XI. Averting Future Crisis: The European Banking Union's Single Supervisory Mechanism

A. Introduction

The European Union has decided to restore faith in European markets through ambitious centralized supervision of the banking system.[1] To this end, the European Parliament has adopted a proposal to set up a Single Supervisory Mechanism ("SSM") that will delegate banking supervision tasks to the European Central Bank ("ECB").[2] Crucial to effective banking supervision is the ability of the European Union to intervene should a bank fall short of any regulatory requirements.[3] Therefore, the European Commission has proposed the adoption of a Single Resolution Mechanism ("SRM").[4] The SRM would enable controlled resolution of a failing supervised bank and establish a central bailout fund should bank shareholders and creditors be unable to cover the bank's losses.[5] While the proposed legislation would take away some sovereignty from the participating states, it could curb future financial crises and ensure that national governments do not favorably protect their large domestic banks.[6]

This article explores the implications of the proposed SRM, with a particular focus on its potential shortcomings. Part B provides

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[1] *See* Press Release, European Comm'n, Commission Proposes New ECB Powers for Banking Supervision as Part of a Banking Union 1 (Sept. 12, 2012), *available at* europa.eu/rapid/press-release_IP-12-953_en.pdf.

[2] *See* Memorandum from the European Comm'n, Legislative Package for Banking Supervision in the Eurozone 1 (Sept. 12, 2013) [hereinafter Memorandum on Legislative Package for Banking Supervision], *available at* http://europa.eu/rapid/press-release_MEMO-13-780_en.pdf.

[3] *See id.* at 9.

[4] *See 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 (July 10, 2013) [hereinafter *SRM Proposal*].

[5] *Id.*

[6] *See* Diego Valiante, *Framing Banking Union in the Euro Area: Some Empirical Evidence* 10 (Ctr. for European Policy Studies, Working Document 388, 2014), *available at* http://ceps.be/ceps/dld/8882/pdf.

an overview of the European Banking Union. Part C discusses the provisions of the SRM. Part D analyzes responses to the SRM, focusing on identified weaknesses. Part E examines the provisional agreement on the SRM reached by the European Parliament and Council.

B. European Banking Union

Faced with an ongoing recovery from the last financial crisis and a desire to avert similar future events, the European Union believes that the time is ripe for centralized banking supervision.[7] As the financial crisis of 2008 proved, individual and uncoordinated national regulation by member states was "not capable of responding to the financial crisis, in particular its systemic nature."[8] While the European Union has long had certain limited Europe-wide crisis frameworks that could deal with failing banks, including the European Financial Stabilisation Mechanism and the European Stability Mechanism ("ESM"), there was never a single comprehensive approach to bank resolution.[9] Even in the case of banks operating across numerous European markets, "[t]here were . . . no tools in place to deal with the collapse of large cross-border banks."[10]

The SSM and SRM are the two legislative packages that make up the European banking regulation proposal.[11] If adopted, the legislation would become applicable to the union's roughly six

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[7] *See* Conor Humphries, *UPDATE 1—Single Supervision to Boost Bank Mergers—Constancio*, REUTERS (Dec. 2, 2013, 7:20 AM), http://reuters.com/article/2013/12/02/ecb-constancio-idUSL5N0JH1UX20131202.

[8] Memorandum from the European Comm'n, A Comprehensive EU Response to the Financial Crisis: Substantial Progress Towards a Strong Financial Framework for Europe and a Banking Union for the Eurozone 2 (Jan. 24, 2014) [hereinafter Memorandum on EU Response to Financial Crisis], *available at* http://europa.eu/rapid/press-release_MEMO-14-57_en.pdf.

[9] *See* Emile McHarsky-Todoroff, *State of the Union: A Critical Analysis of the EU Framework for Future Fiscal Crisis Management* 14 (Univ. of Surrey, Working Papers No. 10, 2012), *available at www.surrey.ac.uk/law/pdf/sslwp/Vol%2010.pdf*.

[10] Memorandum on EU Response to Financial Crisis, *supra* note 8, at 1.

