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„The Increasing Importance Of The ECB In The Process Of Establishing An EU Banking Union“

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ABSTRACT

In the aftermath of the crisis, the EU institutions and the national authorities of Member States implemented various short-term and medium-term measures to prevent collapse of the European financial system. To both national and European representatives it was clear that in order to avoid future meltdown they also had to hinder the 'bank-sovereign feedback loop', therefore reforms were inevitable. The most radical change agreed by the Eurozone Member States was the establishment of a European Banking Union (EBU) consisting of three main pillars. In the process towards a harmonised European banking system the European Central Bank (ECB), as a key financial authority of the EU, underwent and is still undergoing many crucial changes. Through implementation of the first step of the EBU, the Single Supervisory Mechanism, the ECB became the main supervisor for banks in the Euro area. The ECB will also play a significant role in the second step towards a banking union, the Single Resolution Mechanism. The vision is still unclear for the deposit Guarantee Scheme, the last phase of the EBU, but there is no doubt that the central bank of the EU will definitely play an important role there, too. This thesis attempts to present the increasing importance of the ECB in the process of establishing an EU banking union. It also tries to unravel who are the main advocates of the integration and delegation of new powers from national to European level, and to the ECB in particular. Changes concerning banking integration are subject to many theoretical frameworks, two of which are particularly contradictory; neo-functionalism and liberal intergovernmentalism. Their key assumptions have been tested against the progress of the EBU up to now. This thesis tries to find out whether neo-functionalism or liberal intergovernmentalism corresponds closer to the developments in Eurozone banking integration. According to neo-functionalists, EU supranational institutions are the main triggers of the integration process and banking integration itself is an obvious consequence of spillover effects which were 'automatically' responded to by Member States. On the contrary, liberal inter-governmentalists assume that the EBU is shaped by heads of state and governments according to their national interests, therefore the main incentive for integration was self-interest and the role of EU institutions should be limited to serving Member State authorities.

The conclusion of this thesis is that there is no right answer which theory fully corresponds to the developments of the entire process towards EBU. Nevertheless, national interests seem to have an advantage over spillover effects. Although the role of EU institutions should not be underestimated in the process of banking harmonisation, the current form of the EBU mirrors to a great extent the interests of the Member States with the strongest bargaining powers.

INTRODUCTION

After the emergence of the financial crisis in 2008, relevant institutions within the European Union focussed their attention on creating regulations to guarantee a safer financial sector, which was not strong enough to cope with the overwhelming difficulty the European banks got into. As the crisis progressed and developed into the Eurozone debt crisis around late 2009, it became clear that the EU member states and institutions were in desperate need of a new framework. The crisis highlighted not only the weaknesses of the national financial systems, but also their reliance on government bonds and their inability to face problems without interference and support from supranational bodies like the Troika[1]. In a few Member States huge private debt which was a result of a property bubble converted into public debt due to bailouts of financial institutions as well as attempts by authorities to delay the consequences of post-bubble effects.[2] As a result of concerns about their debt sustainability, many investors retreated from the affected markets. The inability of governments to repay debts, feedback loops between sovereigns and banks, together with the fact that bank losses were now part of public debt led to a huge lack of trust in the financial sector.[3]

In order to recover the credibility of the banking sector the ECB and other EU institutions designed and implemented numerous temporary and long-term measures, mechanisms and bodies with the main goal of achieving a banking union. In response to the financial difficulties of the countries not able to deal with these measures, the EU quickly organised bilateral loans from other European governments and the European Commission. Subsequently, ECOFIN[4] created two temporary measures. Firstly, on 10 May 2010, the European Financial Stabilisation Mechanism (EFSM) was launched. This is basically a funding program which provides financial support to EU members exhibiting serious economic trouble. Its budget comes from capital raised on the financial markets combined with the EU budget used by the European Commission as a guarantee.[5] The EFSM is a

[1] In this case: A nickname of three international organisations that deliver assistance programs rescuing the states mostly hit by the crisis (Greece, Cyprus, Ireland, Portugal and Spain); The European Central Bank, European Commission and International Monetary Fund.

[2] European Commission, A comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the Eurozone, Brussels March 2014, pp. 1-10.

[3] N. Véron, *The challenges of Europe's fourfold union*. *Bruegel Policy Contribution*, Issue 13, p. 8. http://www.bruegel.org/publications/publication-detail/publication/741-the-challenges-of-europes-fourfold-union/ (retrieved 05 April 2015).

[4] Economic and Financial Affairs Council.

[5] *EU bonds for Ireland bailout well-received on market*, http://news.xinhuanet.com/english2010/world/2011-01/06/c_13678088.htm. 6 January 2011 (retrieved 2 April 2015).

program based on regulation. The second temporary anti-crisis mechanism, the European Financial Stability Facility (EFSF) was established in June 2010 in the form of a partnership based on an international agreement between Eurozone Member States. The EFSF was also created by ECOFIN on 10 May 2010 to provide financial support to Greece, Portugal and Ireland, with the main source of funds being bonds and other debt instruments on the financial market.[6] The EFSF is only supposed to provide financial assistance until 30 June 2015 to those three member states it was created for.

However, this "Euro rescue package" was created as an immediate measure to prevent the crisis spreading. The European authorities started to seek permanent solutions tailored to the European financial difficulties when the situation in the Eurozone stabilised somewhat at the end of 2010. On 16 December 2010, the Belgian government, which then held the EU Presidency, proposed an amendment to the Treaty on the Functioning of the European Union (TFEU), aiming to expand Article 136 by one new paragraph. At the European Council meeting on 25 March 2011, the change was unanimously adopted and the two additional sentences which give Euro area Member States the right to establish "(…) a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole"[7] were incorporated into the TFEU. The Council's decision came into force on 1 May 2013.

The EFSM and the EFSF are forerunners of the European Stability Mechanism (ESM), which is one of the main permanent tools dedicated to restoring financial stability in the Eurozone. The ESM is an international organisation based in Luxembourg and is the sole mechanism allowed to accept new requests for assistance from EU Member States. So far it has supported Cyprus and Spain with loans.[8] On 2 February 2012, the governments of Euro area Member States signed a treaty establishing the European Stability Mechanism (TESM), which subsequently came into force on 27 September 2012. Its activity was inaugurated on 8 October 2012 and loans were provided to Spain on 5 February 2013 and to Cyprus on 8 May

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[6] Informacja na temat nowych zasad funkcjonowania Europejskiego Instrumentu Stabilności Finansowej (EFSF) oraz przyszłego kształtu Europejskiego Mechanizmu Stabilności (ESM), Departament Zagraniczny NBP, sierpień 2011.

[7] *EUROPEAN COUNCIL DECISION of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro* (2011/199/EU), *Official Journal of the European* Union, L 91/1, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:091:0001:0002:EN:PDF (retrieved 2 April 2015).

[8] K. Regling, *Chief Bail-Out Officer*, in: The Economist, http://www.economist.com/node/16485600?story_id=16485600&fsrc=rss (retrieved 2 April 2015).

2013. One of the key tasks of the ESM is introducing stronger crisis reaction predictability within the EU.

All these new mechanisms have been created to reinstate the credibility of the financial system in EU Member States and in the EU as a whole. The main goal of the EU authorities since 2012 has been to act as a banking union which can respond to the fragility of the alarmingly numerous financial institutions in the Eurozone, as well as to the danger of a feedback loop between the sovereign credit of Member States and the credit conditions for the banks in these countries. The inception and functioning of this banking union in the Eurozone has been a crucial policy success since the beginning of the crisis in the EU. After several years of transition, the policy framework of the banking union is expected to guarantee a more resilient, diverse, and better integrated financial system not only in the Eurozone, but also across Europe. Despite the fact that it is not yet quite complete, it definitely shows the willingness of EU countries to deepen economic and financial integration. This thesis tries to disclose who actually cares about integration and what interests they have in it. Which powers have a deciding role in the efforts to form a properly functioning banking union and how do they influence the functions and powers of the highest European banking authority, the European Central Bank (ECB)?

1. METHODOLOGY AND SOURCES OF INFORMATION

Taking into consideration the comprehensiveness of its approach to the subject, resulting from a complex network of relationships, mutual influences, different models and concepts, this thesis adopts a multiple case study method with a descriptive aim.[9] This should be helpful in understanding different perspectives and attitudes towards a European banking union as well as in answering the following research question: "National Governments or Supranational EU Institutions: Who Plays the More Decisive Role in European Financial Integration and How Do They Influence the ECB's Powers?". Thus, using this method aims to find out who the main advocates of deeper banking (and consequently also fiscal) integration are and what impact they can have on the new decision-making architecture. In line with the following definition, a case study is research which "calls for selecting a few examples of the phenomenon to be studied and then intensively investigating the characteristics of those examples ("cases"). By closely examining a relatively small number of cases, and comparing

[9] Descriptive aim of the case study should depict a phenomenon within its context, [according to:] RK Yin, *Applications of Case Study Research*, Sage, Beverly Hills 1993, pp. 13.

and contrasting them (…)”.[10] This method of research seems to ideally match the complicated transition process to the EBU and the rapidly changing context and circumstances presented in the paper. The purpose of this study is to understand the foundations and principles of the EBU, interdependencies between the Member States and the pan-European institutions, as well as the power of influence of national social preferences on the European decision-making system.

Since this thesis seeks to explain the main powers lobbying for financial unification in the EU, there is a need to present the theoretical framework of this process. Firstly, in order to reveal who has a particularly decisive impact on the efforts to establish banking integration in Europe, the two main competing theories of liberal intergovernmentalism and neo-functionalism will be analysed. Even though both theoretical approaches have been strongly criticised, they include most convincing integration arguments (in the author’s opinion). Following the reasoning of the liberal intergovernmentalists, the bargaining process of European banking integration is determined above all by the national interests of the Member states, meaning it is only an effect of political calculations. On the other hand, supporters of neo-functionalism claim that the process towards a banking union is solely caused by so called “spillover effects” and pressures being applied by institutions. The latter hypothesis is presumably exactly what the fathers of the European integration would wish to be true since, as stated by Rosamond, this seemed to be their intention: “Neo-functionalism can be read on one level as a theory provoked entirely by the interactive activity among the original six member states”[11]. Following this logic, integration will be driven by economic sectors and political integration will be just a side effect. “Spillovers” are undoubtedly the basis of European integration and the role of institutions is significant. Although this theory sounds much more positive, the conclusion of this thesis is that national interests are predominant in the bargaining processes. This means that the powers of the ECB are limited to some extent. In the future, additional difficulties might be triggered by postponement of negotiations and limited funding. Nevertheless, much to its elation, under the numerous supranational regulations adopted within the last years, the ECB still has room to manoeuvre. It is undeniable that this institution has significantly increased in value since it was established back in 1998. In the years since the onset of the Euro crisis it has, in fact, gained more powers than ever before in its history. One might venture to say that the crisis was actually an

[10] D. R. Hensler, et. al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain,* RAND Institute for Civil Justice, RAND, Santa Monica 2000, pp. 527-528.
[11] B. Rosamond, *Theories of European Integration*, Palgrave Macmillan Ltd., Hampshire 2000, p. 10.

accelerator towards the European banking union, even if it simultaneously undermined the relevance of the EU for several Member States. This theoretical part will be based on the literature written by the representatives of each of the two described approaches as well as papers commenting on the attempts to pigeon-hole European integration.

Secondly, to gain more insight into the way the ECB works and the extent to which its powers have expanded since its inception, the history, functions, institutional setup and its course to European Monetary Union will be reviewed.

The next section of the thesis is a comparison between the functions and powers of the ECB (as a successor to the Bundesbank) and the Federal Reserve System (FED) which aims to present the similarities and differences and strong and weak points of the world's two most powerful banking systems.

Next, the reform of the EU's financial supervision system as a 'preparation' process towards further economic and fiscal integration will be presented.

Then, this thesis will focus on the new powers and functions gained by the ECB as part of the process of attaining a banking union, in particular the main components leading to a banking union; the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the Single Rulebook. When presenting all these systemic changes this paper will attempt to show the attitude of the chosen Member States and the crucial institutional actors towards them. The main hypothesis of the theoretical frameworks used in this thesis will be tested through the prism of the events leading to the EBU in the last section.

A literature study is conducted in this thesis in order to answer the research question and highlight the improvement in the position of the ECB. The majority of the data presented in this thesis is based on official texts issued by the European institutions and the national authorities from chosen Member States, draft regulations, policy documents, official speeches and interviews with the highest European and national political and banking authorities, archival records as well as press releases and newspaper articles.

2. THEORETICAL FRAMEWORK

2.1. Neo-functionalism

There are many theories discussing European integration, but only two of them have been accepted as hypotheses *per se*. Although the theories of liberal intergovernmentalism and neo-functionalism seem to be contradictory, they are deemed the most convincing explanations of monetary integration within the EU. This section will test these two main theories against the progress made towards the banking union so far. These theories are preferred over the others because they show the most extreme approaches, while the other recognised integration theories[12] seem to be only sophisticated combinations, fragments, or modified versions of the two grand theories. Since this paper does not aim to present the whole range of EU integration theories, only the two aforementioned will be analysed. Thus, this thesis does not aim to state which theory is most correct, but to provide the reader with an overview of both approaches and let him form his own view of which arguments are most relevant and whether it is at all reasonable to state that European integration adheres only to one theory.

In the second half of the 1950s, Lindberg and Haas laid the foundation of neo-functionalism as a combination of federalist goals and functionalist mechanisms. They backed up their hypothesis with three mechanisms for stimulating regional integration:

- Positive “spillover”
- Technocratic automaticity
- Transfer in domestic allegiances

Positive “spillover effect” is a process whereby increasing integration in one economic sector opens the door for integration in further segments with the aim of benefiting from that integration. Technocratic automaticity is the ‘natural’ way of supranational institutions gaining independence from and increasing their powers of control over Member States as integration proceeds. According to the authors, economic integration is conditioned by the presence of the elite’s complementarity, pluralism, unit size, and transaction rate. Transfer in domestic loyalty is a mechanism which gradually transfers allegiances from national authorities to supranational institutions which are considered to be safer and more beneficial.

[12] E.g. fusion thesis, supranational governance or new institutionalism.

The presence of these mechanisms results in growth in cross-border transactions, regulatory complexity, and consequently the necessity of deeper integration.[13]

Lindberg and Haas' theory has been frequently criticised. Even Haas declared his own concept outdated only a decade or so after publishing it due to a slowdown of European integration in the 1960s caused by the "empty chair" politics of Charles de Gaulle which completely paralysed the functioning of the European Economic Community, the European Coal and Steel Community, as well as the European Atomic Energy Community. Nevertheless, the theory has survived as one of the strongest in the history of EU integration and its reactivation in the late 1990s and 2000s is down to Alec Stone Sweet and Wayne Sandholtz, who updated it by adding numerous empirical records. Their crucial studies confirmed, for instance, that "the Court and the Commission have routinely produced rules and policies that the member governments would not have adopted through intergovernmental bargaining"[14]. They restored Haas' theory to some extent, adjusting it to changed conditions and reality. For example, they stated that political actors do not necessarily have to shift all their allegiance towards supranational bodies as a result of integration. Because of the substantial room to extend supranational powers without diminishing the role of national authorities, European institutions are able to gain more powers without fundamental shifts in identification.

Neo-functionalism attempts to explain political and (especially) economic integration, as well as the possible shift of powers from national to supranational level. The irreversible process of supranational governance expansion has deepened over time and neo-functionalists want to determine why EU integration has expanded so far and what the consequences of this process could be.

According to the neo-functionalists, monetary integration in the EU was developed as a result of successive actions that triggered other actions. The single market was the primary trigger which spontaneously "ignited" EU integration, in turn leading to a snowball effect on subsequent steps (monetary integration). This resulted in the irreversible process of integration spreading into new fields. Indeed, individual societal groups are not insignificant either, as while taking care of their own interests they also try to have an effect on the steps

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[13] A. S. Sweet , W. Sandholtz, *Neo-functionalism and Supranational Governance,* in: E. Jones, A. Menon (Editors), *The Oxford Handbook of the European Union,* Oxford University Press, Oxford 2014, pp. 18-28.

[14] A. S. Sweet, W. Sandholtz, *European Integration, and Supranational Governance*, Oxford University Press, Oxford 1998, p. 12.

made by supranational institutions. Once the supranational bodies (and indirectly also the elites) gain particular powers and functions, they strive for further rational steps towards deepening European integration and subsequently adding new competencies.

Neo-functionalists distinguish between three main kinds of spillovers; technical, political, and cultivated.

In accordance with most neo-functionalist literature, the “technical spillovers” are the most important in the European integration progress. From the perspective of technical spillovers, integration is perceived as an automatic snowball effect. Integration in one sector brings about interdependence in this and further areas. As a result, deepened integration guarantees easier and more effective problem solving processes between partners. Haas describes “technical spillovers” as the “expansive logic of sector integration whereby the integration in one sector leads to ‘technical’ pressures pushing states to integrate other sectors”.[15]

Next, “political spillovers” are an effect of elite groups’ activities. As experience shows that some problems require a solution on a higher than national level, the elites move their political activities and allegiance towards supranational institutional systems. Thus, the elite groups become promoters of integration which may result in closer cooperation between national groups with the same interests. The last type of spillover specified by experts is “cultivated spillovers”. This is driven by staff within EU institutions, who emphasise the importance of replacing the standard bargaining process with one which reflects common interests. The institutions are crucial in the integration process because they are responsible for inducing the national authorities to relinquish some of their powers and autonomy for the common good.[16]

Assuming the contemporary neo-functionalists are right, further integration steps and results should be the following:

- Greater activity of European institutions and extended common laws and regulations
- Increased EU interest group activity as a result of volume extension of the common rules
- Increase in cross-border transactions

[15] E. B. Haas, *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957,* Stanford University Press, Stanford 1958, p. 383.
[16] A. Niemann, P. C. Schmitter, *Neofunctionalism*, in: A. Wiener, T. Diez, *European Integration Theory,* Oxford University Press, New York 2009, pp. 48-51.

- Need for a dispute resolution system at the European level (common rules require supranational judgment)
- Especially fast-paced development towards European control of the crucial sectors
- Increased EU institutions support for the national rule-making bodies responsible for implementation of common rules[17]

Supporters of this theory state that the integration process happens without any significant influence on the part of governments and decisions are completely independent of state authorities.[18] Political actors only have a role in the initial stages of the process and are not able to get involved in long-term actions.[19]

2.2.Liberal intergovernmentalism

The second theoretical proposal called liberal intergovernmentalism is completely at odds with neo-functionalism and strongly believes in the power of Member States governments.

This theory strongly rejects the "spillover" beliefs of the neo-functionalists and, above all, their putting of supranational institutions' powers on a par with those of governments. According to the authors of the theory, Member States are key actors within international institutions and the independent representatives appointed by governments are solely responsible for EC and EU regulation implementation. In consonance with the theory, Member States are the only real shapers of integration development. In contrast to the former hypothesis, proponents of this theory insist that the independent representatives are in any event overwhelmed by the requirements of interest groups.[20] In line with this, supranational bodies are created to serve the governments of nation states that directly or indirectly have authority over them. As such, national preferences are mirrored in the rational decisions made by governments that subsequently result in progressive unification. Acceptance of a supranational polity is a voluntary step of governments which rationally prefer it to sovereignty weakened by other often unpredictable consequences of globalisation. They are also convinced of the desirability of setting up a supranational 'umbrella' in Europe that

[17] W. Sandholtz, A. S. Sweet, *Op. Cit.,* 2014, p. 25.
[18] M. A. Pollack, *A Blairite Treaty: Neo-Liberalism and Regulated Capitalism in the Treaty of Amsterdam*, in: K. Neunreither, A. Wiener (Editors), *European Integration after Amsterdam: Institutional Dynamics and Prospects for Democracy*, Oxford University Press, Oxford 2000, pp. 312-324.
[19] A. Niemann, P. C. Schmitter, *Op. Cit.,* pp. 47-49.
[20] I. Bache, S. George, *Politics in the European Union*, 2nd ed., Oxford University Press, New York 2006, pp. 13-14.

would protect against the harmful aspects of global interdependence.[21] They aim to safeguard the national good and therefore economic benefits. This was believed to be the main reason why European integration is not expected to reach fields like defence and security. As stated by liberal intergovernmentalists, the financial sector, which is from this paper's point of view the most significant field of integration, also engages governments to some extent. The post-war period showed that cooperation between banks and governments played a crucial role in the reconstruction and growth of national economies. Since then the powers-that-be retained close connections with the banking sector.[22]

The precursor of this way of thinking was Stanley Hoffmann who in his book "The State of War: Essays on the Theory and Practice of International Politics" presented the idea of the superior role of governments in the integration process, so called intergovernmentalism. Later, in 1993, A. Moravcsik built upon Hoffmann's statements to develop the theory of liberal Intergovernmentalism. Moravcsik also maintained the leading and solely controlling role of governments in the integration process. Like his predecessor, he pointed out that national governments deal the cards and any transfer of powers from national to supranational level is a result of their decisions, made on the basis of their domestic agenda.[23] Although the liberal intergovernmentalists assert that governments play a leading role in integration, they do not deny the importance of the supranational institutions. On the contrary, they are fully aware of the necessity of their existence in order to ensure coherent and efficient cooperation. Nevertheless, governments conceive these institutions as useful 'tools' and under any circumstances as an impetus for integration, which should support Member States when they are not able to resolve problems on their own.[24] The supporters of this theory also do not reject the role of society. Even though the main players, governments, are considered to be unified actors, they should be willing to take public opinion into account as well as being ready to steer their strategies under the influence of the changing needs and demands of domestic society, whose preferences, determined mainly by juxtaposition of the benefits and costs of interdependence, are accumulated in home policies by national institutions and subsequently taken onto the European stage as the view of the Member State. How far domestic expectations are pushed depends mainly on the bargaining strength of the particular

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[21] A. S. Milward, *The European Rescue of the Nation-State*, Routledge, London 1992, pp. 16-22.
[22] J. Story, I. Walter, *Political economy of financial integration in Europe; The battle of the systems,* MIT Press, Cambridge 1997.
[23] A. Moravcsik, *Preferences and Powers in the European Community: A Liberal Intergovernmentalist Approach,* in: *Journal of Common Market Studies*, Vol.31 (4), John Wiley & Sons Ltd , 1993, pp.473-481.
[24] A. Moravcsik, F. Schimmelfennig, *Liberal Intergovernmentalism*, in: A. Wiener, T. Diez, *Op. Cit.*, pp. 67-69.

country.[25] Moravcsik distinguishes between three characteristics which determine the negotiating powers of states:

- Unilateral alternatives to opt out of the bargaining process
- Capability to find alternative cooperation possibilities
- Capacity for compromise[26]

Both Hoffmann and Moravcsik criticised Haas and his supporters, maintaining that the theory is too narrow. From their point of view, integration needs to be put in a global perspective.[27] To them it is clear; governments are key decision makers in the EU and national authorities are rational and lead crucial international negotiations. To support his theory, Moravcsik highlighted two significant factors showing the position of government in the bargaining process. These are:

- The way the Council of Ministers resolves conflicting interests
- National economic interests

On the basis of five selected case studies[28], Moravcsik concluded that in terms of achieving monetary union, national interests were comparable to economic interests without significant influence of political bodies.[29] Unfortunately for him, his selection of the sources used to strengthen his hypothesis is now frequently used against him. Critics state that it was manipulative of him to merely consider intergovernmental negotiations, thereby ignoring other, smaller decisions that have contributed to a great extent to the current form and position of the EU.

Following the way of understanding of liberal intergovernmentalists, it can be stated that:

1. The banking integration process has been dominated by member States. Their negotiation strengths depend on their abilities to find alternative coalition members, unilateral alternatives, or to compromise with potential partners.
2. Domestic interests as well as abilities and preferences of leaders shape the positions of Member States.

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[25] Ibidem, p. 70.
[26] A. Moravcsik, *Op. Cit*, 1993, pp. 498-500.
[27] I. Bache, S. George, *Op. Cit*., p. 12.
[28] The Treaty of Rome, the Common Agricultural Policy, the European Monetary System, the Single European Act, and the Treaty on European Union.
[29] A. Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht*, UCL Press, London 1998, pp. 20-23.

3. Supranational institutions are created to serve national governments. National authorities are willing to hand over some of their powers regarding the financial system to intergovernmental bodies, as integration in this field touches upon the Member States' autonomy and sovereignty.

