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## THE FRAMEWORK OF THE EUROPEAN FINANCE AND BANKING REGULATION

*Weaknesses in the implementation of financial supervision, the extensive harmonization of banking laws and the financial and eurozone crises have forced the EU Member States to reform financial supervision. In 2011 the EU introduced a new financial supervision system, and in September 2012 proposals for establishing a Single Supervisory Mechanism (SSM) were revealed. The present article seeks to analyse the changes, problems and possibilities for improvement of the new financial supervision system and to give a brief account of potential long-term prospects.*

*Key words: Banking union, ESFS, ESRB, ESM, financial, debt crisis, reform, regulation, SRM, SSM, System Banking Supervision*

*Недостатки в осуществлении финансового надзора, а также гармонизация банковского законодательства и кризисы в зоне евро привели государства-членов ЕС к необходимости реформирования финансового надзора. В 2011 г. в рамках ЕС была введена новая система финансового надзора, и уже в сентябре 2012 г. выдвинуты предложения по созданию единого механизма контроля (SSM). Настоящая статья — результат анализа изменений, проблем и возможностей улучшения новой системы финансового надзора. Описаны потенциальные долгосрочные перспективы.*

*Ключевые слова: Банковский союз, Европейская система финансового надзора, Европейский совет по системным рискам, европейский стабилизационный механизм, финансовый и долговой кризис, реформа, регулирование, единый механизм регулирования, единый механизм контроля, система банковского надзора*

### 1. Introduction: Weaknesses in the current supervision system

The current bank supervision system, which is based on the concept of minimum harmonisation and the country of origin principle, has certain disadvantages. A lack of legal harmonisation raised the potential for distortion of competition in the internal market. Credit institutions carrying out banking transactions and financial services on a cross-border basis must comply with different national permit schemes. Financial control procedures at state level differ from one another and refer to different institutions and criteria. Even harmonised rules may be implemented in different ways by the supervisory bodies of each Member State, as their authority and jurisdiction vary. At the same time, national institutions do not follow a common practice of supervision<sup>1</sup> due to their right of discretion in decision-making, granted by the European legislation. Consequently, regulatory arbitrage and distortion of competition result from these differing approaches. The onset of the European financial and debt crisis in 2009 revealed discrepancies between national supervisory procedures and the new economic realities, and clearly demonstrated that the current supervisory system is unable to respond adequately to the new emerging challenges.

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<sup>1</sup> Speyer B. Internationalisierung von Bankgeschäft und Bankenaufsicht // Pitschas R. Integrierte Finanzdienstleistungsaufsicht. Berlin, 2002. P. 83.

## 2. Introducing a new financial supervision system in September 2011 (*de lege lata*)

The need for a change in the current supervision system pushed the European Commission to seek reform in the financial sector. On 24/25 September 2009 in the context of the European financial crisis and the early attempts at creating a better supervision system, the European Commission unveiled a proposal for a new system of single financial supervision, in accordance with the right granted to it by Article 17 (2) TFEU. The European Commission's decision was based on the findings and proposals of *Jacque de Larosiere's*<sup>1</sup> group. The new financial supervision system was built upon the two following pillars: the European Systemic Risk Board (ESRB) and the European System of Financial Supervision (ESFS).

The ESRB is hosted by the European Central Bank (ECB) and was appointed to succeed the Committee on Banking Supervision. It is responsible for macro-prudential oversight and for monitoring the financial position of banks and identifying potential problems with market functionality or unfavourable developments in capital flows. Once a risk is identified, the Board issues recommendations for the affected governments. The ESRB does not hold any binding decision-making powers as regards the implementation of the recommendations. The ECB provides the Secretariat of the ESRB, which is responsible for holding meetings and preparing necessary information. In addition, it also carries out the functions and analyses of the Board as well as cooperation with international expert committees<sup>2</sup>. Under Article 5 (1) sentence 1 of the Regulation on ESRB<sup>3</sup>, the ESRB is to be chaired by the President of the ECB for a five-year term.

The President and Vice-President of the ECB are represented as members with voting rights in the General Board – the decision-making body of the ESRB<sup>4</sup>. In addition, the Vice-President of the ECB is represented in the Steering Committee of the ESRB, and there is an ECB representative in the Advisory Scientific Committee of the ESRB<sup>5</sup>. The ECB has consequently become heavily involved in macro-prudential oversight. The establishment of the ESRB has created an additional institution responsible for carrying out macro-prudential supervision. Thus, macro-prudential supervision, once spread out over different levels, has been consolidated.

The ESFS, the second pillar, is responsible for micro-prudential supervision. In contrast to the ESRB, the ESFS has legal competence in respect of national financial supervision. The ESFS forms an integrated network of European financial supervisory authorities. The system is composed of one joint committee, the three committees of the European supervisory authorities, and also the national supervisory authorities of the Member States. Consequently, the ESFS comprises an alliance of supervisory authorities, both on a national and a European level. The three EU supervisory authorities are to work in cooperation with the national supervisors, mediate in the event that disputed matters arise between national supervisory authorities and, in the event of a crisis, take decisions on

<sup>1</sup> Report by *Jacque de Larosiere Group* on 25 February 2009. P. 45 et seq. Para. 160 // URL: [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf). The Report found that the European financial market was in need of strong, integrated regulation and supervision. In the view of the Group, there is a lack of appropriate and effective supervision at the macro level, which should encompass all areas of finance and not just the banks. According to the Report, the ECB can effectively exercise its proposed functions within the scope of the European System of Central Banks, provided that a functioning and applicable mechanism is introduced by which mechanism it can be reviewed whether concrete measures are followed in accordance with the analysis of the risks at the macro level taken by the new European authorities and the national supervisory bodies.

<sup>2</sup> *Eriksson A.* Einheitlicher Europäischer Bankenaufsichtsmechanismus // URL: <http://www.bundestag.de/dokumente/analysen/2013/Bankenaufsichtsmechanismus.pdf>. P. 10.

<sup>3</sup> Regulation (EU) № 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 // OJ. 2010. 15 December. L 331/1 (ESRB Regulation).

