designed to avoid any delegation of "wide margin of discretion" to the SRB that may lead to "policy choices" by the SRB and so to ultimately any potential legal issues under the "Meroni doctrine". A key legal safeguard is to be identified (for the time being) in the provision of the SRM regulation proposal stating that the Commission's approval under Article 107 of the TFEU (either because State aid is present or only "by way of analogy" when the use of the SBRF is involved) shall be considered as a precondition for the following separate and independent Commission's decision on resolution. In order to contribute to further streamline the resolution process and increase its legal certainty, it might also be worth considering the introduction of *ad hoc* harmonized procedural and substantive rules for the

judicial review at national level of any act and decision taken by national resolution authorities.

SUMMARY: 1. Banking Union and the need for an EU-wide resolution framework. - 2. State Aid control and resolution measures in the EU financial sector. - 3. Key principles of the special crisis-related acquits for State aid control in the financial sector. - 4. The requirement for a "proportionate" restructuring of State Aid beneficiaries and the main policy objectives. - 5. The two pillars of the new resolution framework for the EU financial sector: the BRRD and the SRM proposals. - 6. The institutional arrangements for the EU Single Resolution Mechanism. - 7. Conclusions.

1. The severity and persistence of the effects of the latest global financial crisis stand proof, *inter alia*, of the need for the Economic and Monetary Union (EUM) – which entered its III and final stage in 1999 – to move towards a “IV stage” which had not been envisaged as part of the original framework set up in its founding report (the so called “Delors Report”)¹.

Indeed, EU leaders have agreed to develop, as one of the remedies to the crisis, “a specific and time-bound road map for the achievement of a genuine [... deeper, stable and prosperous...] Economic and Monetary Union”², namely by strengthening its institutional framework through the implementation of a set of measures based on four essential building blocks or *unions*, the so-called: I) “*Banking Union*”, an integrated *financial framework* meant to ensure financial stability in particular in the euro area and to minimise the cost of bank failures for European citizens; II) “*Fiscal Union*”, an integrated *budgetary framework*

¹ See JACQUES DELORS, *Report on Economic and Monetary Union in the European Community*, presented on April 17th, 1989, by the Committee for the Study of Economic and Monetary Union chaired, in particular paragraph 58.

² See *Conclusions of the European Council* (28/29 June 2012), EUCO 76/12, 29 June 2012, p. 3.

supposed to ensure sound fiscal policy making at the national and European levels, and encompassing coordination, joint decision-making, greater enforcement as well as commensurate steps towards common debt issuance; *III*) “*Economic Union*”, an integrated *economic policy framework* with national and EU mechanisms that will ensure the promotion of sustainable growth, employment and competitiveness through national and European policies compatible with the objective of the smooth functioning of the EMU; *iv*) “*Political Union*”, increasing the *democratic legitimacy and accountability of decision-making* within the EMU, based on the joint exercise of sovereignty for common policies and solidarity³.

In particular, the main elements of the more integrated *financial framework* making up the *Banking Union* are: *I*) the creation of a *single rulebook*, implementing also the requirements of the Basel Committee on Banking Supervision; *II*) the establishment of a single European banking supervision architecture (the so-called *Single Supervisory Mechanism – SSM*); *III*) the harmonization, for banks subject to the European supervision, of national deposit *guarantee schemes* and *resolution frameworks*, including also the creation of a Single Resolution Mechanism (SRM).

One particularly challenging feature of the EU *Banking Union* is that it will have to be established before a proper and full EU fiscal union will be in place, while for example "in the United States, the banking union came after, and not

³ See the report by the President of the European Council, in cooperation with the Presidents of the Commission, the Eurogroup and the European Central Bank, *Towards a Genuine Economic and Monetary Union*, EUCO 120/12, Brussels, 26 June 2012, p. 3. See also the resulting roadmap by the President of the European Council, in cooperation with the Presidents of the Commission, the Eurogroup and the European Central Bank, *Towards a Genuine Economic and Monetary Union*, 5 December 2012.

before the fiscal union”⁴. In other words, the most fundamental issue in designing and implementing an efficient EU framework for crisis management and resolution in the banking sector "arises from the objective of achieving stability in increasingly integrated financial systems, where the authorities responsible for safeguarding their respective stability are still responsible towards their respective taxpayers"⁵.

As a result, with specific reference to crisis management arrangements for the financial sector, the main policy objective that the *Banking Union* is expected to deliver is to allow for the *orderly winding-down* of non-viable institutions and for the *proper restructuring* (*i.e.* cost effective) of viable ones, by minimizing the use of tax payer funds and eventually relying, for the “euro area”, on the backstop offered by possible direct recapitalizations (or other form of direct or indirect financial assistance) of ailing institutions through the European Stability Mechanism (ESM) and namely through a fully owned subsidiary of the ESM. This should also allow breaking “the vicious circle between banks and sovereigns”⁶. In this respect, it has been agreed, *inter alia*, that one of the main conditions for the ESM to intervene is that an ESM Member should be considered to be unable to provide financial assistance to the concerned institutions “without very adverse effects” on its own “fiscal positions” or its “continuous market access”⁷. In addition, direct recapitalization of banks by the ESM will only become possible once the SSM is established, this also in order to avoid moral

⁴ See B. COEURE’, *The Single Resolution Mechanism: Why it is needed*, at ICMA Annual General Meeting and Conference 2013, organised by the International Capital Market Association, Copenhagen, 23 May 2013.

⁵ See COSTANCIO, *A European Solution For Crisis Management And Bank Resolution*, at Sveriges Riksbank and ECB Conference On Bank Resolution, Stockholm, November 14th, 2011.

⁶ See EC, *Conclusions: European Council 13/14 December 2012*, EUCO 205/12, 14 December 2012, 13, p. 3.

⁷ See EUROGROUP, *ESM direct bank recapitalization instrument - Main features of the operational framework and way forward*, Luxembourg, 20 June 2013

hazard. The issue of the financing of legacy debt by the ESM will be addressed in the context of the rules setting the “pecking order” for recapitalization operations, namely in the context of the first part of the burden-sharing mechanism envisaged to determine the contributions of the ESM and the ESM Member(s) to capital injections⁸.

Beside the ESM, in order to “support the resolution process and enhance its effectiveness”⁹ within the *Banking Union* – while also minimizing the reliance on any possible extraordinary public support – the latest SRM regulation proposal¹⁰ provides for the establishment of a *Single Bank Resolution Fund* (SBRF) replacing national resolution financing arrangements of the Member States participating in the *Banking Union* and built-up by levying contributions from the banking industry in the same Member States to be determined by a Commission delegated act taking into account the risk profile of relevant banks. Pursuant to art. 65 of the SRM regulation proposal the “target funding level” to be reached by the SBRF in a period no longer than 10 years is set at minimum 1% of the amount of “deposits of all credit institutions authorised in the participating Member States which are guaranteed under Directive 94/19/EC” (on the basis of 2011 data the estimated target size of the SBRF would be around 55 billion EUR, it would be dynamic and increase automatically if the banking industry grew)¹¹.

⁸ *Ibidem*.

⁹ See EC, Proposal for a Regulation 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, (EU) No 1093/2010 of the European Parliament and of the Council, COM (2013) 520 final, 2013/0253 (COD), Brussels, 10 July 2013 (hereinafter SRM regulation proposal), p. 6.

¹⁰ *Ibidem*.

¹¹ In particular, as specified, participating banks will pay their risk-adjusted share to the Single Bank Resolution Fund within a period of 10 year that could be extended to 14 years if the fund made disbursements exceeding half of the target size of the fund. Thus the annual accumula-

The essential function of the SBRF will be to provide short or medium term financing to ensure the viability of an institution under resolution, and in particular to pursue the main resolution objective (see art. 12.2 or the SRM regulation proposal) of ensuring the continuity of its «critical functions» (e.g. by providing short term funding to the concerned institution or guarantees to its potential buyers). In this respect, it results that the SBRF “should not be considered as a bailout fund», indeed its primary objective shall be «only» “to ensure financial stability, rather than to absorb losses or provide capital to an institution under resolution”¹². In particular, according to Article 24, para.6 and 7 of the latest SRM regulation proposal, the SBRF could act as a backstop and make contributions to an institution under resolution (up to a limit of 5% of the total liabilities including own funds of the latter institution) for covering its losses, restoring its net asset value to zero or recapitalise it, only in the exceptional circumstances where: *I)* the primary objective of ensuring financial stability could not be achieved without allowing the SBRF to absorb those losses or provide capital and, *II)* the internal resources of the concerned institution have been already sufficiently used (*i.e.* «a contribution to loss absorption and recapitalisation equal to an amount not less than 8% of the total liabilities including own funds of the institution under resolution [...] has been made by shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other eligible liabilities through write down, conversion or otherwise»).

tion of resolution funds should reach around 5.5 billion EUR, not taking into account returns and possible outflows. Without taking into account the risk profile of banks estimations on the basis of 2011 data show that 17 largest European banks will make up around 40% of all banks' contributions to the Fund. See the *SRM regulation proposal*, pp. 14-15 and 100.

¹² See the *SRM regulation proposal*, p. 13.

2. Among the measures envisaged for the establishment of the *Banking Union*, those linked to the *resolution framework* are the ones having a specific impact on State aid control under EU law, as resolution has typically implied a direct or indirect use of “State resources”. So far, it has been the Commission that through its State aid control has ensured the coherence with EU law of rescue measures adopted by Member States to support financial institutions and to remedy to a serious disturbance in their financial sectors. The Commission did this by requiring adequate burden sharing, by limiting to the minimum necessary the amount of the States’ support and costs for the taxpayer and by imposing measures to minimize the distortions of competition in order to maintain a level playing field across the EU internal market.

Differently from the US, no bank resolution regime exists at EU level, where Directive 2001/24/EC merely addresses problems relating to conflicts of competence and law for the reorganization and winding-up proceedings of credit institutions with cross-border activities, without harmonizing material provisions on resolution¹³. No comprehensive *ad-hoc* resolution regimes for financial institution existed in most EU Member States either at the start of the crisis or thereafter¹⁴, leaving some national authorities with no tools available for appropriate crisis management intervention¹⁵.

¹³ In particular, Directive 2001/24/EC (of the European Parliament and of the Council of 4 April 2001 on the reorganization and winding up of credit institutions, *OJ L 125*, 5.5.2001) grants competence to the home Member State for the resolution of credit institutions and their branches, but leaves out subsidiaries which are thus subject to host Member State law and authorities. As pointed out, the Directive “embraces the principle of universality for branches but not subsidiaries. Moreover, the directive does not try to harmonise national legislation on reorganization and winding up of credit institutions” (See CARMASSI-LUCHETTI-MICOSSI, *Overcoming too-big-too-fail: A Regulatory Framework to Limit Moral Hazard and Free Riding in the Financial Sector*, report of the Ceps-Assonime task force on bank crisis resolution, Centre for European Policy Studies, Brussels, 2010, p. 58).

¹⁴ Italy was among the few Member States having a special bank resolution regime in place, while in a minority of others (such as Austria, Belgium, France, Germany and Luxembourg) special rules applied to bank insolvencies under the ordinary procedure. UK and Germany in-

Current national regimes still diverge significantly across EU Member States¹⁶ and imply a risk of conflicting objectives between national authorities, with resulting possible increase and inefficient allocation of resolution costs, and ultimately market fragmentation.

In addition, it is widely acknowledged that financial institutions require resolution arrangements different from ordinary insolvency procedures specifically designed to pursue and protect relevant public interests¹⁷, such as preserving the financial stability by ensuring the continuity of the critical and systemic relevant functions of the failing entity, while taking into account the competing needs to minimize the cost for the tax-payers and avoid moral hazard. In order to be effective and efficient, this process should ideally be managed by a public authority being able to exercise special administrative powers, namely to intervene for protecting the public good of financial stability “before the firm is balance-sheet insolvent and before all equity has been fully wiped out”¹⁸. This is

roduced bank resolution regimes after the start of the crisis (See CARMASSI-LUCHETTI-MICOSSI, *op. cit.*, p. 41). For a description of different national systems in the EU see DEMOLIN-BRULARD-BARTHELEMY, *Pre-insolvency - Early intervention – Reorganization – Liquidation*, Final report, 20 April 2010.

¹⁵ See ČIHÁK-NIER, *The Need for Special Resolution Regimes for Financial Institutions – The Case of the European Union*, IMF Working Paper, WP/09/200, 1 September 2009, p. 4.

¹⁶ More over “the difficulty of introducing an effective framework for bank resolution is compounded by a number of specific factors: the EU is in a state of systemic banking fragility and of unusual institutional uncertainty; its financial system is dominated by banks, with a high degree of banking sector concentration in many of its member states; its insolvency framework is fragmented along national lines, and so is its fiscal framework for most purposes in spite of recent tentative steps towards fiscal integration in the euro area; its policymakers and investors have almost no experience of orderly bank resolution, as most past cases of bank failures have been handled through public bail-outs and/or nationalization”. See VÉRON-WOLFF, *From Supervision to Resolution: Next Steps on the Road to European Banking Union*, Brueghel Policy Contribution, Issue 2013/04, February 2013, p. 3.