[11] *Id.* at 8.

thousand lenders.[12] Under the SSM, the ECB will become the European banking watchdog, directly supervising the largest banks in the euro zone as well as in all other member states that join the banking union.[13] The ECB will carry out its supervisory tasks via a new Supervisory Board, some members of which will be representatives of national bank supervisory bodies.[14] ECB representatives on the Supervisory Board will not be involved with the ECB's monetary policy duties, in order to ensure that there is a clear separation between the ECB's supervisory tasks and monetary policy setting functions.[15] The Supervisory Board will be supported by a "steering committee, the ECB Governing Council, and a mediation panel to solve disagreements that may arise between national competent authorities and the Governing Council."[16]

The ECB's supervisory powers are divided into direct supervision and secondary supervision.[17] Direct supervision will apply to banks that have assets worth more than €30 billion, or whose assets make up more than 20% of the GDP of their home country.[18] The ECB will have secondary supervision over all remaining euro zone banks; national supervisors will maintain primary oversight.[19] There will, however, be increased cooperation between the regulators, as national supervisors will have duties to

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[12] *See* Michael Klimes, *Danièle Nouy Set to Become Guardian or Executioner of 6,000 Eurozone Lenders*, INT'L BUS. TIMES (Nov. 27, 2013, 12:52 GMT), http://ibtimes.co.uk/ani-le-nouy-banking-reform-single-supervisory-525579.

[13] *See* Press Release, European Comm'n, Commission Proposes Single Resolution Mechanism for the Banking Union 1 (July 10, 2013), *available at* http://europa.eu/rapid/press-release_IP-13-674_en.pdf.

[14] *See* Directorate Gen. for Internal Policies, Policy Dep't A: Econ. & Scientific Policy, *New Roles and Challenges for the ECB*, at 8, IP/A/ECON/NT/2013-03 (Sept. 2013) (by Karl Whelan).

[15] *See* Memorandum from the European Comm'n, Statement by President Barroso and Commissioner Barnier Following the European Parliament's Vote on the Creation of the Single Supervisory Mechanism for the Eurozone 2 (Sept. 12, 2013), *available at* http://europa.eu/rapid/press-release_MEMO-13-781_en.pdf; Press Release, European Comm'n, Commission Proposes Single Resolution Mechanism for the Banking Union 1 (July 10, 2013), *available at* http://europa.eu/rapid/press-release_IP-13-674_en.pdf.

[16] *Id*. at 3.

[17] *See* Council Regulation 1024/2013, art. 6, 2013 (L 287) 76.

[18] *See id*.

[19] *See id*.

keep the ECB informed about any key decisions they take and must also carry out direct instructions received from the ECB.[20] As a fallback, if the ECB deems it necessary, it may step in at any point and take over direct supervision.[21] Where cross-border banks are involved, the ECB will take over the supervisory tasks of existing national supervisors and coordination with supervisory bodies outside the EU.[22] However, to be fully effective, the SSM will also need a mechanism that allows it to respond effectively should a bank under its supervision face substantial difficulty.[23]

C. Single Resolution Mechanism

The Commission has identified the need to supplement the SSM with the SRM.[24] The key function of the SRM will be to wind up or restructure any struggling bank that the ECB has identified as in significant danger of failure.[25] The road to an EU-wide agreement on such a significant bailout plan has been, and continues to be, uneasy for obvious reasons. Any final regulation will be a product of not only economic considerations but also considerable political compromise.[26] The main aim of the proposal, as expressed by European Commissioner for the Internal Market and Services Michael Barnier, is that "[t]axpayers will no longer foot the bill when banks make mistakes and face crises."[27] This is a considerable departure from prior crisis resolution mechanisms such as the European Stability Mechanism, which was directly funded by member state contributions made from taxpayers' money.[28]

The Commission published a SRM proposal in July 2012.[29] Under the proposal, the resolution fund will be financed by bank

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[20] *See id*.
[21] *See id*.
[22] *See id.* at art. 4, 2013 (L 287) 74.
[23] *See* Memorandum on EU Response to Financial Crisis, *supra* note 8, at 9.
[24] *See id*. at 8.
[25] *See SRM Proposal*, *supra* note 4, at 3.
[26] *See* Tom Fairless & Gabriele Steinhauser, *EU Finance Ministers Agree on Bank Resolution System*, WALL ST. J. (Dec. 18, 2013, 7:03 PM), http://online.wsj.com/news/articles/SB10001424052702304773104579265893866433758.
[27] *Id.*
[28] *See id.*
[29] *See SRM Proposal*, *supra* note 4, at 1.