<sup>4</sup> Article 6 (1) (a) ESRB Regulation.

<sup>5</sup> Article 11 (b), Art. 13 (1) (a) ESRB Regulation.



their own, as they are entitled to issue recommendations to the supervisory authorities of the Member States. These authorities do not have the right to issue directions to Member State governments or to draw up bailout plans for banks by way of loan guarantees or borrowing capital<sup>1</sup>. The aim of the ESFS is to lead and to coordinate the work of national supervisors and to secure collaboration between macro and micro levels and coordination between different national supervisory authorities<sup>2</sup>.

The system functions properly if the ESRB is able, earlier on, to identify potential risks and to issue the necessary recommendations to the General Board and similarly to the three supervisory authorities of the ESFS.

Accordingly, the ESFS passes information on micro-prudential supervision to the ESRB. In this fashion these two structures, which do not have their own legal capacity, are to be strictly separated from each other as regards their basic functions. The aim of the system is to harmonize the substantive supervision standards of the Member States and to create a single supervision authority under the direction of the European Central Bank. However, some critics claim that the establishment of such a system will make sense only once the new supervisory authorities acquire more powers in order to be able to provide effective crisis prevention at a state level<sup>3</sup>.

### 2.1. The Role of the European Central Bank

In accordance with *de Larosiere* report, the ECB will be given an important role to play in the new ESFS at both a macro and micro level. At the macro level, it is to analyze the stability of the financial system and to develop early warning systems for potential risks and weaknesses in the financial system. The ECB will provide the ESRB with all necessary logistical support and give evaluation and recommendations in respect of macro-prudential supervision. At the micro level, the ECB will assume direct control over trans-border EU credit institutions. The ECB will not be responsible for the supervision of individual banks. In the event of a conflict between national supervisory authorities, the ECB can play the role of a binding mediator. Within the framework of the ESFS, the ECB will have a consulting function on matters concerning bank law in accordance with Article 127 (6) TFEU and Article 4 (a) of the Statute of the European System of Central Banks and of the ECB. In order to perform the duties assigned to the ESCB, the ECB may, in accordance with Article 132 (2) TFEU, exert influence on the Member States by means of regulations, decisions, recommendations and opinions.

### 2.2. Assessment

The new supervision system seeks to consolidate the fractured elements of European financial supervision. Nonetheless, the fact that responsibility for financial supervision is divided over different bodies at the supra-national level and that decentralized supervision structures are preserved at the national level demonstrate that the concept is not one of a centralised supervision system. In addition to the ESRB and the ESFS, there are further European bodies and committees that are responsible for financial supervision on the European level, thus leading to overlapping functions. Under Article 134 TFEU, the European Commission, the European Parliament, the European Council, the ECB, and the Economic and Financial Committee are all involved in financial supervision in the EU.

<sup>1</sup> See: *McCreevy C.* The statement of the European Commissioner for Internal Market and Services 23 September 2009, the EU wants to get serious on stricter supervision // URL: [http://www.focus.de/finanzen/news/eu-eu-will-mit-strenger-finanzaufsicht-ernst-machen\\_aid\\_438258.html](http://www.focus.de/finanzen/news/eu-eu-will-mit-strenger-finanzaufsicht-ernst-machen_aid_438258.html).

<sup>2</sup> *Walla F.* Die Europäische Wertpapier- und Marktaufsichtsbehörde (ESMA) als Akteur bei der Regulierung der Kapitalmärkte Europas – Grundlagen, erste Erfahrungen und Ausblick // Zeitschrift für Bank und Kapitalmarktrecht. 2012. P. 265, 266.

<sup>3</sup> *Riecke T.* Finanzaufsicht, Farbe bekennen // Handelsblatt. 2009. 23 September. P. 1; *Mangler-Nestler C.* Rechtsschutz in der europäischen Bankenaufsicht // Zeitschrift für das gesamte Kreditwesen. 2012. № 10. P. 38.



In respect of certain tasks such as the prevention, management and resolution of crises, as well as the development of strategies and securing financial stability, the Economic and Financial Committee and the ESRB display similar functions.

In terms of structure, the new financial supervision system lacks one legal body which can assume responsibility for all issues of financial supervision. A single European central financial supervisory authority responsible for all these matters has not been established. The system leaves the impression that, instead of a reduction in the large and diverse administrative regime, the reform consists rather of restructuring the financial supervisory bodies at a supra-national level. The system focuses on the regulation of financial markets at a European level, whereas supervision of compliance with regulatory standards, which has proved to be quite problematic, remains with the Member States. This approach has proven insufficient over the course of the financial crisis<sup>1</sup>.

The powers of the European Banking Authority (EBA) are to be specified under the new system. The authority has «soft law» competences at its disposal; hence, it can take measures such as issuing guidelines and proposals, but it does not have any powers of enforcement, because sanctions have not been provided for<sup>2</sup>. As regards the national supervisory authorities, it holds the right to intervene where these cannot reach an agreement on the means of financial regulation as well as in the event of a crisis. In addition, under Article 21 (4) of the Regulation on the EBA, the Authority is granted powers in the event of disputes between national authorities. This raises the question of the cases in which the EBA may intervene in respect of national authorities where this power is granted to the Commission under Article 33 (2) of the Banking Directive<sup>3</sup>. The Banking Directive extends this power of the Commission to the entire EEA zone, whereas the EBA has no competence in respect of the EEA states. These fields of competence should be clarified further.

### **3. Commission proposals for reform of European banking supervision (de lege ferenda)**

For the purposes of reforming the current bank supervision system and against the backdrop of the European debt crisis, the European Commission issued two proposals: one regarding the establishment of a European Banking Union and the other for the establishment of a Single Resolution Mechanism for the Banking Union. This will be the means of establishing a single centralised banking supervision system. The three cornerstones would be centralised supervision, conducted by the ECB, and also European legislation on bank resolution and on single deposit insurance<sup>4</sup>. These two reform proposals will therefore cover the initial two steps of the project.