Currently, a lack of empirical studies and evidence counts against the theory of liberal intergovernmentalism. In this respect, it ranks poorly compared to its main rival, neo-functionalism, whose followers are able to support their hypothesis with the results of empirical research. Liberal intergovernmentalism seems to be a relatively inflexible theory which is incapable of accounting for the degree, course, and dynamics of the integration process within the EU.[30] The theory initiated by Haas gives the impression of being more up-to-date and "custom-made" for the current EU situation.[31] One could say that neo-functionalism is a timeless theory in the history of European unification, because it is dynamic and able to adapt to prevailing circumstances.[32]

3. THE PROCESS TOWARDS EMU

European integration has always had an economic background. Cooperation between the relatively small European countries was perceived as the only realistic way to compete with the strong American market. The Treaty of Rome[33], which came into force on 1 January 1958, was the starting point for the implementation of the European Economic Community (EEC). The EEC and Euratom have their origins in the report of the foreign affairs minister of Belgium, P. H. Spaak. Contrary to the existing European Coal and Steal Community (ECSC, in existence from 1952 to 2002), the EEC and Euratom had indefinite validity. Neither Spaak nor the representatives who signed the Treaty of Rome considered a single European currency. The objectives of the fathers of the economic cooperation were definitely more limited.

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[30] W. Sandholtz; A. S. Sweet, *European Integration and Supranational Governance*, in: *Journal of European Public Policy* 4 (3), 1997, pp. 297–317.

[31] T. A. Börzel, *Mind the gap! European integration between level and scope*, in: Journal of European Public Policy Special, *Vol. 12 (2), 2005,* pp.217-236, http://www.tandfonline.com/doi/full/10.1080/13501760500043860 (retrieved 15. April 2015).

[32] B. Rosamond, *The uniting of Europe and the foundation of EU studies: Revisiting the neofunctionalism of Ernst B. Haas*, in: *Journal of European Public Policy, Vol. 12 (2), 2005, pp.237-254*, http://www.tandfonline.com/doi/full/10.1080/13501760500043928#.VYHh7vntlxs (retrieved 15. April 2015).

[33] The Treaty of Rome established the European Atomic Energy Community (Euratom) and the European Economic Community (EEC). Together with the European Coal and Steel Community (ECSC) established in 1952 they were three main cooperation communities in Europe.

Taking into account the historical moves towards monetary integration within the European Community, the "Merjolin Memorandum"[34] issued by the European Commission is perceived as a symbolic starting point. Even though the "Majolin Memorandum" introduced several measures regarding monetary cooperation, it did not directly fix the exchange rates among European currencies. There was no need to do so at this stage, as the Bretton Woods Arrangement[35] secured the stability of exchange rates. In accordance with the Memorandum in 1964, the Committee of Governors of the Central Banks of the European Economic Community was established, which was responsible for creating an institutional structure for monetary cooperation. Thus, the Bank for International Settlements (BIS) was created. While in the early 1970s the system of Bretton Woods started to collapse, the BIS' members were forced to take care of the exchange rate in the participating countries by themselves. They decided to confine the exchange rate fluctuations between currencies within the EEC by founding the European Monetary Cooperation Fund in 1973. This was supposed to be the first step towards closer integration between the members.

Sometimes it is determined that the real process of economic integration in the European Community (EC) started in June 1988, when the European Council approved the objectives of the European Monetary Union (EMU). The following year it decided to launch the EMU by 2000. Next, the EMU was incorporated in the Maastricht Treaty.

In 1988 the Council gave a mandate to a committee chaired by the then President of the European Commission (EC), Jacques Delors, to develop a programme leading to the union. It consisted of the then General Manager of the BIS, Alexandre Lamfalussy from Hungary, a Danish professor of economics, Niels Thygesen, and the then President of the Banco Exterior de España, Miguel Boyer. In 1990, this committee was involved in the preparation of the first draft of the Statute of the European Central Bank (ECB), the Statute of the European System of Central Banks, and Statute of the European Monetary Institute (came into force on 1 November 1993). They issued the so-called "Delors Report"[36] which set out the design of an independent central bank that would be committed to price stability within the EEC. There

[34] Robert Marjolin was a French economist and politician involved in the formation of the European Economic Community. The "Merjolin Memorandum" initiated an idea of a common currency and speeded the discussion on monetary cooperation within the EEC.

[35] A landmark system for monetary and exchange rate management established in 1944. The Bretton Woods Agreement was developed at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire, from July 1 to July 22, 1944 (according to: Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Second Edition), Princeton University Press, 2008, pp. 91-106.

[36] *Report on economic and monetary union in the European Community*. Committee for the Study of Economic and Monetary Union. Jacques Delors, chairman. Presented 17 April 1989.

were three steps to be undertaken in order to achieve economic and monetary union, an objective of the Report:

- I STEP: 1 July 1990 – 31 December 1993
- II STEP: 1 January 1994 – 31 December 1998
- III STEP: 1 January 1999 – present

The first stage of EMU was devoted mainly to enhancing coordination and the abolition of all internal restrictions on the free movement of goods, services, people and capital between EC Members. This was implemented with the intention of introducing complete freedom for capital transactions, and in consequence to increase co-operation between national central banks (and the private sector). This level was hence dedicated mainly to implementation of the Single European Act (SEA) provisions, which were created under the Delors' Commission. The core objective of the SEA was to develop a single market with all four freedoms introduced by 1992 within the Community. At this stage the European Currency Unit (ECU), a forerunner of the single European currency, was introduced and economic convergence was enhanced.[37] Over time the Committee of Governors played an increasingly significant role in economic and monetary cooperation. Nevertheless, the requirement for a reformed institutional structure demanded a revision of the Treaty of Rome (the Treaty establishing the EEC). The result of these changes was the signing of the Maastricht Treaty (Treaty on European Union - TEU) on 7 February 1992 (came into force on 1 November 1993).

Committee of Governors → EMI

Creating a plan of **the second stage** of EMU, the Committee focused particularly on increasing monetary policy co-ordination and improving economic convergence, resulting in the independence of the national central banks, a ban on financing the public sector by central banks, and formation of the European Monetary Institute (EMI) on 1 January 1994. The establishment of the EMI was in practice equivalent to the end of the Committee of Governors. The task of the EMI was not to conduct monetary policy in the Union, but to strengthen coordination of monetary policy and central bank cooperation as well as to prepare

[37] European Central Bank, *Economic and Monetary Union*, https://www.ecb.europa.eu/ecb/history/emu/html/index.en.html (retrieved 22.08.2014).

the introduction of the European System of Central Banks and conditions for the creation of the Euro.

EMI → ECB

The introduction of the single currency in the European Union (EU) – the Euro (€), as well as the intra-EU exchange rate mechanism (ERM II) were provided for in **Stage Three** of EMU. The ERM II was intended to provide the future exchange and monetary rate relationships between the Member States that would introduce the Euro and those that would not. It was to be a guardian of the stability of national currencies and the single currency of the EU. The implementation of the mechanism started in June 1997. In accordance with the unanimous decision of the Council of the EU, eleven countries were ready to adopt the Euro and participate in the third stage of EMU, that is to say, their economies passed a convergence test[38]. Those countries were: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Portugal, Spain and the Netherlands. Subsequently, also in May, the decision-making bodies were appointed from the Member States. They started to serve on 1 June 1998, which marked the beginning of the ECB.[39] From that time, the national central banks handed monetary policy responsibility over to the ECB. The establishment of the ECB was equivalent to the withdrawal of the EMI that had fulfilled its preparatory tasks included in Article 123 TEU. This stage also assumed the irrevocable pegging of conversion rates. In May 1998, the governors of the national central banks of the aforementioned eleven Member States adopted the single currency and the ministers of finance of those countries together with the EC and the EMI decided on the ERM bilateral central exchange rates between Euro and the currencies of other Members. According to the authors of the Report, in order to fulfil the provisions of the TEU there was a need for the Council to adopt the Stability and Growth Pact. The Pact was intended to guarantee budgetary discipline (coordination of fiscal policies and soundness in public finances) in relation to EMU. The document was enacted in 1997 and entered into force in 1999.

When trying to define the starting point of the Report, it is hard to refrain from mentioning that the “Delors Report” was not the first attempt to introduce an EMU-stages programme. In

[38] Each country willing to participate in the Eurosystem is obliged to fulfil bunch of criteria including: price, fiscal, exchange rate, and long-term interest rate developments.

[39] P. Slominski, J. Pollak, *Das politische System der EU*, Facultas Verlags- und Buchhandels AG, Wien 2006, pp. 98-99.

1970 the Werner Committee was already making efforts to implement a concept for the creation of EMU in three stages by 1980. The “Werner Report” envisaged the irreversible convertibility of the national currencies, total liberation of capital movement, as well as fixing of exchange rates. An optimistic scenario of the plan referred also to the adoption of a single European currency. However, the establishment of a central bank for the European Community was not foreseen.[40] Due to the United States’ objections and an absence of support from all Member States, the Plan was never implemented. Despite the fact that in practice the introduction of the plan was not successful, it is seen as crucial for the process of economic and monetary union. The history of the union is even split into pre-Werner and post-Werner periods. Many subsequent initiatives were inspired by the “Werner Report”. The biggest success was the aforementioned “Delors Report”, on which Werner himself commented:

> “There is no fundamental difference between the Delors and Werner Reports as regards doctrine and method … The Delors Report more often quotes the Werner Report as regards the prerequisites for a complete union, that is to say the full and irreversible convertibility of the currencies, the abolition of the margins of fluctuation between currencies, the irrevocable fixing of exchange rates and the complete liberalisation of capital movements.”[41]

It seems that the success of particular reports is very much about being in the right place at the right time. Werner was a precursor of the aforementioned idea, but he was too far-reaching for his times and the circumstances did not allow him to introduce his innovative plan. Delors grabbed the right moment and, even though he copied to a great extent the way of thinking of his predecessor, he succeeded.

However, it is important to bear in mind that the EMU is not only monetary integration, but also part of the process of initiating financial and economic integration in Europe. The European Monetary Union was (and still is) the core of the integration and is undoubtedly the best expression of it so far. From the very beginning, the single currency was supposed to trigger further political integration and ultimately lead to political and fiscal union. The problem was that the interpretation of the EMU was not so much mistaken as incomplete. The EMU was presented as very beneficial to individual countries and not until the crisis broke in the late 2000s would defects in the system be highlighted. It was the crisis that showed that

[40] S. Hamori, N. Hamori, *Introduction of the Euro and Monetary Policy of the European Central Bank*, Singapore 2010, pp. 21-26.
[41] P. Werner, *Der Werner-Bericht und der Delors-Bericht zur Europäischen Wirtschafts- und Währungsunion im Vergleich*, in: O. Franz, *Die Europäische Zentralbank*, Europa Union Verlag, Bonn 1990, pp. 175–178.

the predetermined path created by high and high-level politics[42] was more a pious hope than a realistic target. Before the crisis broke, no one had paid special attention to the readjustment problems caused by the differences between Member States. According to Hancké, who was the first to describe the EMU crisis by means of comparative political economy perspectives, the EMU had been doomed to failure since its advent due to the disproportion between southern and northern countries. While Germany and other countries which were previously in the so called Deutschemark-bloc were well-prepared for changes and gained significantly in national competitiveness, the remainder were not capable of coping with the burden of EMU-membership rules. By and large, trade flowed only from north to south, whereas capital flowed in the opposite direction.[43] Considering that the well-functioning export sector was normally a trigger for more manoeuvring room for wage moderation it is easy to conclude that (by using other safeguards) the export leaders did not have to worry about inflation and could rely almost exclusively on export income. On the contrary, in the other (southern) group of European countries competitiveness fell and consequently inflation rose and the position of those countries on the trade market deteriorated significantly. In order to maintain a decent level of growth they ran into debt with in the public and private sectors. In retrospect, it seems to be logical that nothing good might come out of it for Europe as a whole. Hancké goes as far as to maintain that even without a banking crisis, fiscal crisis, and asset inflation, the huge dynamic of the current discrepancy between Member States, "with its roots in different wage-setting institutions, would have manifested itself perhaps a little later, or less violently, but ultimately no less urgently". The reason for this could be the imposing of a single nominal interest rate on economies with contrasting inflation rates.[44] In this context, the theory of liberal intergovernmentalism seems to be quite realistic. If the real exchange rate had not worked in favour of northern EMU countries, the divergence between them and the southern countries as well as the difficulties with paying for imported goods would not be so extensive.

But, were the Member States really unaware of the dangers related to this way of leading the EMU? Did they not know that imposition of one set of rules and criteria for all Member States (and especially countries already conducting accession talks at the time of adoption of the Maastricht Treaty) may have severe consequences? Maybe they drew up a balance of

[42] B. Hancké, *Unions, Central Banks, and EMU Labour Market Institutions and Monetary Integration In Europe,* Oxford University Press, Oxford 2013, p. 1.: High politics: the virtuous search for common good; High-level politics: politics by elites.
[43] Ibidem, pp. 107–120.
[44] Ibidem, p. 109.

costs and benefits and calculated that it was going to pay off. Or maybe liberal intergovernmentalists were right (again) in their assumption that the strongest Member States were focused more on their national benefits than on the common good of the European Community as a whole.

In this subsection the benefits and interests of the most significant European integration drivers will be revealed. Understanding this field is crucial to unravel which theory had the strongest impact on Member States at the beginning of deepening of the European co-operation.

The experience of the cold war made EC countries aware of the need for deeper integration and mutual support. After communism collapsed and Germany underwent reunification, its neighbours, with France at the forefront, became afraid of the strongest economy in the EC gaining too much power. On the other hand, France could not imagine the creating a counterbalance to the American economy without engaging Germany. From the French point of view, the only reasonable step would be deeper integration of the EC. Specifically this meant the creation of a unified monetary policy binding all Members to common rules, negotiations related to each significant step made for Europe, and the partial relinquishment of their autonomy to new institutions. Also, the United Kingdom was aware of the strength of reunified Germany, however it has never been especially sympathetic about a deepening of the EC, believing that there is admittedly a need for closer co-operation between countries in order to avoid further conflicts and make the world system more coherent. However the UK was not willing to give up its highly valued sovereignty. From the UK's perspective the EC was nothing more than one of several co-operation agreements, like G20, the International Monetary Fund or NATO.[45] Germany saw in European integration a chance for regaining the trust of Europe and the world, therefore it promoted integration on the continent consistently.

When the decision about the formation of the EMU was fairly clear, two different proposals were introduced on how it should be conducted. While all Member States were unanimous that countries willing to participate in the monetary union should be obliged to fulfil convergence criteria, they could not agree on when this should happen. Germany, supported by the Netherlands, the UK and Denmark insisted on the attainment of a particular convergence level before the establishment of the EMU. The second bloc, including France,

[45] K. Dyson, K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union.* New York: Oxford University Press, Oxford 1999, pp. 20-22.

Belgium and Italy preferred a process of convergence as a consequence or continuation of the changing market. From this group's perspective, the creation of supranational monetary institutions with the ECB was essential in the early stages of preparations.[46] Although, the French government promoted the idea of creating a supranational monetary institution, it basically favoured an intergovernmental decision-making system.[47] This was the main reason that France rejected the German idea of a completely independent central bank, as they had learnt from history the problems related to delegation of too much power to bankers. The UK backed France up in this objection, because it would have upset their deeply valued independence and their constitutional connection between parliament and the national central bank.[48] Nonetheless, Germany kept arguing that only the introduction of an independent central European monetary institution would be able to avoid or minimise the risk of a conflict of interests and ensure the greatest good in terms of price stability. It was of primary importance to the German government to instil the Bundesbank's existing ordo-liberal principals in the future European Central Bank.[49] As a result of these negotiations, Member States were forced to sacrifice a significant part of their sovereignty in favour of the ECB. The attitudes of many governments changed during negotiations as they were sometimes forced to yield to the majority to maintain progress, even if they intended at the very beginning of the talks to protect the interests of their particular homelands. In the end, mutual control and reasonable argumentation made them consider the common good, which did not comply with idea of liberal intergovernmentalism at all.

4. THE EBC, EUROSYSTEM, EUROPEAN SYSTEM OF CENTRAL BANKS

4.1. ECB

As has already been mentioned, on 1 June 1998 the EMI's work ended and it was replaced by the European Central Bank. Since then the ECB has been responsible for the final preparations for the initiation of monetary policy for the Eurozone. On 1 January 1999, the day of introduction of the Euro, the ECB has taken control of it. The ECB was created as the heart of the European System of Central Banks and the Eurosystem. Already mentioned

[46] M. O. Hosli, *The creation of the European economic and monetary union (EMU): intergovernmental negotiations and two-level games.* Journal of Public Policy, Vol.7, No. 5, Cambridge University Press, Cambridge 2011, pp.747-751.
[47] K. Dyson, K. Featherstone, o*p. cit.,* pp. 21-24.
[48] M. O. Hosli, *op.cit*., p. 750.
[49] K. Dyson, K. Featherstone, *op. cit.,* pp. 19-20.

Statue of the European System of Central Banks and the European Central Bank (Statue)[50] together with the Treaty on the Functioning of the European Union (TFEU) is the legal basis for the European monetary policy. The central bank of the EU is one of the seven main institutions in this organisation, however it has a special position due to its independent status and very specific functions. In accordance with Article 127 (2) of the Treaty on the Functioning of the European Union, the ECB is in charge of maintaining price stability, definition and implementation of monetary policy for the Euro area, conducting of foreign exchange operations, holding and management of the official foreign reserves of the Euro, promotion of the smooth operation of the payment system, and paragraph (3) of the same article: financial supervision and stability.[51]

The Executive Board of the ECB, which was appointed two weeks earlier, started its meetings officially on 2 June 1998 in Frankfurt am Main (Germany). The building is commonly known as the "ECB Eurotower". In accordance with the approval of the Heads of States or Governments (European Council), the Executive Board is composed of six members appointed from different Member States by a qualified majority. Key selection criterion has however nothing to do with geographical principles but is instead based upon experience. The Board is composed of the President, the Vice-President and four other members. The first team consisted respectively of: W. F. Duisenburg, C. Noyer, E.D. Solans, S. Hämäläinen, O. Issing and T. Padoa-Schioppa. The system remained the same for some time. The members of the current term are respectively: M. Draghi, V. Constâncio, B. Cœuré, S. Lautenschläger, Y. Mersch and P. Praet, who will perform their function for eight years and are not eligible for re-election.

4.2. Eurosystem

In parallel to the appointment of the Executive Board, the Governing Council and the General Council were chosen. The first meeting of these bodies took place on 9 June 1998, also in the head office in Frankfurt am Main. The Governing Council is the highest decision-making body of the ECB that is responsible above all for conducting monetary policy and setting interest rates.[52] Pursuant to Article 283 TFEU, it is composed of the members of the

[50] ESCB and the ECB were established in accordance with Article 8 of the Treaty establishing the European Community (in line with Protocol 4 on the Statue).

[51] *The Lisbon Treaty*, http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-the-functioning-of-the-european-union-and-comments/part-3-union-policies-and-internal-actions/title-viii-economic-and-monetary-policy/chapter-2-monetary-policy/395-article-127.html (retreived 14 April 2015).

[52] J. Zombirt, *Mechanizmy rynku wewnętrznego Unii Europejskiej,* wyd. 2., Difin SA, Warszawa 2009, p. 512.

Executive Board and the governors of the central banks of the Euro area Member States. As of 2 February 2015, there are nineteen EU Member States that have adopted the Euro. These are: the eleven mentioned above (since 1999), Greece (since 2001), Slovenia (since 2007), Cyprus and Malta (since 2008), Slovakia (since 2009), Estonia (since 2011), Latvia (since 2014) and Lithuania, which adopted the Euro at the beginning of 2015. Lithuania's entry to the Eurozone led to a change in the voting system within this body. The previous "one member, one vote" principle established by The Statute of the European System of Central Banks and the European Central Bank has been replaced by a rotation system. A literal implementation of the former principle was possible until the Euro included 11 members plus the Executive Board.

Since 1 January 2015, the governors of the national central banks have taken turns holding voting rights. Currently, the governors' voting rights rotate monthly. The rotation principle was already recommended by the ECB in 2003 as a result of plans for future increases in the number of the states included in the Nice Treaty. The Governing Council was supposed to bring the new system into force when there were 16 Euro area member countries. Although this happened in 2009 when Slovakia joined the group, the implementation of the new rules was delayed due to a Governing Council decision in December 2008.

The members of the Eurozone are divided into two smaller groups according to financial sector size, economic strength, and capital share in the European Central Bank. The highest ranked countries are France, Germany, Italy, Spain and the Netherlands. According to the existing arrangements these five countries share four out of fifteen voting rights, thus giving them the right to vote in 80% of cases. The remainder is distributed between the other countries, meaning they have a considerably lower chance to exercise voting rights. Since Lithuania's accession to the Euro area this year, the number of votes divided between the members (excluding those ranked first to fifth) increased to fourteen. The idea behind this rotation is very reasonable and prospective, as it supports maintaining the ability of the Governing Council to act efficiently and effectively even when the number of members in the Euro area (and consequently the size of the Governing Council) increases. Nevertheless, it will lead to a stronger differentiation of Euro area members, since the new principal foresees a splitting of the much bigger group of economically weaker countries into two groups when the Eurozone exceeds twenty one. As a result, there will be three classes of countries in the Euro area. National central bank governors sitting in the Governing Council will still be allowed to take part in meetings and share their opinions during each discussion, regardless of the number of Governing Council members. The only difference is that they will no longer have voting rights. One might say that this kind of system may distort transparency and the accountability of the ECB.

National central banks of the Euro area Members together with the ECB form the Eurosystem.

4.3. European System of Central Banks

Next decision-making body is the General Council, consisting of the President and Vice-President of the ECB, as well as the governors of twenty eight national banks who are chosen by their own administrations. This means that this body comprises representatives from all EU Member States, both from the Euro area and those maintaining their national currencies. This body is perceived as transitional and should exist as long as there are still countries using their own money (refusing adoption of the common European currency).[53] Representatives from the ESCB take part in the meetings of the Governing Council held every two weeks. However, since the beginning of 2015 decisions which have an impact on ECB monetary policy may only be taken every six weeks. It is noteworthy that the other four representatives of the Executive Board are entitled to attend the meetings of the General Council, however they do not have any voting rights there. The meetings are also open to the President of the EU Council and one Commissioner, but they may not vote either.

4.4. New body -The Supervisory Board

As previously mentioned, closer banking integration and the emergence of a new mechanism required organisational changes and new business areas. The youngest body, created especially for the banking union (to be more precise, for the Single Supervisory Mechanism, hereinafter SSM), is the Supervisory Board supported by a Steering Committee.