¹⁷ See *ex multis* CARMASSI-LUCHETTI-MICOSSI, *op. cit.*, p. 40; ČIHÁK-NIER, *op. cit.*, pp. 7 - 8.

¹⁸ See FINANCIAL STABILITY BOARD, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011, p. 7.

mainly the reason why the current EU proposal on a harmonized banking resolution regime has been completed by one on the SRM¹⁹.

In this regulatory scenario, State aid rules (as specifically “adapted to deliver on three objectives at the same time: maintain financial stability, safeguard the internal market, and protect the taxpayer”²⁰) have served also as a contingent “de facto EU-wide resolution framework”²¹, while their centralized enforcement by the European Commission has led the latter to act “as a de facto crisis-management and resolution authority at EU level”²².

However, the scale and severity of the crisis that hit the EU financial sector have clearly shown the importance of having a “framework in place for resolving failing banks swiftly and impartially”²³, as well as in line with the principles of a private market economy. As also confirmed by the content of the proposal for a “Bank Recovery and Resolution Directive” (BRRD), it seems that the EU is resolutely and formally moving towards a harmonized “non-zero failure approach”²⁴ to effective crisis management in the financial sector based on the idea that no financial institutions shall be unconditionally protected from a market exit. In particular, it has been pointed out that in order to provide the right incentives to financial market participants and to minimize the economic and

¹⁹ See the latest SRM regulation proposal.

²⁰ See ALMUNIA, *Banking crisis, financial stability and State aid: The experience so far*, speech/13/223, Brueghel, 13th March 2013.

²¹ See KOOPMAN, *Stability and Competition in EU Banking during the Financial Crisis: the Role of State Aid Control*, Competition Policy International, n° 2, vol. 7, 2011, p. 8.

²² See ALMUNIA, *Banking crisis, financial stability and State aid: The experience so far*, speech/13/223, Brueghel, 13th March 2013. In particular, it results that, as of March 2013, the enforcement of State aid rules resulted in restructuring of 59 banks in the EU “representing around 20-25% of the European banking sector, and 19 of these have been put into orderly liquidation”, *ibidem*.

²³ See B. COEURE, *The Single Resolution Mechanism: Why it is needed*, at the ICMA Annual General Meeting and Conference 2013, organised by the International Capital Market Association, Copenhagen, 23 May 2013.

²⁴ See FSA (UK), *Reasonable expectations: Regulation in a non-zero failure world*, September 2003, paragraph 2.6.

social costs of the financial crisis, “all financial institutions should be allowed to fail in an orderly manner, safeguarding the stability of the financial system as a whole and minimizing public costs and economic disruption”²⁵. In other words, it seems that the EU legal framework governing the matter will be modernized according to the principle that, as suggested, bank “failures are a part of risk-taking in a competitive environment. Supervision cannot, and should not, provide an absolute assurance that banks will not fail. The objectives of protecting the financial system and the interests of depositors are not incompatible with individual bank failures. The occasional bank exit may help provide the right incentive balance”²⁶.

In this respect, it appears that time has come to gradually establish in the EU a “full-fledged regulatory framework that helps avoid recourse to aid in the first instance and can provide clear ex ante guidance for all market players (which in itself is confidence-enhancing)”²⁷. The main objectives of the upcoming EU regulatory framework for crisis management in the financial sector can be summarized by the overarching policy principle of “more bail-in, less bail-out”. It results accordingly that the “era in which the privatization of profits and socialization of losses was possible should belong to the past”²⁸.

Indeed, minimizing – and ideally ending – public bail-outs is deemed “key not only to enhancing market discipline, but also to ensuring that those who

²⁵ See EUROPEAN CENTRAL BANK, *Opinion of the European Central Bank of 29 November 2012 on a proposal for a directive establishing a framework for recovery and resolution of credit institutions and investment firms* (CON/2012/99), Official Journal of the European Union, 2013/C 39/01, p. 1.

²⁶ See BASEL COMMITTEE ON BANKING SUPERVISION, *Supervisory Guidance on Dealing with Weak Banks*, report of the Task Force on Dealing with Weak Banks, March 2002, p. 30.

²⁷ See KOOPMAN, *Stability and Competition in EU Banking during the Financial Crisis: the Role of State Aid Control*, Competition Policy International, n° 2, vol. 7, 2011, p. 8.

²⁸ See MERSCH, *The Banking Union - a European perspective: reasons, benefits and challenges of the Banking Union*, at the seminar *Auf dem Weg zu mehr Stabilität – Ein Dialog über die Ausgestaltung der Bankenunion zwischen Wissenschaft und Praxis*, organised by Europolis and Wirtschaftswoche, Berlin, 5 April 2013.

appropriate the gains are also those who cover the losses [... In this respect, in order for...] the Single Supervisory Mechanism [...] to be effective, it needs to be complemented by a Single Resolution Mechanism to deal with non-viable banks [...]. From the ECB's point of view, only if the SSM is complemented by a Single Resolution Mechanism with a common backstop can the negative feedback loop between sovereigns and banks be broken, ensuring thereby that monetary policy transmission is fully restored"²⁹.

The actual implementation of such a regime would have inevitable implications on the conditions and procedure for State aid control. In the meanwhile, until the *Banking Union* becomes fully functional, State resources are still likely to be used for banks' restructuring and resolution. As a result, "the role of State aid control during this transition period will remain very important as a proven instrument to protect financial stability, the internal market, and taxpayers' interests"³⁰.

That being said, considering that sufficient funding and liquidity "is one of the most critical aspects of resolution"³¹, it has also to be noted that, even if the SRM will be based on a common backstop intended to be provided in principle solely by privately-funded resolution funds, its effectiveness and credibility will still depend upon the possibility to have prompt and unconditional access also to public backstop at euro area level³² – as an ideally temporary and in principle

²⁹ See B. COURE', *The Single Resolution Mechanism: Why it is needed*, at the ICMA Annual General Meeting and Conference 2013, organized by the International Capital Market Association, Copenhagen, 23 May 2013.

³⁰ See ALMUNIA, *Banking crisis, financial stability and State aid: The experience so far*, speech/13/223, Bruegel, 13th March 2013.

³¹ See MERSCH, *op. cit.*

³² In particular, the creation of a common backstop "is an important tool for the near term to help break the bank-sovereign loop and exit the crisis. In the longer term, the fiscal backstop to the Banking Union could perhaps replicate the successful arrangements we see in the U.S. where the Treasury provides a credit line to the FDIC, which is repaid over time through additional levies on the financial sector", V. COSTANCIO, *The nature and significance of Banking*

fiscally neutral last resort option to be used to satisfy exceptional liquidity needs.

3. Article 107 of the Treaty on the Functioning of the European Union (TFEU) sets forth the general principle of "incompatibility" with the "internal market" of State aid. "State aid" is any measure which distorts (or even only threatens to distort) competition by favouring certain undertakings or the production of certain goods, in so far as it affects trade between Member States. That being said, paragraph (3)(b) of the same article 107 provides for an exception to this principle that has been increasingly relied upon since the outbreak of the latest global financial crisis as the legal basis for (general and *ad-hoc*) State aid measures in favour of financial institutions extensively put in place by Member States to prevent and mitigate the impact on their economies of the conditions of widespread disruption and instability of their financial systems. Indeed, art. 107(3)(b) TFEU states that State aid measures may be exceptionally (and temporarily) considered to be "compatible" where the aid is granted to remedy "a serious disturbance in the economy of a Member State"³³.

In particular, the filing (on 15 September 2008) by Lehman Brothers Holdings Inc. (and subsequently also by 22 of its affiliates) of a petition seeking relief under Chapter 11 of the United States Bankruptcy Code had a global destabilising impact and started scaring liquidity away from financial markets all over the world. As a direct consequence, already by end-September 2008

Union, at the conference *Financial Regulation: Towards a global regulatory framework?*, Chatham House City Series, London, 11 March 2013.

³³ See Paragraph 11 of the Communication from the Commission on "*The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*" – the "*Banking Communication*" (2008/C 270/02) – provides that as "regards the financial sector, invoking this provision is possible only in genuinely exceptional circumstances where the entire functioning of financial markets is jeopardized".

"several large bailout packages were announced [...] joined soon by the introduction of State guarantees schemes aiming at ensuring continuous access of banks to financing"³⁴. At the time, it was even suggested in the EU to declare a moratorium to the enforcement of EU State aid rules in the financial sector, so as to allow banks to quicker and easier access supporting measures made available by Member States³⁵.

The initial EU policy option at the outbreak of the crisis was mainly confined to maintaining the level playing field across Member States in respect to the economic conditions of the State guarantees and recapitalisation measures granted in favour of banks. In order to ensure the consistency and the appropriateness of State aid rules against the exceptional and widespread financial markets disruption, the European Commission has issued a first set of Communications which are providing detailed and *ad hoc* guidance on the criteria for assessing the "compatibility" with the requirements of Article 107(3)(b) TFEU of various forms of State support to financial institutions, namely: I) the "*Banking Communication*" (2008/C 270/02); II) the "*Recapitalisation Communication*" (2009/C 10/03); III) the "*Impaired Assets Communication*" (2009/C 72/01); and iv) the "*Restructuring Communication*" (2009/C 195/04). In addition, with the "*2010 Prolongation Communication*" (2010/C 329/07) the Commission extended the temporal scope of the "*Restructuring Communication*" on amended terms until 31 December 2011 and specified that the *Banking*, the *Recapitalisation* and the *Impaired Assets Communications* needed to stay in place beyond 31 December 2010.

³⁴ See GALAND, *The Application of state aid rules to the financial services sector in the current crisis*, in *The EU economy. Response to the crisis and prospects for the new decade*, edited by KOCZOR M., TOKARSKI P., The Polish Institute of International Affairs, Warsaw 2011, p. 20.

³⁵ *Ibidem*.

The exacerbation of tensions in sovereign debt markets that took place in 2011, put the EU banking sector under increased pressure, particularly in terms of access to long-term funding markets. As a result, the Commission's "*2011 Prolongation Communication*" (2011/C 356/02) has provided for the *Banking*, the *Recapitalisation* and the *Impaired Assets Communications* to remain in place beyond 31 December 2011. The temporal scope of the *Restructuring Communication* was also extended beyond 31 December 2011.

Apart from extending the temporal scope of the foregoing Communications, the "*2011 Prolongation Communication*" also amended, as of 1 January 2012, some of the parameters to be used for assessing the compatibility of crisis-related State aid granted to banks. In particular, more detailed guidance has been provided on the "adequate remuneration" to be required "for capital instruments that do not bear a fixed return", together with a revised methodology for setting the fees to be paid to the State "in return for guarantees on bank liabilities"³⁶. Additionally the "*2011 Prolongation Communication*" has set forth the fundamental "proportionality" principle that the Commission is required to follow when assessing the long-term viability of banks in the context of the "measures for restoring confidence in the banking sector" (so-called "*banking package*") agreed upon by the Heads of State or Government at their meeting of 26 October 2011. This package requires banks to *inter alia* temporarily maintain "a significantly higher capital ratio of 9 % of the highest quality capital [...] after accounting for market valuation of sovereign debt exposures".

³⁶ The new rules refer to guarantees on liabilities with a maturity between one and five years (seven in case of covered bonds). The rules for shorter maturities are not modified.

On the 30 July 2013 a "*New Banking Communication*" (2013/C 216/01)³⁷ has been published, replacing the 2008 "*Banking Communication*" and adapting, complementing and supplementing the other crisis rules³⁸ with effect from 1 August 2013. In this latest Communication the Commission expressly acknowledges and provides that the "high volatility of financial markets and the uncertainty in the economic outlook and the resulting persistent risk of a serious disturbance in the economy of Member States justifies maintaining, as a safety net, the possibility for Member States to grant crisis-related support measures [...] in respect of the financial sector"³⁹. Nevertheless it has been also specified that any derogation to State aid prohibition or better any assessment of the compatibility of State aid with the internal market pursuant to art. 107(3)(b) TFEU remains "possible only as long as the crisis situation persists, creating genuinely exceptional circumstances where financial stability at large is at risk"⁴⁰. The need for revision of the Crisis Communications through this "*New Banking Communication*" essentially stemmed from the fact that "an increasing divergence in economic recovery across the Union, the need to reduce and consolidate public and private debt and the existence of pockets of vulnerability in the

³⁷ See the *Communication from the Commission on the application, from 1 August 2013, of state aid rules to support measures in favour of banks in the context of the financial crisis (Banking Communication)*, 2013/C 216/01.