levies, which would over the course of ten years[30] be pooled together into one central fund.[31] Aiming to be fully operational in 2026, the fund could have €55 billion to work with.[32] The chosen system of financing ensures that the burden of bailing out failed banks will not fall solely on the more financially resilient EU members.[33]

The ESM is currently the crisis resolution mechanism for euro zone countries.[34] The highest contributor to the fund has been Germany, providing more than 27% of capital contributions.[35] Germany's level of involvement sparked much debate and controversy in Germany.[36] "Critics [have] argued that the ESM commits Germany to potentially unlimited funding of debt-ridden euro zone states."[37]

Unsurprisingly, it was German Finance Minister Wolfgang Schäuble who was the key figure in negotiating the new SRM among the other European finance ministers.[38] From the point of view of Germany and other strong euro zone economies, the new resolution fund will ensure that "failing banks inside the euro zone can be liquidated in the future without requiring German taxpayers to cover the costs of mountains of debt built up by Italian or Spanish institutes."[39]

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[30] Under the provisional agreement reached on March 20, 2014 by the European Parliament and the Council, the original ten-year period for establishing the resolution fund has been shortened to eight years. *See* discussion *infra* Part E and note 69.

[31] *See* Peter Spiegel & Alex Barker, *Banking Union Falls Short of EU Goal*, FIN. TIMES, Dec. 19, 2013, at 3.

[32] *See id*.

[33] *See id*.

[34] *See ESM Factsheet*, EUROPEAN STABILITY MECHANISM, http://esm.europa.eu/pdf/ESM%20Factsheet.pdf (last visited Apr. 16, 2014).

[35] *See id*.

[36] *See German Court Backs Eurozone's ESM Bailout Fund*, BBC (Sept. 12, 2012, 8:31 AM), http://bbc.co.uk/news/world-europe-19567867 ("Some 37,000 people had signed a petition to the court asking it to block the ESM, and make it subject to a referendum.").

[37] *Id*.

[38] *See* Gregor Peter Schmitz, *Not Fit for the Next Crisis: Europe's Brittle Banking Union*, SPIEGEL (Dec. 19, 2013, 1:59 PM), http://spiegel.de/international/business/weak-eu-banking-union-could-have-dangerous-side-effects-a-940065.html.

[39] *Id*.

D. Insufficiencies

As soon as the Commission published the blueprint of the SRM**,** concerned voices began pointing out the proposal's weaknesses.[40] Dominant among the complaints are suggestions that 1) the fund is not large enough to handle a crisis; and 2) the mechanism it sets up for dealing with an endangered bank is not expedient enough to prevent a real emergency situation.[41]

1. Insufficient Financial Backing

Under the proposal agreed on by the Commission, the banking resolution fund is expected to have €55 billion by 2026.[42] Compared to the ESM, which is the euro zone's current rescue fund, this number is very small.[43] The ESM has €500 billion at its disposal.[44] Further, the SRM's fund will not be established immediately but will be built up over a span of years during which time banks will gradually contribute via levies.[45] Two clear questions arise: 1) will the SRM have sufficient funds to deal with a potential financial crisis?; and 2) will the SRM funds be built up quickly enough?[46]

€55 billion is not a large amount when it comes to rescuing banks.[47] By comparison, "the rescue of a single Irish bank several years back required half that amount."[48] Should the fund prove insufficient, the responsibility for the bailout would fall back on the bank's home country.[49] However, should banks be required to pay

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[40] *See, e.g.*, Jan Strupczewski, *EU Ministers to Consider Faster Sharing of Bank Closure Costs*, REUTERS (Feb. 18, 2014, 6:53 AM), http://reuters.com/article/2014/02/18/eu-banks-resolution-idUSL6N0LN1AW20140218.
[41] *See id*.
[42] *See SRM Proposal*, *supra* note 4, at 14–15.
[43] *Compare ESM Factsheet*, *supra* note 34, *with SRM Proposal*, *supra* note 4, at 14–15.
[44] *See ESM Factsheet*, *supra* note 34.
[45] *See SRM Proposal*, *supra* note 4, at 15. For an explanation of the time span, see *supra* note 30.
[46] *See* Strupczewski, *supra* note 40.
[47] *See* Schmitz, *supra* note 38.
[48] *Id.*
[49] Simon Nixon, *Germany Right to Hold Out on Banking Union*, WALL. ST. J. (Dec. 22, 2013, 4:05 PM), http://online.wsj.com/news/articles/SB10001424052702304475004579274610525918126.