The Supervisory Board of the SSM was established together with this mechanism in 2013 and started its official work in late 2014. The Board is made up of a Chair whose 5-year tenure is non-renewable (Danièle Nouy; France) a Vice-Chair who is appointed from among the representatives of the Executive Board of the ECB (Sabine Lautenschläger, Germany), four representatives of the ECB (Luc Coene, Belgium; Julie Dickson, Canada; Sirkka Hämäläinen, Finland, Ignazio Angeloni, Italy)[54], and representatives of national supervisors that do not

[53] Ibidem, p. 511.
[54] Nationality of the Board’s members is just indicative information. None of the ECB’s representative is chosen on the geographical criterion.

necessarily have to be the same as national central bank representatives[55] (19 Member States of the Eurozone). The Board is principally engaged in planning and performing the supervisory tasks of the ECB and proposing draft decisions for adoption to the Governing Council. The Supervisory Board is one of the main decision-making bodies of the ECB and the decision-making process within the SSM is rooted in the non-objection principle. The figure below shows the way decisions are made within the SSM:

Figure 4.1. Decision-making process within the SSM

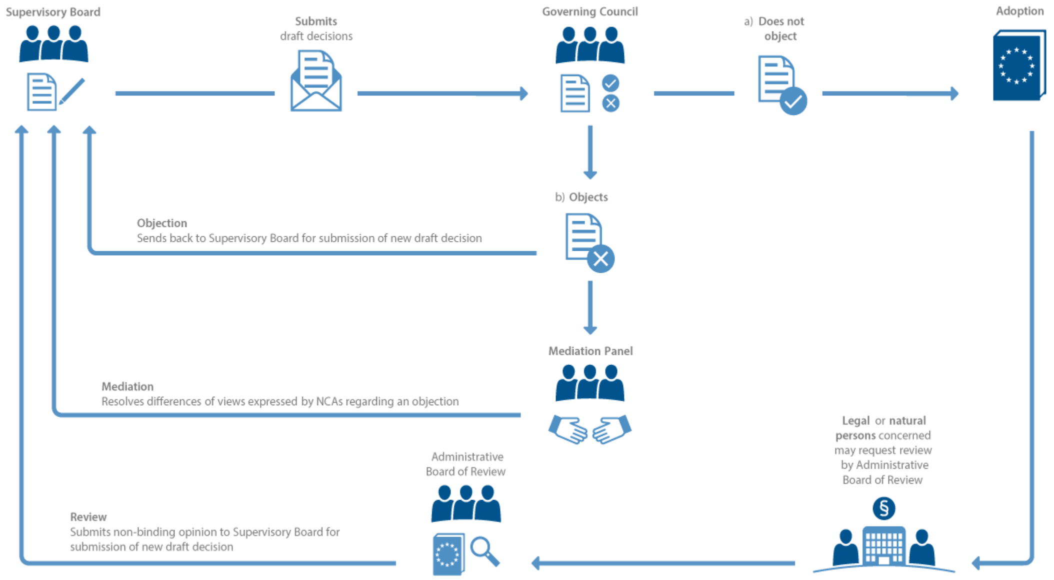

Diagram 1. Source:https://www.bankingsupervision.europa.eu/organisation/governance/html/index.en.html. Retrieved 07 April 2015

Moreover, four new Directorates General (hereinafter DGs), and a Secretariat have been created to support the Supervisory Board in its work. They are involved in micro-prudential works. The DGs are responsible for: direct supervision of the day-to-day functioning of the so called ‘significant banks’ (micro-prudential supervision I and II); indirect supervision including supervisory oversight over national guardians of less significant national banks and methodological support (micro-prudential supervision III); horizontal supervision and specialised expertise consisting of crisis management; centralised inspections, enforcement and sanctions, standards development, quality assurance of supervisions, risk analysis, authorisation, and planning and coordination of supervisory examination programs (micro-

[55] Member States may choose if their country is represented by a national central bank representative or other national supervisory authority. Nevertheless the competent designated authority may be accompanied by the NCB’s representative.

prudential supervision IV). The Secretariat takes part in the decision making process and drafting decision making policy. For reasons of credibility the administrations of the supervisory and monetary tasks of the ECB should be strictly separated. However, in order to avoid duplicating existing structures within the ECB, many of the sections simply exceed their duties to provide assistance for the new ECB supervisory tasks (e.g. budget, HR, IT). The effectiveness and efficiency of work and information exchange might thereby be improved.[56]

5. THE ECB VS. THE BUNDESBANK AND THE FEDERAL RESERVE – SIMILARITIES AND DIFFERENCES

The Maastricht Treaty established the ECB as one of the seven main EU institutions[57]. According to this document the ECB is enjoys complete political independence, which is believed to be a key to price stability and maintaining inflation at the desired low level. Normally, countries with dependent central banks prioritise other indicators (e.g. low unemployment rate), so as a consequence the issue of price stability takes on a lower priority. A central bank considered as the most prominent example of independence is the Deutsche Bundesbank[58], which is notable for having had the lowest inflation in Europe during the whole post-war period[59]. The German national bank has frequently been presented as a role model for the European Central Bank. However, there was also a proposal in the Maastricht Treaty to use the Anglo-French model. The main objectives and features of the Anglo-French model are very simply consolidated by Grauwe[60]:

> "In the Anglo-French Model, the central bank pursues several objectives, such as price stability, stabilisation of the business cycle, the maintenance of high employment, and financial stability." [61]

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[56] *Organisational structure at the ECB*, https://www.bankingsupervision.europa.eu/organisation/structure/html/index.en.html(retrieved 07 April 2015).

[57] The European Parliament, the European Council, the Council of the European Union, the European Commission, the Court of Justice of the European Union, the European Court of Auditors, the European Central Bank.

[58] The Central Bank of Germany.

[59] B. Winkler, *Is Maastricht a good contract?*, Journal of Common Market Studies, vol. 37 (1), John Wiley & Sons Ltd, 1999, pp. 39-58.

[60] P. de Grauwe, Professor at the London School of Economics, having been professor at the University of Leuven, Belgium and a visiting scholar at the IMF, the Board of Governors of the Federal Reserve, and the Bank of Japan (according to: http://www.voxeu.org/person/paul-de-grauwe, retrieved 30 August 2014).

[61] P. de Grauwe, *Economics of monetary union*, Oxford University Press, Oxford 2005 p.164.

All these objectives seem to be very reasonable. The Keynesian concept was very popular in the 1950s and 1960s. Low unemployment levels along with high economic growth seem to have a positive influence on union. Nonetheless, the 1970s showed that this model only returns positive results in the short-run.[62]

However, the Anglo-French model had one very disturbing feature in that the central bank was politically dependent.

> "The Anglo – French model is characterised by the political dependence of the central bank, for instance the monetary policy decisions are subject to the government's (the minister of finance's) approval. Thus, in this model the decision to raise or lower the interest rate is taken by the minister of finance."[63]

5.1. ECB - Bundesbank

Therefore, in order to ensure decision making freedom of the ECB in fixing the rates as well as a lack of political interference, the final decision was taken in favour of German standards. According to experts, inflation rates are very difficult to maintain in the long run in countries with dependent central banks.[64]It was not insignificant that the ECB is located exactly in Frankfurt am Main, the German finance and business capital. The system of the ECB was originally derived largely from the Bundesbank's institutional and functional design. The reason for this was simple: The Bundesbank enjoys a great reputation for being a stable, credible, and very well-organised financial institution. This was also evidenced previously by the fact that the European Monetary System (EMS)[65] tried to import the German approach to its policy.[66] The EMS was expected to have monetary cooperation on the basis of fixed exchange rates, while the EMU was intended as a more precise alternative in terms of cooperation arrangements. Naturally, the EU authorities would have preferred to introduce monetary cooperation based on fixed exchange rates. In the case of the EMU, they would have had to resign their control rights. Their bargaining powers were therefore weaker, but at the same time this was a way to build a reliable monetary institution which could ensure price stability. Since the idea of the EU was to take care of the Member States as a whole, this

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[62] R. Dornbusch, S. Fischer, R. Startz, *Makroökonomik, Übungsbuch*, Oldenbourg, München 2004, p. 105.
[63] P. de Grauwe, *op.cit.,* pp.164-165.
[64] M. Fratianni, J.von Hagen, C. Waller, *The Maastricht Way To EMU*, Princeton University Press, Princeton 1992, p. 28.
[65] An exchange rate regime established in 1979 to foster closer monetary policy cooperation between the central banks of the Member States of the European Economic Community (EEC) so as to lead to a zone of monetary stability in Europe, in: https://www.ecb.europa.eu/home/glossary/html/glosse.en.html#195 (retrieved 25.08.2014)
[66] J. von Hagen, *Fixed exchange rates and policy delegation*, in: International Economic Review, vol. 33, no. 4, Blackwell Publ., New Jersey 1992, pp. 849-870.

German-like concept has been introduced. Some authors describe the ECB as a ‘twin-sister’ of the German Bundesbank.[67] In particular this ‘twin-sister hypothesis’ (TSH) underlines the similar legal status of both banks, their strong insistence on political independence, and their striving for price stability through anti-inflationary behaviour. The ECB inherited the inflation target of 2% maximum per annum from the Bundesbank. The Bundesbank was the first bank in history to be free of governmental influence, which is one reason it has a reputation as an institution which defends price stability. One of the Bundesbank Chiefs, Otmar Emminger, said in the late 1970s: “Preisstabilität ist nicht alles, aber ohne Preisstabilität ist alles nichts.”[68] (Eng. *Price stability is not everything, but without it everything is nothing*).

Thanks to the German bank regime the European economy is considered to be one of the world’s pioneers, and the Euro is one of the strongest currencies. The German Mark was very strong. In the 1970s the price variation limits in Western Europe were laid down on the basis of its current rate. In order to do so, there was a need for some kind of monetary policy coordination, which is why some European countries (e. g. Benelux and Scandinavian countries) copied the German central bank’s rates policy.[69] It is important to bear in mind that it was the Germans who insisted on maintaining low inflation rates. They were aware of the danger of falling into inflationary shock if their approach was not followed.

Nevertheless, one may state that after delegation of powers to the ECB, German economic activity slowed down. The Harmonised Index of Consumer Prices (HICP), inflation, and annual real gross domestic product (GDP) growth in Germany were surprisingly weak, especially in the first five years after the establishment of the ECB. While at this time annual real GDP growth in the euro area averaged 2.1%, in Germany it was the lowest of all Member States that had adopted the single currency at not more than 1.2%. During the same period HICP inflation in the euro area was an average 2.0%, while in Germany it was 1.3%. However, since the ECB prepares the same short-term nominal interest rates for all Member States (€), this means that in spite of the weaker German activity, it recorded higher average real interest rates than the other euro countries. This indicates that at the beginning of functioning of the EMU, the monetary policy was completely inadequate for German economic needs.

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[67] X. Debrun, Bargaining Over EMU vs. EMS: Why Might The ECB Be The Twin Sister Of The Bundsbank?, in: The Economic Journal, 111, Royal Economic Society, Willey-Blackwell, London 2001, pp. 566-590.
[68] C. Demuth, *Der Bundestag als lernende Institution: eine evolutionstheoretische Analyse der Lern- und Anpassungsprozesse, insbesondere an die europäische Integration,* Nomos-Verl.-Ges., Baden-Baden 2009, pp. 176-212.
[69] Ibidem, pp. 76-79.

The next field taken into account which is worth mentioning is monetary reaction functions. The ECB demonstrates a stronger reaction to the output gap than the Bundesbank. This is presumably due to the higher interest rate sensitivity in the latter, rather than to greater attention being paid to output stabilisation by the ECB. Nonetheless, both showed a similar weak reaction to expected inflation, thereby indicating another feature of the ECB inherited from the Bundesbank.

There are, however, several theoretical analyses which state that the ECB is ‘symmetric’ and supranational with no bias towards any country. As justification for this theory they refer to the ECB’s focus on the Euro-area Member States or the majority voting system.

5.2. ECB - FED

Within the Federal Reserve (FED) the ECB policy is frequently ironically called ‘inheritance from radical Bundesbank monetarists”. The FED is an example of a bank working closely with government, especially with the Ministry of Finance. Although the FED and the ECB represent two significantly different schools of economics (economic philosophies), they are both successful at developing their programmes, resulting in them having the world’s two largest GDP shares.

Despite sharp criticism, the FED and the ECB seem at first to have much in common. The first feature worth mentioning is their structure. Considering the decentralised composition of the FED and the ECB, which consists of different national banks, one can argue that their attributes are comparable. The FED consists of twelve districts, whereas the ECB is parallel to the core of nineteen national central banks of the Member States that adopted the single currency, as well as the other nine Member States’ central banks. One can state that they use similar monetary instruments such as open market operations and reserve requirements.

The next similarity is independency. Two types of independency can be distinguished: political and economic. As Gökbudak puts it:

> “Political independence is defined as the ability of the central bank to determine its policy objectives free from the government influence. On the other hand, economic independence is

the ability of the central bank in determining and implementing its policies freely to achieve its objectives."[70]

Following this definition, independence shall be measured taking into consideration the way the bank's body is appointed.

Despite the aforementioned cooperation between the FED and the U.S. government, the FED is protected by a significant level of freedom. Nevertheless, the final decisions regarding interest rates have to be approved by the Ministry of Finance. Moreover, the President appoints all the members of the Board of the FED. They also need the approval of the Senate in order to fulfil their functions. American politicians always desire the lowest possible level of unemployment and national budget deficit. The FED receives instructions and policies pre-approved by the government. Moreover, the structure of the FED can be changed by a simple majority vote by Congress, which also has the power to interfere in the functions of the bank, thus limiting to some extent the FED's autonomy. As touched upon earlier, the ECB enjoys complete political independence. The President of the ECB is only obliged to meet five times a year with the European Parliament (EP): Once to present the Annual Report prepared by the ECB, and four times in order to explain the main issues of the ECB's policies, and answer the Committee's questions (if any) on the Economic and Monetary Affairs' (ECON) of the EP. At the request of the EP, or if the ECB expresses its willingness to do so, more hearings may be arranged.[71] Nonetheless, the Parliament has no power to legally change, prevent or enforce nomination of the ECB[72]. The independence of this institution is guaranteed in the Maastricht Treaty. There are no bodies with superior power over the ECB's policies. Thus, the only way to limit its freedom would be a Treaty revision, which seems impossible as it requires unanimity between all the Member States. It is believed that all this makes the central bank of the EU the most independent in the world ("followed by the Bundesbank and the FED"[73]).

Usually, independence goes hand in hand with accountability. Likewise, there are some significant differences between the EBC's and the FED's level of independence, as well as discrepancies considering accountability. Other than price stability, The Treaty of Maastricht

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[70] N. Gökbudak, *Central bank independence, the Bundesbank experience and the central bank of the Republic of Turkey,* 1996, p.4. http://www.tcmb.gov.tr/wps/wcm/connect/ca53a307-1792-40ef-8fb6-777b9d71a9d6/9610eng.pdf?MOD=AJPERES&CACHEID=ca53a307-1792-40ef-8fb6-777b9d71a9d6 (retrieved 1 April 2015).

[71] J. de Haan., S. C.W. Eijffinger, S. Waller*, The European Central Bank. Credibility, Transparency, and Centralization.,* MIT Press Cambridge, 2005, pp. 108-123.

[72] C.R. Plath, T.P. Schioppa, *The European Central Bank: independence and accountability*. Zentrum für Europäische Integrationsforschung, Berlin 2000, p.7.

[73] P. de Grauwe, *Op. Cit.*, 2005, p.177.

neither includes a definition of objectives, nor ways of achieving them. This leads frequently to vagueness. The Treaty allows the ECB to support the economic policies within the EU as long as they do not hinder realisation of the fundamental target of price stability. There is no explicit framework or guidelines for how and what exactly the ECB is allowed to do in order to complete its mandate. One can argue that bureaucracy and the relatively slow communication between the Member States are the main reasons for the weak accountability of the ECB.

Both these issues bring up the issue of transparency. Transparency is to be understood as the central bank providing the markets and public with important information related to policy decisions, procedures, assessment, and strategy. This should be provided *"in an open, clear and timely manner"*[74].[75]According to many experts, policy implementation transparency is crucial since it allows financial institutions to have unambiguous expectations and to create credible exchange rate forecasts. The FOMC emphasises transparency as a factor restricting contradictory opinions expressed by the members of decision-making bodies.[76] Although, the ECB President's hearings before the EP are open to the public as well as to external monitoring by Economic and Financial Affairs Council (ECOFIN) and the European Commission, the Treaty prevents publication of the Governing Council minutes. According to the Treaty, this is to preclude the inclusion of the national interests of Member States in monetary policies. This is reasonable as the ECB is a supranational institution which is obliged to take care of the policies of the Euro-area as a whole, not just of individual countries. The ECB could find more ways to increase transparency and subsequently accountability.

The FED, on the contrary, is very transparent. It is obliged to submit to Congress not only an annual report, but also special reports every six months regarding the condition of the economy and credit and money growth objectives. Also, it draws up other more frequent publications every month, for example the Federal Reserve Bulletin.[77]

Next, the FED and the ECB have prescribed diverse targets and methods with which to achieve them. On one hand, the FED aims to achieve several objectives simultaneously. According to the FED's papers, while conducting its flexible economic and monetary policy it

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[74] I. Begg, (n.d.), *Economic policy and institutional transparency: the ECB.* http://www.qub.ac.uk/ polproj/reneg/contested_meanings/Begg_transparency _draft %20aug05.doc (retrieved 27.08.2014)
[75] P. de Grauwe, *Op. Cit.,* 2005, p. 187.
[76] I. Begg, (n.d.), *Op. Cit*, p. 11.
[77] The Federal Reserve System, 1984, 6.

focuses above all on “a high level of employment, stability in the purchasing power of the dollar, stability and growth of the economy, and reasonable balance in transactions with foreign currencies”[78]. As already mentioned, an essential objective of the ECB is price stability through low inflation. There are two pillars which embody the method for achieving the primary objective of the central bank of the EU. The first pillar constitutes a development of M3, a broad monetary aggregate which is crucial for price stability assessment.[79] The second pillar is a broadly based estimation of threats to price stability and prices.[80] The pillars are treated as intermediary objectives of the ECB. No specific intermediary targets are identified in the FED system.[81]

5.3. To what extent should governments be involved in the process of restoring the banking sector?

Forced by the global crisis, governments intervened in almost all countries across the world. Without their help, many banking institutions would have collapsed. Only in the EU did the authorities commit to paying:

- 2,92 trillion € as liability guarantees
- 505,6 billion € for bank funding and liquidity support
- 311,4 billion € as capital injections for distressed institutions
- 33 billion € as relief for banking-impaired assets[82]

A consequence of these steps is direct or indirect government engagement in the functioning of banking institutions. The banks have become either stated-owned or implicitly protected by the authorities. As of April 2015, more than 90 financial institutions have been bailed out by government capital assistance programs or central banks, as well as supported with blanket guarantees of governments.[83]

[78] Board of Governors of the Federal Reserve System, *The Federal Reserve System; Purposes and functions*, Washington D.C 1984, pp. 1-3.
[79] A “broad” monetary aggregate that comprises M2 plus repurchase agreements, money market fund shares and units as well as debt securities with a maturity of up to two years.
[80] J. de Haan, S. C.W. Eijffinger, S. Waller, *op.cit.*, pp. 12-14.
[81] E. L. Heron, *The new governance in monetary policy: a critical appraisal of the Fed and the ECB*. *Macroeconomics and Macroeconomic Policies*, 10/2005 http://www.boeckler.de/pdf/ v_2005_10_28_ leheron.pdf (retrieved 27.08.2014).
[82] A. Hryckiewicz, *The Role of Government Interventions in Restoring the Banking Sector Stability*, [in:] M. Balling, P. Egger, E. Gnan, (eds.), *States, Banks, and the Financing of the Economy: Fiscal Policy and Sovereign Risk Perspectives*, SUERF Larcier, Vienna 2013.
[83] Ibidem, pp. 251-257.

Theoretically, government bailouts should be beneficial to national banks because of the improved charter values of these banks. Nevertheless, experience has shown that conflicts of interest often arise between banking institutions and authorities which own them or their shares, as politicians attempt to use their position of power to promote their own interests. This is notably visible in the case of capital injections, since they are associated with a kind of the bank recapitalisation. As nationalisation was one of the most popular measures of recapitalisation, states gained a lot of power within the supported banking institutions.

Moreover, the literature indicates that banks with greater charter values are not so willing to take an excessive risk due to fear of loss of future rents.[84] On the contrary, other experts claim that institutions with greater state participation are more susceptible to excessive risk-taking.[85] Now, it should be asked whether risk-taking by banks is a positive or negative activity. Reasonable risk-taking seems to be a very good way for institutions to develop. Many bailed institutions tend to take fewer risks directly after government intervention, followed by higher risk several years later. This means that in the long run the stability decreases of institutions which have undergone intervention. According to recent studies, institutions that receive public support are also more likely to declare insolvency. Since intervened banks are much less efficient than their non-intervened competitors, two thirds[86] of them are not able to recover their performance to pre-crisis levels. This is why they try to take higher risk as a last resort.[87] The bailed banking institutions encounter further difficulties when a disciplined credit regime is reinstated, which results in gloomy prospects for credit supplies. The aforementioned nationalisation paired with asset management companies[88] are crucial drivers behind this effect. As reported by many specialised organisations, control by non-political investors is more effective at reviving and stabilising banking institutions in the long run.[89] Governments should be active in the restoration process of banking institutions, though only

[84] M. C. Keeley, *Deposit insurance, risk and market power in banking*, in: American Economic Review Vol. 80 (5), American Economic Association 1990, pp. 1182-1197. http://www.jstor.org/stable/2006769 (retrieved 07 April 2015).

[85] N. G. Iannota, A. Sironi, *Ownership structure, risk and performance in the European banking industry*, in: Journal of Banking and Finance Vol. 31 (7), pp. 2127-2149. http://hal-audencia.archives-ouvertes.fr/docs/00/86/18/06/PDF/Iannotta_Nocera_Sironi_2007_JBF_PP.pdf (retrieved 09 April 2015).

[86] Data based on the analysis of 120 Italian banks.

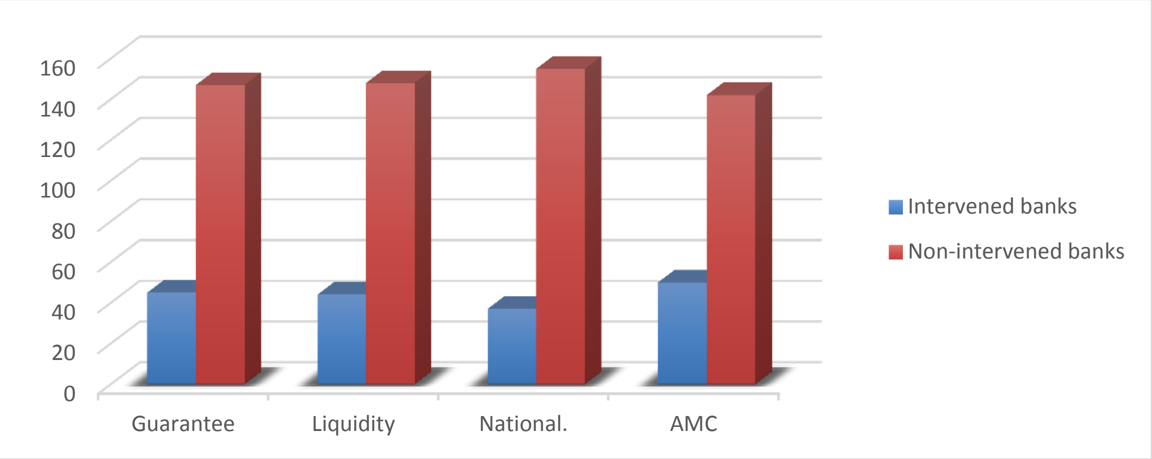
[87] P. Bonaccorsi, A. K. Kashyap, *Which banks recover from a banking crisis*, mimeo.

[88] A company that invests its clients' pooled fund into securities that match its declared financial objectives. Asset management companies provide investors with more diversification and investing options than they would have by themselves, according to Investopedia.com, http://www.investopedia.com/terms/a/asset_management_company.asp#ixzz3cDc0RMwl (retrieved 12 April 2015).

[89] G. Wehinger, *The Financial Industry and challenges related to post-crisis exist strategies*, Financial Markets Trends 2009 (2), OECD Publishing, Paris 2009, pp. 37-53.

to a limited extent. Figure 5.1. presents the performance variables of bailed and non-bailed banking institutions on the basis of loan quality measures. The data shows the situation four years after implementation of the measures.

Figure 5.1. Descriptive statistics at bank-level using loan quality measure



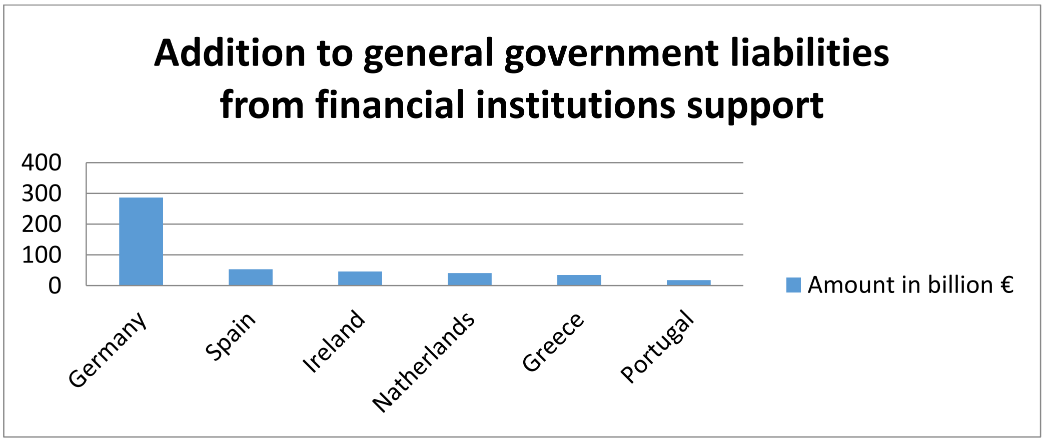
Source: Bereau van Dijk/IFCA's Bankscope database (designed by author).

