# Reforming the hidden wiring of the banking union

TransCrisis
Enhancing the EU's Transboundary Crisis Management Capacities

**Lydie Cabane** and **Martin Lodge**
Centre for Analysis of Risk and Regulation
London School of Economics and Political Science

**Summary**

*Calls for 'completing the banking union' are widespread. Different versions of what it means to 'complete' the banking union exist – as do fundamental criticisms about the emerging shape of this banking union. Despite initial agreement in 2015, member states remain divided over a deposit insurance scheme and of a common backstop. While these themes dominate the discussion, too little attention is being paid to the 'hidden wiring' of the banking union. In this paper we take a closer look at how the current pillars of supervision and resolution operate. Despite the considerable progress in developing supervision and resolution, significant issues and tensions need to be resolved in order to 'crisis-proof' the system before the next crisis hits.*

## Introduction

The banking union is central to contemporary debates about the future of the European Union in general and the eurozone in particular. Widespread agreement exists that the banking union is, as yet, 'incomplete' and should extend beyond a common supervision (spearheaded by the ECB) and a common banking crisis tool (the Single Resolution Board) by creating a European Deposit Insurance Scheme and a common 'financial backstop'. Despite initial agreement on a deposit insurance scheme and a 'backstop' in the initial phases of the banking union (in 2015), little progress has been made since. Indeed, it is likely that we will witness some further developments regarding a 'backstop', but debates about a deposit insurance scheme appear, at this time, to reflect deep divisions among member states. Nevertheless, debates about the future shape of the advancing banking union require considerable urgency. Experts, political and institutional actors are advocating further reform of the overall architecture of the banking union before the next crisis hits (and threatens) the euro area.[1]

Deeply entrenched cleavages among member states have inhibited any moves beyond the two existing banking union pillars. Some member states advocate the prioritisation of risk reduction across national banking systems' balance sheets before embarking on any further mutualisation of risks. Other member states support increased fiscal solidarity to 'crisis proof' the eurozone. Since his election, President Emmanuel Macron has notably championed the reform of the European Stability Mechanism into a fully-fledged European Monetary Fund that could serve as a common backstop were the funds currently available to banking resolution shown to be insufficient to deal with a large financial crisis.

To some extent, the contrast between the two positions can be over-emphasised. The key differences are largely about questions of timing: should there be an initial emphasis on reducing risks or should there be an emphasis on initially creating resources to alleviate the impact of potential further crises.

Discussions over the banking union usually focus on its 'missing parts'. Despite some critical reviews by the European Court of Auditors,[2] the European Commission,[3] and other international organisations,[4] little attention has been devoted to how the existing parts actually work.

The existing arrangements have certainly attracted some concern, for example about the lack of ECB oversight over national controls (over money laundering) or about specific member states' resistance to tightened supervisory controls (over bad loan rules). In the field of banking crisis management, the liquidation and precautionary recapitalisation of some Italian banks (Veneto Banca and Banca Popolare di Vicenza, Monte dei Paschi), as well as the resolution of Banco Popular in Spain in the summer of 2017 have revealed loopholes and legal challenges.

These inconsistencies highlight the need for a **closer examination of the current pillars and capacities of the banking union**. A key question is to what extent the banking union really offers a centralised system to supervise and resolve banks in times of crisis, moreover, whether the banking union provides effective and credible tools to manage crises.

In theory, the banking union offers a centralised model of banking regulation and crisis management. In practice, even though legal competence has been devolved to the EU, supervision and resolution capacities remain distributed across European institutions and national competent authorities (central banks and resolution authorities). The dispersed distribution of competences and capacities requires further examination as unresolved tensions threaten the effectiveness and legitimacy of the banking union.

The **modes of interactions between national and European authorities thus require urgent attention** to make sure that the current system is sufficiently 'crisis-proofed'. By addressing the existing 'hidden wiring', essential steps can be undertaken that are likely to improve the functioning and overall credibility of the existing system. Taking these steps will facilitate overcoming the existing stalemate over larger reforms of the banking union.

In the following, we first describe the origins of the banking union and then move to the identification of tensions and deficits in the current system. We conclude by suggesting ways of addressing them.[5]

## Setting up the Banking Union

The banking union was set up in the context of, and as a response to the financial and sovereign debt crisis (which was, in many ways, a banking crisis). More generally, it sought to address keys developments in the banking sector that had emerged as a result of the financial integration in the Single Market.