#### **3.1. Proposal of the European Commission for the establishment of a banking union on 12 September 2012 and the agreement on the part of the European Council on 12 December 2012**

On 29 June 2012 the heads of state and of government of the eurozone decided at a high-level meeting to introduce a Single Supervision Mechanism (SSM) under the control

<sup>1</sup> Eriksson A. Op. cit. P. 5.

<sup>2</sup> Under certain exceptional situations the EBA may, according to Recital (29) to the EBA Regulation, issue binding legal acts in the form of decisions. See, Regulation (EU) № 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision № 716/2009/EC and repealing Commission Decision 2009/78/EC // OJ. 2010. 15 December. L 331. P. 12. The decision will be issued via a three-stage mechanism, a complex cooperation between the EBA and the Commission. At the initial stage, the EBA will issue a recommendation. At the second stage the Commission will make a formal submission to the national authorities, and at the third stage the EBA will issue the decision.

<sup>3</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions // OJ. 2006. 30 June. L 177. P. 1.

<sup>4</sup> EU continues bickering on the banking union. P. 2 // URL: <http://www.handelsblatt.com/politik/international/deutschland-bremst-eu-zankt-sich-weiter-um-bankenunion/8201096.html>.

of the ECB, pursuant to Article 127 (6) TFEU. This was the first step towards establishing a financial as well as a banking union. The banking union's major purpose is not only to harmonise substantive regulation but also to implement single banking supervision within the framework of the ESFS<sup>1</sup>. On the basis of the proposals issued at that meeting and those of the *de Larosiere* Report, the European Commission issued two proposals for regulations on 12 September 2012 – one conferring specific tasks on the ECB<sup>2</sup> and the other concerning the amendment of the EBA Regulation<sup>3</sup>, as well as a schedule for the banking union<sup>4</sup> on the establishment of a single supervision mechanism in Europe. The new banking union is to improve integration on both the economic and finance levels of all EU Member States and of the European Economic and Monetary Union. Each Member State in need of international financial aid has to meet the political requirements, including extensive requirements in respect of the financial sector. According to the Commission, the result would be the consolidation of supervision by the EBA in the direction of highly centralised management<sup>5</sup>.

### 3.1.1. Proposal of the European Commission for conferring supervision tasks on the ECB

According to the proposal of the European Commission, the ECB is to be granted the competence to take final decisions regarding bank supervision issues. In further spheres of bank supervision, it will take over the role of the national supervision authorities<sup>6</sup>. The ECB is to have unlimited powers of intervention in respect of all credit institutions and hold various powers to request information, to carry out investigations or inspections, or to impose sanctions<sup>7</sup>. The national supervision authorities will retain competence over all tasks that have not been conferred on the ECB, for example consumer protection, fighting money laundering, and supervision of banking institutions from third states<sup>8</sup>. The imposition of sanctions will be divided up between the ECB and the national supervision authorities. Initially, the ECB will supervise only large, systemically important credit institutions, and after the end of the one-year transitional term it will take over the supervision of smaller institutions as well. The European Commission justifies this thorough supervision model on the basis that smaller credit institutions have a significant negative impact over the overall financial stability of the Union. Bank branches of non-SSM states which, under Article 4 (2) of the proposed Regulation, are situated within the territory of an SSM member state, will also be subject to the supervision of the ECB. Under Article 6 (2) (a) and (b) of the proposed Regulation, all EU countries outside the eurozone can establish close cooperation with the ECB within the context of the SSM, provided that they meet the relevant conditions. They will be obliged to comply with the guidelines and requests of the ECB and to provide information concerning particular credit institutions and to enact national legislation.

<sup>1</sup> Eriksson A. Op. cit. P. 5.

<sup>2</sup> Proposal for a Council Regulation conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions dated 12 September 2012, COM (2012) 511 // URL: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0511:FIN:EN:PDF>.

<sup>3</sup> Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) № 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) № .../... conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, dated 12 September 2012, COM 2012 (512) // URL: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0512:FIN:EN:PDF>.

<sup>4</sup> Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, COM (2012) 510 final, dated 12 September 2012 // URL: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0510:FIN:EN:PDF>.

<sup>5</sup> MEMO/12/662, Commission proposes a package for banking supervision in the eurozone – frequently asked questions, dated 12 September 2012 // URL: [http://europa.eu/rapid/press-release\\_MEMO-12-662\\_en.html](http://europa.eu/rapid/press-release_MEMO-12-662_en.html).

<sup>6</sup> Eriksson A. Op. cit. P. 16.

<sup>7</sup> Article 19–12, 15 of the proposed Regulation conferring specific tasks on the ECB.

<sup>8</sup> Recital (22) and Article 4 (4) of the Commission's proposal ECB.



Provided they do this, their national supervision authorities will retain bank supervision over local credit institutions.

In order for the activities of the ECB to be strictly divided into two sets – banking supervision and monetary policy – Article 19 (2) of the proposed Regulation provides that an Internal Supervision Committee be established. It would consist of four representatives of the General Board of the ECB and a representative from each Member State of the EU, and the body would have only limited authority as to the planning and execution of bank supervision tasks. According to Article 19 (3) of the proposed Regulation, the Governing Council of the ECB is to delegate clearly defined tasks to the Supervisory Board, subject to the oversight and responsibility of the Governing Council.

The question of whether supervision should be subject to the control of the ECB and, more specifically, whether Article 127 (6) TFEU is a suitable basis for conferring banking supervisions tasks on the ECB was and remains a disputed question<sup>1</sup>. Under Article 127 (6) TFEU as well as Article 25.2 of the Statutes of the ESCB, the ECB can be conferred «specific tasks» regarding the supervision of credit institutions. The provision deals with the monetary policy of the EU, and it should be considered as granting limited competence to the ECB in respect of bank supervision. Such a supervision duty does not constitute a complete transfer of banking supervision over to the ECB, but rather a set of particular obligations in the form of supervision competences with the right of veto<sup>2</sup>. With the ECB's authorisation as a central EU banking supervisory authority, counter-arguments such as the conflict of objectives between supervision and monetary policy, the differences between euro and non-euro Member States, as well as EFTA states, the lack of democratic legitimatisation in the event of interventions, and the formation of a super-authority have to be taken into account. On these grounds, Article 127 (6) TFEU can be a legal basis for transferring of «specific tasks» regarding banking supervision to the ECB, but it cannot be a basis for transferring banking supervision in its entirety to the ECB.