6. The European Banking Union (EBU) as a medium-term response to the Eurocrisis

As has already been mentioned, the problems of the financial sector in the European Union severely affected not only shareholders and depositors, but also national authorities seeking to prevent collapse of their domestic banking systems. Unfortunately, their efforts were counter-productive and led to even worse 'bank-sovereign feedback loop' which subsequently did harm to national economies.

Increasing lack of trust in the viability of the common European currency triggered the necessity of the EU's action. Absence of a fiscal union in Europe led to a grave shortcoming that resulted in serious market disequilibrium not only in a European context, but also globally. Three years after the official announcement of the debt crisis in the Euro area, the European authorities were still struggling to prevent the Eurozone fragmenting. Existing banking regulations of both individual Member States and at the Union level were not sufficient to guarantee financial stability. The lack of central financial authority in the EU that would have the power to shut down ailing lenders (as, for example, the U.S. Federal Deposit Insurance Corporation does) exacerbated the slow recovery of the European economy. In the face of those problems, in June 2012, the EU leaders promised to support centralisation of crisis management and banking supervision. This was perceived as the most significant shift of sovereignty since the introduction of the Euro. Policy makers agreed on the goal of a so called banking union which would result in transfer of the main decisions from a national to a European level, as well as putting an end bailouts made by EU taxpayer. At the beginning of these negotiations Germany was not fully convinced that this was a good idea. Chancellor Angela Merkel said in an interview for Spiegel that "as long as she lives" there would not be Euro bonds. This strong opposition to Euro area debt sharing was nothing new and Germany had many supporters from other Member States. As far as they were concerned, this would be an incentive for rejecting and/or postponing reforms for countries in debt and would not solve the EU financial troubles at all.[90] This is hardly surprising considering previous experience and the fact that Germany, over only a three year period, paid €287 billion in order to keep markets afloat, whereas Spain, the country second most supportive in this matter, paid only a fifth of this amount. Germany was also the strongest financial supporter of all countries affected by the crisis and during negotiations regarding the possibility of creating a European banking union stressed that it did not wish to pay all European 'bills'. According to FDP politician Christian Lindner, the EBU could be "a new, admittedly creative way to tap German solvency".[91] The differences in the scale of support in different EU countries are presented in the Figure below.

Figure 6.1. The differences in the scale of support in different EU countries



Source: EUROSTAT

[90] Spiegel, *The Coming EU Summit Clash: Merkel Vows 'No Euro Bonds as Long as I Live'*, 27 June 2012, http://www.spiegel.de/international/europe/chancellor-merkel-vows-no-euro-bonds-as-long-as-she-lives-a-841163.html (retrived 15 July 2015).

[91] M. Baxter, *Bull and bear: Is it time to buy infrastructure bonds?,* in: The Share Centre, Simply Easier, 07 June 2012, https://www.share.com/blog/2012/june/bull-and-bear-is-it-time-to-buy-infrastructure-bonds/ (retrieved 15 July 2015).

Before agreeing to the creation of a banking union, the most influential EU members demanded clear guidance on who would be responsible for pronouncing the potential collapse of a bank, meeting its financial commitments, and how to divide the losses. It was also crucial for German politicians to fix how much the banks should contribute to the resolution fund. In 2012, the German government in its official comment on Chancellor Merkel's aforementioned statement, stressed that the only way towards joint liability was to ensure adequate controls.[92] The idea of nominating the EU central bank as the only supervisor in the Eurozone was not perfect or reasonable to Germany. The German government was admittedly in favour of changes in the institutional supervisory setup within the EU and even greater centralisation, however, this was true only to some extent and without violation of Member States' rights. It was clear that the sovereignty of the national authorities had to be diminished, but they should not be excluded from participation in the new structure. In the opinion of the German government, coordination of the financial issues in the EU would be enough for the ECB and the handing over to it of the issue of bank failures would be too much appropriation of banks' and national authorities' sovereignty. The UK shared the German fear of delegation of too much power to the ECB. The British government has never hidden its antipathy towards any proposals to deepen the economic, and banking in particular, integration within the Union. Successive British governments stated that further commitments in the field of financial unification and delegation of national powers to the supranational institutions would question national autonomy and sovereignty. More detailed information regarding the position of those countries towards the specific steps leading to the creation of a banking union in Europe will be given in subsequent chapters of this paper.

This section deals with the process of establishing the European Banking Union. The next steps and stages leading to the installation of the new measures will be discussed.

6.1. Reform of the EU's financial supervision system (more supervisory powers of the ECB)

In 2009, in the face of the growing crisis within the Euro area, the European Commission submitted a proposal on reform within the struggling existing financial supervisory structures.

Upon the request of the then President of the Commission, Jose Manuel Durão Barroso, the renowned French finance expert and civil servant Jacques de Larosière, together with other

[92] Bundesregierung, *Regierungserklärung von Bundeskanzlerin Merkel zum Europäischen Rat am 28. und 29. Juni 2012 in Brüssel*, http://www.bundesregierung.de/Content/DE/Regierungserklaerung/2012/2012-06-27-bkin.html (retrieved 15 July 2015).

banking specialists (*de Larosière Group,* sometimes also called The Committee of Wise Men)[93], created a report stating the necessity and urgency of the foundation of a Union level body overseeing risk in the European banking system as a whole which would strengthen and increase the efficiency of financial activities within the EU. It should cooperate with the micro-supervisors protecting consumers as well as take care of the financial soundness of individual organisations and institutions. New supervisory arrangements were expected to regain trust within the European financial system and to protect European citizens. The experts stressed the great significance of cooperation with the key global partners, e.g. the International Monetary Fund (IMF), the Basel Committee, the Financial Stability Forum (FSF), and the Group of Twenty major economies (G20).

According to the Group, existing financial regulation and supervision were either too inefficient, too weak, or gave the wrong incentives. In the opinion of engaged experts, lack of transparency and excessive complexity caused deterioration in the supervision process.[94] In their opinion, the EU, as the world's strongest economy, is only able to implement and enforce standards at the highest level when it has a solid and fully integrated regulatory agenda, crisis management procedures, and supervision system. Before the crisis each country governed its financial and banking systems. In order not to distort the Single Market rules, the domestic financial institutions agreed on the functioning of their fellow markets as branches, without so called *passporting*[95]. Mutual recognition was the key for cross-border financial cooperation. Nevertheless, the crisis shed light on all existing oversights and loopholes in regulations. Lack of appropriate common legislation and supervision led to feelings of instability and a lack of mutual confidence. According to the *de Larosière Report* and other evaluation documents, this fragmented supervision and reliance merely on national states' control systems was not capable of keeping up with the increasing internationalisation of the markets. Reform of the supervisory system within the EU was inevitable.[96]

[93] The High-Level Group on supervision: Leszek Balcerowicz, Otmar Issing, Rainer Masera, Callun Mc Carthy, Lars Nyberg, José Pérez and Onno Ruding.
[94] Jaques de Larosière, the de Larosière Group, *De Larosière Report*, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf, pp. 2-6, (retrieved 17 May 2015).
[95] Prior approval of a local supervisor.
[96] L. Quaglia, *Financial Regulation and Supervision in the European Union after the Crisis*, in: Journal of Economic Policy Reform, Vol. 16 (1), Routledge, London 2013, pp.17-30.

The suggested change referred to the replacement of the so called *Lamfalussy level 3 Committees* of supervision[97] with a new framework called the European System of Financial Supervisors (ESFS) comprising national financial supervisors and three main supervisory bodies responsible for micro-prudential control[98]:

- European Banking Authority (EBA)
- European Insurance and Occupational Pensions Authority (EIOPA)
- European Securities and Markets Authority (ESMA)[99]

Basically, the new bodies inherited the entire "essence" of the old ones plus new responsibilities, greater authority, and legal powers.[100] Unlike their predecessors that had to be satisfied with being advisors issuing non-binding recommendations and guidelines, the European Supervisory Authorities (ESAs) have legal personality in accordance with EU law.[101]

Besides the aforementioned bodies, the Joint Committee of ESAs supported by a group of specialised authorities from the Member States (in line with the regulations establishing ESAs) and the European Systemic Risk Board were established as a complement to their activities in dealing with macro-prudential supervision within the ESFS.[102] The latter works under the auspices of the ECB and gives it more powers to interfere in the matters of the European financial supervisory bodies. Reorganisation in the supervisory architecture of the European Communities was expected to ensure "an overarching European framework for financial supervision with the expertise of local micro-prudential supervisory bodies that are closest to the institutions operating in their jurisdictions".[103] In other words, according to the Commission's proposal, the European Supervisory Authorities not only took over all the

[97] The Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR).
[98] Names of the supervisory bodies suggested by the Group were slightly different. However they were expected to cover the same areas.
[99] European Commission, *Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing a European Banking Authority*, COM (2009) 501 final, 23 September 2009, pp. 2-4.
[100] European Commission, European Financial Supervision, 252 final, Brussels, 27 May 2009, p. 3., http://ec.europa.eu/internal_market/finances/docs/committees/supervision/communication_may2009/C-2009_715_en.pdf (retrieved 19 May 2015).
[101] Council of the European Union, Council Conclusions on Strengthening EU Financial Supervision, 2948 ECOFIN Affairs, P. 3., Luxemburg 9 June 2009, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/108389.pdf (retrieved 19 May 2015).
[102] A. Willis, *Europe seals deal on financial supervision*, https://euobserver.com/economic/30866 (retrieved 13 May 2015).
[103] European Commission, Op. Cit., *Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT…,* p. 2.

existing functions of the former committees, but also gained new, significantly more specified legal powers, liabilities, as well as greater authority.

Despite some initial reluctance of the European Parliament, it backed the rearrangement suggested in 2010 by the Commission and Member States. The final introduction of these new supervisory authorities and the ESRB took place on 1 January 2011.[104]

6.1.1. Banking supervision reform and differences in attitudes between Member States and EU institutions

In spite of the overall consensus (reached after a series of stormy negotiations) on the need to reconstruct the existing system, the Member States and the European institutions had different opinions on how wide the scope of the powers delegated to the new bodies and their structure should be. The Member States led fierce debates on the structure and role of the emerging entities. Taking into account the persistence of these different points of view in the whole EU-evolution, it seems obvious to select Germany and the United Kingdom as examples illustrating contrasting attitudes to EU decisions concerning supervisory system reform. Other arguments in favour of selection of these exact countries are that they are the largest EU economies, have the strongest financial sectors, and have completely different politics: a bank-based financial structure in Germany and an equity-based system in Great Britain.[105] Thus, the views on the changes in the EU supervisory system from representatives of a liberal market economy and those of coordinated market economy are described in this section. The level of influence of domestic interests on authorities' conduct and attitudes within the EU is also presented in this part.

6.1.2. The position of the Member States

6.1.2.1.Germany

Germany, being faithful to its social market economy model, weathered the crisis relatively well. Even in the initial phase, when most of the other Eurozone countries struggled to stay afloat, the German economy was quite stable. From the German point of view, reduction of deficit spending would be much more reasonable than pure funding preceded by the tax cuts suggested by many other Members. Backed by the government, the then finance minister Peer

[104] European Commission, *Banking and Finance*, General Policy, http://ec.europa.eu/finance/generalpolicy/committees/index_en.htm(retrieved 12 May 2015).

[105] J. Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change*, Cornell University Press, Ithaca 1983, pp. 99-121.

Steinsbrück stated that the main problem of the existing financial system was the lack of stricter regulations. In his opinion, the genesis of the crisis was the US, which should implement more rigorous legislation.[106] In one interview he stated that London and New York's declaration that "the markets regulate everything" is a huge historic mistake.[107] In one of her speeches in 2008, Chancellor Angela Merkel mentioned that the security of rules governing financial markets is still insufficient because of the domination of the Anglo-Saxon system.[108] In the same year, she declared that the only way to get out of the crisis and ensure order in the future was to instil the principles of the social market economy into common financial regulations not only in Europe, but also the rest of the world.[109] As an advocate of ordo-liberalism, Germany bases its economy on the principle that the state should always seek a legal framework which guarantees price stability. In this way it enables markets to work efficiently.[110]

German politicians supported the project of greater centralisation of supervision and financial regulations in the EU.[111] They were definitely in favour of the *de Larosière Report* proposal to create ESAs. France and Italy were German allies during the negotiations on this subject. In 2009, the heads of governments together with finance ministers agreed that each financial sector, each financial product and each financial policy within EU should be regulated.[112] Minister Steinbrück criticized many times British ignorance and "lack of interest" in stricter regulations of supervisory system.[113]

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[106] W. Reuter , T. Tuma, *We Were All Staring into the Abyss,* interview with German Finance Minister Steinbrück Spiegel, 29 September 2008, http://www.spiegel.de/international/business/spiegel-interview-with-german-finance-minister-steinbrueck-we-were-all-staring-into-the-abyss-a-581201.html (retrieved 17 May 2015).

[107] Ibidem.

[108] L. Barber, B. Benoit, H. Williamson, *March to the Middle: Merkel Celebrates Germany's Social Market Model*, in: Financial Times. n.6, 2008, http://www.ft.com/intl/cms/s/0/bb9ca588-374f-11dd-bc1c-0000779fd2ac.html#axzz3gA6rMclI (retrieved 17 May 2015).

[109] A. Merkel, Rede der CDU-Vorsitzenden, Bundeskanzlerin Angela Merkel, Parteitag in Stuttgart, 1 Dezember 2008, http://www.stuttgart08.cdu.de/wp-content/uploads/2008/12/081201-rede-merkel-stbericht.pdf (retrieved 20 May 2015).

[110] R. Ptak, *Vom Ordoliberalismus zur Sozialen Marktwirtschaft: Stationen des Neoliberalismus in Deutschland*, VS Verlag, Wiesbaden 2004, pp. 19-23.

[111] H. Zimmermann, Varieties of Global Financial Governance. British and German Approaches to Financial Market Regulation, in: E. Helleiner, S. Pagliari, H. Zimmermann, (eds.) Global Finance in Crisis, Routledge, London 2010, pp. 121.

[112] C. Bryant, *EU leaders push sweeping regulations*, in: Financial Times, 23 February 2009, http://www.ft.com/intl/cms/s/0/a896e59e-011f-11de-8f6e-000077b07658.html#axzz2cdQ5uC5x (retrieved 20 May 2015).

[113] Handelsblatt, Finanzmärkte: *Steinbrück knöpft sich die Briten vor*, 1 July 2009, http://www.handelsblatt.com/politik/deutschland/regulierung-finanzmaerkte-steinbrueckknoepft-sich-briten-vor/3210678.html (retrieved 20 May 2015).

However, not only German politicians were in favour of the formation of new supranational supervisory bodies: the executive board member of the German Savings Bank Association (Ger.: *The Deutscher Sparkassen- und Giroverband*, DSGV), Schackmann-Fallis also expressed his enthusiasm for the *de Larosière Group* idea of connecting national supervisors and issuing early warnings during the European Savings Bank Group's (ESBG) meeting on the *de Larosière Report*. Moreover, he stated the urgent need for a tougher and more trustworthy structure so as to create a "full scale supervisory authority for the system relevant cross-border banks at EU-level".[114]

On behalf of the Association of German Banks (Ger.: *Bundesverband deutscher Banken*), its then Chief Executive Manfred Weber articulated the necessity of better harmonisation of the EU Single Market and thus of centralisation of the supervisory competences and convergence of existing national legislations.[115]

Also, the German Insurance Association (Ger.: *Gesamtverband der Deutschen Versicherungswirtschaft*, GDV*)* indicated its support for stronger supervision which should ensure fairness to all actors in the competitive insurance environment. In addition, because of the turbulence, the trust of customers had decreased significantly and an efficient common supervision system would strengthen the confidence the insurance industry relies on.[116]

Results of many surveys conducted in Germany exactly mirrored the previously described attitudes. A significant majority of German respondents showed their trust in state intervention and aversion to relying only on market rules.[117] They also supported greater harmonisation and centralisation of financial rules and the subsequent creation of ESAs as guardians of financial order within the EU. This also revealed that German approval for restructuring the struggling EU-supervision was completely in line with its domestic interests.

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[114] ESBG, Statement Dr. Karl-Peter Schackmann-Fallis, *ESBG's View on the De Larosière Report*, Brussels, 7 May 2009, http://ec.europa.eu/internal_market/finances/docs/committees/supervision/schackmannfallis_en.pdf (retrieved 20 May 2015).

[115] M. Weber, *What Europe's Future Financial Marketplace Will Look Like*, in: et al., Europe's World, Special Dossier: Banking and Finance, Spring 2008, Geert Cami Publ., Brussels 2008, pp. 143-146. http://eurocollege.ru/fileserver/infcenter/EuropesWorld_No8_Full.pdf (retrieved 20 May 2015).

[116] GDV, *The Positions of German Insurers*, July 2012, Berlin http://www.gdv.de/wpcontent/uploads/2012/07/GDV_Positions_of_German_insurers_2012_engl.pdf (retrieved 21 May 2015).

[117] Bundesverband Deutscher Banken, *Kraftakt Krisenbewältigung*, Berlin, Mai 2009, http://bankenverband.de/downloads/meinungsumfrage/2009-05-13_Ergebnisse-Umfrage_Krisenbewaeltigung.pdf (retrieved 20 May 2015).

6.1.2.2. The United Kingdom

The UK, on the other hand, was in a difficult situation at the beginning of the crisis. The British media called it the worst economic decline since the recession in the 1930s that forced the government to take action in order to keep the banks afloat.[118]

The then prime minister Gordon Brown was convinced that reform of the supervisory system was needed, but instead he suggested a quick financial injection to keep businesses running and to avoid further a decline in the European economy.[119] The UK was not against the *de Larosière Report*. On the contrary, they were aware of the necessity to implement new measures. However, by new measures the UK authorities did not mean stricter rules. The British have always traditionally demonstrated their resistance to relinquishing any decision-making powers to the Community. Ireland and Luxembourg shared this British reluctance to give up national autonomy in regulatory matters. Moreover, they were very unwilling to increase standards of common financial regulations and to develop independent and common supervision abroad.[120] The UK bases its financial politics on the principle of "trust in market forces", which results in its high dependence on national financial institutions. Before the crisis erupted in 2005 during the UK's presidency Prime Minister Brown tried to convince the Member States of the brilliance of the risk-based British model of regulation.[121] Also, in a speech to the *Confederation of British Industry*, he explained that this is the best approach, as it lets the economy develop and does not burden politics, which is able to concentrate on the matters it should.[122] Nonetheless, under the national social pressure triggered by the crisis, Prime Minister Brown was forced to give up his 'limited political interference' approach and to consequently support greater political engagement in the reconstruction of market failures. As required under political correctness, just a few months later the same Prime Minister stated that "stronger supervision is in our interest in Britain" as it would be a notable step towards development of cooperation between over 420 European financial entities based in the City of

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[118] J. Curtice, A. Park, *A tale of two crises: banks, MPs' expenses and public opinion,* in: A. Park, J Curtice, E. Clery, C. Bryson (eds), *British social attitudes: the 27th report*, SAGE Publications Ltd, London 2010, pp. 131-154.

[119] D. Summers*, Financial crisis: Gordon Brown calls for new global order*, in: The Guardian, http://www.theguardian.com/politics/2009/jan/26/gordon-brown-economic-policy (retrieved 17 May 2015).

[120] H. Zimmermann, *Op. Cit.*, pp. 121-136.

[121] G. Brown, *Global Europe: full-employment Europe*, HM Treasury, October 2005, http://library.fes.de/pdf-files/bueros/london/03631.pdf (retrieved 20 May 2015).

[122] A. Farrant, *Hayek, Orwell, and The Road to Serfdom*, in: R. Lesson (Ed.), *Hayek: A Collaborative Biography, Part IV Good Dictators, Sovereign, Producers and Hayek's ‚Ruthless Consistency',* Palgrav Macmillan, London 2015, pp. 39-42.

London.[123] The UK did not want to hinder the launch of the new authorities, but it was not willing to delegate to them as much power as was proposed, since in its view this would mean the loss of national sovereignty and increased fiscal burden. They also argued that the suggestions were to some extent protectionist and intrusive and would subsequently influence negatively the competitiveness of the market.[124] The UK was aware of the fact that new bodies could have the right to demand bailouts from the Member States even without their agreement. It was also seen as a risk to the global financial position of London. Attempts to introduce stricter supervisory regulations were deemed in the UK to be other Member States' aspiration to undermine the position of the City of London as the banking capital of Europe.[125]

The next unbearable proposal for the UK government was the shifting of decision-making powers to a supranational level. This was illogical to them because it was national money that had to fill the funding hole created by the crisis.[126]

Moreover, unlike the Germans, the British authorities, relying on the principle of "individual responsibility"[127], argued that the source of the global crisis should be sought primarily in the failure of individual actors, rather than in insufficient supervision and slack regulations.[128] Chancellor Alistair Darling went even as far as to say that the defective regulations and supervision system should not be blamed for the economic troubles in the EU, but rather the boardrooms of financial entities. Since supervision reform was indeed needed, British politicians suggested focusing more surveillance on individual key players and their activities. From their point of view, the introduction of tougher common European supervision regulations would jeopardise the principle of the open global market. In his letter to the minister of finance of the Czech Republic[129], Chancellor Darling tried to dissuade him from accepting stricter regulations proposed in the *de Larosière Report* stating that *"EU supervisory and regulatory arrangements must not in itself become a barrier to more*

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[123] J. Brunsden, *Agreement on Financial Supervision Reforms*, in: European Voice, 19 June 2009, http://www.politico.eu/article/agreement-on-financial-supervision-reforms/ (retrieved 19 May 2015).

[124] Handelsblatt, *Darling: Protektionismus wäre fatal*, 12 February 2009, http://www.handelsblatt.com/politik/international/interview-mit-alistair-darling-darling-protektionismus-waere-fatal/3109968.html (retrived 27 May 2015).

[125] D. Hodson, L. Quaglia, *European Perspectives on the Global Financial Crisis*, in: Journal of Common Market Studies, Vol.47 (5), Blackwell, Oxford 2009, pp. 948-951.

[126] The Economist, *Financial Reform in the EU. Neither One Thing Nor the Other*, 2 July 2009, http://www.economist.com/node/13944730 (retrieved 23 May 2015).

[127] S. A. Schirm, *Varities of Strategies: Societal Influence on British and German Responses to the Global Crisis*, Journal of contemorary European studies, Vol. 19 (1), Taylor & Francis, London 2011, pp. 47-62.

[128] T. Besley, *P. Henessy, Letter to the Queen*, in: Financial Times, London, 22. July 2009, http://www.ft.com/intl/cms/3e3b6ca8-7a08-11de-b86f-00144feabdc0.pdf (retrieved 20 May 2015).

[129] Czech Republic held presidency of the Council of the EU in the first half year of 2009.

integrated global markets – or indeed put at risk the integrity of the Single Market."[130] Therefore, the reasons given by Germany and similarly thinking countries were insufficient for the UK to give up their banking supervisory and regulatory authority to the EU. This was the reason for blocking an agreement at the meeting of the Economic and Financial Affairs Council. During the same session the UK achieved one of its main goals; namely, to guarantee that the ESAs would not have power to demand bailouts from governments if they were not willing to pay.

Also here (in Great Britain) representatives of non-governmental sectors took a stance on the subject of EU supervisory system reform. Most active were obviously industries that would be most affected by the proposed changes; namely, investment managers, bankers, and insurers. Of the 'involved' institutions, the least critical of the *de Larosière Group's* proposals seemed to be the Investment Management Association (IMA), which actually supported the development of micro-prudential oversight and even the equipping of the new bodies with the power to issue 'binding technical standards'. The IMA was most wary of the issue of the open global market and the potential protectionism that it presented in the document it submitted in November 2009: *"Closing Europe's borders is not an option in the globalised economy. We agree that the EU can and should take the lead, but it must act responsibly and in co-ordination with other jurisdictions."*[131] The British Bankers Association (BBA) was also fully aware of the necessity of changes in the EU financial supervision and regulatory policy and even noted the need for centralisation of powers at the EU level to some extent. However, there was one issue that was particularly alarming for this institution, namely the scope of powers given to the new authorities. The BBA representatives were specifically concerned about *"the ability of the ESAs to take binding decisions addressed to individual institutions"*, which from their point of view could destabilise financial markets. According to them, national supervisors should cooperate with the new authorities so long as this does not undermine national powers and they do not have the right to issue binding decisions to

[130] A. Darling , *European Financial Regulation and Supervision*, Letter to Minister of Finance of the Czech Republic, Miroslav Kalousek 03 March 2009, http://data.parliament.uk/DepositedPapers/Files/DEP2009-0735/DEP2009-0735.pdf (retrieved 19 May 2015).