higher levies, they will consequentially have less capital to lend, which could be counterproductive for the European economy.[50]

2. Too Slow in Case of Real Emergency

Should a bank fall into serious trouble, it will be up to the ECB to blow the whistle that will submit the bank to an examination of its stability.[51] The next step will be a comprehensive examination by a "committee comprised of national banking supervisors and EU representatives [who] will decide on its liquidation."[52] Under the Commission's proposal, the Commission would have the power to veto any decision of the committee.[53] In case of an impasse, the "national finance ministers have the last word."[54] The *Financial Times* has estimated that, "[i]n total, the process could involve nine committees and up to 143 votes cast."[55] Should a bank face serious crisis, this process may be too complicated and lengthy to ensure a rapid response.[56] While German Finance Minister Schäuble maintains that "[i]t has to go quickly in an emergency, over a weekend,"[57] others dispute whether a weekend is quick enough.[58] For example, "Vitor Constancio, a member of ECB's executive board,

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[50] *See* Rebecca Christie & Rainer Buergin, *Schaeuble Disagrees with ECB over Attempt to Pool Bank Levies*, IRISH EXAMINER (Jan. 29, 2014), http://irishexaminer.com/business/schaeuble-disagrees-with-ecb-over-attempt-to-pool-bank-levies-256934.html.

[51] *SRM Proposal*, *supra* note 4, at 43 ("Where the ECB or a national resolution authority assesses that the conditions referred to in points (a) and (b) of paragraph 2 are met in relation to an entity referred to in Article 2, it shall communicate that assessment without delay to the Commission and the Board.").

[52] *See* Schmitz, *supra* note 38.

[53] *See id*.

[54] *Id*.

[55] Alex Barker, *EU Ministers Set to Define Banking Union*, FIN. TIMES (Dec. 17, 2013, 6:01 PM), http://ft.com/intl/cms/s/0/c552f182-6736-11e3-a5f9-00144feabdc0.html#axzz2sKKPUSdr.

[56] *See* Schmitz, *supra* note 38.

[57] John O'Donnell & Martin Santa, *Europe Moves to Banking Union with Blueprint for Failing Lenders*, REUTERS (Dec. 19, 2013, 12:19 PM), http://reuters.com/article/2013/12/19/us-eu-banks-idUSBRE9BI01620131219.

[58] *See* Fairless & Steinhauser, *supra* note 26.

urged finance ministers to adopt an emergency procedure that would ensure resolution decisions could be taken within 24 hours."[59]

E. Provisional Agreement by European Parliament and Council

When the Commission's proposal entered the European Parliament, it was clear from the Parliament's initial statements that the negotiations over the SRM would be challenging.[60] The Parliament identified two main issues with the Commission's proposal: 1) the proposal does not provide a decision-making process for dealing quickly with failing banks; and 2) there are insufficient guarantees that the SRM will be free from "political interference."[61] The Parliament also found that the SRM does not fulfill a "fundamental goal of banking union—breaking the link between taxpayers and banks."[62] There was fear that the Parliament's divide with the Commission over the provisions of the SRM could lead to a standstill.[63] According to one observer, "Elisa Ferreira, who is leading the parliament's negotiation team on the draft law, has said that it's 'a very serious possibility' that no deal will be possible on the bill, because the ministers' plan is 'completely different' from the parliament's."[64]

The Commission and the European Parliament seemed to have irreconcilable opinions regarding the SRM's provisions.[65]

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[59] *See id.*

[60] Press Release, European Parliament, Launch of Tough Negotiations on Final Step to Banking Union 1 (Jan. 8, 2014), *available at* www.europarl.europa.eu/news/en/news-room/content/20140107IPR3 2002/pdf.