### 3.1.2. Proposal of the European Commission for amendment of the EBA Regulation

The new EBA regulation<sup>3</sup> proposed by the European Commission seeks to adapt the procedures of the European Banking Authority to the newly formed supervision structures, including the status of the ECB as a banking supervision authority<sup>4</sup>. The concept of competent authorities, which previously only referred to national authorities, is extended to include the ECB. The proposed EBA Regulation governs the relationship between ECB and EBA. Under Article 18 in the case of a crisis and under Article 19 in the case of conflicting statements issued by national supervisory authorities, it provides that the ECB has the right to refuse to comply with a request for action by the EBA upon stating the justification. In addition, it is planned that, in the event of a breach of EU law by any supervisory authority pursuant to Article 17, or in the event of differences of opinions of the supervisory authorities pursuant to Article 19 of the EBA Regulation, an independent panel will be established from the Supervisory Board, consisting of the Chairperson and two other members of the Supervisory Board<sup>5</sup>. This seeks to avoid a situation in which the EU States participating in the SSM hold a minority blocking veto<sup>6</sup>. In this connection, the composition of the General Board is thus to be changed such that two members come from EU Member States that are not part of the SSM<sup>7</sup>.

<sup>1</sup> Berschens R., Sigmund T. Juristische Bedenken gegen Euro-Bankenaufsicht wachsen // Handelsblatt. 2012. 20 October. P. 15. According to the opinion of the legal service of the European Council, the ECB «oversteps» the possibilities under the EU Treaties. Therefore, the EBA must be subject to the ECB.

<sup>2</sup> Glatzl S. Geldpolitik und Bankenaufsicht im Konflikt. Baden-Baden, 2009. P. 257.

<sup>3</sup> EBA Regulation.

<sup>4</sup> Eriksson A. Op. cit. P. 18.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid. P. 19.

<sup>7</sup> Article 1 (8) of the proposed EBA Regulation. P. 11.

### 3.1.3. Requirements of the European Parliament

In the conclusions by the European Parliament on 18/19 October 2012, the head of states and prime ministers called on legislators to react the European Commission's proposal for new supervisory legislation. It was followed by a commitment to reach an agreement by 1 January 2013 on the disputed issues of the legal grounds for the establishment of the banking union and a strict division between monetary political and supervisory functions of the ECB, in addition to ensuring equitable treatment and representation of both euro and non-euro area Member States participating in the SSM<sup>1</sup>. The European Parliament demanded amendments as regards the types of supervised credit institutions and the collaboration between the ECB and the national supervisory authorities. The European Parliament also insisted that a Board of Appeal that would settle all the appeals against decisions of the ECB be established and that an express provision be inserted to the effect that proceedings can be brought before the Court of Justice of the European Union contesting a decision taken by the Board of Appeals under Article 263 TFEU<sup>2</sup>. In order to strictly separate monetary policy functions from the supervisory functions of the ECB, staff involved in supervision are to be organisationally separated from other staff. The Parliament would also be granted a right of approval in respect of the appointment of the Chair and Vice-Chair of the Supervisory Board<sup>3</sup>. In order to protect the best interests of the countries which are not a part of the Banking Supervision Mechanism, the qualified majority for decisions taken by the Supervisory Board of the European Banking Authority are to include at least half of the Member States included in the ECB supervisory mechanism as well as half of the Member States not taking part in it<sup>4</sup>.

### 3.1.4. Political Agreement in the European Council

The proposals for new banking regulation, issued by the European Commission, have been met by criticism from some quarters<sup>5</sup>. The political agreement of the Member States on the establishment and the design of the Single Supervisory Mechanism (SSM) was only reached on 12 December 2012 in the Council of Economic and Financial Affairs<sup>6</sup>. On the basis of the proposals of the European Commission and taking into consideration in part the proposals for amendments of the European Parliament, the Member States came to an agreement in the Council of Economic and Financial Affairs on conferring specific tasks on the ECB<sup>7</sup> and on a proposal for an amendment of the EBA<sup>8</sup>. Under the agreement, the ECB is to

<sup>1</sup> Conclusions of the European Council dated 18/19 October 2012, EUCO 156/12. P. 7 // URL: <http://register.consilium.europa.eu/pdf/en/12/st00/st00156.en12.pdf>.

<sup>2</sup> Article 15a and 15b of the M. Thyssen Report // URL: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2012-0392+0+DOC+PDF+V0//EN>.

<sup>3</sup> Eriksson A. Op. cit. P. 21; Art. 19 M. Thyssen Report.

<sup>4</sup> Article 1 VII of the Report on proposal of the European Commission for amendment of the EBA Regulation, S. Giegold // URL: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2012-0393+0+DOC+PDF+V0//EN> (in relation to Art. 44 of the European Banking Authority).

<sup>5</sup> Eriksson A. Op. cit. P. 6, 19; The President of the German Federal Bank takes a stand against banking supervision from inside the ECB // URL: <http://www.m.faz.net/aktuell/wirtschaft/bundesbank-prae-sidentweidmann-macht-front-gegen-bankenaufsicht-unter-dach-der-ezb-11906411.html>; submission of Deputy Meister and others and the CDU/CSU party as well as Deputy Vising and others and the FDP party on 25 September 2012 // BT-Drs. 17/10781; discussions at the session of the German Bundesrat dated 19 October 2012 // BR-Drs. 546/12 and the protocol of the meeting of 19 October 2012 (631. EC). P. 11 et seq. A disputed issue was the supervision of small credit institutions lacking systemic relevance, although such institutions may create systemic risks for the eurozone (Handelsblatt. 2012. 19 September; URL: <http://www.handelsblatt.com/unternehmen/banken/ezb-kontrolle-sparkassen-geben-der-bankenaufsicht-den-kleinen-finger/7156230.html>; Brandt T. O., Gieseler K. Vorschläge der EU-Kommission zur einheitlichen Bankaufsicht in der Eurozone // Betriebs-Berater. 2012. October. P. 2646, 2650).