³⁸ In particular the *New Banking Communication*: 1) replaces the 2008 Banking Communication, and provides guidance on the compatibility criteria for liquidity support; 2) adapts and complements the Recapitalization and Impaired Assets Communications; 3) supplements the Restructuring Communication by providing more detailed guidance on burden-sharing by shareholders and subordinated creditors; 4) establishes the principle that no recapitalization or asset protection measure can be granted without prior authorisation of a restructuring plan, and proposes a procedure for the permanent authorisation of such measures; 5) provides guidance on the compatibility requirements for liquidation aid (see paragraph 24).

³⁹ See *New Banking Communication*, paragraph 5.

⁴⁰ See *New Banking Communication*, paragraph 6.

financial sector have led to persistent tensions in the financial markets and fragmentation with increasing distortions in the single market”⁴¹.

As a result, notwithstanding the forthcoming evolution of the EU institutional and regulatory framework aimed at improving the stability of the financial sector and the prevention, management and resolution of banking crises (namely through the creation of the SSM and the SRM and the implementation of the BRRD), in the meantime it has been considered that the “integrity of the single market needs therefore to be protected including through a strengthened State aid regime. Adapting the Crisis Communications can help to ensure a smooth passage to the future regime under the [... BRRD ...] by providing more clarity to markets. The adapted Crisis Communications can also ensure more decisive restructuring and stronger burden sharing for all banks in receipt of State aid in the entire single market”⁴², *i.e.* also for those not subject to the SSM and the SRM.

In a nutshell, under the resulting legal framework, where recapitalisation or asset relief measure involves the use of State resources and fulfils the relevant requirements, the relevant Member State is subject to a standstill obligation and to an obligation to notify the measure to the Commission in order to enable it to adopt a decision possibly approving the State aid, subject to a "proportionate" restructuring of beneficiary institutions. With reference to the latter aspect the "*New Banking Communication*" set an important turning point in the way the Commission is going to assess the compatibility with the "internal market" of State Aid in the financial sector, and namely the compliance of restructuring plans with the requisites set forth by the State aid temporary rules established in response to the economic and financial crisis.

⁴¹ See *New Banking Communication*, paragraph 13.

⁴² See *New Banking Communication*, paragraph 13.

Indeed, until 31.7.2013 it was common practice that the Commission firstly took an *interim* rescue decision temporarily approving the State aid, subject, *inter alia*, to the submission by the concerned Member State of a satisfactory restructuring plan of beneficiary institutions, and only later took a final decision on the compatibility of the State Aid. These procedural arrangements, encompassing an *interim* approval of rescue aid followed by a final decision about the same aid, have been followed by the Commission since the outbreak of the crisis with the explicit purpose of avert panic and restore the market confidence by promptly and timely allow the implementation of measures necessary to safeguard financial stability.

On the contrary the "*New Banking Communication*" establishes the principle that (from 1 August 2013) the Commission will take a final decision authorizing State recapitalisation and impaired asset measures only once it has approved a "restructuring plan" (including a "capital rising plan") of beneficiary institutions. In other words, from now on "no recapitalisation or asset protection measure can be granted without prior authorisation of a restructuring plan"⁴³. The main rationale of this policy change is that in the current market conditions, after the first "emergency phase" started in 2008, the promptness of certain State interventions has become a less critical factor for maintaining financial stability. According to the Commission there is in particular "less need for structural rescue measures granted solely on the basis of a preliminary assessment which is based on the premise that practically all banks need to be rescued and which postpones the in-depth assessment of the restructuring plan to a later stage. Whilst such an approach helped prevent the irremediable collapse of the financial sector as a whole, restructuring efforts of individual beneficiaries were often

⁴³ See *New Banking Communication*, paragraph 24.

delayed. Late action to address banks' problems has resulted in some cases in a higher final bill to the taxpayers"⁴⁴.

Nevertheless, the "*New Banking Communication*" also provides (see para. 50) for a so called "financial stability clause", still allowing recapitalisation and impaired asset measures granted by Member States to be exceptionally authorised by the Commission on a temporary basis as rescue aid even "before a restructuring plan is approved", subject to the conditions that: 1) the concerned Member State invokes that such measures are required to preserve financial stability; 2) a capital shortfall exists at the time of the Commission's decision, "which would force the supervisor to withdraw the institution's banking license immediately if no such measures were taken"; 3) the exceptional risk to financial stability cannot be avoided or reasonably mitigated through the use of private resources or "by any other less distorting temporary measure such as a State guarantee". In any case, a restructuring plan must be submitted by the concerned Member State within two months of the date of the Commission's decision temporary authorising such a rescue aid.

Any restructuring plan notified to the Commission – either before or after the granting of public recapitalisation and/or impaired asset measures – will be assessed on the basis of the principles of the various "*Crisis Communications*", as lately adapted and supplemented by the principles expressed in the "*New Banking Communication*", in particular with reference to the enhanced burden-sharing requirements. As a result, a restructuring plan is in principle not required in case of public support in the form of State guarantees. Nevertheless, "heavy users" of State guarantees on their liabilities (both in absolute terms and

⁴⁴ See *New Banking Communication*, paragraph 23.

in relation to total liabilities)⁴⁵ are required to submit restructuring plans to the Commission. The final decision by the Commission can approve the aid as being compatible with the “internal market” only upon the satisfactory assessment that the required restructuring plan contains credible and effective measures (e.g. adequate burden-sharing, adequate own contribution to the cost of the restructuring by the bank and the holders of its liabilities, adequate remuneration for the State, appropriate structural measures and behavioral commitments, etc.) that would: I) allow the beneficiary institution to return (within maximum 5 years) to long-term viability, II) minimize the amount and effects of State support to the level strictly necessary to preserve financial stability and thus remedy "a serious disturbance in the economy of a Member State", and III) limit the resulting distortions of competition through effective and proportional compensatory measures.

In this respect, it is worth noting that the "2010 Prolongation Communication" has removed the distinction, originally established by the Commission, between *fundamentally sound financial institutions* (i.e. “institutions whose problems merely and largely had to do with the extreme situation in the financial crisis rather than with the soundness of their business model, inefficiency or excessive risk taking”⁴⁶) and *distressed financial institutions* (i.e. institutions “suffering from endogenous, structural problems linked, for instance, to their particular business model or investment strategy”⁴⁷) for the purposes of requiring the submission of a “restructuring plan” as opposed to a

⁴⁵ In particular, according to paragraph 59 (d) of the *New Banking Communication* a "restructuring plan must be submitted to the Commission within two months for any credit institution granted guarantees on new liabilities or on renewed liabilities for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of that decision) exceed both a ratio of 5 % of total liabilities and a total amount of EUR 500 million"

⁴⁶ See *2010 Prolongation Communication* (2010/C 329/07), paragraph 12.

⁴⁷ *Ibidem*.

“viability plan”. As a result, since 1 January 2011, a restructuring plan (showing the “determination to undertake the necessary restructuring efforts and return to viability without undue delay”) is required from every beneficiary of a new recapitalisation or an impaired asset measure⁴⁸. Yet, the distinction is still relevant for the assessment of the compatibility of the aid received. Thus, the Commission’s approval of States support measures in favour of financial institutions that are not fundamentally sound, is subject to stricter requirements, *e.g.* in respect to the (higher) remuneration required, the level of burden-sharing and the need for a thorough and far-reaching restructuring or an orderly winding up.

As regards this key issue, following the “political” agreement reached in 2011 on the “banking package” mentioned above, paragraph 14.3 of the “2011 Communication” is now providing for a “proportionate” assessment of the long-term viability of banks, so that banks should be considered viable (in the long term) *without the need for significant restructuring (i.e. a soft restructuring*⁴⁹ shall be deemed sufficient) where the following conditions are met: *I)* the capital shortage is mainly linked to a confidence crisis on sovereign debt; *II)* the public capital injection in banks which are otherwise viable is limited to the amount necessary to offset losses stemming from marking to market sovereign bonds of the States part to the EEA Agreement; *III)* the banks in question did not take excessive risks in acquiring sovereign debt.

The key policy objectives of this exceptional and temporary regulatory framework for State aid in the financial sector, which was progressively fine-

⁴⁸ *Ibidem*, paragraph 14.

⁴⁹ In this context it means a restructuring addressing mainly burden sharing and competition issues, namely by requiring adequate remuneration for the aid received together with compliance with some behavioural safeguards such as for example: an acquisition ban; a dividend ban; a coupon ban, a ban on calls and ban on aggressive pricing and advertisement practices.

tuned by the European Commission in accordance with the evolution of the economic and financial crisis, can be summarized as follow.

To start with, the Commission has balanced the necessity of taking into account the exceptional market circumstances prevailing in the financial sector since 2008 (and the resulting large amount of State aid granted), with the overarching objective that the State support measures in favour of financial institutions should “not generate unnecessary distortions of competitions [...] or negative spill over effects on other Member States”⁵⁰. It has thus aimed at preserving the stability, competitiveness and efficiency of the EU financial sector and the level playing field among competitors.

As a result, in applying the relevant criteria to measures taken by Member States, the Commission has committed itself to use a special procedure for the quick adoption of decision on the “compatibility” of aid granted and in general to proceed “with the swiftness that is necessary to ensure legal certainty and to restore confidence in financial markets”⁵¹.

From the substantial point of view, the Commission has been firmly and constantly requiring a rebalancing of the risk profile and a proper restructuring of financial institutions that received State aid, to the extent necessary to avoid excessive risk-taking and to ensure that only sound and viable intermediaries will keep operating in the market. In particular, in order to guarantee that the “outcome of market competition continues to depend on the quality and price of the services offered and not on the amount of aid received”⁵², and simultaneously preventing a potential “subsidy race” among Member States and future

⁵⁰ See *Banking Communication* (2008/C 270/02), paragraph 5.

⁵¹ *Ibidem*.

⁵² See GALAND, *The Application of state aid rules to the financial services sector in the current crisis*, in “*The EU economy. Response to the crisis and prospects for the new decade*” edited by Marcin Koczor, Paweł Tokarski, The Polish Institute of International Affairs, Warsaw 2011, p. 23.

“moral hazard”, the Commission’s clearance of notified measures has been constantly subject to the requirements that: *I*) any State support was limited (in amount, scope, time and intensity) to the strict minimum necessary; *II*) adequate remuneration was paid to the State and maximum own-contribution to the restructuring costs was achieved from existing shareholders and other investors; and *III*) a bundle of structural and behavioral safeguards and restrictions was temporarily implemented by the beneficiary institutions (*e.g.* acquisition ban, coupon and dividend ban, price leadership ban, remuneration policies, etc.)

Under the above crisis-related rules on the implementation of Article 107(3)(b) TFEU in the financial sector, in the period from 1 October 2008 to 1 October 2012, the Commission adopted more than 350 decisions addressing the problems of over 90 financial institutions. This resulted in the approval, in the same period, of an amount of € 5,059 billion (40.3% of EU GDP) of aid to the financial sector⁵³. In particular, the largest part “of the aid was authorised in 2008 when € 3,394 billion (27.7 % of EU GDP) was approved, mainly comprising guarantees for banks’ bonds and deposits. After 2008 the aid approved focused more on the recapitalisation of banks and impaired asset relief rather than on guarantees, while more recently a new wave of guarantee measures have been approved mainly by those countries experiencing an increase in their sovereign spreads, such as Spain and Italy. Between 1 January 2012 and 1 October 2012 further aid totalling € 429.5 billion was approved”⁵⁴.

As a result, the largest part of the State aid approved by the Commission in the period from 1 October 2008 to 1 October 2012 was represented by

⁵³ See EUROPEAN COMMISSION STAFF WORKING DOCUMENT, *Facts and figures on State aid in the EU Member States, 2012 Update*, accompanying the document *State aid Scoreboard, 2012 Update. Report on State aid granted by the EU Member States*, Brussels, 21.12.2012, [SEC(2012) 443 final], p. 28.

⁵⁴ *Ibidem*, p. 29.

guarantees (which amounted to roughly € 3,647 billion and 28.9% of EU-27 GDP), followed by recapitalisation measures (about € 777 billion and 6.2% of EU-27 GDP), asset relief interventions (about € 446 billion and 3.5% of EU-27 GDP), and finally liquidity measures (€ 216 billion and 1.7% of EU-27 GDP). The top five Member States in terms of the nominal amount of State aid granted to financial institutions were the United Kingdom (€ 873 billion), Germany (€ 646 billion), Denmark (€ 613 billion), Spain (€ 575 billion) and Ireland (€571 billion). The top five Member States in terms of the amount of the aid as percentage of national GDP in 2011 were instead Ireland (365.2%), Denmark (256.1%), Belgium (97.4%), Greece (59.9%) and Spain (53.6%)⁵⁵.