[61] *Id.*

[62] *Id.*

[63] Jim Brunsden, *EU Puts Bank-Union Credibility on Line in Talks*, BUS. WK. (Jan. 8, 2014, 6:56 AM), http://bloomberg.com/news/2014-01-08/eu-puts-banking-union-credibility-on-line-in-resolution-talks.html.

[64] *Id*.

[65] Christopher Ball, *Schulz Letter Increases Pressure in Institutional Dispute over EU Single Resolution Mechanism*, PARLIAMENT (Jan. 22, 2014), http://theparliament.com/latest-news/article/newsarticle/schulz-letter-increases-pressure-in-institutional-dispute-over-eu-single-resolution-mechanism/#.Uu8X37Ttq3Y.

However, "after record-breaking 16-hour talks,"[66] the European Parliament and Council arrived at a provisional agreement regarding the SRM on March 20, 2014.[67] The Parliament secured several changes to the original proposal.[68] The SRM fund "will be built up over eight years, rather than 10 as originally foreseen."[69] The agreement also clarified that mutualization of the fund will take place at a faster rate, with forty percent of accumulated funds to be shared by participating countries in the first year.[70] In a significant compromise, the agreement eliminated the Commission's veto power in bank resolution decisions.[71] Under the updated proposal, executive decisions by the Single Resolution Board involving use of the fund not exceeding €5 billion will be final.[72]

The SRM proposal must be jointly adopted "by the European Parliament and by the EU Member States in the Council" to become law.[73] The European Parliament meets twice more in April before the European elections in May 2014.[74] According to a statement made by the Commission, "[i]t is expected that the European Parliament will vote this legislation in plenary in April, while the Council will formally adopt it subsequently."[75]

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[66] Alex Barker, *EU Reaches Deal on Final Piece of Banking Union*, FIN. TIMES (Mar. 20, 2014, 11:17 AM), http://ft.com/intl/cms/s/0/b640b02e-b003-11e3-b0d0-00144feab7de.html#axzz2xBbOW3lp.

[67] *See* Statement from the European Comm'n, European Parliament and Council Back Commission's Proposal for a Single Resolution Mechanism: A Major Step Towards Completing the Banking Union 2 (Mar. 20, 2014), *available at* http://europa.eu/rapid/press-release_STATEMENT-14-77_en.pdf.

[68] *See id*.

[69] John O'Donnell & Tom Körkemeier, *Europe Strikes Deal to Complete Banking Union*, REUTERS (Mar. 20, 2014, 3:18 PM), http://uk.reuters.com/article/2014/03/20/uk-eu-bankingunion-idUKBREA2J0IW20140320.

[70] *See* Statement from European Comm'n, *supra* note 67, at 3.

[71] *See id.* at 2.

[72] *See id.*

[73] *Id.* at 3.

[74] Press Release, European Parliament, European Parliament Approves its Session Calendar for 2014 (June 12, 2013), *available at* www.europarl.europa.eu/news/en/news-room/content/20130610IPR11413/pdf.

[75] Statement from the European Comm'n, *supra* note 67, at 3.

F. Conclusion

The European Union's goal to centralize supervision of the banking system is a very challenging undertaking. Although there is general consensus that a functional banking union requires an effective resolution mechanism,[76] the Commission and the European Parliament have different views about the key aspects of such a mechanism.[77] The European Parliament succeeded in reaching a provisional agreement regarding the SRM;[78] however, concerns remain that the updated proposal leaves some of the mechanism's shortcomings unresolved.[79] Criticisms include the insufficient size of the resolution fund and the complex, lengthy process for winding down a failing bank.[80] However, the provisional agreement is an important achievement. Had the SRM failed, the SSM would likely have failed with it.[81]

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[76] *See* Memorandum on EU Response to Financial Crisis, *supra* note 8, at 8–9.
[77] *See* Ball, *supra* note 65.
[78] *See* Statement from the European Comm'n, *supra* note 67, at 2.
[79] *See* O'Donnell & Körkemeier, *supra* note 69.
[80] *See id.*
[81] *See* Ball, *supra* note 65 ("Failure to find an agreement of the SRM would in effect undermine the entire banking union . . . .").
[82] Student, Boston University School of Law (J.D. 2015).