<sup>6</sup> Eriksson A. Op. cit.

<sup>7</sup> URL: <http://register.consilium.europa.eu/pdf/en/12/st17/st17812.en12.pdf>. Since 29 October 2013 a Council Regulation (EU) № 1024/2013 // OJ. 2013. 29 October. L 287. P. 63.

<sup>8</sup> Since 29 October 2013 Regulation (EU) № 1022/2013 // Ibid. P. 5.

undertake the supervision of the important banks only, i. e. those with a balance sum of 30 billion euros or where they exceed the gross national product of a Member State by 20 %<sup>1</sup>. The supervision of the small credit institutions is to be subject to the national authorities. The ECB will issue guidelines and instructions for the supervision of the small institutions to the national authorities and, according to Article 5 (5) (b) of the proposed ECB Regulation, it can itself directly exercise supervision of these credit institutions at any time. The ECB is responsible for the effective and harmonious functioning of the Supervisory Mechanism. The practical modalities of implementation of the supervision are to be organised via consultation between the ECB and the national authorities<sup>2</sup>.

The proposed Regulation also adds the option for the non-euro Member States to unilaterally terminate their participation in the SSM in the case that they do not agree with the SSM's decisions.

In respect of the separation of the functions of the monetary policy and supervision, the proposals of the European Commission are amended and supplemented with new provisions. The reason was that the existing ECB decision-making organs cannot guarantee this. According to the proposed ECB Regulation, in addition to the existing Governing Council of the ECB and the Executive Board, the following three new bodies are to be added: a Supervisory Board, a Panel of Review and a Mediation Panel. The planning and the execution of the tasks conferred upon the ECB must be undertaken by the Supervisory Board<sup>3</sup>. It is to provide full draft resolutions to the Governing Council of the ECB for supervisory decisions. The Governing Council of the ECB thus continues to have decision-making powers in respect of supervision. The Supervisory Board is composed of representatives of the ECB appointed by the Executive Board of the ECB and representatives of the competent authorities of the Member States. The members of the Governing Council of the ECB must elect the Chairperson of the Supervisory Board from the bank ECB Directorate and the Vice-Chairperson from the members of the ECB Executive Board<sup>4</sup>. This, however, raises the question of whether there is sufficient division between the banking supervision and the monetary policy when a person who is a member of the Governing Council of the ECB, which determines the monetary policy of the EU, is also able to influence the decisions of the Supervisory Board.

A deviation from the European Commission's proposals is a Review Panel that consists of supervisory experts from the Member States who are not simultaneously supervisory authority personnel<sup>5</sup>, and that is to be responsible for reviewing the Supervisory Board's decisions pursuant to Article 17b of the proposed Regulation.

A new Mediation Panel for ensuring strict segregation of the monetary-political and supervisory functions pursuant to Article 18 of the proposed Regulation is also to be established.

The Mediation Panel will resolve differences of views expressed by the competent authorities of concerned participating Member States regarding an objection of the Governing Council to a draft decision by the Supervisory Board<sup>6</sup>. To ensure a separation of operative functions, meetings and agendas of the Governing Council are to be kept strictly separate pursuant to Article 18 (3a) of the proposed Regulation, and representatives elected from the Governing Council on the Supervisory Board are to be barred from exercising monetary-political functions within the ECB<sup>7</sup>.

<sup>1</sup> Article 5 (4) (a) of the proposed ECB Regulation. P. 32.

<sup>2</sup> Article 5 (7) of the proposed ECB Regulation.

<sup>3</sup> Article 19 (1) of the proposed ECB Regulation.

<sup>4</sup> Article 19 (2) of the proposed ECB Regulation.

<sup>5</sup> Article 17b (1) of the proposed ECB Regulation.

<sup>6</sup> Article 18 (3b) of the proposed ECB Regulation.

<sup>7</sup> Article 19 (2a) sentence 1 of the proposed ECB Regulation.



In addition to the proposed Regulation on the ECB, the Member States also agreed on the amendment to the EBA Regulation in the Council of Economic and Financial Affairs. In accordance with the agreement, the preparation for the exercise of powers of intervention and instruction of the European Banking Authority shall be performed by an independent panel, under Articles 17, 18 and 19 of the EBA Regulation<sup>1</sup>. It is to be composed of the Chairperson of the Board of Supervisors and six other members, who are not representatives of the competent authority, because, in the case of Article 17 (breach of Union law) they are alleged to have breached Union law or, in the case of Article 19 (differences in opinion between national authorities), they are parties to the differences in opinion between the national authorities. The amendments proposed by the Commission to the provision on the relationship between the EBA and the ECB in accordance with Articles 18 and 19 of the proposed EBA Regulation were not adopted<sup>2</sup>. In this respect, the ECB is not to have a special role in respect of the national authorities, but rather it would also be subject to the powers of instruction of the EBA, subject to the requirements of Article 18 of the EBA Regulation<sup>3</sup>. The national banking supervisors will be in control of market and solvency supervision, whereas the task of the EBA is to execute the coordination procedure for the SSM.

### 3.1.5. Problematic issues

The proposal of the EU Commission for the establishment of a banking union under the direction of the ECB was introduced on the basis of Article 127 (6) TFEU. There remains the question whether, after the agreement in the Council of Economic and Financial Affairs, the proposal is covered by this principle of competence and whether the tasks transferred to the ECB can fall under the notion of «specific tasks» in Article 127 (6) TFEU<sup>4</sup>. Establishing banking supervision at the European Central Bank is also associated with problems such as: the hierarchical relationship with the EBA, the current absolute independence of the ECB in respect to its monetary-policy functions, the priority of these tasks under Article 127 (1) sentence 1 TFEU, and with the decision-making structures of the ECB. In this regard, the transfer of banking-supervision enforcement powers to the ECB is closely intertwined with the competence for substantive EU legislation.