[131] IMA, *Written evidence submitted by the IMA*, Commons Treasury Committee, 09 November 2009, UK Parliament Website, http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/1088/1088we07.htm (retrieved 28 May 2015).

individual institutions.[132] To Angela Knight, the Chief Executive of the BBA, it was clear that national authorities should be responsible for national financial institutions as it is national governments that stand behind them.[133] Similarly to the German Insurance Association, its British counterpart, the Association of British Insurers (ABI), was entirely in favour of changes restoring confidence in the financial regulatory system to a large extent lost as a result of the pre-crisis and crisis period. Although the Commission's proposal was quite well received by the ABI, there were two matters it was seriously afraid of; risk of overregulation and undermining of the open market rules which could subsequently lead to an increase of unnecessary costs and stifling of innovation.[134] When it came to delegation of powers, the ABI's main concern was transferring them to the European Securities and Markets Authority (ESMA). In its opinion, in cases of potentially incorrect application of the Community law, it is the Commission which should intervene, not ESMA, since this could "increase the risk of EU level intervention in individual cases, creating regulatory confusion (…)."[135]

Polls conducted on the British public revealed that the people held the banks responsible for the crisis.[136] According to their answers, the British seem to be open to greater state intervention in financial matters. Yet, in one survey 59% of respondents excluded this option.[137] This shows that British people, unlike Germans, are not in favour of greater state intervention in the economy. It also can be concluded that even though the UK supports regulatory and supervision reforms in the EU, it is not happy about the enhancement of the pan-European bodies' powers. What the UK has in common with Germany is that their attitude to changing EU policies is conditioned by domestic interests.

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[132] BBA, *Written Evidence submitted by the BBA*, Commons Treasury Committee, 09 November 2009, UK Parliament Website, http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/ 1088/1088 we05.htm (retrieved 28 May 2015).

[133] S. O'Grady, *Britain Gives In on European Bank Supervision*, in: The Independent, 04 December 2009, http://www.businessweek.com/globalbiz/content/dec2009/gb2009124_598167.htm (retrieved 01 June 2015).

[134] ABI, *ABI response to the European Commission consultation on the improvement of supervision for the financial services sector*, 09 April 2010, https://www.abi.org.uk/~/media/Files/Documents/Consultation %20papers/2009/04/De_la_rosiere_vFINAL10Apr09_150409101359.ashx (retrieved 01 June 2015).

[135] ABI, *Written evidence from the ABI*, Commons Treasury Committee, UK Parliament Website , 09 November 2009, http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/1088/1088we06.htm (retrieved 28 May 2015).

[136] Survey 2012 showed that 62% of voters blame the banking industry for the financial breakdown.

[137] J. Curtice, A. Park, *Op. Cit.*, pp . 139-140.

6.1.3. The position of the EU institutions

6.1.3.1. The ECB

The ECB was a great supporter of the creation of a supervisory system across the European Union as possible which was harmonised as much as possible. Since the Committee of European Banking Supervisors was created in 2004 the ECB has supported the persistence of its purpose. In its opinion, strengthening the pan-European financial supervisory and regulatory authorities of the EU was the only and most effective way to increase the efficiency and consistency of the European banking system.[138] Notwithstanding the awareness of the need to create new control and coordination entities, it was clear to the ECB authorities from the outset that the implementation of new rules and finding a consensus would be complicated. The then ECB President Jean-Claude Trichet declared the need to give the possibility to make decisions to the new bodies as well as of the introduction of an adequate information exchange within the EU.[139]

6.1.3.2. The Commission

The position of the European Commission was clear right from the start of the Eurocrisis. While it gave the Member States a large dose of freedom and flexibility in terms of short-term measures, the long-term measures were meant to be common to the entire EU and rather strict. At the beginning of 2009 it set up a High-level group of dedicated experts[140] so as to prepare a long-term solution to the crisis.[141] In May 2009, the Commission presented its accelerated schedule towards reforms of the supervisory system, stating that its keystone should be supranational institutions.[142] It seemed quite clear, the EC had in mind delegation of new powers and obligations to the central bank of the European Union. Nonetheless, new bodies, with the stress on the European Banking Authority, were also needed to support the ECB in performing its tasks. According to the then Internal Market and Services Commissioner Charlie McCreevy:

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[138] European Central Bank, *European Financial Integration*, Speech by Jean-Claude Trichet, 11 December 2008, http://www.ecb.europa.eu/press/key/date/2008/html/sp081211.en.html (retrieved 19 May 2015).
[139] European Central Bank, Opinion of the ECB of 18 March 2010 (CON/2010/23), http://www.ecb.europa.eu/ecb/legal/pdf/c_08720100401en00010008.pdf (retrieved 19 May 2015).
[140] Aforementioned *de Larosière Group.*
[141] D. Alford, *Supervisory colleges: The Global Fiinancial Crisis And Improving International Supervisory Coordination*, Emory International Law Review 57, Emory University, Atlanta 2010, pp. 57-66.
[142] European Commission, Communication from the Commission, European financial supervision.COM(2009) 252 final, 27 May 2009, http://ec.europa.eu/internal_market/finances/docs/committees/supervision/communication_may2009/C-2009_715_en.pdf (retrieved 19 May 2015).

> "The financial crisis has demonstrated the need to further strengthen EU supervisory arrangements and has reminded us of the importance of transparency and independence, especially when setting financial reporting and auditing standards. An essential move in this direction is to reinforce the role of key bodies in these fields, at both European and international level, and to provide them with financial support."

He also stated that "Additional reforms may be needed in relation to the EU supervisory framework, in particular in the light of the forthcoming recommendations of the High Level Expert Group chaired by Jacques de Larosière and other work under way".[143]

6.1.3.3. The EP and the Council

The European Parliament was the first European institution which suggested that the financial supervision system of the EU should undergo profound changes. In the early 2000s MEPs were already questioning the existing supervision structure, maintaining that systemic risk should definitely be monitored by the supranational authorities.

After the crisis erupted, MEPs supported radical changes. Their chief demands were: a bigger transfer of powers to the European level and stricter legislation. They criticised the outcome of the meeting of the Economic and Financial Affairs Council (ECOFIN)[144] that challenged to some extent the results of the report prepared by the *de Larosière Group*. Among other amendments, the Council clearly indicated that "decisions taken by the ESAs should not impinge in any way on the fiscal responsibilities of the Member States" and all ESA decisions should be reviewed by a court within the Union. [145] In the EP's opinion the Council's suggestions were unfeasible and went "in the wrong direction", whereas the *de Larosière Report* very accurately determines the link between microeconomic and macroeconomic supervision as well as the coherence of the European framework.[146] Each of the four largest

[143] European Commission, *Financial markets: Commission adopts measures to strengthen supervisory committees and standard-setting bodies for accounting and auditing.* Press Release 26 January 2009, http://europa.eu/rapid/press-release_IP-09-125_en.htm?locale=en (retrieved 19 May 2015).

[144] Economic and Financial Affairs Council is a body within the Council of the EU, which comprises the finance and economics ministers representing 28 EU members. When budgetary issues are opened to discussion the Budget Ministers are also involved.

[145] Council of the European Union, Press Release 16838/09, 2981st Council meeting, *Economic and Financial Affairs*, Brussels 2 December 2009, https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111706.pdf (retrieved 19 May 2015).

[146] European Parliament, *The European Parliament and financial supervision reform,* 17 September 2010, http://www.europarl.europa.eu/news/en/news-room/content/20100506BKG74226/html/The-European-Parliament-and-financial-supervision-reform (retrieved 19 May 2015).

political groups of the Parliament (EPP, S&D, ALDE, Greens) delegated a rapporteur to pilot the EP's stand on the results of the ECOFIN meeting. In February 2010, the European Parliament's Economic Affairs Committee stated that the safeguard clauses of the Council which aimed to protect the fiscal powers of the Member States were "over-restrictive". According to the EP, such an opportunity should be limited and the Member States engaged should be required to deliver a detailed assessment proving the extent of impingement on their fiscal powers. At the same meeting the MEPs proposed setting up the headquarters of ESAs in one city (Frankfurt) so as to reduce operating costs. In its report, the Commission suggested basing them in different countries. Moreover, a suggestion emerged that the President of the ECB should also undertake governance of the European Systemic Risk Board. The Parliament expressed willingness to conduct regular hearings of the president and members of the Steering Committee. Furthermore, there was no doubt for them that the ECB should be significantly involved in macro-prudential supervision within the new system. Considering the micro-supervision, the Parliament proposed giving the ESAs the power to initiate stress-tests and represent the EU during meetings of international supervisors. From their point of view, the European Banking Authority should play the role of binding mediator in cases of disagreements between national supervisors.[147] Eventually, the ECOFIN adopted the *de Larosière Report* as the European Supervisory Framework with small amendments.[148]

As a representative of European citizens, the EU Parliament was united in the view that Europeans should be protected from the risk of future crises and need better consumer and/or customer protection. The people should not be afraid of investing or saving their money through banks and other financial institutions. The EP reached an agreement with the Council that strengthening of the Single Market is crucial to reinstating people's trust in the banking system within the EU. MEPs expressed the need to equip the European authorities with more powers in order to ensure all the aforementioned objectives. Logically, the ECB should gain core powers and responsibilities as the highest banking and financial authority within the EU. The ESAs should cooperate closely with the ECB and support its work.

To conclude, the European institutions were definitely in favour of delegating powers from national to European level. According to them, banking and financial supervision within the

[147] European Parliament, *More powerful EU financial supervisory bodies and less national interest, demand MEPs,* Economic and monetary affairs, 24 February 2010, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+IM-PRESS+20100223IPR69355+0+DOC+XML+V0//EN&language=EN (retrieved 19 May 2015).
[148] Council of the European Union, *Op. Cit., Council Conclusions...*

EU would only be coherent, consistent, effective and efficient with supranational governance. The only institution willing to save some fiscal powers for the Member States was the Council.

6.1.4. New Bodies

If the level of relevance of the new micro-prudential supervisory bodies is taken into consideration, the EBA should definitely play the key role. Before it was established, the single currency and the Single Market functioned at EU level, whereas the supervisory framework and regulatory standards related to the 'four freedoms' were still to a large extent national responsibilities. Even though an integrated system would definitely bring more transparency and efficiency, a few previous ideas concerning the creation of such a supranational body were rejected by the Member States. Their autonomy seemed to be more important to them than increased efficiency. Nevertheless, eruption of the crisis motivated nearly all EU members to support the idea of changing and specifying supervision and regulations at the pan-European level. During the crisis, the first encouraging step towards strengthening the powers of the Committee of European Banking Supervisors (CEBS) came from France in October 2008. In January the following year, the Commission took a decision to support this idea and in September the three regulation proposals were presented to the Member States. As the system needed to be confirmed by all of them, the process of reaching agreement was quite turbulent. As already mentioned, most objections came from the UK as it did not want to sacrifice its financial regulation sovereignty to the supranational authorities. At a meeting of the finance ministers in Luxembourg, Chancellor Alistair Darling said: *"we could not have a situation where a European supervisor could make an order to an institution in our country which could have fiscal consequences."*[149] Later, the UK blocked the agreement of ECOFIN. To move forward in the negotiations while keeping Great Britain on board, the ESAs powers included in an initial proposal of the *de Larosière Group* were reduced. It was agreed for instance that EBA would have the power to issue binding draft technical standards, but, pursuant to Article 290 TFEU, they would have to be endorsed by the Commission first.[150]

[149] J. O'Donnell, *Government delays deal on EU watchdog,* in: Reuters, Business News, 20 October 2009, http://uk.reuters.com/article/2009/10/20/uk-watchdogs-eu-idUKTRE59J1YL20091020 (retrieved 03 June 2015).

[150] Regulation establishing EBA, Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending

6.1.4.1. The European Banking Authority

The European Banking Authority (EBA) replaced the CEBS that dealt with coordination of banking regulation before the crisis. Its headquarters are located in London, United Kingdom. The EBA is responsible for ensuring the effective functioning and stability of the financial market in the European Union. In order to be able to carry out its tasks more efficiently than its predecessor and improve the consistency of internal model outcomes, it was equipped with a legal personality as well as administrative and financial autonomy. Furthermore, the Authority was endowed with the power to issue aforementioned binding draft regulatory technical standards as well as recommendations and guidelines on how to apply EU law. The EBA was established to ensure consistent and effective prudential supervision and regulation across the banking sector within the Union. In line with the Regulation establishing the EBA, it aims mainly to safeguard banking sector discipline of the EU, maintain financial stability (in the short-, medium- and long-terms), and increase the integrity and efficiency of the financial system. It is also responsible for contributing to the European Single Rulebook in parts related to banking matters and providing standardised prudential principles for financial institutions in the EU. Promotion of convergence of oversight practices and assessment of risks and vulnerabilities throughout the Union's banking sector also falls under its remit.[151] Furthermore, the EBA is entitled to act as a mediator in cases of conflict or disagreement between supervisory authorities from different EU countries and has the right to perform banking stress tests within the EU so as to evaluate the resilience of financial entities to a hypothetical adverse economic scenario.[152] By doing so, the authority helps explain systemic risks and contributes to increased transparency and market discipline.[153] The risks taken into consideration in the tests include: market risk, credit risk, sovereign risk, cost of funding and securitisation. The stress tests are conducted in cooperation with the ECB, the ESRB, the European Commission, and national authorities. They form three task-groups:

- The EBA → common methodology + disclosure of the results

Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (23), in: Official Journal of the European Union,
http://eur-lex.europa.eu/legal0content/EN/TXT/?qid=1437849459671&uri=CELEX:32010R1093 (retrieved 02 June 2015).

[151] Ibidem, (14)-(43).

[152] The first stress test was performed in 2009 by CEBS. It started to be performed in the aftermath of the economic crisis in the EU.

[153] EBA, Report: *Results of 2014 EU-wide stress test*, *Aggregate results*, 26 October 2014, http://www.eba.europa.eu/documents/10180/851779/2014%20EU-wide%20ST-aggregate%20results.pdf (retrieved 10 June 2015), pp. 5-10.

- The ESRB + The Commission → designing the underlying macroeconomic scenarios
- The ECB + national authorities → quality assurance of the financial institutions' results; the ECB → Asset Quality Review (that laid the groundwork for the stress tests)

The ECB hence plays a significant role in the preliminary and final phases of the of bank assessment process and is responsible for assuring the quality of banks' results.

In order to make its work smoother and more coherent, and the regular supervisory reporting obligations stronger, the EBA issued standardised reporting guidelines called the Common Reporting Framework (COREP).[154] Almost 30 European countries adopted COREP. Their banks, financial and investment institutions are obliged to report on their credit risk, operational risk, market risks, capital adequacy ratios and own funds according to the harmonised European instructions and formats.[155] The guidelines cover "consolidated, sub-consolidated and solo reporting" in line with amended directives 2006/48/EC and 2006/49/EC. The main documents which the framework of COREP is based on are the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV).[156]

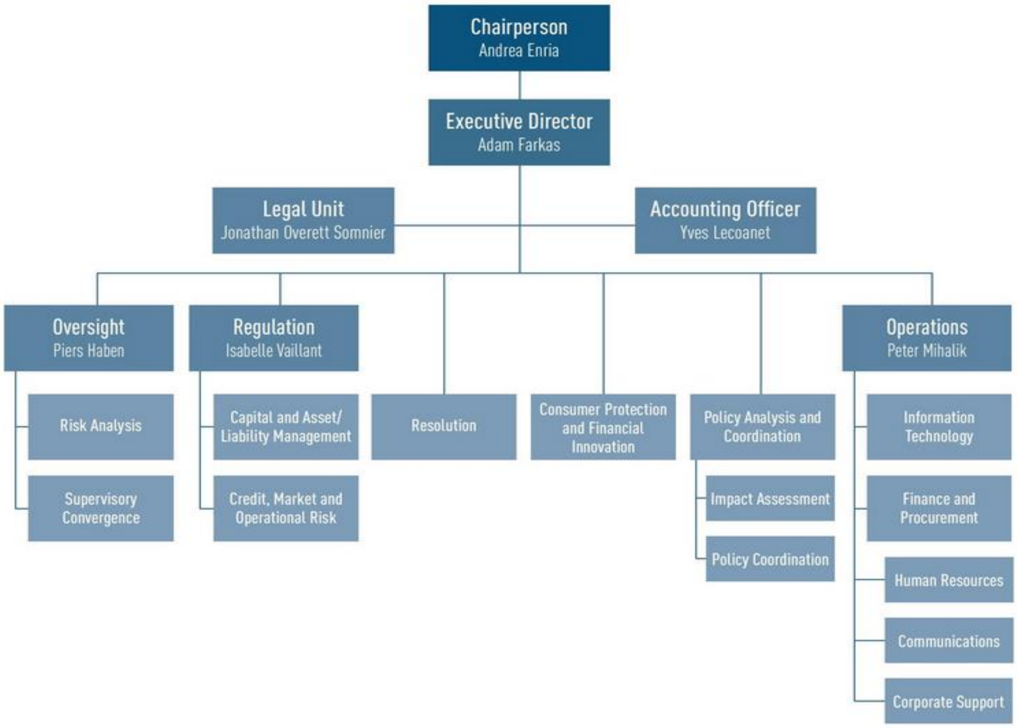
[154] COREP was introduced already in 2006 by the CEBS in *Basel II*, but the new one has been adjusted to the requirements of current situation.

[155] Moody's Analitics, *Common Reporting Framework (COREP) – FAQs*, http://www.moodysanalytics.com/~/media/Brochures/Enterprise-Risk-Solutions/UK-COREP/2011-30-11-MA-COREP-FAQ.pdf (retrieved 06 June 2015).

[156] Financial Services Authority, CRD IV Harmonised reporting, *Common Reporting (COREP),* http://www.fsa.gov.uk/about/what/international/crd-iv/corep (retrieved 06 June 2015).

The EBA comprises many different sectors. The chart below presents the internal organisation of this body.

Figure 6.2. The EBA, internal structure



Source: The European Banking Authority Website, http://www.eba.europa.eu/about-us/organisation/organisation-chart (retrieved 04 June 2015).

The EBA is composed of many co-operating bodies, e.g. the Board of Supervisors (main decision-making body), the Management Board (monitoring the proper conduction of tasks assigned to the EBA), the Resolution Committee, the Banking Stakeholder Group, the Joint Board of Appeal, and the Joint Committee. Particular sections comprise the Chairperson of the EBA, Andrea Enria (Italy), the Executive Director, Adam Farkas (Hungary), representatives from 28 Member States, observers from Iceland, Liechtenstein and Norway[157], as well as from EU institutions; the Commission, the Single Supervisory Mechanism, ESRB, EIOPA and ESMA.

The Chair and the executive director of the EBA are appointed for a five year renewable[158] term.

[157] The EEA EFTA countries represented in the EBA Board of Supervisors.
[158] Just one re-election is possible.

6.1.4.2. The European Securities and Markets Authority

The ESMA is a substitute for the Committee of European Securities Regulators and has its headquarters in Paris, France. As one of the three European Supervisory Authorities within ESFS, it has been operational since the beginning of 2011. It was created to improve investor protection and cooperation between national financial authorities and, like all the ESAs, to support greater efficiency, transparency, effectiveness, integrity, and credibility of the European financial system.[159] To achieve these goals, the ESMA has been tasked with regulating Credit Rating Agencies in the EU, preparing technical standards and guidelines for the agencies and the European Commission, and fostering supervisory convergence across financial sectors in cooperation with other two ESAs and bodies responsible for security regulations.[160] Through its work on securities legislation, the ESMA also contributes to the advancement of the Single Rulebook, which aims to achieve equal treatment and legal protection of all investors in the EU, as well as at the same competitive conditions for providers of financial services. Furthermore, it is expected to ensure cost efficiency and effectiveness of supervision for supervised companies. This body supports the work of the ESRB and also in this way gets involved in the short-, medium- and long-term financial stability of the Union.

The ESMA is an independent body. Nevertheless, it is fully accountable to the EU Parliament, the Commission and the Council for its work. The functioning and work of the authority is mainly based on Regulation (EU) No 1095/2010. [161]

The ESMA comprises the Board of Supervisors, the Management Board, the Board of Appeal, and the Securities and Markets Stakeholders Group. These bodies basically consist of different combinations of a Chair, Executive Director, 28 national competent authorities, one observer from Iceland, Liechtenstein, and Norway, and one representative from ESRB, EBA, EIOPA, and the Commission. The Chairperson of the ESMA is Steven Maijoor (the Netherlands), whereas the position of the Executive Director is held by Verena Ross

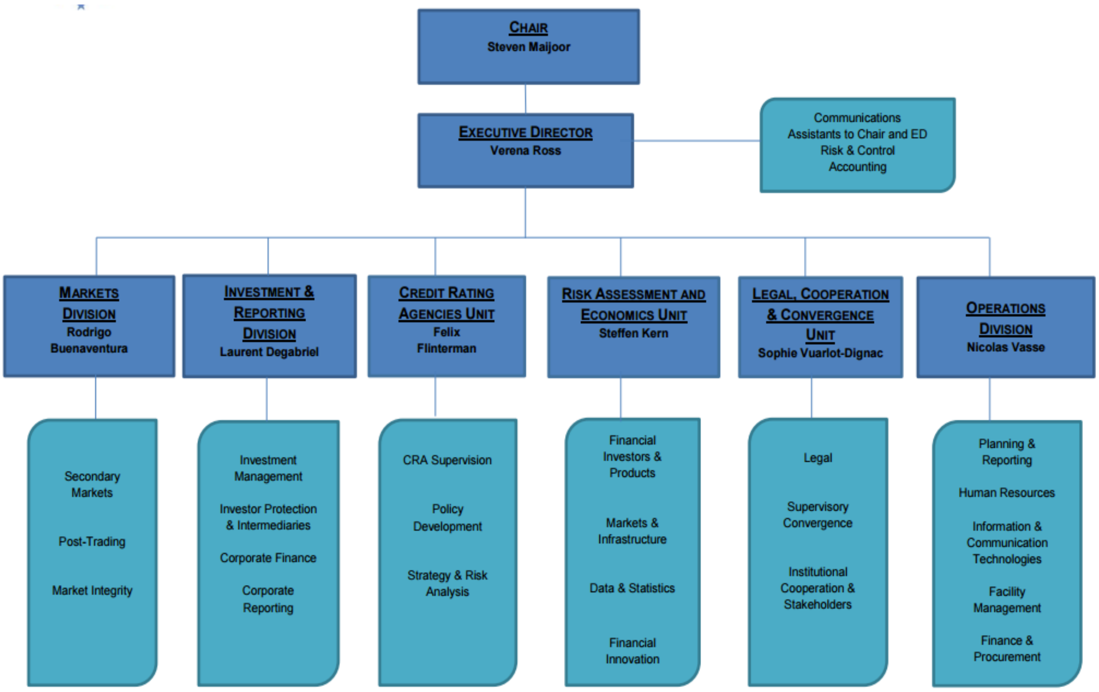
[159] M. Barnier, *A turning point for the European financial sector, Declaration by Michel Barnier on the start of three new authorities for supervision*, in: European Commission, Press release, 01 January 2011, http://europa.eu/rapid/press-release_MEMO-11-1_en.htm?locale=enn (retrieved 12 July 2015).

[160] BBC, BBC News, Business, *EU plans new financial regulator for rating agencies*, 02 June 2010, http://www.bbc.com/news/10215957 (retrieved 12 July 2015).

[161] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (6)-(46).

(Germany). They were appointed for a term of five years, which may be extended once. The Figure below presents the entire organisational structure of the ESMA.

Figure 6.3. Organisational structure of the ESMA



Source: ESMA-Website, http://www.esma.europa.eu/system/files/organigramme_1_july.pdf (retrieved 12 July 2015).

6.1.4.2. The European Insurance and Occupational Pensions Authority

The EIOPA replaced the Committee of European Insurance and Occupational Pensions Supervisors on 1 January 2011. The central office of this authority is in Frankfurt am Main, Germany. This is the last of the micro-prudential financial regulatory watchdogs within EFSF. Besides the tasks shared with its peers, like supporting financial stability, transparency, and improved development of the European supervisory system, the EIOPA is also responsible for protection of pension scheme members and beneficiaries as well as insurance policyholders.[162] Additionally, in accordance with the regulation establishing EIOPA, it should also be active "in the field of activities of insurance undertakings, reinsurance

[162] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, (1)-(12).