Most of all, the financial crisis highlights the limits of the existing mode of cooperation between European banking supervisors, one that had relied on loose information exchange between national supervisory authorities (through the Committee of European Banking

Supervisors set up in 2004 after the so-called Lamfalussy process). This weak form of coordination was said to have supported a continuation of a supervisory 'national home bias', i.e., the favouring of national champions at the expense of overall eurozone financial stability.[6]

The various crises that hit the national banking systems in the eurozone (and the EU at large) between 2007 and 2012 highlighted the shortcomings in national regulatory approaches, and the absence of consistent procedures to deal with bank failures and of cross-border regulatory cooperation in the context of the EU state aid and competition regime. The traditionally close-knit relations between governments and their banks turned into the so-called doom loop. Consequently, banking crises initially threatened countries on the 'periphery' (Portugal, Ireland), but then threatened the viability of the overall Eurozone once major crises hit Greece, Spain and Italy in 2011 and 2012. It was at this point of acute crisis (the June 2012 European Council) that political leaders accepted the adoption of a banking union.

The Single Supervisory Mechanism (SSM) was set up in 2013 for eurozone countries.[7] It established an independent supervisory function as part of the European Central Bank. The Supervisory Board (composed of ECB and national supervisory authority representatives) is supported by actual banking supervision and dedicated ECB units tasked with cross-cutting functions. Joint Supervisory Teams (JSTs) conduct actual supervision of banks; these teams are chaired by the ECB, but consist of members from national regulatory authorities. A single rule book aims to ensure regulatory consistency, especially in terms of capital requirements and assessments of banks' exposure to risk. At time of writing (summer 2018), the Supervisory Board directly supervises 118 banks (representing about 80 per cent of the eurozone banking area). For less significant (usually alternative or regional) banks, national supervisory authorities remain *de jure* and *de facto* in charge; however, with the provision that the ECB might appropriate supervisory activities to ensure consistency.

The introduction of a common resolution system built on international initiatives by the G20 (especially in the adoption of 'Key Attributes for Effective Resolution Regimes' in 2011 by the Financial Stability Board). These were translated into the EU-wide context by the Bank Recovery and Resolution Directive (BRRD, adopted in 2014). This Directive required national governments to adopt formal resolution planning and to create resolution authorities. It also introduced the 'bail-in' instrument that aims to structure banks' capital in such a way that shareholders and creditors will initially cover a failure (before any taxpayers' money comes in).

In the euro area, the banking union transferred resolution powers to the EU level (distinguishing here between large and cross-border groups on the one hand, and smaller entities on the other). A Single Resolution Board was created in 2015 as an independent agency located in Brussels. The Single Resolution Mechanism represents a complex institutional arrangement.[8] The centralised decision-making requires oversight by the Commission since resolution touches upon fiscal powers. As the SSM, the SRB works with national resolution authorities in Internal Resolution Teams (IRTs) to prepare resolution plans. The Single Resolution Fund, underpinned by contributions by banks (which is intended to grow to €55 billion by 2023), is managed by the SRB, although it is based on an intergovernmental agreement. As resolution represents a new field, and as the SRB continues to evolve, the on-going implementation of an EU-wide resolution regime represents a bigger challenge than the area of supervision which is a more 'settled' regulatory area.[9]

## A centralised system of banking supervision and resolution?

As noted, the banking union represents a centralised system of banking regulation and transboundary crisis management in the European Union. It relies on agencies at the EU level (SSM and SRB) and legal authority is centralised through common legal texts and frameworks for supervision and resolution. However, this centralisation of organisation and authority is not accompanied by centralised capacities in any one EU organisation, but is dependent on the capacities of national competent authorities in both supervision and resolution. **A system of centralised legal competence and dispersed administrative capacity involves inherent tensions.** In this section, we consider four deficits[10] in the banking union: namely, deficits in central authority, in prescriptiveness, in subsidiarity and in flexibility.[11]

### Deficits in central authority

As noted, the banking union represents a centralised crisis management regime in that it has centralised legal authority as well as some organisational resources to deal with questions of supervision and resolution. Nevertheless, considerable deficits remain to this centralised authority.

First of all, the difference between 'significant' and 'less significant' banks raises challenges regarding the consistency of supervision in the euro area. For example, the collective weight of the large networks of regional banks (in particular Germany with its *Volksbanken* and *Sparkassen*) is potentially highly significant. Their exclusion from the SSM might, therefore, be seen as representing a systemic risk. This situation is also being perceived as unfair competition or permitting supervisory bias by those member states whose more concentrated banking systems are almost fully under European supervision. Others suggest that the likelihood of these smaller banks' failure leading to a systemic failure is very unlikely.

However, even with the existence of a common rule book, differences in supervision are also likely. For example, even though the language of supervision has become English, for smaller banks within the SSM national languages remain at the core of their business models, especially when it comes to legal details.