#### 3.1.5.1. Article 127 (6) TFEU

As already mentioned, Article 127 (6) TFEU is not a sufficient basis for transferring all banking supervision to the ECB<sup>5</sup>. Based on a grammatical interpretation of Article 127 (6) TFEU, it refers to «specific» and not to «the» or to «all» supervisory functions. In addition, in accordance with a historical interpretation, the Member States, at the treaty negotiations of Maastricht, rejected the demand of the managers of the central banks for participation of the ECB in banking supervision, and, as a compromise, the possibility of participation of Article 127 (6) TFEU was adopted, provided the Council unanimously agreed to such participation<sup>6</sup>. Under the proposal of the European Commission, the ECB will not take over all banking supervision duties, as the supervision of small and systematically irrelevant credit institutions in the eurozone will remain under the control of the Member States. It is unclear whether of Article 127 (6) TFEU allows the ECB to take over this supervision as well. In accordance with the wording of Article 127 (6) TFEU, it is not expressly laid down that core competences must remain with the Member States. Moreover, based on a teleological interpretation, it can at most be concluded that the provision seeks to rule out the

<sup>1</sup> Article 1 (5) of the proposed EBA Regulation // URL: <http://register.consilium.europa.eu/pdf/en/12/st17/st17813.en12.pdf>.

<sup>2</sup> See: 2<sup>nd</sup> Commission proposal for amendment of the EBA Regulation.

<sup>3</sup> Eriksson A. Op. cit. P. 25 et seq.

<sup>4</sup> Ibid. P. 27.

<sup>5</sup> See: 1<sup>st</sup> Commission proposal for conferring specific tasks to the ECB.

<sup>6</sup> Glatzl C. Op. cit. P. 257.



entire transfer of banking supervision to the ECB<sup>1</sup>. The ECB was granted direct powers of supervision, investigation and sanctions under Article 8 of the proposed ECB Regulation. In addition to the supervision of systemically relevant credit institutions assigned to it, it can extend its assigned powers to one or more small credit institutions under Article 5 (5) (b) of the proposed ECB Regulation<sup>2</sup>. The wording «one or more» does not include all such institutions; therefore, it cannot be considered to be full banking supervision by the ECB. In any case, certain supervisory powers remain with the supervisory authorities of the Member States, and the ECB is mainly focused on the systematically relevant credit institutions. Therefore, the proposed Regulation can be based upon Article 127 (6) TFEU in the sense of «effet utile».

It is also questionable whether the Supervisory Board, which was not provided for until now, can be established along with the Governing Council of the ECB and Executive Board. In respect of the division of monetary policy from supervision, the provision raises significant doubt in respect of the primary objective of price stability of the ECB in accordance with Article 127 (1) sentence 1 TFEU, and the decision-making power of the Governing Council of the ECB. During the negotiation process in the Council of Economic and Financial Affairs, it was found that the establishment of a Supervisory Commission was in breach of Article 13 (2) TEU<sup>3</sup>. According to the provision, each organ of the EU must act in accordance with the procedures determined in treaties. The decision-making organs of the ECB, in accordance with Article 129 (1) TFEU in conjunction with Article 9.3 of the Statutes of the ECB, are the Governing Council of the ECB and the Executive Board. As no provision is made for an amendment of these organs and their procedures or voting rules, the Commission's proposal exceeds the powers held by the Council pursuant to Article 127 (6) TFEU.

On the other hand, a conflict of objectives between the monetary policy and supervisory functions should be avoided. Under the two current bodies, this cannot be guaranteed. In this regard, Article 127 (6) TFEU can be understood in the sense that the transfer of «specific tasks» of banking supervision to the ECB provides the European Council with an opportunity to introduce such an organ for this purpose. In addition, the new Supervisory Board will not have the power to take decisions itself, but rather it will prepare decisions which are reserved for the ECB<sup>4</sup>.

It should also be clarified to what extent the decisions of the Mediation Panel will have to be binding, especially if the Governing Council of the ECB has the final decision-making power in relation to supervisory decisions. If the view that Article 127 (6) TFEU does not establish a new decision-making body is followed, the decisions of the Mediation Panel should not be of a binding nature. Therefore, it can be argued that Article 127 (6) TFEU may be invoked as a legal basis under such circumstances.

#### 3.1.5.2. Competences of the EBA, the ECB and the ESRB

As the EBA was introduced as a central European banking authority, the question now arises as to the ECB's role in respect of supervision. The *De Larosiere* Report envisaged only the mediation functions of the ECB when dealing with conflicts between the national supervisory authorities<sup>5</sup>, whereas according to Article 33 (2) of the Banking Directive this power is granted to the European Commission. The EU Commission likewise has the last word when it comes to drafts relating to the binding technical standards of the European Banking Authority<sup>6</sup>. According to the Commission's proposal, the ECB will initially take

<sup>1</sup> Eriksson A. Op. cit. P. 29.

<sup>2</sup> Notwithstanding the provisions defining significant credit institutions, the ECB is in any case to undertake supervision in respect of the three most significant credit institutions in each of the participating Member States, under Article 5 (4) (b).

<sup>3</sup> Eriksson A. Op. cit. P. 29. Opinion of the legal service of the European Council dated 9 October 2012.

<sup>4</sup> Ibid. P. 30.

<sup>5</sup> The De Larosiere Report. P. 49. Para. 170.