4. The impact and persistence of the financial crisis highlighted the need for a specific EU resolution regime for financial institutions that harmonizes and coordinates the intervention of competent public authorities. This issue is first of all addressed by the proposal for a directive on the recovery and resolution of credit institutions, investment firms, parent financial holding companies in the EU and their subsidiaries which is currently under discussion (*i.e.* the Bank Recovery and Resolution Directive – BRRD)⁵⁶. The proposal provides for the implementation of a set of harmonized crisis management arrangements across Member States, with the aim of pursuing two main policy objectives: *I*) avoiding financial instability, and *II*) minimizing costs for tax payers. The proposal is struc-

⁵⁵ *Ibidem*, pp. 30-31.

⁵⁶ See EUROPEAN COMMISSION, *Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM(2012) 280 final, Brussels, 6 June 2012* (hereinafter BRRD proposal).

tured around three pillars: preventative measures, early intervention measures and resolution tools.

Four main types of preventive measures are foreseen ("recovery plans", "resolution plans", "intra group financial support", "removal of impediments to resolvability" of a group or institution also through changes to their legal or operational structures). Early intervention powers (Articles 23-26) allow supervisory authorities to take a number of measures when the solvency or financial position of a financial institution deteriorates, including the appointment of a special manager for a limited period. Resolution is considered as a last resort remedy and consists in "the restructuring of an institution in order to ensure the continuity of its essential functions, preserve financial stability and restore the viability of all or part of that institution" (article 2 (1) of the BRRD proposal). According to the BRRD proposal, resolution "constitutes an alternative to normal insolvency procedures and provides a means to restructure or wind down" an orderly manner a bank and other entities falling within the scope of the BRRD proposal.

Resolution authorities have at their disposal the following set of resolution tools: I) the sale of business tool; II) the bridge institution tool; III) the asset separation tool and, IV) the widely debated "bail-in" tool, allowing resolution authorities the power to write-down the claims of unsecured creditors of a failing institution and to convert debt claims to equity. All these resolution tools entail a degree of restructuring of the concerned institution. The asset separation tool has to be applied only in conjunction with another resolution tool (Article 32 (4) of the BRRD Proposal). When applicable, the use of any of the resolution tools will need to be consistent with the EU rules on State aid control in the "internal market".

Pursuant to Article 26 of the BRRD Proposal, resolution authorities should apply the resolution tools and exercising the resolution powers having regard to the provided resolution objectives, and choose among the resolution tools and powers at their disposal those tools and powers that best achieve in the circumstances of the case the six resolution objectives considered of equal value, namely: 1) ensuring the continuity of “critical functions”; 2) avoiding significant adverse effects on financial stability; 3) protecting depositors and investors covered by the relevant schemes; 4) protecting clients’ funds and assets ; 5) minimizing the reliance on extraordinary public financial support; and 6) avoiding unnecessary destruction of value and minimizing the cost for the resolution altogether.

The fragmentation and lack of homogeneity currently existing among EU Member States with reference to the administration of resolution procedures and crisis management of financial intermediaries do not guarantee in certain circumstances an effective and efficient resolution of cross-border groups, in particular where resolution has a different systemic impact in several Member States⁵⁷.

In this respect, Article 3 of the BRRD proposal only requires that resolution powers and functions shall be conferred to public administrative authorities but, in order not to interfere with the constitutional and administrative orders of Member States, leaves open to Member States the decision upon the actual

⁵⁷ As a result “if a cross-border bank fails, supervisors and other (resolution) authorities concentrate only on operations within their own territories. This may complicate cross-border cooperation and lead to inefficient and possibly competing approaches to resolution, with suboptimal results at EU level”, EC, *Commission staff working document, Summary of the impact assessment. Accompanying the document “Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010”*, Brussels, 6.6.2012 [SWD(2012) 167 final] p. 2.

design of their most appropriate national institutional framework. This subject, nevertheless, to compliance with the overarching policy principle that "functional separation of resolution activities from the other activities of any designated authority is mandated"⁵⁸.

To ensure enhanced cooperation between national authorities and application of a group and EU wide approach in case of recovery and resolution measures to be applied to cross border groups, the BRRD proposal envisages the establishment of a system of "Resolution colleges". The European Banking Authority (EBA) will participate to these colleges in order to facilitate cooperation and mediate if necessary.

Considering the once the SSM is in place a more integrated EU institutional framework will be even more needed also for recovery and resolution purposes, the Council supported the Commission's initiative to establish a SRM and an EU resolution fund (the SBRF)⁵⁹. The scope of the SRM's jurisdiction shall be limited to Member States participating in the SSM, and the SRM is intended to replace the "Resolution colleges" envisaged in the BRRD with reference to entities established in Member States participating in the SSM. As a result, for other entities additional institutional arrangements and *ad-hoc* cooperation mechanisms with national resolution authorities in non-participating Member States will need to be implemented to maintain the level playing field⁶⁰. In this respect, the latest SRM proposal envisages that "where a group includes credit institutions established in a participating Member State and in a non-

⁵⁸ See BRRD proposal, p. 9.

⁵⁹ See EC, *A Roadmap towards a Banking Union*, COM(2012) 510 final, Brussels, 12 September 2012, p. 9. EC, *Conclusions : European Council 13/14 December 2012*, *op. cit.*, p. 4, point 11.

⁶⁰ See Articles 5 and 30 of SRM regulation proposal.

participating Member State, the [... SRB ...] replaces the national resolution authorities of the participating Member States in the resolution colleges"⁶¹.

Under the latest Commission proposal, such SRM shall consist of uniform rules and procedures to be applied by a newly established EU Agency with legal personality and the most extensive legal capacity accorded to legal persons under national law⁶² (*i.e.* the *Single Resolution Board*, SRB, expected to become fully operational by January 2015)⁶³, together with the Commission and the resolution authorities of the participating Member States.

In particular, according to articles 41 and 43 of the latest SRM regulation proposal, the SRB will be accountable towards the European Parliament, the Council and the Commission and shall act independently and in the general interest. The SRB is also intended to be financially independent, indeed the SRM budget, which includes the SBRF, is not part of the EU budget and will be financed by contributions levied on the banking sector. The SRB will also own, administer and use for resolution purposes (as listed in Article 71 of the SRM proposal)⁶⁴ a newly established SBRF financed through: *i) ex-ante* and extraordinary *ex-post* contributions by entities subject to the SRM regulation; *ii) voluntary borrowing* between financing arrangements; *iii) borrowings and alternative funding means* to be used when funding from *ex-ante* and *ex-post* contributions are not immediately accessible or sufficient; *iv) return on assets* in which the SBRF has to invest its liquidity.

⁶¹ See SRM regulation proposal, p. 11.

⁶² See Article 38 of the SRM regulation proposal.

⁶³ See Article 87 of the SRM regulation proposal. The SRB shall be composed of an Executive Director, a Deputy Executive Director, a member appointed by the Commission, a member appointed by the ECB and a member appointed by each participating Member State, representing the national resolution authority (art. 39 of the SRM regulation proposal)

⁶⁴ In particular, article 71(3) of the SRM proposal expressly prohibits using the SBRF to directly recapitalize or absorb the losses of an institution or an entity subject to the SRM regulation.

The SRB will also normally prepare decisions to initiate the resolution of banks which shall however be adopted only by the Commission (which can also act on its own initiative or upon information received from the ECB or national authorities as provided by article 16 of SRM regulation proposal). When taking the decision to initiate a resolution the Commission shall also define the framework of the resolution tools that shall be applied in each case and decide on the use of the SBRF to support the resolution action. The SRB shall following decide on the details of the resolution tools to be used and instruct national authorities of the measures to be taken in this respect. It would also take all other decisions under the SRM Regulation and would monitor the implementation by the national resolution authorities of its decisions. Should national resolution authorities fail to properly implement SRB's decisions, the SRB could directly address decisions to banks. From the legal and institutional point of view, it appears that this decision making process envisaged in the SRM proposal has been clearly designed to avoid any delegation of "wide margin of discretion" to the SRB that may lead to policy choices by the SRB and so to ultimately avoid any potential legal issues that may arise under the "Meroni doctrine"⁶⁵. At the same time, although the final decision on whether or not to place an entity under resolution, on the framework of the resolution tools and on the use of the SBRF is reserved to the Commission, the central role and functions assigned to the SRB in resolution procedures can be regarded as an institutional measure that increases the

⁶⁵ See ECJ, 13 June 1958, case 9/56, *Meroni & Co., Industrie Metallurgiche, SpA vs High Authority of the European Coal and Steel Community*, Reports of Cases 1958, p. 00011 and ECJ, 13 June 1958, case 10/56, *Meroni & Co., Industrie Metallurgiche, società in accomandita semplice vs High Authority of the European Coal and Steel Community*, Reports of Cases 1958, p. 00053. See, for an opinion according to which such delegation is possible by the legislative power after the Lisbon Treaty that extended the competence of the CJEU to EU bodies: REPASI, *Legal issues of Single European Supervisory Mechanism*, Brussels, 1 October 2012, available online at www.sven-giegold.de

independence of resolution functions from other Commission's powers and functions.

5. The general conclusion that can be drawn from the analysis of proposed legal provisions on the new resolution framework for the EU financial sector is that the efficiency and effectiveness of this new institutional architecture will dramatically depend on the actual degree of coordination and cooperation among the different authorities and institutions involved at EU and national level⁶⁶.

For example, in order to contribute to further streamline the resolution process and increase its legal certainty, it might worth considering the introduction of *ad hoc* harmonized procedural and substantive rules for the judicial review at national level of any act and decision taken by national resolution authorities. That said, the creation of a harmonized SSM and SRM for Member States adhering to the *Banking Union* will also directly impact, and needs to be properly coordinated in practice with, the control of State aid possibly granted by these Member States.

In this respect, assigning the task of taking the final decision upon resolutions to the European Commission, as foreseen in the latest SRM regulation proposal, is to be regarded as the most appropriate institutional arrangement, for the time being, to streamline the resolution process and increase the accountability and legal soundness (*e.g.* under the "Meroni doctrine") of resolution decisions.

⁶⁶ With reference to the ability to maintain a timely and constant exchange of information, the SRM proposal already envisages for the Commission a full access to information held by the SRB, and assigns to the latter (see Article 32-35) wide investigatory and informative powers including the possibility to conduct on-site inspections.

Moreover the fact that the SRM regulation proposal (Article 16 (8-10)) envisages that Commission's approval under the State aid rules and criteria established for the application of Article 107 of the TFEU (either because State aid is present or only "by way of analogy" when the use of the SBRF is involved) shall be considered as a precondition for the following (separate and independent) Commission's decision on resolution represents a key legal safeguard to allow the necessary coordination and level playing field with Member States not participating in the SRM with reference to State Aid control in the EU internal market.

IMPACT OF AMERICAN FINANCIAL CRISIS ON CHINA'S ECONOMY AND CHINA'S RESPONSE TO IT

*Yuan Jianxin**

ABSTRACT: *The American financial crisis, started in late 2008, has an evident influence on the business performance of the Chinese financial institutions, which have purchased the United States subprime mortgage bonds, taking even the risk of an attack by speculative capitals from Europe.*

This long recession is posing serious challenges to China's monetary policy, currently influenced by credit contraction and corporate profit decline. The growing expectation of appreciation of the renminbi has seriously affected China's real economy, which is highly dependent on foreign trade.

China has however an enormous potential of consumption to stimulate economy, related to a process of rapid urbanization. Every year, there is a population of about 10 million urbanized, which has a considerable influence on economic growth by upgrading consumption.

Since 2009, the Chinese government has implemented a package of fiscal measures in order to cope with the international financial crisis and promote rapid and stable economic development, by implementing a two-year investment plan and adjusting its industrial planning for a revitalization in a large scale.

SUMMARY: 1. The negative impact of American financial crisis on China's economy - 2. Favourable Conditions for China to Cope with the Financial Crisis - 3. China's Measures to the Financial Crisis - 4. Concluding remarks.

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1. The ongoing American financial crisis will have a certain impact on the business performance of the Chinese financial institutions, which have purchased the United States subprime mortgage bonds. According to statistics from the United States Department of the Treasury, by the end of June 2006, American mortgage bonds bought by Chinese institutions have totalled 107.5 billion dollars, accounting for 47.6% of the total purchased by Asian countries. Usually, subprime mortgage bonds accounts for nearly 15% in the mortgage bond market. If it is calculated according to this ratio only, the American subprime mortgage bonds purchased by Chinese institutions are close to 16 billion dollars. Some China's financial institutions, including six listed banks, namely the Bank of China, Industrial and Commercial Bank of China, China Construction Bank, China Bank of Communications, China Merchants Bank, CITIC Bank, have bought the United States subprime mortgage bonds, which sustained losses of more than 10 billion dollars.