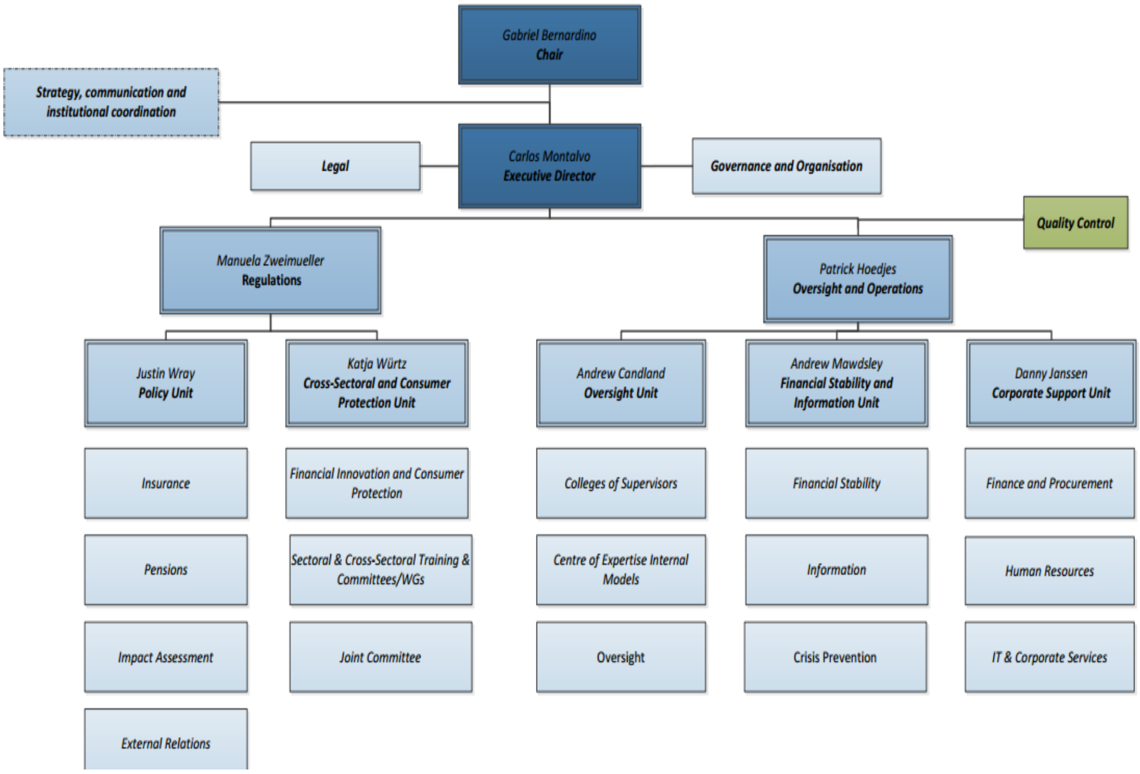
undertakings, financial conglomerates, institutions for occupational retirement provision and insurance intermediaries".[163]

Similarly to the other ESAs, the EIOPA is an independent body that is however accountable to the Parliament and the Council. The legal status and powers of the EIOPA were conferred by Regulation (EU) No 1094/2010 establishing the EIOPA[164].

The authority comprises the Board of Supervisors (BoS), which is the main decision-making body, the Management Board that ensures the proper fulfilment of EIOPA's mission, the Board of Appeal, Stakeholder Groups, the Review Panel, and numerous committees, panels and task forces consisting of national supervisory bodies' representatives. The EIOPA's BoS is composed of the Chairperson, the relevant supervisory authorities from each Member State (voting members), one representative from each of the ESRB, the EBA, and the ESMA, the Commission (non-voting members) and from Iceland, Liechtenstein, Norway (observers). The Chairman of the EIOPA is Gabriel Bernardino (Portugal) and the Executive Director is Carlos Montalvo Rebuelta (Spain). They are both appointed for a five-year term that may be extended once.[165] Very interesting here is the Board of Appel, which is actually a joint body of all three ESAs. Nevertheless, it is completely independent. It has been established in order to protect the rights of entities affected in any way by ESAs' decisions. The decisions of Board may be subject to an appeal to the Court of Justice of the EU.

[163] Ibidem, Chapter I, Article 1.2.-1.3.
[164] Ibidem, Article 5.1.-5.3.
[165] EIOPA, *The Board of Supervisors of EIOPA*, BoS 11/003, pp.2-3, https://eiopa.europa.eu/Publications/Administrative/EIOPA-Rules-of-Procedure.pdf (retrieved 12 July 2015).

Figure 6.4. Organisational structure of the EIOPA



Source: EIOPA-Website, https://eiopa.europa.eu/Publications/Administrative/EIOPA_Organigram_11_2014.pdf (retrieved 12 July 2015).

6.1.4.4. European Systemic Risk Board

The Banking Supervision Committee was replaced by the ESRB which was proposed by the *de Larosière Group* in its report from the beginning of 2009.[166] It acts under the responsibility of the ECB, which shares its experience and gives comprehensive support to the ERSB so as to improve the functioning of the new supervisory system in the EU. Because of its connection with the ECB special attention will be paid to this body.

The ESRB is responsible for macro-prudential monitoring of the financial system. It is a kind of guardian of European financial system stability. When there is a risk of the financial system becoming unstable, it issues warnings and recommendations to the Member States, the EFSF-authorities, and the European Parliament.

Specialists from the Group were unanimous that the main area which should be subject to reform is macro-prudential supervision for the full range of financial activities of the EU.[167] The supervision should include not only control of individual companies, but also put

[166] Actually, the Group proposed the creation of the European Systemic Risk Council. The name was changed as negotiations continued.
[167] Ibidem, pp. 44-47.

emphasis on balance in the whole financial system. Since it had already been suggested that the ECB should be the main player in conducting macro-prudential supervision, it was clear to the report's authors that the ESRB would be composed of the representatives of the ESCB. The Member States from outside of the Euro area should also be included.

The Parliament and the Council adopted the report without any significant amendments pursuant to Regulation No 1092/2010 (ESRB Regulation).[168] The functioning of the ESRB was additionally subject to Council Regulation No 1096/2010[169]. In accordance with the ESRB Regulation, this is an independent body without legal personality which comprises the General Board, the Steering Committee, the Secretariat, the Advisory Scientific Committee, and the Advisory Technical Committee.[170]

The General Board is the main decision-making body within the ESRB. The members of the General Board are split into two groups: members who have voting rights and those who do not. Among the first group are: the President and Vice President of the ECB, the governing authorities of the national central banks from all the EU Member States, one representative of the Commission, the Chairpersons of the EBA, EIOPA and ESMA, the Chairperson of the Advisory Technical Committee (ATC), and the Chairperson and two Vice Chairs of the Advisory Scientific Committee (ASC). The latter group comprises the President of the Economic and Financial Committee (EFC) and one expert representing supervisory authorities from each Member State.[171] The General Board meets at least once a quarter (March, June, September, and December). Its main task is taking decisions that ensure the smooth performance of the ESRB's tasks. According to ESRB Regulation, the leadership of the ESRB should be held by the President of the ECB for a period of five years after this document comes into force.[172] The reason for this is the necessity of the ECB's monitoring and support for the macro-prudential oversight responsibilities of the ESRB. Even though the ESRB is an independent body, it acts under the auspices of the ECB.

The Steering Committee is responsible for preparing the meetings of the General Board, revision of documents discussed at meetings, and surveillance of the ESRB's work. It consists

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[168] *Regulation (EU) No 1092/2010 OF THE EUROPEAN PARLIAMENT AND THE COUNCIL of 24 November 2010 on the European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB Regulation)*, Official Journal of the European Union, 2010, L 331, pp. 1-11.

[169] *Council Regulation (EU) No 1096/2010 of 17/11/2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.*

[170] ESRB Regulation, Chapter II Organisation, Article 4(1)

[171] Ibidem, Chapter II, Article 6-10.

[172] Ibidem, Introduction (12).

of fourteen members who represent basically the same groups as the members of the General Board in a slightly different combination[173]. Its meetings should be held at least once every three months before the General Board meets.

The Secretariat takes care of the administrative day-to-day work of the ESRB and its workers are provided by the ECB.[174] As the ECB is responsible for the functioning of the ESRB, in line with ESRB Regulation the ECB is obliged to provide logistical, administrative, statistical, and analytical assistance to its charge. To do so, the ECB can consult the national central banks and supervisory authority. Both the ESRB's tasks and the support of the ECB should be conducted without affecting the smooth performance of the tasks assigned to the ECB in the TFUE.[175]

Both the ASC and the ATC give advisory help and general assistance to the ESRB when requested by its Chair. The ASC comprises the Chairperson of the ATC and fifteen specialists from diverse fields.[176] In the ATC sit representatives of national central banks of the Member States, of the national supervisory authorities, of the Commission, and one representative from each from those bodies: the EBA, EIOPA, ESMA, EFC and ASC.[177]

The ESRB also has the right to seek advice from the private sector if the efficient performance of its tasks is depends upon this.[178]

The representatives of the ESRB and other people involved in its work are subject to the obligation of professional secrecy which is binding both during and after their engagement.[179]

Both the ECB and the ESRB are impartial. The members of both bodies are obliged to act solely for the benefit of the EU as a whole without taking instructions either from their national governments, interest groups, nor EU institutions.[180]

The aim of conducting macro-prudential supervision across the EU is to prevent or at least minimise systemic risks of financial stability arising from developments within the financial

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[173] European Systemic Risk Board, *Organisation and structure*, in: European System of Financial Supervision,, https://www.esrb.europa.eu/about/orga/steercomm/html/index.en.html (retrieved 16 May 2015).
[174] Ibidem, https://www.esrb.europa.eu/about/orga/secr/html/index.en.html (retrieved 16 May 2015).
[175] ESRB Regulation, Introduction (6).
[176] European Systemic Risk Board, *Op. Cit.*, https://www.esrb.europa.eu/about/orga/asc/html/index.en.html (retrieved 16 May 2015).
[177] *ESRB Regulation*, Chapter II, Article 12-13.
[178] Ibidem, Article 14.
[179] Ibidem, Article 8.
[180] Ibidem, Article 7.

system. In this way the ESRB is expected to save the European internal market from the spread of financial problems and potential instability, and subsequently contribute to economic growth.

According to ESRB Regulation, in order to achieve these objectives the ESRB is in charge of identifying and creating the hierarchy of systemic risks, issuing warnings “where (relevant) systemic risks are deemed to be significant” and publishing those warnings “where appropriate”. Where a risk is identified, the ESRB should recommend ‘remedial action’. It is also responsible for proving an emergency situation and subsequently for issuing a confidential warning to the Council and. after its adoption, the Council’s decision to the ESAs. Together with other ESAs, the Board is expected to prepare “a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk”. Furthermore, the ESRB should keep in touch and exchange information relating to macro-prudential supervision with other international organisations, in particular with the Financial Stability Board and the International Monetary Fund.

The Chairperson of the ESRB is obliged to attend a hearing in the EU Parliament at least once a year (or more often in times of financial distress), during which he/she should outline the annual report to the Council and the Parliament. This report should be made public after presenting it to those two institutions. The President of the ECB, who also acts as the Chair of the ESRB, is obliged to separate his monetary and supervisory functions and for that reason he cannot under any circumstances combine the monetary dialogue with the Parliament with the hearing regarding the performance of the ESRB.[181] In duly justified cases, the Parliament also has the right to request the Chairperson of the ESRB to take part in a hearing of one of the EP’s competent committees. Especially important are his confidential discussions with the Chair and the Vice-Chairs of the Economic and Monetary Affairs Committee of the Parliament that should take place at least once every six months. Upon the request of the Commission, the Parliament or the Council, the ESRB is bound to inspect specific issues.[182]

[181] Ibidem, Chapter IV, Article 19.

[182] J.-C. Trichet, *Introductory statement by* Chair *of the ESRB*, in: The ESRB, *European System of Financial Supervision*, Hearing on the ESRB before the Committee on Economic and Monetary affairs of the EP, Brussels, 07 February 2011, https://www.esrb.europa.eu/news/pr/2011/html/sp110207.en.html (retrieved 16 July 2015).

7. THREE STEPS TOWARDS THE EBU: THREE PILLARS

As the EBU is a significant reform of very sensitive issues, it has to be implemented gradually so that Member States and EU institutions have an opportunity to adapt to the new measures. According to Howarth and Quaglia, there are five core elements leading to the EBU; namely: "a Single Rulebook; a single framework for banking supervision; a common deposit guarantee scheme; a single framework for the managed resolution of banks and financial institutions; and a common backstop for temporary financial support." [183]

The Single Rulebook is a legislative framework which was designed to solve the financial crisis and prevent the next ones. The regulations included in the document serve as a foundation for the European Banking Union and are binding for all 8,300 EU credit institutions in the 28 Member States. The Single Rulebook concentrates capital requirements for financial institutions, regulates prevention actions and management of banks in cases of failure and, last but not least, guarantees greater protection of depositors. Its tasks include ensuring uniform application of Basel III[184]. [185]

The first established phase of the EBU is the Single Supervisory Mechanism (SSM) that has been operational since 4 November 2014. Through the introduction of this mechanism the ECB took over significant responsibilities from national supervisors related to prudential control. In this way, the SSM immensely changed the EU institutional architecture of micro-prudential oversight. The second stage of the EBU is the establishment of the Single Resolution Mechanism (SRM) that should guarantee an organised and uniform resolution of banks and other credit institutions in case of their failure. It is expected to minimise taxpayer and real economic costs in such cases. In accordance with Regulation 806/2014 establishing the SRM, bank resolutions are to be controlled through a Single Resolution Board as well as a Single Resolution Fund. For the recovery of banks at risk of failure the mechanism implements the Bank Recovery and Resolution Directive (BRRD). The last planned phase of the process towards the EBU is the implementation of the Common Deposit Guarantee

[183] D. Howarth, L. Quaglia, *Banking Union: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and 'Completing' Economic and Monetary Union*, in: Journal of Common Market Studies Vol. 51, Issue Supplement S1, Annual Review of the European Union, Wiley-Blackwell, Oxford 2013, p. 103.

[184] According to the EBA: Basel III is a regulatory framework supposed to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. It should replace Basel I and Basel II after eruption of the financial crisis in 2008, when the both former regulatory frameworks turned out to be insufficient to cope with the current EU financial troubles.

[185] The EBA, Regulation and policy, Single Rulebook, http://www.eba.europa.eu/regulation-and-policy/single-rulebook (retrieved 26 July 2015).

Scheme (DGS), which focuses on deposit protection and has a direct impact on individuals if banks fail or a crisis occurs. Even though there is still 'a long way to go' before the DGS is implemented and there are very few specific details related to its way of functioning, it is already stimulating a heated debate because the III pillar would imply changes which affect EU members' sovereignty.

Since the first two pillars are much more advanced than the last one and highlight the increase in the importance of the ECB in the European economy, this chapter will pay attention specifically to the SSM and SRM.

7.1. The position of the Member States

7.1.1. Germany

Right from the beginning of negotiations on a European banking union, Germany perceived it rather as a tool to avoid the next potential crisis than as means to repair damage caused by the last financial meltdown in the EU.[186] The German government sought a solution that would not only strengthen the European economy, but also (and above all) protect their national civilians from the cost of bailing out banks from other Eurozone members. It was also unwilling to introduce mutual national deposit guarantee funds which would lead to stable German financial institutions incurring the costs of other Member States' banks failures. Moreover, German leaders declared many times their aversion towards risk mutualisation and the creation of a common public backstop as a prevention tool when insufficient national or private funds would hinder recovery and resolution of failing entities, as in their opinion this could encourage the use of risky strategies by banking institutions. Furthermore, Germany was also reluctant to delegate its supervision powers related to cooperative banks and local savings to the Union. The idea of giving up national decision-making rights on resolution and recovery of national economic bodies was also not welcomed.[187] A protest letter by over 170 German economists in 2012 raised further doubts about the idea of a banking union between the authorities there.[188] These concerns regarded the risk of legal complaints before the

[186] A. Barker, *EU ministers set to define banking union*, in: Financial Times, EU Economy, 17 December 2013, http://www.ft.com/intl/cms/s/0/c552f182-6736-11e3-a5f9-00144feabdc0.html#axzz3S5mrhRQS (retrieved 15 July 2015).

[187] D. Howarth,L. Quaglia, *The Steep Road to European Banking Union: Constructing the Single Resolution Mechanism*, in: Journal of Common Market Studies Vol. 52, Issue Supplement S1, Annual Review of the European Union, Wiley-Blackwell, Oxford 2014, pp. 127–130.

[188] Frankfurter Allgemeine Zeitung, Protestaufruf, *Der offene Brief der Ökonomen im Wortlaut,* 05 July 2012, http://www.faz.net/aktuell/wirtschaft/protestaufruf-der-offene-brief-der-oekonomen-im-wortlaut-11810652.html (retrieved 15 July 2015).

German Federal Constitution Court about deprivation of Parliament's budgetary powers.[189] This is another indicator that the German position towards European integration is conditioned by domestic interests. Lobby groups especially, such as credit unions and saving institutions, were suspected of influencing government aspirations. Since Chancellor Merkel committed herself to saving domestic saving institutions in 2008, her later persistence to implement the SSM encountered strong dissatisfaction in Germany. Aware that the SSM was the only reasonable way to insure Germany against potential negative effects of the direct recapitalisation of the Southern European banks, Merkel started action leading to implementation of the SSM but with limited powers of the ECB, so as to not affect her national saving institutions. The German Savings Banks Association (the Deutscher Sparkassen- und Giroverband, DSGV), the Association of German Public Sector Banks (Bundesverband Öffentlicher Banken Deutschlands, VÖB) and Cooperatives (the Bundesverband der Deutschen Volksbanken) were clearly against the extension of direct ECB supervision to smaller German banks.[190]

As mentioned previously, Germany was definitely in favour of centralisation of supervision of banks and other financial institutions in the EU. Nevertheless, it found far too broad the scope of powers delegated to the supranational level suggested by the European Commission. According to the German government, oversight over the biggest banks in the European Union should be enough for the ECB, whereas the smaller banks should stay under national control.[191] Chancellor Merkel officially questioned the "capacity of the ECB to monitor 6,000 banks".[192] From the German point of view, overseeing too many institutions would hinder the efficiency, effectiveness and speed of a common supervisor's actions. However, the EC argued that the ECB has to have the power to intervene even in cases of smaller banks, as they also threatened the EU-financial structure during the crisis. Germany also wanted to exclude smaller banks from transnational activities outside the second EBU pillar, whereas bodies responsible for national resolution and restructuring should in their opinion be brought to the European level and get support from national bailout funds. Installation of such a

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[189] S. Bulmer, W. E. Paterson, *Germany as the EU's reluctant hegemon? Of economic strength and political constraints*, in: Journal of European Public Policy, Vol. 20 (10), Routledge, London 2013, pp. 1398–1404.

[190] Handelsblatt, Reuters, *Sparkassen wehren sich gegen EZB-Kontrolle,* 12 September 2012, http://www.handelsblatt.com/unternehmen/banken-versicherungen/bankenaufsicht-sparkassen-wehren-sich-gegen-ezb-kontrolle/7125908.html (retrieved 16 July 2015).

[191] Germany wanted to retain control especially over its cooperative banks and national savings.

[192] Helsinki Times, *Rehn: Schedule for single supervisory mechanism feasible,* 13 September 2012, http://www.helsinkitimes.fi/finland/finland-news/politics/3588-rehn-schedule-for-single-supervisory-mechanism-feasible.html (retrieved 16 July 2015).

decentralised structure would be more feasible. Next, convergence of regulations should be followed by stronger integration. Germany insisted on submitting only the biggest banks to common supervision. Nonetheless, in 2012 chancellor Merkel advocated centralisation of economic oversight in the euro area. Using its stronger bargaining position, Germany tried to make a deal with other Member States: support for the SSM under the auspices of the ECB in exchange for direct recapitalisation of the banks in need through the ESM.[193] According to the Council agreement from December 2012,

> "it is imperative to break the vicious circle between banks and sovereigns… 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 recapitalise banks directly."[194]

Germany, as a leader in these negotiations, convinced other countries that further capital injections for banks require external control which would effectively stimulate the changes necessary to restore the financial systems of Member States most affected by the crisis. Although the German government's acceptance of the ESM was greeted by a huge wave of criticism in Europe, it started to be officially perceived as an initiator of the creation of a banking union. EU leaders saw the SSM and later the SRM, and especially the Resolution Fund, as way out of the crisis for banks and a means to prevent them from getting their national economies into financial trouble.[195] Although Germany was a great supporter of introduction of the SSM, it did not want to rush it. According to the German relevant authorities, the changes had to be implemented gradually and thoughtfully only after appropriate preparation in line with the rule "quality before speed", unlike France and many other countries which were willing to apply the new mechanism as soon as possible. Whereas countries with banks 'in need' pushed to directly recapitalise banks immediately after the SSM came into force, Berlin preferred not to set a specific date of activation of the new mechanism. Additionally, Germany wanted separation of the ECB's supervision and monetary powers from the beginning, so that it could not be tempted in future to try to save failing banks by setting unreasonably low interest rates.[196] Germany was also cautious about

[193] Most interested in recapitalisation of their banks were governments of Spain, Italy and France.

[194] R. Goyal, et. al., A Banking Union for the Euro Area, IMF staff discussion note, SDN 13/01, published by IMF, pp. 20-21.

[195] Spiegel Online International, *French-German Compromise: Chances Improve for EU Deal on Bank Supervision*, 12 December 2012, http://www.spiegel.de/international/europe/french-german-agreement-on-bank-oversight-boosts-hopes-for-eu-deal-a-872428.html (retrieved 16 July 2015).

[196] BBC News, Business, *The eurozone's banking union,* 17 December 2013, http://www.bbc.com/news/business-20700946 (retrieved 17 July 2015).

the SRM, suggesting a two-step approach to achieve it. In September 2012, Germany together with the Netherlands and Finland issued a joint declaration against direct recapitalisation of banks by the ESM in cases of institutions which fell into crisis before the SSM came into force.[197] To them, the ESM should be used as a last resort fund after unsuccessful attempts to use private and national public capital. Germany was a consistent supporter of the bail-in method in creating a future funding system for failing banks where contribution of financial institutions from countries other than the failing one would be minimalised.[198] Even almost 18 months later, the German minister of finance was still clear: "We do not want a shift of legacy assets of individual countries to other countries' national taxpayers".[199] Together with a group of other countries, including the UK, Germany advocated an earlier date for the BRRD to become operational. They suggested 2016 instead of 2018 as, from their point of view, this could save taxpayers from bailing out failing banks. Taking into consideration the DGS, Germany is still rather cautious and definitely not convinced that it is a great idea. Thus far, it has categorically rejected the idea of a mutual borrowing option between different DGSs.

7.1.2. The United Kingdom

The position of Britain towards deeper EU financial and banking integration is completely different from that of Germany. The UK is not a member of the Eurozone, so it is not obliged to take part in the steps taken by this group. The non-euro area countries may be included in the SSM and the SRM if they wish. As befits the UK, it declared its unwillingness to participate in any of the EBU stages right from the beginning of negotiations regarding the new supervisory system in the EU. Great Britain is the only UE Member State that has explicitly excluded any involvement in the EBU steps. Currently, the UK and Denmark are the only EU countries which are not legally required to join the Eurozone, and subsequently the EBU. Yet, the Danish business and growth minister Henrik Sass Larsen and the finance minister Morten Østergaard announced their willingness to join a common European banking union. Many British politicians, headed by the Prime Minister David Cameron, stated that the creation of a unified banking system within the EU would question their national autonomy

[197] EurActive, *Germany, Finland, Netherlands begin to unravel EU banking union plans,* in: Euro&Finance, 26 September 2012, http://www.euractiv.com/euro-finance/germans-finns-dutch-unravel-eu-p-news-515027 (retrieved 16 July 2015).
[198] S. Poelchau, *Der Bail-In des Wolfgang Schäuble,* in: Neues Deutschland, 27 March 2013, https://www.neues-deutschland.de/artikel/817102.der-bail-in-des-wolfgang-schaeuble.html (retrieved 17 July 2015).
[199] W. Schäuble, *Mit gesünderen Banken in die Bankenunion*, in: Börsenzeitung, Nummer 44, Finanzplatz Frankfurt, 05 March 2014, https://www.boersen-zeitung.de/index.php?li=1&artid=2014044800&titel=Mit-gesuenderen-Banken-in-die-Bankenunion (retrieved 16 July 2015).

and sovereignty.[200] Even though Great Britain does not take active part in the phases of a banking union, it follows carefully each action taken by the engaged Member States. It cannot afford to be ignorant, as the EBU is closely connected with the Single Market, which the UK is a part of. During European negotiations on the SSM, the House of Lords expressed its concerns that the new mechanism could hinder cross-border transactions and consequently also undermine the Single Market rules and the EBA.[201] In 2013, when the EU authorities were struggling to take specific decisions regarding a banking union, Chancellor George Osborne demanded a guarantee from the EU that UK taxpayers would not be liable for decisions concerning the Eurozone.[202] To the UK, as a member of the EBA and a non-member of the EBU, it was very important to make a clear distinction between the ECB as a supervisor for the euro area and the EBA as a rule-setter for all EU banks. It was afraid the non-euro area members could be voted down in the EBA by the Eurozone majority and its influence at the EBA's regulations would decrease, since they do not have right to vote in the ECB. The UK was the main advocate of changes in the voting system within this Authority. In the light of these concerns, the EBA changed its voting system. As a result, the members not participating in the SSM gained significantly more voting powers through Regulation 1022 (2013)[203]. Since then, EBA decisions have required a double majority of both SSM-members and those outside the mechanism.[204]

There are many open issues related to the UK's non-participation in the EBU. The main complication is the co-existence of two major banks carrying out bank regulation and monetary policy within the European Single Market, namely, the Bank of England responsible for the UK, and the ECB acting for a minimum 23[205] EU Member States. What could turn out to be problematic is that Britain hosts numerous wholesale financial markets of

[200] Gov.UK, *Prime Minister's statement on European Council,* 17 December 2012, https://www.gov.uk/government/news/prime-ministers-statement-on-european-council--2 (retrieved 17 July 2015).