<sup>6</sup> Article 10 (1) (8), 15 (1) (7) of the EBA Regulation.

over only the role of the national supervisory authorities within the eurozone, whereas the harmonization of the banking sector in the whole EU and the introduction of a uniform supervisory practice will remain under the control of the European Banking Authority. Thus, on a European level, the ECB will have the same relationship towards the European Bank Supervision Authority as towards the national authorities of the non-eurozone Member States. In terms of hierarchy it will be under the EBA. In order to differentiate the functions of both authorities, a suggestion was raised to leave the operative supervision of credit institutions to the ECB, whereas decisions on the permission, dissolution or restructuring of institutes would be reserved for the EBA<sup>1</sup>. A similar idea existed for the division of banking supervision between the ECB and the European Stability Mechanism (ESM)<sup>2</sup>. At the same time, when making a comparison between the ESRB and the ECB, it is apparent that the two institutions have similar functions concerning the macro-prudential supervision and the associated information-gathering. However, unlike the ESRB, the ECB can directly collect the statistical data required to exercise its functions from the national authorities, according to Article 5.1 of its statutes with the support of the national central banks. Thus, unlike the ESRB, the ECB has greater access to information, without being involved in the procedure of information acquisition, as Article 15 of the Regulation on the ESRB envisages for the ESRB. In contrast to the ECB, the ESRB does not have legal personality, which means that the ESRB is capable of taking action only through the ECB. The ECB is hierarchically subordinate to the ESRB, whereas according to the proposal of European Commission and in practice it is the ECB that is more in the public eye since the debt crisis. This lead to the opportunity that the ESRB could become a forum for a dialog lead by the ECB and the ESRB leadership and decision-making could be dominated by the ECB and banking union concerns<sup>3</sup>.

#### 3.1.5.3. Independence of the ECB

According to Article 130 TFEU, the independence of the ECB and of the members of its decision-making organs is guaranteed for the entirety of their field of activity. The same chapter contains the section stating that the ECB may be assigned «specific tasks» in relation to supervision, according to Article 127 (6) TFEU. This provision does not mention any change in the independence of the ECB. A systematic interpretation of the TFEU permits the independence of the ECB in respect of monetary-policy functions. The granting of functions and powers that are not to be independently exercised should necessitate an amendment of the TFEU<sup>4</sup>. Dispensing with political responsibility and reviews is also at odds with the principle of democracy under Article 2 (1) TEU. The functioning of the European Union is founded on representative democracy according to Article 10 (1) TEU. Any form of independent exercise of sovereign rights on the part of independent bodies of the EU requires special justification by the European Parliament, the European Council or the European Commission. In respect of the monetary policy functions of the ECB, such a justification may be based upon the independence of central banks and currency stability. There is no such justification for the independence of the ECB where supervisory functions and the stability of the banking system are concerned<sup>5</sup>. Particularly in respect of bank supervision there is no tension between the interests of stability and the monetary functions of

<sup>1</sup> Herdegen M. Europäische Bankenunion: Wege zu einer einheitlichen Bankenaufsicht // Wertpapiermitteilungen. 2012. P. 1889, 1897.

<sup>2</sup> Ibid. P. 1897 et seq. The European Stability Mechanism is an international organisation created in accordance with the international law that can assume such functions. If the European Stability Mechanism does not represent the national authorities of the Member States in the EBA, an amendment of secondary EU law will be required. An integration of the functions and powers currently held by the EBA with banking supervision by the ESM will require an amendment of the TFEU.

<sup>3</sup> Ferran E., Balis V. The European Single Supervisory Mechanism // Journal of Corporate Law Studies. 2013. № 13. P. 255, 285.

<sup>4</sup> Herdegen M. Op. cit. P. 1894.

<sup>5</sup> Ibid.

the ECB. Consequently, a transfer of banking supervision to the ECB would, in light of its independence, be contrary to the principle of democracy<sup>1</sup>.

#### 3.1.5.4. Scope of Supervision

Under the proposed Regulation, the supervisory powers of the ECB would be restricted in principle to the eurozone. Therefore, UK institutions are not included, despite the fact that the head offices of some of the largest institutions are located there. The Member States outside of the eurozone can establish close cooperation between their supervisory authorities and the ECB under Article 6 of the proposed ECB Regulation. They will not have as great an influence on the decisions in the Supervisory Board as the eurozone Member States, which are represented via their own votes as well as these of the chairpersons of the ECB. Such a divided Supervisory Board would result in system failure to a certain extent. The reason is that in a mainly harmonised sector companies would be subject to differing supervisory mechanisms side-by-side<sup>2</sup>. It remains questionable whether these states can enjoy benefits from such a cooperation if they have none of the advantages of a single currency. The ECB can also not guarantee that it will protect the euro and their national currencies to the same extent.

### 3.2. Proposal of the European Commission for a Single Resolution Mechanism (*current*)

At a meeting of the ministers of finance of the eurozone on 13/14 May 2013, it was discussed whether, when and how the big bank investors would have to bear losses in the event of a bailout of a bank. A new structure, supported by the European Stability Mechanism (ESM), is to take over bank resolution in the eurozone. Germany was opposed to such a rapid introduction of the resolution mechanism because first a single bank restructuring procedure and a common deposit insurance would have to be established in the context of a banking union and a single supervisory authority<sup>3</sup>. In the absence of strict implementation, the deposit insurance would result in a significant redistribution. In Germany's view, the bank restructuring will require an amendment of the Lisbon Treaty<sup>4</sup>. The funds for the bank restructuring or dissolution should not be in a common fund until such time as a more centralised supervisory system with a stable legal basis has been established in the EU<sup>5</sup>.

In light of this discussion, the European Commission proposed a Single Resolution Mechanism (SRM) for the banking union on 7 July 2013. This system is designed to recapitalize credit institutions that have gotten into financial difficulties via a resolution fund. The system would work in such a way that the ECB, as the bank supervisor, would first signal when a bank was in severe financial difficulties and needed to be resolved<sup>6</sup>. As a second step, a Single Resolution Board (SRB) consisting of representatives of the ECB, the European Commission and the national authorities where the bank has its headquarters would prepare the resolution of the bank. On the basis of the Single Resolution Board's recommendation, or on its own initiative, the Commission would decide whether to place a bank into resolution. Thus, the final say would be with the European Commission. The legally binding discretionary decision will accordingly be with a democratically

<sup>1</sup> Herdegen M. Op. cit. P. 1894; Hahn H., Häde U. Währungsrecht. 2010. P. 112.

<sup>2</sup> Ibid. P. 1894.