At the same time, the risk of overseas investment of our financial institutions has increased. On the one hand, the American financial crisis helps our financial institutions bypass the barriers to market access and M&A, and increase financial investment in the United States at a relatively reasonable cost. On the other, the international financial market turmoil and monetary tightening undoubtedly increases the financing and investment risk taken by Chinese financial institutions. With the deepening of the subprime crisis, investors' risk aversion and leave emotions can lead to higher levels of pricing revaluation of mortgage-backed securities, thereby endangering safety and profitability of the overseas investment from the financial institutions within the territory of China.

The American financial crisis has increased the risk of Chinese financial market. On the one hand, due to the influence of the financial crisis in the United States, Europe and the United States speculative capital reevaluate their investment risk in the emerging markets, like China. They give up the high-yield/high-risk investment, divest and return home so as to alleviate liquidity and financing crisis. If a massive withdrawal was made in a short period of time, it would have a significant impact on the Chinese stock market and economy. Similar situation occurred ten years ago during the Asian financial crisis. On the other hand, financial markets in some Asian emerging market countries have become the safe haven for international hot money. In response to the negative influence of the financial crisis, the United States government has adopted a loose monetary policy and a weak dollar policy. With the economic slowdown in developed countries, China's sustained economic growth, as well as the expectation that continued weakness in the US dollar and the RMB appreciation remain unchanged, the international capital is sure to flow into China and other Asian countries at full speed, searching for a safe haven, which will increase the risk of China's capital market. In addition, due to the chain reaction in stock markets, the slump in American stock market will exert a significant impact on stock markets in Europe, Asia and even around the world.

The financial crisis in the United States leads to the complexity and transience of the global economy, which also poses serious challenges to China's monetary policy. On the one hand, as credit contraction and corporate profit decline start to appear in the United States, Europe and other major economies, the possibility of slowdown or even a decline in economic growth has increased. On the other hand, the global inflationary pressure remains high, for the global real estate and stock prices fluctuate sharply, and the prices, denominated in dollars, of commodities, like food, gold, oil, in the international market continue

to rise. Therefore, China needs not only to cope with the pressure caused by America's reduction of interest rates and low demand as a result of the financial crisis, but also to deal with the domestic economic slowdown, and inflation pressure, all of which makes monetary policy making a dilemma.

Since the outbreak of the American financial crisis in 2008, America's economic growth has been under a weak situation. It has adopted the quantitative easing monetary policy and a weak dollar policy, so as to deal with the negative impact of the financial crisis. It, on the one hand, has led to shrinkage in China's foreign exchange reserve. By the end of September 2008, China's foreign exchange reserves have been close to 2 trillion dollars. Therefore, the stock loss caused by devaluation of the dollar is tremendous. On the other hand, as the Fed continues to lower the interest rate and depreciation of the dollar accelerates, the interest rate inversion is further aggravated, which will result in more speculative capital inflows into China. Therefore, the subprime crisis could lead to more money flowing into China rather than the other way around. Therefore, the RMB will face greater pressure of appreciation, and the central bank's hedge against it will become more difficult.

The growing expectation of appreciation of the renminbi has seriously affected China's real economy, which is highly dependent on foreign trade. The slowdown in demand in the international market has slowed Chinese export growth and made export enterprises difficult to recover capital, which further results in the closedown of thousands of small and medium-sized export enterprises. Thus, "a tide of shutdown" appears in the coastal provinces. Statistics show that, at present, the textile industry is the biggest victim, while other industries, like toy, home furnishing, sanitary ware, hardware and steel, automobile, electronic information, have also been influenced to a certain extent. Especially those industries that depend upon the bubble in the capital market have

been hurt seriously. For example, the downturn in the America's housing market has hurt China's iron and steel industry badly. It is alleged that, spare productive capacity in China's iron and steel industry now has exceeded 100 million tons.

The global economic recession and the stock market volatility brought by the financial crisis have had an increasing psychological impact on Chinese investors. As the decline in market confidence in the future growth of the Chinese economy due to the financial crisis, coupled with the huge rise in the Chinese capital market at an early period, as well as the interior requirement for technology adjustment, when financial crisis triggered a turmoil in the global stock market, China failed to survive, and even became the biggest declining market in the world. The crisis of confidence in the credit market triggered by the American financial crisis has resulted in partial tight liquidity in developed countries, which has also shacked the confidence of Chinese investors in the financial market.

Besides, the financial crisis has led to the change of consumer psychology, expectation of Chinese residents, as well as the loss of confidence in future macro-economy. These factors have further put downward pressure on China's capital market and real estate market. Therefore, indirect impact on China by the American financial crisis can not be ignored, and it may deepen over time.

2. First of all, the impact of the financial crisis on China's financial sector is relatively small. At present, Chinese financial institutions do not have the problem of shortage of liquidity, and they also have strong ability to use and allocate funds.

Secondly, China's finance is quite sound. China's current national debt rate is about 20%, while that rate in the United States was as high as 70% in 2008, which has exceeded the national debt rate cordon.

Thirdly, China has an adequate foreign exchange reserve, which now has exceeded 2 trillion dollars.

Fourthly, the enterprises' capital chains and residents' investment capital chains are fairly smooth. By October 2008, Chinese enterprise savings have accumulated more than 2 trillion yuan, and the residence deposits amounting to 19 trillion yuan. Such a huge amount of savings not only provides powerful fund application space for Chinese financial institutions, but also creates favourable conditions for the business operation and residential consumption.

As the western developed countries have almost completed all the infrastructure construction, their investments mainly focus on technology upgrade and modification and functional recovery, which are relatively small and do little to stimulate the economy. On the contrary, China's existing infrastructure can not meet the needs of China's economic development and people's improving living standards. Thus, there is a vast space for investment in infrastructure, specifically in transportation (such as rail, highway, airport, port, and bridge construction), energy infrastructure (such as oil, coal, power plant, and power grid construction), urban infrastructure and new rural public infrastructure. Therefore, there is still a huge space for China to expand domestic demand and stimulate economic growth through investment in infrastructure.

There are two important features of consumption and economic growth in the western developed countries: (1) on the premise of the limited demand for investment, the national economy is consumption-oriented, in which the falling spending power exerts a significant impact on the economic recession; (2) the residential consumption has reached a relatively high level. Even if the

consumption ability remains, there is not much room for the development of new consumer demand. This is the primary reason why the western developed countries' economic growth has remained low over the long term. However, the situation in China is different. There are bright prospects of the development of the consumer market and its ability to stimulate economic growth. These years, the annual increase of labour force in China is around 8 million. The consumption and employment of these new employees will promote economic growth. Apart from that, China is in a process of rapid urbanization. Every year, there is a population of about 10 million urbanized, which has a considerable influence on economic growth. With China's economic development and people's improved income level, Chinese residents' upgraded consumption, in terms of housing, automobiles, clothes, tourism, entertainment and leisure, has played an increasingly important role in household consumption, which means it has a huge market potential.

Compared with the governments of those western developed countries, the Chinese government has a relatively strong macro or regional economic competence. There are several reasons for it. First of all, relatively speaking, state-owned economy is a critical component of China's economy, so the government can control the state-owned enterprises to take more social responsibility for maintaining the stability of national economy in a certain period of time. Secondly, the Chinese government has strong control and regulation capacity and advantage in terms of concentration and distribution of national resources, coordination of regional economic development, promotion of industrial reconstruction and social investment direction. Thirdly, China's huge investment demand depends on the government's planning, guidance and coordination. Thus, if the China's economy is greatly affected by the international fi-

nancial crisis and its GDP growth rate declines rapidly, the Chinese government will further increase its investment and, like the western developed countries, adopts a more active fiscal policy and loose monetary policy, in order to ensure steady economic growth.

The steady promotion of its international economic status is favourable for China to cope with the global financial crisis. On the one hand, as China's economic development has an increasingly important impact on world economy, some countries or regions will pay more attention to “China factor” and take China’s legitimate demands and interests into account in the coordination of the world’s major development issues. On the other hand, China is not only a major exporter, but also an import country, that is to say, a huge potential market. For some nations or international economic giants, it is of particular significance to explore, expand, and develop Chinese market. In this process, taking the legitimate interests of China into consideration is a necessary prerequisite for their participation in the Chinese market competition.

3. Since 2008, the Chinese government has introduced a number of measures to guarantee economic growth, such as the expansion of domestic demand by investing 4 trillion yuan (about 670 billion dollars) within two years in its infrastructure construction plan, including rail, highway and port construction. The Chinese government also plans to build low-cost rental housing, so as to house low-income groups. This approach will bring two benefits: (1) the development of the real estate industry can give a boost to the steel, furniture, building materials and other industries; (2) with housing these low-income families can settle down, which not only maintains the social stability, but also expands their consumption demand, such as interior decoration, furniture, home appliances, etc.

Since 2009, the Chinese government has implemented a package of fiscal measures, in order to cope with the international financial crisis and to promote stable and rapid economic development.

Firstly, the Chinese government has substantially increased its investment, by implementing a two-year investment plan, with a total worth of 4 trillion yuan (equivalent to 16% of China's GDP in 2007), in which the central government plans to increase another 1.18 trillion yuan. At the same time, the government embraces structural tax cuts, so as to expand the domestic demand.

Secondly, the government adjusts its industrial planning for industrial revitalization in a large scale and enhances the overall competitiveness of the national economy. In the face of the international financial crisis, the central government clearly makes adjustment and revitalization planning in ten key industries, namely automobile, steel, textile, equipment, ships, electronics, light industry, petrochemical, non-ferrous metal, logistics industry. Besides, the government vigorously intensifies efforts to encourage innovation, and strengthens its support for the development of science and technology, so as to enhance the further development. In particular, the 16 major projects, including core electronic devices, development and utilization of nuclear energy and high-end CNC machine tools, and a number of breakthroughs in core technologies and key generic technologies provide scientific and technological support for China's sustainable economic development at a higher level.

Fourthly, the government significantly improves social security, stimulates urban and rural employment, and promotes the development of social undertakings, including continuing to raise the basic pension for enterprise retirees, raising the standards of the unemployment insurance and industrial injury insurance, and improving the minimum life guarantee of the urban and suburban population and five-guarantee system in the rural areas. In order to actively

promote the reform of the medical and health system, the government strives to complete the basic medical and health system that covers both urban and rural areas within three years. In addition, accompanied with its loose monetary policy, China adopts a positive fiscal policy, such as raising the threshold of personal income tax, reducing corporate tax burden, and stimulating domestic demand.

First of all, considering that the American interest rates are lower than its counterpart in China with the same period, the central bank should adopt a cautious monetary policy to prevent the influx of international hot money into China, which will lead to increased inflationary pressure in China. Secondly, the government should adopt a less tightening monetary policy for banks, in order to reduce the impact of the global economic slowdown on China's economic development. Meanwhile, it should strengthen its control of the real estate mortgage, so as to reduce the possible risk involved in real estate mortgage. The third measure is to steadily promote market-oriented interest rates, focusing on the marketization of deposit interest rate, and the development of interest rate hedging business, in order to reduce interest rate risk of commercial banks after its marketization. Fourthly, the government should make good choices and promote the managed floating exchange rate policy, in accordance with market practice. Fifthly, having an in-depth study of China's current conditions and the advantages and disadvantages of interest rate, exchange rate and reserves, the government should make the best of each tool, coordinate with each other and promote macroeconomic regulation and control. One important reason of the United States' subprime mortgage crisis is mentality of "the risk be forget where gain follows" of financial institutions. They lent a great amount of money in pursuit of interest. They neglected the basic principles of loan management because of the constantly increasing housing prices, which led to higher risk and

eventually to the serious crisis. The commercial banks of China must learn from this crisis and pay more attention to risk management of financial institutions. Financial institutions should establish the risk monitoring and early warning system. Banks should pay more attention to the housing credit market monitoring and early warning analysis, make accurate judgment of the changes in the real estate price, and take measures in advance to avoid adverse effects brought about by the fall of housing prices. At the same time, banks should further improve the long-term mechanism of risk management of real estate credit, keep balance between the business development and risk control, and save for the rainy day, so that they will not be helpless in the face of crisis. Besides, banks should focus on the borrower's credit status and the actual ability to repay the loan rather than relying on the second source of repayment, like the mortgaged property.