Second, there is also an issue regarding the scope of shared banking supervision under the SSM. The recent cases of banks accused of money laundering in Latvia (ABLV) and Malta (Pilatus Bank) affected areas that have remained under the sole competence of national supervisory authorities.[12]

Third, there are also various challenges involved in the coordination of supervisory and resolution functions. One issue is that the overlap between the SSM and the SRB is not necessarily smooth. For example, the remit of the SRB includes banks that are not in the SSM (as it includes banks with cross-border businesses). In addition, there is a degree of unevenness in terms of crisis preparedness among the banks that are in the SSM, as is the case with the degree of SRB-related resolution planning.[13] These potential inconsistencies arise from the fact that supervisory intensity is determined by the risk profile of the individual bank. As a consequence, the resourcing and degree of recovery and resolution planning do vary across banks and might pose challenges to those crisis managers at times when these 'low risk' banks show sign of crisis.

In addition, nationally competent authorities that participate in the JSTs and IRTs have varying degrees of capacities, both in the sense of resources and expertise, which re-introduces a potential for variation in control practices. Furthermore, resolution is highly complex since it needs to take into account nationally diverse insolvency and fiscal laws. Ensuring a common and consistent approach to resolution planning remains a considerable challenge for the SRB.

A related issue is that significant differences remain in the ways in which national supervisory and resolution authorities are organised. There have been long-standing debates about whether monetary policy and banking supervision should be united in one organisation. Similarly, there are questions as to where to locate resolution activities, whether in a separate authority, as part of central banks and/or as part of banking supervision authorities. These functions are currently organised differently across member states, reflecting institutional inheritance and domestic policy choices. Such differences inevitably

introduce their own biases, whether it is because of difficulties of facilitating information exchange between domestic institutions, differences in supervision styles between significant, less significant and other banks, or differences in national approach towards the SSM and SRB. In turn, these different levels of pre-existing national arrangements shape engagement with the overall regime.

These challenges are particularly acute in the case of resolution. Resolution as a specific field of expertise emerged during the last financial crisis. It therefore represents not just new institutional provisions but also a new profession. Member states are in the process of building up expertise and competence– only a handful of them had established resolution functions prior to the BRRD (UK, Germany, Spain, France). It also meant that the SRB, in its early days,[14] focused its limited resources on countries that required most attention (initially, some member states had only one delegate to send to the SRB), whereas those member states with perceived higher levels of capacities were provided with somewhat more discretion to

**Table 1: Heterogeneity and diversity of national resolution and supervision**

| Member states | Supervisory Authority | Resolution Authority | Institutional status |
|---|---|---|---|
| **France** | ACPR | ACPR | Institutional autonomy within the Banque de France |
| **Germany** | Bafin (jointly with Bundesbank) | Bafin (separate directorate, since Jan 2018) | Subordinate executive agency |
| **UK** | PRA (part of the Bank) | Resolution directorate | Within the Bank of England |
| **Spain** | Directorate within the Banco de España | FROB and Banco de España | FROB is an independent institution |
| **Italy** | Directorate within the Banca d'Italia | Directorate within the Banca d'Italia | Institutional autonomy within the Banca d'Italia |
| **Portugal** | Directorate within the Banco de Portugal | Directorate within the Banco de Portugal | Institutional autonomy within the Banco de Portugal |

develop resolution plans.

### Prescriptiveness deficit

Allocating legal authority at one level does not necessarily ensure that decision-making will be consistent across cases. Put differently, to ensure consistency, prescriptive guidance is required, especially in systems where similar professional norms may not be fully institutionalised so as to ensure shared problem-definitions and responses. Such prescriptiveness is to some extent lacking in the banking union.

In its reports, the ECA noted a lack of documentation and preparedness across the different aspects of crisis management in both the SSM and the SRB. Partly, this reflected the emerging properties of the banking union where different organisations needed to develop more detailed procedures when dealing with questions of access to information. This issue was most acute for resolution planning, where methods for calculating critical aspects of the regime, especially MREL, and assessing resolution planning took time to develop. Another challenge was exchange of information between the SRB and the SSM. These issues are being addressed, as a new Memorandum of Understanding is under discussion.

Furthermore, some debates also existed whether the first encounters with actual or potential bank resolution had pointed to the existence of too much flexibility, thereby putting the overall credibility of the regime into doubt. Albeit resolution planning follows the same rules across the EU, it needs to be handled flexibly to adapt to different member states' fiscal competence, legal remit, winding up procedures and insolvency laws. This national diversity grants some leeway to member states, as illustrated by the liquidation of the Italian banks, Veneto Banca and Banca Popolare di Vicenza. After the SRM had deemed that resolution was not in the public interest (as the banks were considered too small and only of regional interest), the Italian state utilised its national insolvency laws and deployed state aid (approved by the Commission) to protect senior unsecured creditors. Even though legal (albeit coming as a surprise to many observers),[15] this case provoked debate about the biases that national insolvency laws can introduce into a supposedly common system of banking resolution.