[201] House of Lords, EU Committee, 8th Report of Session 2013-14, '*Genuine Economic and Monetary Union' and the implication for the UK,* Authority of the House of Lords, London 2014, pp. 23-25.

[202] B. Waterfield, *UK demands legal guarantee as EU finance ministers struggle to agree 'banking union' will work,* in: The Telegraph, 18 December 2013, http://www.telegraph.co.uk/news/worldnews/europe/eu/10525566/UK-demands-legal-guarantee-as-EU-finance-ministers-struggle-to-agree-banking-union.html (retrieved 17 July 2015).

[203] REGULATION (EU) No 1022/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, OJ L 287/5.

[204] F. Bruni, *Learning on the Road Towards the Banking Union*, in: F. L. Calciano, et. al, *The Restructuring of Banks and Financial Systems in the Euro Area and the Financing of SMEs,* SIPI, Roma 2014, pp. 109-111.

[205] According to their treaties of accession, at least 23 current Member States will become part of the Euro area and accordingly also the banking union by 2020 (assuming no new members join the EU by then).

Euro area members. The problem here is whether and to what extent it pays off to have two separate sets of regulations for one common market. Furthermore, those two banks represent different taxpayers, but sometimes their functions may interfere or overlap, meaning problems on the EBU side of the fence may disturb smooth functioning on the other side, even when banks are legally separate subsidiaries. In such cases, national interests dominate when financial troubles occur.[206] In other words, non-participating countries hosting significant subsidiaries of financial institutions with headquarters in a participating-member country are likely to support international supervision and problem-solving and therefore become a participating-country. Such a separation also seems to bring unnecessary costs and excessive bureaucracy. The matter will become even more complicated when the EBU pillars are fully operational. Currently, bringing the entire SRM into force the seems to bring enough complications, especially for the countries not taking part in it. The British aversion to joining the SSM is quite difficult to understand when considering the fact it would give them opportunity to participate actively in the EU-banking changes, and the 'opt-out clause' allows non-euro area Member States to resign from it after three years under normal conditions, or earlier under special circumstances..

On the other hand, while the UK does not want to participate in the EBU, it does not condemn the creation of such a system. Numerous British authorities and interest groups have determined that the EBU is the next step of European integration similar to the Single Market, which turned out to be very beneficial for the UK. At the beginning of negotiations on a banking union within the EU, the UK was curious about how this would develop. As mentioned in a preceding chapter, the UK was in serious financial trouble, especially in the first phase of the crisis, so it was also in its interest to maintain a stable and effective European market. As Chancellor Osborn said: "We're not going to stand in the way of the Eurozone banking union as long as the rights of those countries not taking part are properly protected. That means we must not be financially liable for decisions taken as part of banking union."[207] Nevertheless, the British Prime Minister seems to trying to use the deepening integration as a chance to weaken the link between the UE and England. He has even promised to hold an in/out referendum by the end of 2017. One of his arguments is that "today the main, over-riding purpose of the European Union is different: not to win peace, but

[206] A. Armstrong, *UK and EU Financial Regulation,* in: The UK in a Changing Europe, 27 May 2015, http://ukandeu.ac.uk/uk-and-eu-financial-regulation/ (retrieved 17 July 2015).
[207] B. Waterfield, *Op. Cit.*

to secure prosperity."[208] The British Bankers' Association (BBA) welcomed the idea of the European Banking Union as it could lead to stabilisation and consistency of the Euro-regime and subsequently of the Single Market, which would also benefit the UK.[209]

7.2. The position of the EU-institutions

7.2.1. The ECB

There is no denying that the ECB has been most affected by the changes in the new European financial system. Its functions, powers, mandate and responsibilities have been significantly extended. The developments which have taken place in recent years clearly showed the strong interdependence and interconnections between the Eurozone's markets and financial entities as well as the helplessness (or at least inefficiency) of national authorities in the face of the crisis. This led to the idea of delegating significantly more powers and tasks to the supranational banking authority. Right from the beginning of negotiations the ECB has advocated the inauguration of the SSM, which is definitely the greatest power gain of this body since the introduction of a single currency. The ECB representatives, headed firstly by Jean-Claude Trichet and then by Mario Draghi, were totally in favour of increasing the importance of the role of the central bank of the Euro area in the European economy, even though this involves great responsibility. In 2012, Mario Draghi declared at a press conference that the ECB was ready and able to oversee all the 6,000 biggest Eurozone banks. This was his indirect answer to the concerns expressed by some Member States[210] who argued that the stability of the European financial system and keeping the banking system afloat is worth the partial sacrifice of sovereignty now in order to develop and benefit in the future from a unified and stable structure.[211] After inauguration of the SSM, the President of the ECB ensured "a strict separation between monetary policy and banking supervision, both these areas of activity will be able to rely on the accumulated expertise in shared services

[208] D. Cameron, *Europe speech* (video), in: The Telegraph, 23 January 2013, http://www.telegraph.co.uk/news/newsvideo/uk-politics-video/9820375/David-Camerons-Europe-speech-in-full.html (retrieved 17 July 2015).

[209] BBA, *BBA statement on European Commission banking union proposals*, 12 September 2012, https://www.bba.org.uk/news/press-releases/bba-statement-on-european-commission-banking-union-proposals/#.Vb_NvfntmGU (retrieved 17 July 2015).

[210] M. Draghi, *ECB press conference* (video), 06 December 2012, http://www.youtube.com/watch?v=HC2lcIybdE8 (retrieved 20 July 2015).

[211] The ECB, *Stronger together in Europe: the contribution of banking supervision,* Speech by Mario Draghi, President of the ECB, marking the inauguration of the ECB's new supervisory responsibilities, Frankfurt, 20 November 2014, https://www.ecb.europa.eu/press/key/date/2014/html/sp141120.en.html (retrieved 20 July 2015).

areas and of course be inspired by the European spirit that guides our work."[212] The ECB is also an advocate of the SRM, which should be a great complement to the SSM. Since the supervisory mechanism is built on the supranational basis, it would be unreasonable and ineffective to launch a resolution mechanism based on the national authorities. Moreover, the SRM operated by European bodies improves the reliability of the whole EU financial system. One set of rules and instructions for all Member States is fair and will help to avoid unequal treatment between different countries. The ECB authorities also insisted on implementation of the BRRD as a matter of high priority. They also indicated the need to fix a specific timetable for starting board operations and funding of a resolution mechanism before the SSM was implemented, which has been achieved.

7.2.2. The Commission

The European Commission was in favour of institutional and regulatory changes within the financial system. It acted very fast. Less than three months after the Eurozone members agreed on creating a new supervisory structure, it prepared a comprehensive and ambitious proposal on the SSM. The EC suggested that a new mechanism should enter into force by the beginning of 2013, major banks should be under the EBC's supervision by mid-2013, and the mechanism should be implemented by 1 January 2014. President Barosso urged the Member States as well as the Parliament and the Council to reach a rapid agreement on the SSM: "We should continue step-by-step, but now we need a very big step. Either Europe takes a step forward, or there is a risk of fragmentation."[213] The same level of ambition was shown by the Commission in the timeframe of the implementation of the SRM and preparation of the DGS. In its proposal for establishing uniform procedures for the resolution, the EC indicated key benefits of the common resolution system for: a quick and effective decision-making process, increased efficiency, avoidance of uncoordinated action, minimalisation of negative impacts on financial stability and reduced need of financial support.[214] Michel Barnier, the Internal Market and Services Commissioner stated that "We need a system which can deliver decisions quickly and efficiently, avoiding doubts on the impact on public finances, and with

[212] SSM Regulation, Art. 6 (1); SSM Framework Regulation , Art. 21.

[213] P. Spiegel, *Barroso pushes EU banking union,* in: Financial Times, 11 June 2012, http://www.ft.com/intl/cms/s/0/ccb2fda0-b3cd-11e1-8b03-00144feabdc0.html#axzz3hgf3ganY (retrieved 20 July 2015).

[214] European Commission, *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,* 12 July 2013, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013PC0520:EN:NOT (retrieved 20 July 2015).

rules that create certainty in the market. That is the point of today's proposal for a Single Resolution Mechanism (…)".[215]

7.2.3. The EP and the Council

As previously mentioned, the Parliament saw the need much earlier than other institutions for a new supervisory system. As early as 2010 it suggested the creation of a cross-border crisis management structure in which the main supervisory role would be played by "a separate body or as a unit within the EBA."[216] Even though the proposal submitted by the Commission in September 2012 did not include many of the EP's previous suggestions, the latter approved the SSM in September 2013. Nevertheless, the EU Parliament warned the ECB against mixing its 'old' monetary functions with the new supervisory ones. The EP performed in-depth checks on legitimacy, compliance with democratic rules, and the scope of oversight powers in the new system. Furthermore, the EP's President Jerzy Buzek together with the ECB's President Mario Draghi committed themselves to making an inter-institutional agreement on strengthening parliamentary oversight of the responsibilities conferred to the ECB supervisor and its accountability.[217] In October 2013, the ECOFIN adopted documents proposing the creation of the SSM for the banking system as it was an efficient way to break the vicious circle between banks and national authorities and a precondition to ease the direct recapitalisation of banks within the ESM.[218] Both, the EP and the Council insisted on being involved in the selection process of the Chair and Vice-Chair of the Supervisory Board. The final appointment is made by the Council after the EP's approval of a candidate suggested by the ECB. They both also have the right to remove the Chair.

[215] Delegation of the EU to the US, *Commission proposes Single Resolution Mechanism for the Banking Union*, Press & Media, http://www.euintheus.org/press-media/commission-proposes-single-resolution-mechanism-for-the-banking-union/ (retrieved 20 July 2015).

[216] European Parliament, *European Parliament resolution of 7 July 2010 with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector (2010/2006(INI))*, 2010, Annex (3), http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P7-TA-2010-0276+0+DOC+PDF+V0//EN (retrieved 20 July 2015).

[217] European Parliamentary Research Service, *EP Strengthens Transparency And Accountability Of Single Banking Supervisor,* 17 September 2013, http://epthinktank.eu/2013/09/17/ep-approves-single-supervisor-for-eu-banks/ (retrieved 20 July 2015).

[218] Council of the EU, *Council approves single supervisory mechanism for banking,* Luxembourg, 15 October 2013, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/139012.pdf (retrieved 20 July 2015).

7.3. The EBU

7.3.1. Pillar I: SSM

In 2012, aware of the need to introduce significant changes in the EU financial system, Member States supported Herman van Rompuy's idea of creating "an integrated financial framework [that] should have two central elements: a single European banking supervision and a common deposit insurance and resolution framework".[219] The SSM, after the Single Rulebook, is the second of five components on which the EBU is expected to be based. At the same time, it is the first of three pillars of the Euro area banking union and therefore is the start of a radical initiative leading to reorganisation of financial market, regaining confidence and breaking of the vicious circle between sovereigns and banks and fragmentation of the European market. In December 2012, after a fairly rapid negotiation process (six months), the Member States officially approved the SSM thereby giving the ECB direct supervision of the banks within the Eurozone and responsibility "for the overall effective functioning"[220] of the new mechanism. However, the ECB should conduct its supervisory tasks in cooperation with relevant national authorities and its direct oversight is meant to embrace all 'significant' banks.

The SSM should have been implemented in 2013, but mainly due to Germany, which on one hand pushed for the establishment of the SSM in terms of direct banks recapitalisation from the ESM and on the other hand procrastinated in order to delay start of its functioning, it was postponed until November 2014. However, the position of Germany can be excused, because it was stuck between a rock and hard place, the 'rock' being European countries pushing for the undertaking of specific measures against the crisis, and the 'hard place' being its domestic actors wanting to prevent the delegation of too much power in terms of national financial matters to the supranational institutions. This issue is described in more detail in the section dealing with national attitudes towards the EBU.

The SSM is mainly based on SSM Regulation (1024/2013)[221] made under Article 127 (6) of the TFUE and the SSM Framework Regulation (468/2014)[222]. The SSM Regulation requires

[219] H. v. Rompuy, *Towards a Genuine Economic and Monetary Union,* Report by President of the European Council, Brussels, 26 June 2012, pp. 1-7.

[220] The Council of the EU, *Council agrees position on bank supervision,* Brussels, 13 December 2012, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/134265.pdf (retrieved 25 July 2015).

[221] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, pp. 63-89.

participation from all Euro area members in the new supervisory structure. The countries without the right to vote in the Governing Council are not obliged to follow the decisions of the ECB. Although the non-Euro area Member States are also welcomed to voluntarily join the mechanism, they are not eligible to have the same rights as full members. 'Close cooperation' may be established between the ECB and EU countries whose currency is not the Euro in order to enable the supervision of these country's national banks by the ECB, provided this country is ready to take all appropriate measures to make the national authorities bound by the relevant ECB acts. These countries would then participate in deliberations in the Supervisory Board of the ECB. The 'Close cooperation agreement' may be terminated by the considered Member State or the ECB. [223] In April 2015 the government of Denmark expressed its willingness to become a member of the EBU. "We believe it would be beneficial to take part in this strengthened cooperation. We will make our decision on the issue when we see how the cooperation works in practice", said the Danish government in its statement.[224]

On 4 November 2014, the ECB together with the national supervisors started oversight of the 4,600 banks in the Eurozone. In order to make future work smoother and foster transparency, the ECB started a comprehensive assessment of banking sector health before the SSM became operational. This step seemed to be crucial as overall the SSM was meant as a preparation for undertaking resolution tasks by the ECB.

As mentioned previously, the ECB has the right to supervise the 'significant' banks in the Euro area. Banks are deemed as 'significant' if they meet at least one of the following conditions: minimum €30 billion assets; capital of at least 20 per cent of their national (country of location) GDP, and at least €5 billion; being one of the three most significant banks in the country of location; benefiting from assistance through the ESFS or the ESM; significant cross-border activity.

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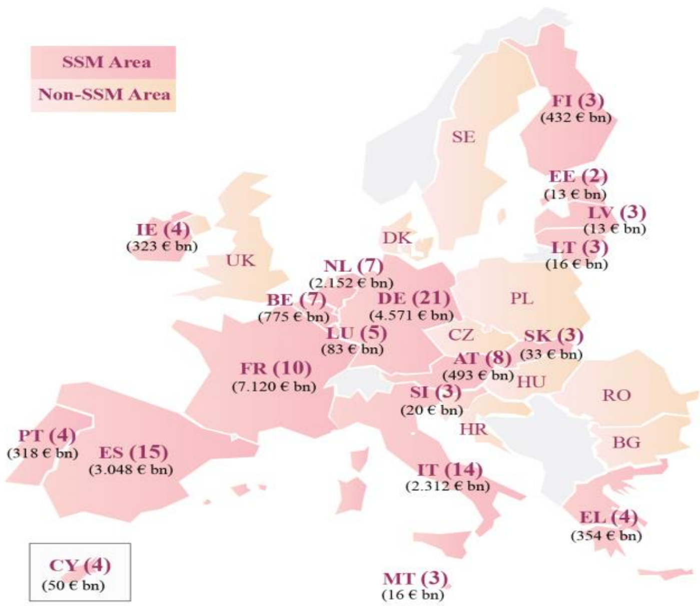
[222] REGULATION (EU) No 468/2014 OF THE EUROPEAN CENTRAL BANK of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (ECB/2014/17), OJ L 141/41, pp. 1-50.
[223] SSM Regulation, Chapter II, Art. 7, p. 77.
[224] Ministry of Business and Growth Denmark, *Report on possible Danish participation in the Banking Union,* Press release, 11 May 2015, http://www.evm.dk/english/news/2015/15-05-11-banking-union (retrieved 25 July 2015).

As of 19 May 2015, there are 1,100 ‘significant’ bank entities in the Euro area (123 ‘significant banks hold almost 82 per cent of total banking assets in the Eurozone).[225] The Commission proposal on the SSM suggested that the ECB would monitor all Eurozone banks, but Chancellor Merkel, who was under pressure from the regional German banks and saving institutions, succeeded in negotiations guaranteeing the national supervisors power to directly control ‘less significant’ institutions. However, the ECB indirectly oversees all 4,600 bank entities in the Euro area. It has the right to intervene if it finds that there is an infringement or incorrect application of the EU financial supervisory regulations by national supervisors. Figure 7 presents the geographical distribution of European banks supervised by the SSM and the total assets of those banks (at the beginning of 2014).

Figure 7.1. EU-Map: SSM Supervised banks as of 19 January 2015



Source: European Parliament, https://polcms.secure.europarl.europa.eu/cmsdata/upload/10324b0b-5df9-4e5d-958e-b7bd10e0541f/IPOL_ATA(2014)528759_EN.pdf (retrieved 20 July 2015).

As the structure overlaps to a great extent with the composition of the ECB bodies, which only highlights the major position of the ECB in the new supervisory system, there is no need to present it in detail in this section. The organisational structure and its functions are described in the chapter “The ECB, Eurosystem…” of this thesis. In brief, the crucial SSM bodies are the Supervisory Board and the Governing Council of the ECB. Interesting SSM

[225] European Central Bank, Banking Supervision, Supervisory statistics, https://www.bankingsupervision.europa.eu/about/ssmexplained/html/supervisory_statistics.en.html (retrieved 25 July 2015).

elements that have not been mentioned before are the Joint Supervisory Teams (JST) that were created to monitor individual 'significant' banks or 'significant' groups of financial institutions. Each JST comprises representatives from the national competent authorities and the ECB which are coordinated by an ECB delegate and sub-coordinated by staff from national supervisory authorities. They are responsible for; the "supervisory review and valuation process"; an examination programme that is proposed to the Supervisory Board; and smooth coordination "with the on-site inspection team" which conducts investigations and inspections on the basis of ECB decisions.[226]

The SSM was created to: guarantee consistent banking oversight; ensure soundness of significant financial institutions and in this way reinstate trust in the European financial system; improve stability of European banks and financial integration; and ensure "unity and integrity of the internal market".[227] As the most important European supervision authority, the ECB is responsible for: the issuance and withdrawal of authorisations of credit institutions; conducting supervisory reviews, "investigations and on-site inspections"; ensuring compliance with single prudential regulation set in the EU; assessment of "notification of the acquisition and disposal of qualifying holdings in credit institutions"; participation in supplementary oversight of a financial conglomerate including credit institution overseen by the ECB.[228] In terms of the ECB's macro-prudential tasks, scrutiny of the capital buffers[229] applied by the competent authorities of the Member State risks is highly significant. If the ECB finds that national authorities set buffers too low, it has power to raise them to counter potential financial risk.[230]

The EBU-steps are the greatest delegation of powers and responsibilities to the ECB since its inception. The EBU was supposed to be built in the spirit of efficient cooperation and mutual recognition between supranational European institutions, headed by the ECB, and national supervisory authorities. However, after introduction of the first EBU stage, asymmetry in the governance and organisational framework which is definitely in favour of the ECB has already been indirectly indicated . In the 'close cooperation' between the ECB and the

[226] SSM Framework Regulation, Chapter I, Art.3, p. 9.
[227] SSM Regulation, (16)-(30), pp. 64-66.
[228] Ibidem, Chapter II, Art. 4, p. 74.
[229] According to the SSM Regulation, (24), p. 65: "a sufficient capital base to absorb losses in stressed periods, global and other systemic institution buffers, and other measures aimed at addressing systemic or macroprudential risk, are key prudential tools."
[230] Ibidem, Chapter II, Art. 5, p. 75.

national supervisors mentioned in the SSM Regulation, the latter play more of a supporter than a partner role.

7.3.2. Pillar II: SRM

The SSM was a preparation phase before the ECB undertakes resolution tasks over financial institutions in Europe. The second pillar of the EBU, meant to reduce the dependence of banks on the creditworthiness of their national sovereigns, is called the Single Resolution Mechanism. In all participating countries the ERM implements the Bank Recovery and Resolution Directive of the EU, whose document prescribes the application of a Single Rulebook for resolution of 'significant' financial institutions. The ERM aims to guarantee the efficient resolution of distressed banks. If a bank experiences serious financial difficulties despite SSM supervision, it is the role of the SRM to assess the level and solution to the situation. According to SRM Regulation (806/2014)[231], it also should ensure smooth coordination and effectiveness of resolution decisions taken in participating countries as well as minimise negative impacts of these decisions on the single financial market stability.[232] After signs from the Member States, especially Germany, stating that the mutualisation and transfer of funds from national to European level breaches EU primary law, the Member States together with the institutions decided to transfer those aspects from the SRM Regulation into the Intergovernmental Agreement (IGA) signed 21 May 2014.[233]

The SRM was and still is the subject of great controversy in the negotiations between the European institutions and the Member States as it is criticised for interfering too much in national sovereignty. Decisions on deeper financial cooperation within the EU are taken much slower than before 2013, when the crisis situation was urgent.

The new mechanism will consist of the Single Resolution Board (SRB) and the Single Resolution Fund (SRF). Based in Brussels, the SRB started its work as a key resolution authority in the Eurozone on 1 January 2015. It comprises six members headed by the Chair, Elke König (Germany) and the Vice-Chair, Timo Löyttyniemi (Finland). 2015 will serve as an orientation and preparation period when the Board will have a chance to develop resolution

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[231] REGULATION (EU) No 806/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
of 15 July 2014 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 Resolution Fund and amending Regulation (EU) No 1093/2010, OJ, L 225, pp. 1-90.

[232] Ibidem, Part 1, Art. 6 (3c), p. 25.

[233] Council of the European Union, *Agreement on the transfer and mutualisation of contributions to the Single Resolution fund 8457/14*, Brussels, 14 May 2014, pp. 1-48. http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT (retrieved 26 July 2015).

plans, collect and exchange data and information, understand where the EU is in terms of financial integration, and find out how the current system can be made more efficient. This central decision-making body will be fully operational and able to use its resolution powers from 1 January 2016. The SRB is a crucial element of the new system as it will be in charge of minimalisation of cost “for taxpayers and the real economy” in the performance of orderly resolution of distressed and failing banks. It is also expected to prevent disorderly insolvency. Under its responsibility will be ‘significant’ banks supervised by the ECB, with which it will cooperate closely. The ECB will be a permanent observer in the Board’s sessions and should attend their meetings due to the EBC’s Supervisory Board invitation.[234] The Board will also manage the SRF, which consists of contributions from financial institutions. This should lead to improvement of those institutions’ independence, financial stability in the Eurozone, and elimination of the dangerous link between banks and sovereigns.[235] When a credit institution is under reconstruction, the financial resources from the SRF should ensure medium-term financial support. Contributions will be calculated in the basis of the SRM target. In the eight year period 2015 to 2023, credit institutions from participating Member States will contribute fixed amounts to the Fund, so that at the end of that period its assets will equal at least 1 per cent of the total “amount of covered deposits of all credit institutions authorised in the participating Member States.”[236] This is estimated to be around €55 billion. Initially the start date for the ERB and the ERF was scheduled for 2018, but Germany succeeded in insisting on bringing the date forward, as it wanted to ensure that there is “likely to be smaller capital gap for rescue funds to cover”.[237]

[234] E. Angelopoulou, Head of Crisis Management Division of the ECB, *Resolution Planning from a Supervisors Perspective*, presentation, 24 April 2015, http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/5/15961430926223820/02-BRRD-Workshop-Eleni-Angelopoulou-ECB.pdf (retrieved 26 July 2015).
[235] SRM Regulation, Part III, Art. 42-44, pp. 65-66.
[236] Ibidem, (105), p. 19.
[237] A. Barker, P. Spiegel, *EU sets out framework for banking union,* in: Financial Times, 11 December 2013, http://www.ft.com/intl/cms/s/0/f65fa1ee-61e6-11e3-aa02-00144feabdc0.html#axzz3iK8zgRpt (retrieved 26 July 2015).