In order to prevent some negative influence brought about by the volatility of the international financial market on China's financial market, the Chinese government need to safeguard China's financial security, strengthen the construction of financial market, and constantly enhance the ability of China's financial market to resist risks under open conditions. First of all, the government needs to deal with the issue of the system and mechanism of market development, so as to improve the efficiency of market operation and the overall competitiveness. secondly, it needs to encourage those qualified large enterprises and small and medium enterprises with rapid growth to gain a listing on the market, expand the proportion of tradable shares, promote the development of corporate bond market, introduce the financial futures at the proper time, diversify the channels to increase the proportion of direct financing. The third measure is to encourage the constant innovation in the securities, funds, and futures industry in order to enhance the overall competitiveness. Fourthly, in

order to meet the needs of the different levels of investors and money raisers who are in need of diversified investment and financing and risk management, the government should further improve the market standard, promote the product and its structure, create favourable conditions to fulfil the effective function of capital market, and increase the resistibility against the risk involved in China's capital market when opening to the outside. The outbreak of the American financial crisis does not prove that China's financial industry is better than that of other countries. On the contrary, it, to some extent, reveals that the reform of China's financial industry lags far behind. At present, the development of China's financial lags behind that of the real economy, which leads to the fact that in such a country with a large population of 1.3 billion, there is a considerable excess saving, and that the deposit and lending interest rate is significantly lower than its economic growth rate. Excess saving makes China's economy dynamically inefficient. Such surplus capital needs to look for investment opportunities in a country, like the United States, where the economy grows slowly and the asset bubble is quite obvious. Meanwhile, we introduce 50 to 60 billion dollars worth of foreign direct investment projects annually and pay high capital returns to foreign investors.

The outbreak of the subprime mortgage crisis shows that financial innovation is not a panacea. It has inherent defects. It can accumulate and expand the risk, which is a hidden danger for the financial crisis? And the opacity of financial innovation makes supervision more difficult and undermines the supervision? If backward supervision system cannot keep up with financial innovation, it is easy to incur financial risk. Therefore, when encouraging financial innovation, the government should not ignore the negative effects of the financial innovation. It needs to tighten its supervision of financial innovation? Firstly, it should improve the capital adequacy ratio? The important cause of the financial

crisis lies in the characteristics of some innovative products, which can transfer of risk, like assets securitization. The characteristic caused that the scale of sub-prime mortgage on the market was out of control. Therefore, the government needs to tighten its supervision of innovative products, and improve credit structure and the capital adequacy ratio of securitization products, so as to effectively take the irrational expansion of innovative products under control and enhance the stability of the financial market. The second measure is to increase the transparency of financial innovation and to fully reveal the structure and the risk of derivatives, so as to protect the investors' interests and maintain the normal market operation. Thirdly, the government should improve the evaluation standard of innovative products so as to accurately reflect the risk and return involved in these products. Fourthly, the government needs to guide financial institutions in the banking system to make full use of the customers' risk information system of CBRC and credit information system of the People's Bank of China, so as to closely monitor the various domestic and overseas customers' defaults. Fifthly, the government needs to carry on more investigation and analysis of the credit risk of the real estate industry, establish a monitoring system, regularly reporting the credit risk of the real estate, strictly execute the loan program for the real estate companies, and intensify punishment for crimes, like the loan fraud and false mortgage.

4. Under the influence of the economic financialization and financial globalization, it is necessary for the Chinese government to take effective measures to open up its financial industry step by step. Besides, the enormous foreign exchange reserve and the rapid development of the macro-economy have established a solid foundation for the relevant reform. Objectively speaking, when the American financial crisis was spreading across the world, China's

steady financial policy of opening to the outside world has made a great contribution to avoiding the overseas financial risk. As an emerging market economy, in the presence of many defects in its economy and financial structure, China uses moderate financial regulation and foreign exchange management as an important “firewall” to resist the impact of international hot money. Especially in the current financial crisis, China should actively and steadily push forward the policy of opening up its financial industry, which can effectively prevent the relatively fragile financial system from completely exposing to the international economic environment and reduce various external uncertainties. Therefore, it is a gradual process for China's financial industry to comprehensively open to the outside world. It must adjust to China's economic development, its ability to macro-control and financial supervision, and the requirements for opening to the outside world. At present, we should gradually promote opening-up policy in securities and capital market, carefully loosen the control of capital accounts, strengthen the supervision of foreign exchange, steadily push forward the reform of RMB exchange rate system, and pay close attention to the consequences of the financial crisis.

In short, the American financial crisis exerts some impact on China's financial institutions, financial market, and macro-control in financial area. There are also many things that need the deep reflection of China's financial industry. We should draw a lesson from this, so as to better promote the steady and healthy development of China's financial industry.

THE FISCAL SUSTAINABILITY OF CHINA'S PENSION SYSTEM

Wei Nanzhi*

ABSTRACT: *China is trying to further extending the old-age pension program to cover all its residents. Such a process presents two jigsaw transitions: one is the transition from family support and danwei welfare to state responsibility and social insurance, the other is the transition from a danwei based pay-as-you-go pension system to “the combination of social pooling with personal saving accounts” pension system. Nonetheless, the reform of state-funded public pension scheme has long been in difficulties and thus formed a dual-track pension system. The superposition of different schemes and fiscal federalism resulted in the fragmentation of China's current pension system. Furthermore, the transition from pre-reform labour insurance program to social insurance scheme formed the fiscal insufficiency since the new scheme should pay pension benefits to those retired before the reform. Accordingly, the empty account problem seriously endanger the fiscal sustainability and equitability of China's pension system.*

Besides, China's pension system is facing challenges brought by the aging population, low investment return of pension fund, heavy dependency on public subsidy, which forms potential insufficiency and thus largely depends on Chinese economy's working well in the long term. The Suggestions for improvements are then provided, aiming at universalization and uniform of the fragmented pension schemes, postponing the retirement age, raising the investment return of pension fund, and so on. China's pension system still needs further reform to ensure its fiscal sustainability.

SUMMARY: 1. Introduction. - 2. Fragmentation of China's Pension System. - 3. China's Urban Employee' Pension System. - 4. Aging Population, Economic Growth and Pension System. - 5. Suggestions.

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1. China is in the process of social reform. Since late 1990s, pensions have spread at extraordinary speed in China. In August 2012, China's authority said that China had "basically" established a social security network on the foundation of social insurance, social assistance, social welfare and preferential treatment and comfort for special groups by the end of 2011. China's Ministry of Human Resources and Social Security (MHRSS) released *the 2012 Statistic Bulletin on Human Resource and Social Security Development* on May 28 2013, which outlines that, at the end of 2012, the total number of people participating in the country's basic pension fund scheme of urban employees reached 304.27 million, a 20.36 million increase from a year earlier, while those participating in the new rural old-age insurance and old-age insurance for urban residents reached 483.70 million, a 151.87 million increase from a year earlier.

Undoubtedly, today's growth rate of Chinese economy, though not as high as in the last decade, still seems to be high enough to afford its pension system. Nevertheless, the vulnerability of China's pension system has long been criticized due to it's being saddled with a wide range of problems, such as its fragmented management, a low return on investment of pension fund, and in particular, an increasingly aging population, etc. *The Law of Social Insurance* implemented in 2011 has the requirement of financial sustainability for social pension system; whereas such a legal requirement is also criticized for having no financial risk management mechanism in practice.¹ Then, can China's pension system ensure its fiscal sustainability and equitability?

The status of the elderly, who have long enjoyed authority in China because of the traditional "isomorphic state/*guojia*-family" structure and filial pie-

¹ See WANG XIAOJUN and REN WENDONG, *Population Ageing and The Financial Sustainability of Social Pension System in China*, 2012 China International Conference on Insurance and Risk Management, July 18- 21, 2012 Qingdao, China

ty², undoubtedly changes a lot along with the modernization of China, the changing relations between state, market and civil society, and especially the establishment of pension system. Nonetheless, such a transformation process cannot be simply regarded as a destruction of the old system and the establishment of a new one. It rather consists in the superposition of different schemes, with successive advances and relapses. Therefore, such a process results in the fragmentation of the current pension system (2).

Based on such a fragmented management, China has a pension system which generally distinguishes between four large collectivities: state-funded public pension scheme, urban employee's pension scheme, old-age insurance scheme for urban residents, and new rural old-age insurance scheme, among which, the urban employees' pension system constitutes the most important one (3). China's urban employees' pension system is based on a three pillars / three tiers framework, under which pension funds are sourced from the government, employers and employees. Besides the internal vulnerability due to the empty account and fragmentation, China's pension system have external challenges at the same time (4), which finally is followed by some alternative suggestions (5).

2. Influenced by the *Hukou* system (the household registration system), the Chinese pension system is basically divided into two parts, the pension scheme for rural residents, and other schemes for the urban residents. The urban elderly, according to their socio-occupation status, can be further divided into two groups: one is those inside the state system (retired civil servants, part of the public institutions' retirees) who benefit from the state-funded public

² The philosophy of imperial China can be described as "a Confucian exterior covering a core of Legalism". "Rule by filial piety", "rule by rites" and "Benevolent Rule" became three major mechanisms of governance.

pension scheme; the other is those outside the state system (part of the public institutions' retirees, enterprises' retirees, self-employed persons, and others), while the latter group benefit from two pension schemes - urban employee's pension scheme and old-age insurance scheme for urban residents. Such a dual-track pension system is triggering great public discontent.

Sectors	Inside the state system		Outside the state system		
Rural/urban	Urban schemes			Rural scheme	
Social groups	Civil servants	Other fully-public supported persons ³	Permanent urban residents	Migrant workers	Permanent rural residents
Scheme	State-funded public pension scheme		Scheme for urban residents	Scheme for urban employees	New rural old-age insurance scheme
Finance	Non-contributory Fully public subsidy		Individual contribution + public subsidy	Employee contribution + employer contribution + public subsidy	Individual contribution + public subsidy
Management	Work Unit		Administrations of Human Resources and Social Security		

Table 1: Fragmentation of China's Pension System

Three groups of retirees enjoy state-funded public pension: retired civil servants⁴, retired institutional persons in government, and the fully public sup-

³ Employees in urban areas of government agencies and public institutions which are financed (either wholly or partially) from sources other than the state budget are usually covered by the rural old age insurance.

⁴ Generally speaking, the term "civil servants" refers to employees of government ministries and public agencies and institutions that are financed entirely from the state budget, whether at the central, provincial or local (city, county, district) level.

porting retired institutional persons in public institution⁵. According to *the Regulations on National Civil Servants*, the pension of these three groups is fully paid for by public finance without paying any social contribution.⁶ The financial administration of this scheme can further divided into two types: one is retirees of public organs at central and provincial tiers whose pension expenditure is included into departmental budget, the other is those retirees of public organs at city, county or other more basic tiers whose pension is allocated by the local finance bureau. If someone no longer continues to be a civil servant, the government will not pay their future pension; instead, they will participate in other pension schemes.⁷

Retirees entering the this scheme mainly include two groups: retired non-institutional people (*qiye bianzhi ren yuan*) in public institutions /government⁸; and retirees from other companies/organs (including urban companies, individual economic organizations, private non-enterprise units, and self-employed in-

⁵ Chinese public institutions can be subdivided into three categories: self-supporting (most public institutions belong to this category, they are actually similar to enterprises), partly public supporting (including public hospitals, etc.), and fully supported by public finance (including public schools, public universities, public research organs, epidemic prevention organs, etc.). Those retirees of the institutions corresponding to the first and the second categories, are going to or have already participated in the urban employees' pension scheme. The retired institutional people who used to work in the third category of public institutions receive pension benefits ensured by public finance.

⁶ According to *the Civil Servant Law*, Article 77 stipulates that, "The state shall establish an insurance system for civil servants so as to ensure that a civil servant may get help and compensation under circumstances such as retirement ..." Article 79 stipulates that, "The expenditure for wage, welfare, insurance, retirement pay ... shall be listed into the fiscal budget so as to provide guarantee for them."

⁷ It is deemed that they paid their individual contribution for the duration of their work as civil servants. But the total sum of payment years should be no less than 15 years.

⁸ Article 2 of *the Labour Contract Law* stipulates that, "...The establishment of labour relationships, and conclusion, fulfilment, amendment, termination and expiration of labour contracts by the state departments, public institutions, social organizations and their contracted employees shall be handled pursuant to this Law."

dividuals). This scheme has not been established until 1997⁹, the year when the Chinese Government issued *the Decision on Establishing a Unified Basic Pension System for Enterprise Workers*. This scheme is a combination of mandatory contributory pay-as-you-go system and funded system, whose burden of pension provisions is shared by the government, employers and employees. Following the rapid urbanization and the enlarging coverage of social protection, this scheme forms the most important one in the four branches of China's pension system.

Since July 2011, Chinese Government carry out the plan of full coverage of urban old-age insurance, that is to say, it covers all the urban residents who do not enter the urban employees' pension scheme. Traditionally being full responsibility of the family, this scheme transfer the responsibility of supporting the elderly to be state responsibility. The fund of this scheme is constituted by individual contribution and public subsidy. The central government subsidizes the basic pension differently according to the regions¹⁰ while the local government subsidize according to their financial capacity.