<sup>3</sup> Kotz H.-H. Nach der Krise; Neue Herausforderungen für die Bankenregulierung // Zeitschrift für Bankrecht und Bankwirtschaft. 2012. P. 322, 328.

<sup>4</sup> Werner M. EU-Pläne für Bankenabwicklung kaum haltbar // Frankfurter Allgemeine Zeitung. 2013. № 10. P. 1; URL: <http://www.faz.net/aktuell/wirtschaft/eu-plaene-fuer-bankenschliessung-kaum-haltbar-12277981.html>.

<sup>5</sup> Сотирова С. В капана на банковия съюз // Банкеръ. 2013. 17–24 Mai. P. 6.

<sup>6</sup> This assessment will be conducted by the ECB Supervisory Board for the banks subject to the SSM and by the national resolution authorities for banks not member of the SSM. See, Micossi S., Bruzzone G., Carmassi J. The New European Framework for managing Bank Crises // CEPS Policy Brief. 2013. № 304. P. 21, 29 // URL: <http://www.ceps.be/category/book-series/ceps-policy-briefs>.

legitimate organ in accordance with European jurisprudence<sup>1</sup>. If the European Commission decides to place a bank into resolution, the national resolution authorities would be in charge of the execution of the resolution plan. The SRB would oversee the resolution and if the national resolution authorities not comply with the decision, it would directly address executive orders to the troubled bank<sup>2</sup>.

In addition, a Resolution Directive establishing uniform rules and procedures for the resolution of credit institutions and investment firms is to be enacted<sup>3</sup>. The proposed order of seniority in the event of insolvency is still the subject of dispute. According to the Commission's proposal, the shareholders, followed by bondholders and finally savers with savings of more than 100,000 euro will be held liable<sup>4</sup>. Only then would the taxpayer, initially via the Member State in question and subsequently the other euro states via the European Stability Mechanism, be called upon<sup>5</sup>. It remains unclear whether this scheme would apply to all EU Member States, or whether the decision as to whether the taxpayer must intervene will be left to the individual states. The banking union is to be built upon the framework of this Directive and the SSM<sup>6</sup>. The Directive will apply to credit institutions of Member States not participating in the banking union and should govern the interface between the SRM and the national resolution authorities of these Member States. The Commission's proposal faced some negative reaction<sup>7</sup>. Concerns were raised that the Commission would be given powers beyond those it can be granted under the EU treaties, which powers would require an amendment of primary European law<sup>8</sup>. Until such time as this is reached, a «network» of national resolution authorities could carry out this function<sup>9</sup>. It is thus that it will require a certain period of time for the introduction of the SRM, due to the absence of an agreement on certain questions.

#### 4. Conclusion

The new European system of financial supervision established on 1 January 2011 was designed to ensure a consolidation of financial supervision. However, the centralised supervision at a supranational and a national level is in contrast to the decentralised system of supervision by the country of origin. The Commission's proposal to confer banking supervision on the ECB in accordance with Article 127 (6) TFEU is conditional on the ECB not taking over all banking supervision activities, but only certain functions in connection with the oversight of credit institutions. According to the *De Larosiere* Report, supervision at an EU level should encompass all areas of the financial markets and should not be restricted to the banking sector<sup>10</sup>. A European central financial supervisory authority would be the logical step in this direction after the introduction of a single currency and the establishment of a ECB, although according to some eurosceptics this is more associated with a single

<sup>1</sup> *Hyoltchi R.* The European Commission issued a legislative proposal for the Europeanization of bank resolution. It wants to create a board and a fund. The project met with harsh criticism from Berlin // *Neue Züricher Zeitung*. 2013. 11 July; URL: <http://www.nzz.ch/aktuell/wirtschaft/wirtschaftsnachrichten/bruessel-fordert-berlin-heraus-1.18114544>.

<sup>2</sup> Commission proposes Single Resolution Mechanism for the Banking Union, dated 10 July 2013 // URL: [http://europa.eu/rapid/press-release\\_IP-13-674\\_en.htm](http://europa.eu/rapid/press-release_IP-13-674_en.htm). See also, Council agrees general approach on Single Resolution Mechanism, 18 December 2013 // URL: [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/140190.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/140190.pdf).

<sup>3</sup> See: Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions. P. 2. The Directive would also govern the order of priority for compensation.

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> See: *Сотирова С.* Указ. соч.

<sup>7</sup> EurArchiv dated 12 July 2013 // URL: <http://www.euractiv.de/finanzen-und-wachstum/artikel/schauble-gegen-eu-plane-zur-bankenabwicklung-007765>.

<sup>8</sup> *Hyoltchi R.* Op. cit.

<sup>9</sup> *Ibid.*

<sup>10</sup> See: The De Larosiere Report. P. 45. Para. 153.

state<sup>1</sup>. The proposals of the Commission are directed towards the centralisation of bank supervision. However, the competence for European-wide supervision of credit institutions along with all the necessary rights to information and of intervention is still lacking. The establishment of a banking union is limited to the eurozone. As a new piece of regulation, it meets the need for further integration in Europe. It will also be better able to meet the challenges of global competition. Nonetheless, it remains open to debate whether the banking union should be run by the ECB, as there are doubts in respect of independent supervision and monetary policy of the ECB. The economic and monetary policies of the participating Member States will likewise be placed at different levels: whereas monetary policy is conferred to the supra-national ESCB, responsibility in terms of economic policy will remain with the Member States, which will not be able to prevent further crises, pending the establishment of an economic union. In retaining the decentralised system of supervision there will be further problems in respect of differing supervisory practices in the Member States. Such problems can be resolved via central European financial supervision. The European Commission's new project for the introduction of a Single Resolution Mechanism as a foundation for the functioning of the banking union remains controversial. Consequently, the reform proposals of the Commission should be viewed as preliminary steps for the planned rollout of a centralised model of supervision in the future. It remains to be hoped that such a model will be implemented in the near future.

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<sup>1</sup> *Baring A.* Wir reden von einem Europa, das es gar nicht gibt // Focus. 2013. 30 May. P. 26.

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