7.3.3. Pillar III: DGS

The last planned pillar of the EBU should be the Single Deposit Guarantee Mechanism (SDM), also called Common Deposit Guarantee Schemes (DGS). However, the Bundesbank announced on its website that "policymakers have now postponed this initiative until further notice; instead, efforts are first being focused on the harmonisation of national DGSs."[238]

Although the DGS Directive (2014/49/EU)[239] was adopted on 16 April 2014, further steps have not been taken and specific dates have not been revealed so far. The new document replaced the original directive on DGSs from 1994. The DGS are financial aggregates funded by credit institutions that are its members. Membership is obligatory. The DGS tasks are to protect depositors in case of insolvency of their bank, ensure the stability and confidence in the European financial system "while avoiding systemic risks", and minimise (or even eliminate) situations in which taxpayers are affected by bank failure.[240] However, this is supposed to be beneficial not only for depositors, but also for the stability of the European financial system as it could prevent mass capital withdrawal from banks by panicked customers in times of trouble. The coverage level of each depositor of a failed credit institution is any sum up to € 100,000, which should be paid after several days or weeks.

[238] The Bundesbank, Eurosystem, Common deposit guarantee scheme (DGS), https://www.bundesbank.de/Redaktion/EN/Glossareintraege/C/common_deposit_guarantee_scheme.html (retrieved 26 July 2015).
[239] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0049 (retrieved 26 July 2015).
[240] DGS Directive, (14)-(17).

Figure below presents timeline for implementation of the EBU.

Figure 7.2. Timeline-process towards a banking union within the Euro area

2012

- Announcement of OMT program
- Replacement of the temporary instrument EFSF with the permanent ESM **(oprational amount 500 billion €)**
- Call of the EU leaders for Single Supervisory Mechanism (SSM) and standards of national banks on financial resolution and deposit insurance by end of 2013; time-bound road map to achieve all goals of EMU (vital part of it should be the EBU)

2013

- Parliament and the Council reached an agreement on establishment of the **SSM as the first pillar of the EBU** that should cover all banks in the Eurozone. The SSM is expected to start its works in Nov 2014.

2014

- Parliament and the Council reached an agreement on establishment of the Single Resolution Mechanism (**SRM) as a second pillar of the EBU**. The SRM is expected to ensure efficient management of potential bank failures in the future to limit taxpayers cost if it to minimum.
- Decision on creating **The Single Resolution Fund (SRF)** in case neither bank itself, nor its stakeholders or even creditors will be not able to finance bank's problems threatening its keeping afloat.
- Parliament and the Council agreement on a **Deposit Guarantee Scheme** directive (DGS) which is expected to contribute to the third pillar of the EBU (together with the ESM and the SRF). Thanks to the DGS all deposits up to **100 000 €** are protected (in accordance with the Bank Recovery and Resolution Directive).
- Adoption of the fourth Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR). **CRD+CRR=CRD IV.** CRD IV is responsible for transposition of the **Basel III principles** (prudential capital supervision and coordination for invertments firms and credit institutions) into common European law.
- Start of the SSM works.

Source: European Commission, European Parliament, and European Central Bank Websites. Designed by author.

7.4. The establishment of the EBU explained from the perspective of neo-functionalism and liberal intergovernmentalism

7.4.1. Neo-functionalism

There are many theoretical frameworks attempting to explain each phase of European integration. The contradictory frameworks of neo-functionalism and liberal intergovernmentalism are the two best-known which were chosen for the purposes of this paper and are described in the theoretical section. They have been selected this way intentionally to encourage readers to form their own opinion on the matter of the driving forces and directions of European integration, and in this section particularly on the European Banking Union. In other words, this section is an attempt to find out what the incentives were for the steps towards financial, supervisory and resolution unification, and if any of the presented hypothesis can be determined to be right or wrong with some certainty.

Neo-functionalism refers to functional spillovers, these being the actions of European supranational institutions or external international actors which encourage and support deeper integration of the European Banking Union. According to this theory, cogency and soft power of the integration advocates is strong enough to tempt the Member States to automatically sacrifice their supervision and resolution powers and subsequently adopt measures suggested from above. Having looked at the situation in Europe in recent years, at least two sets of incentives for banking integration created through spillover effects may be found:

1. Tight and dangerous inter-connection between single currency spread and a 'doom-loop' between national authorities and banks;
2. A Single Market and constantly increasing level of cross-border bank activity.

The first point indicates the risk of mutual dependency between national sovereigns and banks. States need their crucial banks to function well, banks need the authorities as protectors in times of trouble. As the crisis showed, banking debt may be converted very quickly into national debt. For members of the Eurozone this meant financial disruption of the entire euro area and was an incentive for delegation of more powers to the European level. The idea was particularly welcomed among the European institutions that pushed for its prompt implementation. The Member States, encouraged by the Commission, the Parliament and the ECB decided to join the new mechanism and create a common fund that is expected to conduct resolution of failing banks. Nevertheless, the fund was conditioned by the adoption and implementation of the common supervisory body's proposal that it should co-operate with the national banking authorities and provide the SRM with necessary information and support. The SSM also monitors compliance with budgetary discipline, so to be in line with the IMF: “common safety nets and backstops without effective supervision and resolution would break sovereign-bank links, but risk distorting incentives, reinforcing tendencies for regulatory forbearance, and shifting losses to the euro-area level. Effective control must accompany, or precede, risk or burden sharing.”.[241] However, considering the correctness of the neo-functionalism hypothesis regarding the process of joining the Member States to the SSM , the aspect of automaticity is worth mentioning. The Member States led stormy negotiations on the new structure and tried to defend their rights to be able to inspect or even influence the work of the SSM.

The second point includes mostly practical reasons for functional spillover leading to the creation of firstly a single supervisor, followed by a single resolution body; improved efficiency of growing international transactions, decreased institutional costs and a more stable system overseen by a central player. The spreading Single Market together with the growing number of financial institutions offering international transactions seem to be enough to create a new, pan-European system that is in principle more effective than a ‘mosaic’ of different national structures.

The next hypothesis assumed by the neo-functionalists is that the European institutions in cooperation with other international external actors are the main motivation for Member States to integrate their financial systems and give up great parts of their sovereignty. The institutions advocated centralisation of supervision in the EU much earlier than the idea of the European Banking Union was suggested. In 2009, the Commission put additional responsibilities on the CEBS; in 2010, the Parliament aimed to concentrate main supervisory powers in the EBA and the ECB declared its readiness to take over more responsibilities from the national authorities. The fact that the pre-crisis propositions of the EC, the EP and the ECB to create supranational bodies to control financial and supervisory market met no response from the Member States leads to the assumption that they agreed on that just because of a lack of better options. Nonetheless, the institutions tried to take quick action when they sensed the opportunity. The Commission prepared the proposal on the SSM in only three months (over the summer holiday). The Parliament dealt with matters related to the SSM’s accountability to it and compliance of the supervisor’s powers with democratic standards. The

[241] International Monetary Fund, *A banking union for the Euro area,* p. 12, http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf (retrieved 21 July 2015).

ECB kept repeating that “decisive, firm and complete” powers should be transferred to it.[242] The European institutions were consistently backed up by the IMF and the European Banking Federation (EBF), who managed to bring all the Member States to an agreement. The majority of the negotiation outcomes mirrored the preferences of institutions, which shows their ability to influence the positions of the Member States. The discussions on the SRM were much more difficult. Firstly, the scope of the delegated powers were expected to affect national sovereignty to a greater extent than previous measures. Secondly, the crisis receded and therefore interest in deeper integration declined. Individual governments started to lead separate discussions before official EU meetings which encouraged them to resist further delegation of powers proposed by the institutions. During this phase, the European organs were under huge political pressure. When it came to the negotiations on the DSG, the institutions were not able to convince the national authorities to make a significant sacrifice. Discussions on this are still in the early stages, although institutions have attempted many times to convince the Member States of the necessity of its introduction. When all these factors are taken into consideration, it seems to be quite difficult to estimate who influenced whom to a greater extent.

As the financial situation became more stable, the interest of Member States in the quick implementation of new EBU measures significantly decreased. This leads to a quite rethorical question: was the crisis actually the main ‘driving force’ that gave the right pace to European banking integration? Neo-functionalists would probably not like the answer.

7.4.2. Liberal intergovernmentalism

Liberal intergovernmentalism theorists assume that steps towards the EBU were taken as a result of domestic interests of the EU countries. National authorities’ willingness to adopt the SSM and readiness for the next steps were stimulated by benefits of individual Member States and domestic pressures. In this case, pressure from pan-European or other international institutions did not play any role because the national authorities had everything under control. The results of negotiations depend on the bargaining powers of individual countries or groups of countries.

Since the beginning of the crisis, the Member States were aware of the fact that a new system is necessary. They knew it would require delegation of powers and reorganisation of the

[242] M. Steen, A. Barker, *Debate rages on eurozone banks supervisor,* in: Financial Times, EU Economy, 09 December 2012, http://www.ft.com/intl/cms/s/0/6d7c4eaa-41e8-11e2-bb3a-00144feabdc0.html#axzz3hyf2SUw0 (retrieved 21 July 2015).

existing structure. Up to this point all were unanimous. The problems began when it came to defining a new system and the scope of rights its main actors delegated from the national authorities. National preferences of the Member States were clearly divided into two groups: the German group consisting mainly of Germany, the Netherlands and Finland; and the French group comprising France and the Southern European countries. At the beginning of negotiations the Northern 'team' was rather careful in expressing its willingness to create a banking union whose scope would be wider than just financial stability, whereas the Southern 'camp' strongly advocated the idea of a banking union whose members would delegate a great part of their sovereignty and share liabilities. The next feature of liberal intergovernmentalism is revealed here; namely, the bargaining powers of individual countries or groups if they decide to merge their interests. Since the economies of the latter group were weak, they found the idea of using the fund from ESM to support distressed banks very beneficial. At that time, the Spanish and Cypriot banks were in serious trouble and it was mainly those countries backed by France that pushed the German group to agree on the direct recapitalisation of those banks by the ESM. Taking into account the principles of this theoretical framework, the role of France in the whole process appeared to be quite hard to explain. Of course, France was also affected by the Eurocrisis, but the situation of its national banks was not so bad that it could explain its position and great desire to agree on debt-sharing. This example showed (at that time) the new government's desire for EU integration based on solidarity. On the other hand, France, taught by its history, could be concerned about the dangerous' vicious circle between banks and national authorities' Despite a storm of negative comments from banks and savings associations, the German Chancellor Merkel made a deal with the Southern group during the summit in June 2012; recapitalisation of banks outside the ESM for agreement on the single supervisory system. Although smaller saving institutions were against the ECB's supervision project, the government, pushed by other countries, saw the need to create a pan-European body with the power to oversee the banks within the Eurozone. Nevertheless, being afraid to disappoint her national social groups too much, Chancellor Merkel insisted on reducing the ECB's supervisory powers within the SSM. The Bundesbank Vice-President, Sabine Lautenschläger said that "Whoever accepts liability also has to have a right to control".[243] According to the northern members, it would be unreasonable to implement a resolution framework without having ex-ante controls implemented by an independent body. The SSM was a 'bill' provided by the German group to

[243] A. Rettman, *Barroso to unveil 'political union' plan at EU summit,* in: EU Observer, 13 June 2012, https://euobserver.com/institutional/116605 (retrieved 22 July 2015).

banking union enthusiasts for the direct recapitalisation of their banks from the ESM. This trade-off deal was also intended to discipline the financial systems of other countries. Banks under common European supervision would be more unlikely to take risky actions than they would under national control. The theory of liberal intergovernmentalism also applies to the non-euro area EU Member States because their attitude to the EBU depends on their national interests. Stability of the Eurozone equals correct development of the Single Market and thereby ensures smooth functioning of national economies. Although there is no hard evidence confirming the above liberal intergovernmentalism assumption, on the basis of the described moves it can definitely be stated that it cannot be rejected.

The next assumption of liberal intergovernmentalism mentioned in the theoretical chapter was that the European institutions play an admittedly significant role in banking integration, but they were created only to serve the Member States in performing their national interests. Since the critical situation on the European market forced the Member States to give up their sovereignty and many powers, they do not let European institutions act without their agreement or constantly control their moves. The certainty of this assumption is as hard to confirm as it is to reject. In the first phase of EBU creation the institutions were those which determined the conditions, whereas when crisis calmed down in 2013, the Member States were not so willing to delegate more powers to the institutions anymore in order to deepen financial cooperation and started to consider their rights. At the beginning of the crisis, when most of the countries were lost in their economic troubles, the ECB went many times beyond the scope of the powers given by the treaties. However, the resistance by the Member States was either negligible or inconsistent. The greatest guardian of the matter was Germany, but in spite of its calls to bring the ECB back into line it was never brought to tribunal. What is more, it received more rights and powers within a new supervisory system. This shows that as long as the ECB’s actions were improving the credibility of the financial system, the Member States were more focused on keeping their financial systems afloat than on guarding the treaties. These moves towards the banking union rather contradict liberal intergovernmental assumptions. Nevertheless, negotiations on the SRM and the DGS reveal that the roles are now reversed to some extent, or that the Member States now definitely try to preserve as much of their sovereignty as possible. The negotiation pace also slowed down in accordance with the national preferences. This revealed that the position of both the Member States and European institutions are completely dependent on circumstances. Yet, the attitude of state representatives is strongly influenced by a cold calculation of benefits.

Although neo-functionalism and its spillover effects are exactly what idealistically should be an explanation of the Member States' willingness to create and join the banking and fiscal integration, the theory presented by liberal intergovernmentalism seems to be more realistic. The best evidence for this is that the countries supported development of the EBU when the ground was sliding from under their feet. Between 2009 and 2012 they were ready to sacrifice a significant part of their financial sovereignty for the "common good". However, in 2013 when the situation started to be more stable, negotiations on further EBU steps slowed down as it became less appealing. Nevertheless, there are also some arguments in favour of neo-functionalism. This shows that it is extremely difficult to fully adopt or reject either of these two theories in the European movement towards a banking union.

CONCLUSION

This thesis is an attempt to find out whether national governments of supranational EU institutions are more important advocates of European integration. Attention is focused primarily on the structural, regulatory and management changes in the EU's financial sector as a whole and its individual Member States. The paper aims to show the greatly increased importance of the ECB in the European economy since the agreement was made on deeper financial cooperation, reform in supervisory structure, and later the EBU. The two chosen theoretical frameworks of neo-functionalism and liberal intergovernmentalism, both of which try to explain progressive integration, are tested in the paper. Additionally, the whole process of banking harmonisation and numerous systemic changes are also presented from the perspective of the Member States, with the main focus on the economically strongest ones: Germany and the UK.

In the aftermath of the crisis, the EU Member States together with the European institutions started to seek various recovery measures. At first, they introduced short-term measures under which Member States had a significant amount of independence in the way the measures were introduced. Next, the supranational institutions decided there was a need to install medium-term solutions which would not only mitigate the negative effects of the protracted crisis, but also prevent future meltdown of the EU financial system. Troubles within the Eurozone banking system indicated a significant lack of discipline in this sector. Stricter rules and efficient management and reinforcement of the EU capacity for preventing circumstances posing a threat to stability of the system were necessary in order to avoid similar situations in the future,. At their summit in June 2012, the EU institutions and Euro area heads of states or governments agreed upon the European Banking Union. According to the Commission's proposal on the EBU, presented only three months later, strengthening financial integration should be accomplished in three steps which should reinstate the credibility of credit institutions and prevent a 'vicious circle between them and sovereigns'. The first pillar of the EBU is the Single Supervisory Mechanism, whose implementation was also a condition for the foundation of direct bank recapitalisation by the European Stability Mechanism. The SSM's role is to oversee the stability of banking institutions in the Euro area. The ECB is a key supervisor in the new structure. The second pillar of the EBU is the European Resolution Mechanism. responsible for implementation of the Bank Recovery and Resolution Directive including methods of restructuring failing banks. The third planned phase is the Deposit Guarantee Scheme, which should ensure that savers and investors across the EU are be protected from losing their money (up to € 100,000) even in cases of bank failure. At the time of writing this thesis, there are still only national deposit guarantee schemes which are expected to be harmonized in the future, but this still seems a long way from being achieved as there is no specific timeframe. The EBU requires a great delegation of decision-making powers from national to European level, especially to the ECB. As financial issues are always very sensitive, giving the ECB powers to monitor and intervene in national banking systems raised many concerns among Member States about its effect on their sovereignty. Some of them even stated that some moves towards the EBU are not compatible with EU primary law. Nevertheless, the decision on implementation of the EBU and the first steps towards it have been taken. This thesis attempts to find out whether national authorities or supranational EU institutions were those who play more decisive role in European financial integration and how they influence the ECB's powers.

In order to answer the research question, two contradictory theoretical frameworks explaining the banking integration have been tested; namely, neo-functionalism and liberal intergovernmentalism. The first theory assumes that incentives for the EBU originated in spillover effects which were 'automatically' responded to by Member States. This theory puts strong supranational institutions in the middle of this process. They are the main supporters of deeper integration and have enough powers to convince the Member States to participate even if sacrificing their own sovereignty. Nevertheless, even though spillovers were important factors that logically should lead to introduction of the EBU, they cannot be perceived as the main trigger signal for agreement on deeper banking integration. The spillovers existed even before the sovereign debt crisis erupted and the EU institutions repeatedly suggested unification of the financial architecture, the Member States have never agreed on implementation of this proposals before. The next point against the validity of the neo-functionalist explanation of banking harmonisation is the principle of 'automaticity' which indicates that the EBU project should be implemented swiftly, however this has not happened. Whereas implementation of the SSM was quite quick (although not trouble-free), negotiations on the SRM looked more like an obstacle race. Not to mention the DGS where no specific decisions have been taken. Taking into account these facts, the conclusion can be drawn that the only reason the Member States agreed on the EBU is that they were completely losing their grip of the crisis and needed urgent measures. Since 2013, the crisis has slowed down and the measures are not so urgent anymore.

From today's perspective, institutional pressures seem much weaker than national pressures which usually mirror domestic interests in the process towards the EBU. Looking objectively, the Member States needed anti-crisis measures, so they swiftly implemented them. Now these measures are not so necessary, so the Member States are acting much slower, thereby giving themselves time to consider carefully all the pros and cons and consequently find the most beneficial way for them as national states. Once the situation became slightly more relaxed, a consolidation of the two latter EBU phases is much more complicated and requires more time than the SSM. Such moves correspond more to liberal intergovernmentalism, the second theory tested in this thesis, which states that European banking integration is a result of rational actions taken by states mainly for their individual benefit. In line with this theory, the key players in the integration towards a banking union are the Member States which dictate conditions for it. The liberal intergovernmentatists assume that the current form of the EBU mirrors the preferences of the states which have the greatest bargaining powers. Moreover, the positions of national representatives are defined by the pressures of domestic social groups. This theory also does not seem to be fully correct as it states that Member States control the progress of integration and keep supranational institutions on a short leash. However, the EU institutions showed many times that they are not created to serve states and are able to extend their powers without agreement from Member States. This was most evident during the first phase of the crisis, when the ECB exceeded its powers without asking for permission and went significantly beyond the scope of the responsibilities assigned to it in the TFUE. Even though the ECB was acting on the edge of the law, instead of calling for discipline it received more powers as the main supervisor in the SSM. Nevertheless, in spite of some shortcomings, the theory of liberal intergovernmentalism seems more realistic and the national interests of the Member States are presumably dominant in the process towards the EBU, rather than the supranational institutions that are main actors of neo-functionalist assumptions. Spillover effects were not enough for the Member States to take action before the sovereign debt crisis.

Whatever might be the trigger for banking integration in the EU, it is just the beginning of the long process to complete harmonization of banking and subsequently fiscal union. Robust fiscal integration should be a twin sister for the EMU. So long as these two foundations of the European integration cooperate efficiently and effectively, the EU will be a successful long-term global player. Taking into consideration the differences between Member States' interests, consensus seems to be very difficult to achieve. Even though the implementation of the EBU is only an initial attempt to create significantly more expansive fiscal integration, achieving the goals of the EBU's pillars alone (especially two latter pillars[244]) will in all likelihood not be an easy process. Lack of clear details, the long timetable for implementation, and the reluctance of some important players[245] does not augur well for the future of a fiscal union within the EU. Policymakers will definitely have a substantial challenge in convincing the Member States that sacrifice is the price they have to pay for the stability of the European economy and the leading position of Europe in the global market. None of the individual countries are able to compete at the same level with the world's strongest economies. This is why strengthening of the Eurozone should be a priority goal for all decision-makers.

Currently, it is of the greatest importance to create clear structures, an operational framework, deadlines, and a set of common rules to be fulfilled for the adoption of firstly, a banking union, and subsequently, a fiscal union. This would be the first and crucial step towards regaining investors' confidence in the EU's ability to recover after the crisis as well as towards boosting bank lending (after a lack of credit in recent years). As a result, countries currently reluctant to deepen banking integration could be lured by a sustainable economic situation, the specified and credible perspectives and benefits that could arise from stronger growth, such as more profitable tax revenue conditions. This could subsequently lead to the development of a deposit guarantee fund and bailout facility.

[244] Process leading to achievement of the EBU is split into three pillars: the Single Supervisory Mechanism, the Single Resolution Mechanism, and the Deposit Guarantees Scheme.
[245] Austria, Finland and Germany are still not convinced if they are ready to support the idea of creating the Single Resolutions Mechanism for fear of "bail-in" strategy stating that in case of future financial troubles the losses may be covered from the taxpayers' pockets.

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LIST OF FIGURES:

LIST OF ABBREVIATIONS:

ABI: Association of British Insurers
ASC: Advisory Scientific Committee
ATC: Advisory Technical Committee
BBA: British Bankers Association
BIS: Bank for International Settlements
BRRD: Bank Recovery and Resolution Directive
CEBS: Committee of European Banking Supervisors

CEIOPS: Committee of European Insurance and Occupational Pensions Supervisors
CESR: Committee of European Securities Regulators
CESR: Committee of European Securities Regulators
COREP: Common Reporting Framework
CRD IV: Capital Requirements Directive IV
CRR: Capital Requirements Regulation
DG: Directorate(s) General
DGS: Deposit Guarantee Scheme
DSGV: Deutscher Sparkassen- und Giroverband (Eng. German Savings Bank Association)
EBA: European Banking Authority
EBU: European Banking Union
EC: European Communities
ECOFIN: Economic and Financial Affairs Council
ECSC: European Coal and Steal Community
ECU: European Currency Unit
EEC: European Economic Community
EFSF: European Financial Stability Facility
EFSM: European Financial Stability Mechanism
EIOPA: European Insurance and Occupational Pensions Authority
EMI: European Monetary Institute
EMS: European Monetary System
EMU: European Monetary Union
EP: European Parliament
ESA: European Supervisory Authority
ESBG: European Savings Bank Group
ESCB: European System of Central Banks
ESFS: European System of Financial Supervisors
ESM: European Stability Mechanism
ESMA: European Securities and Markets Authority
ESRB: European Systemic Risk Board
EU: European Union
Euratom: European Atomic Energy Community
FED: Federal Reserve System
FSF: Financial Stability Forum
GDV: Gesamtverband der Deutschen Versicherungswirtschaft (Eng.: German Insurance Association)
HICP: Harmonised Index of Consumer Prices
IMA: Investment Management Association
IMF: International Monetary Fund
MEP: Member of the European Parliament
SEA: Single European Act
SRM: Single Resolution Mechanism
SSM: Single Supervisory Mechanism
TESM: Treaty establishing the European Stability Mechanism
TFEU: Treaty on the Functioning of the European Union
TSH: Twin Sister Hypothesis
TUE: Treaty on European Union
VÖB: Bundesverband Öffentlicher Banken Deutschlands (Eng.: The Association of German Public Sector Banks)