As to the rural old-age insurance scheme, Nowadays, Chinese peasants can be divided into two groups: migrant workers and retired peasants. Migrant workers can enjoy "low payment, portable individual account, and pension benefits similar to urban permanent residents" when they enter the urban employ-

⁹ Until 1990s, Chinese companies had not saved (or created accumulation) for social security purposes: the state stipulated that all profits from state-owned and state-operated enterprises had to be surrendered upward to the state in their entirety, and that the workers' pensions or retirement funds would have to be listed as costs for those companies. Zhang Zhuoji, "On the Question of the Construction of a Social Security System", *The Chinese Economy*, vol. 36, No.5, September-October 2003, pp. 45-76.

¹⁰ As to provinces in eastern part of China (the rich regions), the Central Government subsidize 50% of the basic pension of the old-age insurance scheme for urban residents. As to other regions, the Central Government afford full subsidy.

ees' pension system.¹¹ As to retired peasants, all those over 60, provided they do not get pension from the urban retirement schemes, can get basic pension¹² from new rural old-age insurance funds since September 2009, when the State Council issued *the Regulations on the New Rural Social Endowment Insurance*. The central government subsidizes the basic pension differently according to the regions. Subsequently, the local governments will give subsidy to the insured peasants according to their financial capacity.¹³

(10,000 persons)

Year	Rural Basic Pension Insurance Contributors at Year-end	Beneficiaries of Pension Insurance			
		Contributors in the Year	Contributors from Township Enterprise in the Year	Farmer Beneficiaries in the Year	Surrendered Persons due to Transfer or Death in the Year
2011	32643.5	8921.8	1069.7	587.7	1199.2
2010	10276.8	2862.6	453.4	200.4	422.5
2009	7277.3	2016.6	16.7	1335.2	88.2
2008	5595.1	819.1	35.6	511.9	124.5

Table 1 Statistics on Rural Basic Pension Insurance in China¹⁴

Accordingly, the decentralized set up of the China's pension system leads to high fragmentation and complexity and thus makes it actually reconcile basically separate artificial devices, with great disparities between prosperous east and poorer west. Except the state-funded public pension scheme, the other

¹¹ According to the Draft Scheme of Farmer workers' Participation in Basic Endowment Insurance issued by the Ministry of Human Resources and Social Security on February 1st 2009, the migrant workers are encouraged to participate in the urban employees' pension system while their employers are obliged to pay social contributions for them. They can also transfer their individual account to the new rural social old age insurance scheme when they decide to return back hometown.

¹² When a participant retires, he/she can receive a government subsidy of Y55/month (or Y660/year).

¹³ There are five grades of contribution: the contributor pays his or her contribution amounting from ¥ 100 to ¥ 500. Then, the government provides a subsidy no less than ¥ 30 per annum.

¹⁴ China Statistical Year Book 2012, 2011, 2010, 2009.

three pension schemes are managed by the administrations of human resources and social security at different levels. That is to say, though MHRSS are in charge of the management and allocation of old-age benefits at the central level, it only has policy making power and supervision power, but not direct executive functions over the localities. As a result, the financial capacity of local governments and economic disparities directly condition the level of old age insurance that local residents receive. In addition, the National Social Security Fund (NSSF), serving as a buffer mechanism to mitigate pressure stemming from gaps in the pension system, finance part of the unfunded liabilities.¹⁵

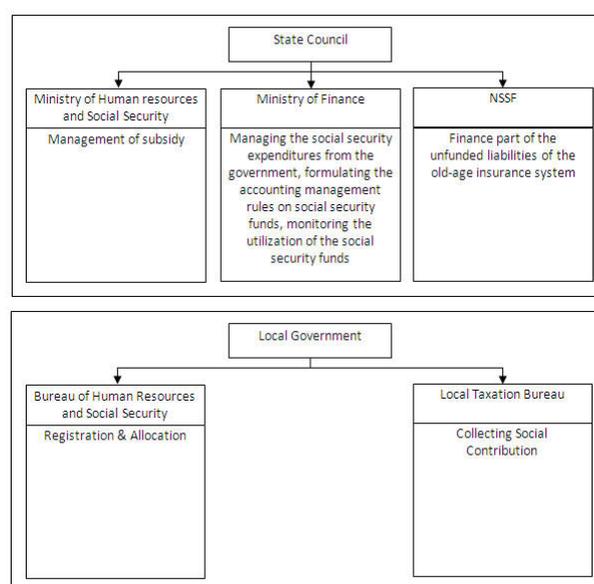


Chart 1 Financial administration of China's pension system at both central and local tiers

The fragmentation of China's pension system leads to the disparities of contribution, benefits and finance among different schemes, the disparities among different regions, and thus makes its financial sustainability more complicated. The rural-urban, regional, departmental and sectional disparities in

¹⁵ NSSF is a fund of “last resort” established by the Central Government in 2000. Its funds are derived from allocations from the central government budget, the sale of state shares, investment returns, and “capital being raised in other manners with approval of the State Council”. The Fund is administered by the National Social Security Fund Executive Council (NCSSF).

China's pension system represents a process of striving for distributing the benefits brought by economic development between and within different social groups.

3. Since the early 1950s, *danwei* system is regarded as a “cradle-to-grave” one as it made enterprises owned by all the people (SOEs), enterprises owned by the collective (COEs) and the public pension for the employees of government and the public institutions responsible not only for their employees’ life-long employment, but also for providing pension¹⁶ and other welfare treatments. Since 1980s, the economic reform changed the enterprises from native place to workplace.¹⁷ The collapse of the *danwei* system generated considerable resistance from formerly protected public employees and the individuals. They demand their “right to subsistence” directly to the government.

The central-provincial nexus is of key importance to the pension reform. After the 1994 Tax-sharing Reform, the local governments’ driving force to develop economically no longer is incentives from the financial system, but from reduced revenues and pressure of increased responsibilities.¹⁸ However, in order to establish the public pension system motivated by the reform of SOEs which decreased their burden on redundancy and the insurance expenditures, there is a classic “unfunded mandate” as the central government has assigned the establishment of the urban employee’s pension scheme as new responsibility to local governments. So at the beginning of pension reform, the level of so-

¹⁶ Male workers became eligible for a pension at 60 years of age after 25 years’ continuous employment. For female workers the qualifying age was either 50 or 55 after 20 years’ employment. In the 1955–60 period, average life expectancy at birth was 43.1 years for men and 46.2 years for women.

¹⁷ See LU XIAOBO and PERRY, *Danwei: the Changing Chinese Workplace in Historical and Comparative Perspective*, M. E. Sharpe, 1997, p.51.

¹⁸ See ZHOU FEIZHOU, *Fenshuizhi Shinian: Zhidu jiqi Yingxiang (A Decade of Tax Sharing: the System and its Evolution)*, China Social Science, 2006, vol.5, pp. 100-15.

cial pooling was very low, in some provinces even at county level, which inevitably led to the regional disparity since the financial capacity and willingness of local governments differs a lot.

Since 1990s, the urban employee's pension system has undergone two important reforms: one is the 1997 reform, which transformed the defined benefit, pay-as-you-go system to a "three-pillar, three-tier model". The social pooling account is a pay-as-you-go scheme, under which the government uses the old-age premium paid by current workers to pay pension to retirees.¹⁹ The individual account forms a cash-basis total accumulation "account" method, under which the employees' pension is paid when they retire. It is named as a structural reform since it basically reformed the former fully pay-as-you-go pension system into a partially funded one.

Such a design has the purpose of both highlighting the government's role in redistribution and easing the government's financial burden through individual participation. Nonetheless, the transition from labour insurance program to social insurance scheme produced serious problem of empty account. Individual accounts were in debt and accumulating mounting annual deficits because majority of local governments, being unable to afford the cost of transition, that is, the fund gap in the current urban employee's pension system caused by pensions paid to people who retired before the reform in 1997, diverted the fund of individual account to pay the pensions of today's retired, especially those shed by state-owned enterprises during the downsizings of the 1990s. This made the "supposedly-fully-funded" individual accounts an empty shell and thus become

¹⁹ The rules established in 1997 apply only to those who started to work after 1994. For those retired before 1994, they continue to receive pension benefits based on the old system. For those who started their job before 1994 but retire after the year will receive benefits in compromise between the old and the new rules.

accounting tools. Hence, the requirement of contributions to these accounts are regarded not as assets but as another form of tax.

In 2005, the State Council issued *the Decision on Improving the Basic Social Insurance System for Enterprise workers Chinese Government* and carried out another reform to change the contribution and benefit calculation policies²⁰ in order to resolve the empty account problem. Named as a parametric reform, this reform tries to standardize the first pillar-public pension benefits and contributions across pension pools. Nevertheless, the empty account problem has not been entirely resolved until now. The reform also focuses on resolving the interest conflicts among local administrations because that the local administrations separately controlled their own social security fund. Since then, the central government provided subsidy to the pension schemes. The free transfer of individual account has also finally been realized in 2010.²¹ It indicates a major transformation of the central-provincial nexus as to the pension system in China. Now the social pooling fund of urban employees' pension scheme has been financed and managed at the level of province.

²⁰ It rewards retirees with a higher pension for every additional year that they have contributed.

²¹ On Dec. 22nd 2009, the State Council issued *the Interim Measures on Transferring Basic Old-age Pension Accounts for Workers of Urban Enterprises between Different Provinces*, which marks a major breakthrough in the building China's national pension system of the urban employees. It also greatly benefits the free movement of labour and reduces the regional and departmental disparities of the retirement treatment.

First Pillar	Second Pillar	Third Pillar
Third tier: none	Voluntary supplementary enterprise annuity (urban enterprises' retirees) Estimated target replacement rate 20%-30%	Voluntary comple- mentary private pen- sion savings, private insurance, etc.
Second tier: Individual account (funded + DC scheme) 8% of individual salaries Target replacement rate 24%		
First tier: social pool (pay-as-you-go + DB scheme) ----- 20% of the total payrolls Target replacement rate 35%	Mandatory occupational pension: none	Mandatory private pension: none
Public Pension	Supplementary Pension	Voluntary saving

Chart 2 Three-pillar three-tier pension system in China

Today, China's urban employee's pension scheme forms a three pillars / three tiers pension system. Besides the basic pension, it comprises two other parts: enterprise supplementary pension insurance and personal savings for old-age insurance. The three pillars include: public pension, voluntary or supplementary occupational pension, and voluntary private savings.

The first pillar is the mandatory public pension, or basic old-age benefit, which consists of two components: the one is base old-age benefit; the other is individual account benefit. The former one is provided by the social pool, while the latter is funded by the individual account. The social pool is a mandatory pay-as-you-go and defined benefit scheme (first-pillar / first-tier) to provide pensioners with a minimum level of benefits. As a pay-as-you-go system financed by employers, it covers the urban retirees except public finance supported ones. The mandatory defined contribution scheme (first-pillar/ second-

tier) is to accumulate additional benefits by contributions via individual accounts managed as fully funded individual accounts.

According to the State Council Document 38 of 2005, the employer contributes tax-deductible 20% of the employee's total monthly wage bill to the social pooling. Individual account is now funded solely by employee contributions of 8% of his or her monthly wages (before tax). In all cases the wages used to calculate the contributions are subject to a maximum of 300% and minimum of 60% of average wages in the locality.²² The two constitutes the contribution to the mandatory basic pension system.

Region	Urban Employee Basic Pension Insurance Contributors at Year-end (10 000 persons)			Revenue and Expenses (100 million yuan)		
		Number of Staff and Workers	Number of Retirees	Revenue	Expenses	Balance at Year-end
National Total	28391.3	21565.0	6826.2	16894.7	12764.9	19496.6
Beijing	1089.4	888.2	201.2	812.8	560.8	869.8
Shanxi	623.8	464.9	158.9	483.9	329.3	791.8
Liaoning	1556.6	1070.1	486.5	1039.0	883.1	895.1
Shanghai	1382.7	976.2	406.5	1089.2	993.5	557.6
Zhejiang	1919.2	1665.8	253.4	901.2	543.2	1520.2
Guangdong	3800.7	3428.2	372.6	1400.3	764.5	3108.2
Sichuan	1494.2	998.8	495.4	1085.6	753.9	1260.0
Gansu	263.0	177.9	85.1	223.4	154.0	247.6
Xinjiang	431.5	299.6	131.9	352.9	272.8	465.8

Table 2: Statistics on Urban Employee Basic Pension Insurance in some provinces (2011)²³

The table above shows that, in Shanghai (41.64%), Liaoning Province (46.77%) and Sichuan (49.6%), where there are many SOEs, the ratio of number

²² The standard of the average wage of the employees of the previous year differs in each provinces, autonomous regions and municipalities, or cities specifically designated in the state plan.

²³ China Statistical Year Book 2012.

of retirees to the number of staffs and workers is much higher than that of Guangdong Province (10.87%) and Zhejiang Province (15.21%), where most of its enterprises are private ones. Such disparities directly lead to the disparities of financial burden of the provincial governments towards the urban employee's pension scheme.

The second pillar is a voluntary or supplementary pension benefit called the enterprise annuity (EA). EA is a key supplement to the public system using voluntary, employment-based, privately managed defined-contribution arrangements regulated by the government. Only after making the required mandatory contributions under the public pension system and being financially sound, can the employer become eligible to establish an enterprise' annuity. It must have collective negotiation mechanism in place for its workers.

The third pillar consists of voluntary complementary pension savings and private insurance, and so on. Although the Chinese economy as a whole is characterized by a high savings rate²⁴, but neither the pension savings nor the private insurance are supported by tax incentives or public subsidies. Therefore, this option is not significant up till now.

4. China's pension system has internal problems such as empty account, fragmented management, and disparities, which bring difficulties to its fiscal sustainability and equitability. At the same time, it faces external challenges such as China's demographic development and the sustainability of Chinese economy growth.

The social pooling fund is operated based on the principle of reallocation and individual account is operated based on the principle of civil saving. In rela-

²⁴ Per Capita Balance of Saving Deposit is ¥13058 in 2007. *China Statistical Year Book 2008*.decision

tion to social pooling, the method of pay-as-you-go plays still dominant role, which is facing the challenge of aging population. The sustainability of pension funds and the equitability of pension schemes in China heavily depend on the public financial capacity, and thus ultimately depend on the economic growth.

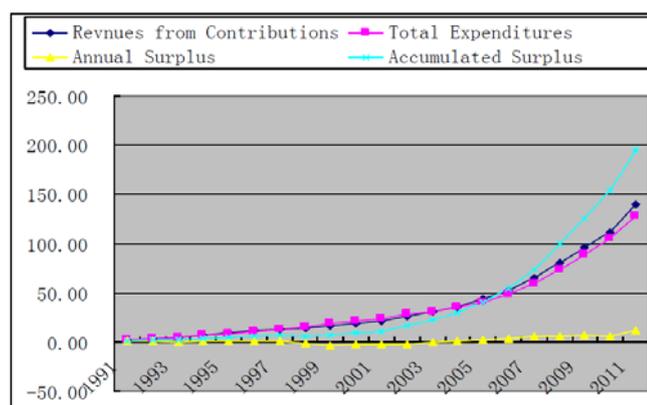


Chart 3: Revenues and Expenditures of urban employees' pension scheme (1991-2011)²⁵

Chart 3 shows that, revenues from contributions, total expenditures and accumulated surplus of urban employees' pension scheme all increased rapidly since 2003. Nonetheless, the annual surplus has long been very low, among which it had insufficiency in some years.

Why there is such a rapid increase of both contribution and accumulated surplus? The urban employees' pension scheme was established to release the heavy burden of SOEs and COEs in late 1990s. Since 2003, it extended its coverage from employees of SOEs and rural collective enterprises to enterprises of other ownership, employment in the informal sector and self-employed. The extending coverage undoubtedly increase revenues from contributions. Meanwhile, the financial capacity of both central government and local ones have been improved since the beginning of 21st Century, which enables them to af-

²⁵ See XUEJIN ZUO, *Designing Fiscally Sustainable and Equitable Pension Systems in China*, IMF OAP/FAD Conference Designing Fiscally Sustainable and Equitable Pension Systems in Asia in the Post Crisis World, Tokyo, January 9-10, 2013.

ford high public subsidy to the pension funds, and increase the accumulated surplus. Why the annual surplus retain at low level, even in some years the pension spending exceeds the ability to collect contributions? It is because of the rapid increase of total expenditure brought by the rapid aging population. Chart 4 will further explain such a demographic change.

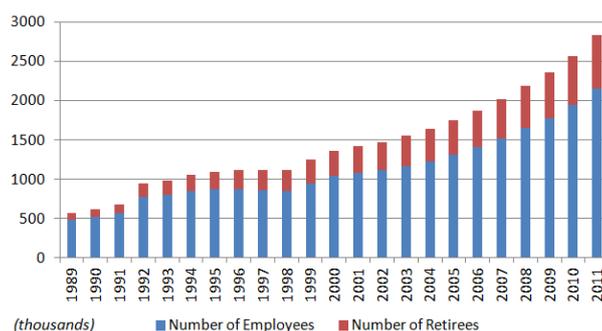


Chart 4: The number of employees and number of retirees (1989-2011)

According to chart 4, the rapid urbanization and aging population leads to the simultaneous increase of employees and retirees. One important reason of the coverage extension of pension system is to encounter challenge of aging population. However, the growth rate of retirees is even higher than that of the employees, makes the future pension burden obviously much higher than today.

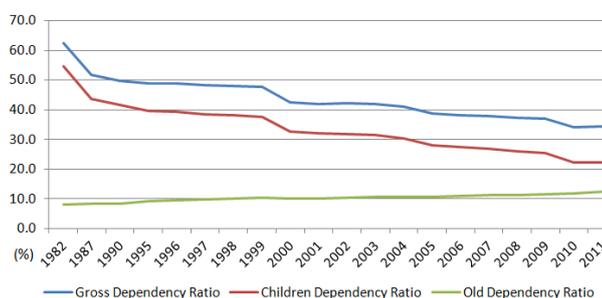


Chart 5: Changes of dependency ratio (1982-2011)²⁶

²⁶ China Statistical Year Book 2012.

Chart 5 shows that the children dependency ratio has continually and rapidly decline since 1982 while the old dependency ratio has long been increasing stably and slowly, which as a result, makes the gross dependency ratio decline during the period from 1982 to 2011. The decline of children dependency owes to the urbanization and birth control policy. These two factors together changed family ethics. The One-child Policy results in the “421-type” family structure (4 grandparents – 2 parents – one child), forces parents to cherish their only child and thus makes the family support of the elderly unsustainable.

The decline of gross dependency ratio and demographic dividend played a major part in the rapid economic development of China. However, the birth control policy has rapidly led not only to the decline of the number of births but also to the aging of the population. The National sample survey shows that the total fertility rate of the population is below 1.5.²⁷ It is also estimated that, by 2020, the proportion of the elderly population will increase from the current 7% to 11.8%. The aging population in China will continue to increase and will growingly affect the working-age population. That is to say, in the future, the old dependency ratio will increase rapidly and change the decline tendency of gross dependency ratio.

Such a demographic change is showed by table 3.

²⁷ See GUO ZHIGANG, *Jinnian Shengyulv Xianzhu Huisheng de Youlai (How Come the Notable "Pick Up" of the Fertility-rates in Recent Years: Evaluation on the 2006 National Population and Family Planning Surve)*, Chinese Journal of Population Science, 2009, vol. 2, p. 2 - 15.

Year	TP	MA	LP	RP	LR	RR	DR ²⁸
2010	13.4	34.5	9.4	1.8	70.1	13.3	18.9
2015	13.7	36.2	9.2	2.1	67.1	15.1	22.5
2020	13.9	38.1	9.1	2.4	65.9	17.4	26.4
2025	14.0	40.1	9.0	2.8	64.2	20.2	31.5
2030	13.9	42.5	8.5	3.4	61.0	24.4	40.0
2035	13.8	44.7	8.0	3.8	58.1	28.0	48.2
2040	13.6	46.4	7.8	4.0	57.0	29.4	51.6
2045	13.3	47.7	7.4	4.1	55.4	31.1	56.1
2050	13.0	48.7	6.8	4.3	52.6	33.9	64.4
2055	12.5	49.1	6.4	4.5	50.9	35.6	69.9
2060	12.1	49.4	6.0	4.4	49.8	36.6	73.5

Table 3: Estimated China's population change (2010-2060)²⁹

Table 3 shows that the total population will decline since 2020 while the aging population will increase rapidly. The ratio of old dependency will increase rapidly in the next five decades, which will amount to be 73.5% in 2060 if China will not change its birth control policy. In addition, the proportion of working-age population will decline to 49.8% in 2060. Such an extremely high ratio of old dependency and low proportion of working-age population will obviously bring disaster to the sustainability of China's pension system. The size of the empty account will continue to grow because of such a population aging and declining system support ratio.

According to *the 2012 Statistic Bulletin on Human Resource and Social Security Development* on, the revenue of basic pension funds of urban employees' pension scheme amounted to RMB2 trillion, up 18.4 percent year-on-year. Around RMB1.65 trillion came from basic pension payments, while the rest came from fiscal subsidies from various levels of governments. But some local

²⁸ TP means the total population, MA means the middle-aged population, LP means the population of age between 15 to 59, RP means the population above 60, LR means the proportion of population of age between 15 to 59, RR means the proportion of population above 60, and DR means the dependency ratio of population above 60.

²⁹ See WANG XIAOJUN and REN WENDONG, *Population Ageing and The Financial Sustainability of Social Pension System in China*, 2012 China International Conference on Insurance and Risk Management, July 18- 21, 2012 Qingdao, China.

matching funds are not enough because of the limited local financial capacity. Total expenditures through basic pension funds stood at RMB1.56 trillion last year, with a year-on-year increase of 21.9 percent. No matter how serious aging population problem it will be, another method to ensure the sustainability of China's pension system is to increase its fund surplus through high investment return and enough public subsidy.

What the elderly need is not only money, but production and service they can afford. In this sense, people need to exchange current production for a claim on future production and service. If there will be not enough working-age population to support the huge population of aging people. If the pension fund, especially the money of the individual account people saved for their years after retirement is shrinking, they cannot get enough production and service when they are old. So it is important to ensure and increase the value of the pension fund to encounter both the inflation and aging population problem.

According to current regulation, the central government, with the purpose of avoiding avoid financial risks involved in the investment of pension funds by the local governments, mandates that all the local pension funds should be deposited in the state commercial banks or invested in the government bonds. Such a requirement ensures the financial safety of pension funds at the prices of receiving very low returns or even negative returns when the inflation is higher than the return.

The mission of the NSSF is to raise funds through various channels, accumulate funds through investment activities, provide an important financial reserve for social security provisions and guarantee the sustainable development of social security in China. In order to increase the value of pension funds, in 2012, Guangdong won approval from the State Council to entrust RMB100 billion of its pension fund to NSSF for two years. The NCSSF said that most of the

money would be placed in savings accounts or used to buy government and corporate bonds and other fixed-income securities. Such an experiment will be followed by other provinces. It is expected to be a win-win situation for the capital market and pension funds.

Last but not the least, the sustainability of the pension funds also largely depends on the fiscal capacity of the government. That is to say, the well function of China's economy is of high importance to the security of funds. The huge deficits in the pension system will create heavy burdens on fiscal expenditures.

5. According to the official data, the pension funds has no fiscal deficit up till now. Nonetheless, the fiscal sustainability of pension system in China will be in difficulties in coming decades. Hence, it is high time for the central government to take charge of the pension system. It could fill the empty accounts, glue the fragmented system together, ideally make pensions much more portable and increase the investment return of pension funds. It can also adopt flexible retirement policy and change the birth control policy.

The pilot to pay-back to the empty personal saving accounts have been extended from Liaoning to eleven provinces since 2001. The central government provided fiscal aids to the central and western provinces. However, this problem has not been entirely resolved because the local governments have neither fiscal resources nor incentives to pay back to the empty personal saving accounts. Hence, Liaoning, instead of government subsidies to urban employee's pension scheme, began to diversify the funds in personal saving account to paying pension benefits, which is deemed to be the failure of pilots.

Since current Chinese economy is still developed at high speed, the central government can change the empty accounts into notional" accounts, under which part of pension benefits (social pooling) are decided by a transparent

formula that reflects the retiree's life expectancy and the economy's ability to pay. This part of pension benefits are paid out from a mix of current taxes and a central pension fund. As to the part of individual account, the central government shall make pensions much more portable since local governments in developed areas would tend to hide the surplus pension funds in their possession while those in undeveloped areas would report retirees as much as possible to get more funds transfer.

China's rapid economic growth has increased average wages beyond the imagination of the pension system designers. The low rate of return in contributions into individual account is largely due to the fact that the contributions into individual accounts are not effectively invested. China should allow the pension funds to be invested across a wider range of assets. The cautious but open investment should be a mixture one, for example, mixture of bank deposits, corporate bonds, financial bonds, shares of enterprises with good return of investment, and other fixed-income products. The management and supervision of the investment should be very strict - the case of Guangdong entrusting its pension funds to NSSF will be a good example.

Since the public pension will have serious deficit due to the aging population, China should highly develop its multiple pillars pension system to encourage and help people to win old-age insurance through multiple channels, for example, private saving and occupational pensions.

However China finances its pensions, their burden will increase as the country ages. If taking into account of the deficits in rural pension programs, the burden on fiscal expenditures would be heavier. Over the next decade the official retirement age should be raised from 60, for men, and as early as 50, for blue-collar women, to 65 for everybody. Meanwhile, a flexible retirement age policy can be adopted by local governments.

Although the birth control policy makes China benefit from demographic dividend in past thirty years, such a policy should be changed in coming years to encounter the aging population problem.