### Subsidiarity deficit

The notion of a subsidiarity deficit refers to criticisms of too much central decision-making with too little reliance on national supervisory and resolution authorities to undertake their work. To some extent, one might argue that the existence of the 'less significant bank' category

**Table 2: SRB Resolution decisions**

| Date | Bank | Country | Problem / failure | SRB decision |
|---|---|---|---|---|
| 2018 | ABLV | Latvia | Accusation of money laundering by US regulators | Resolution not in public interest; winding up under national law |
| 2017 | Veneto Banca<br>Banca Popolorare di Vincenza | Italy | Capital shortfall and loss making due to non-performing loans. | Resolution not in public interest; winding up under national law |
| 2017 | Banco Popular | Spain | Severe liquidity crisis, in the context of capital pressure (following the housing crisis). | Resolution in the public interest; sale to another bank (Santander) |

was the recognition of a functional need for subsidiarity: the large number of and risks associated with these banks neither warrants ECB-level oversight nor is it administratively feasible to do so.

However, for banks categorised as 'less significant', there was some ambivalence in terms of supervisory style. Some observers suggested that there was uncertainty as to 'who' was really in charge: the ECB or the national supervisory authority.

There was also a question about the type of decisions that had to be signed off at the level of the SSM supervisory board. It might be argued that following a process of institutionalisation, it is time to consider which decisions need to be taken at this central level, and which decisions can be delegated to either other parts of the SSM or even national supervisory authorities (operating within the framework of the SSM).

More fundamentally, the banking union has changed national inspection and supervision styles, from a system in which banks (supposedly) knew their supervisors, and supervisors were aware of the peculiarities of banks' economic models and national legal frameworks, to a system ruled 'at a distance' through more databases and numbers. Even those systems that had previously relied on 'numbers' were said to have evolved towards obtaining a more fine-grained picture of SSM-supervised banks, involving a better transboundary view of banking activities. For some, the change in inspection style, and the impact on the existing 'home bias', was an essential component of the banking union. Others noted that this might come at the expense of 'local knowledge' emerging between supervisors and banks. The JSTs sought to balance these tensions, but it is nevertheless the case that the new SSM-style supervisory style has introduced distinct biases and it is time to reflect further on the biases and potential blind spots across the JSTs in the SSM.

### Flexibility deficit

Supervising and crisis managing diverse national systems requires a degree of inbuilt flexibility to adapt to the inevitable peculiarities of each case. However, flexibility is likely to be in short supply in sectors that have experienced widespread crisis: there is a lack of trust between parties and 'rigid' frameworks are adopted to safeguard against future detection, coordination and enforcement problems.

Banking supervision and resolution are characterised by deep cleavages over supervisory requirements and distrust about the quality of banking supervision in other national jurisdictions. Therefore, criticism about a bias towards prescriptiveness over flexibility does exist. For example, the SRB was, at times, criticised for its lack of 'respect'' for national authorities' approaches, leading to accusations of an overbearing and over-prescriptive approach.[16]

Flexibility is also required to adapt to the changing banking universe in different member states. It is notable that there has been a considerable concentration among small banks in particular, partly as a result of longer-term processes, partly as a response to the pressures of the eurozone.

Questions about national differences in banking systems are particularly prominent in debates about non-performing loans. This debate highlights contrasting views about the level of flexibility that should be granted to national banking systems. Those demanding flexibility usually highlight the undesirable consequences of a 'one-size-fits-all' approach towards the different national legacies across banking systems.[17] In their view, a 'hard' approach is likely to risk destabilising national economic systems, and therefore, the eurozone more generally. More generally, proponents of this view highlight the potential redistributional consequences of non-flexible approaches towards supervision, affecting in particular vulnerable populations.

Others are less enthusiastic about granting flexibility as this is seen as lack of commitment to common supervision. It is seen as introducing additional risks to the Eurozone. Seen from a standpoint that focuses purely on banking supervision and financial stability, then the issue of 'non-performing loans' should be addressed urgently. However, questions about strengthening the credibility of the banking union need to also consider the wider legitimacy questions affecting the eurozone at a time of poly-crisis.[18] Put differently, an emphasis on a more stringent supervisory approach towards risk reduction is appropriate to address economic and financial risks arising from the banking sector, but it may involve wider political costs in terms of long-term political legitimacy, as illustrated by the current political situation in Italy.

## Banking union and the legitimacy challenge

Beyond its internal challenges, the current functioning of the banking union raises a series of concerns as regards its legitimacy, and the broader relations between **banking policy and democratic accountability** in the European Union, in particular when it comes to tensions between national heterogeneous contexts. More generally, legitimacy issues also point to wider questions inherent in any debate about the regulatory regime's **credible commitment**, namely the balance between stability and predictability on the one hand and flexibility on the other.

One critical issue is whether the existing pillar infrastructure would be fit for anything but sole institutional failures. The limited availability of financial resources to deal with banks in crisis has been raised as a concern by a number of observers and participants, involving the ECB and the SRB (The Single Resolution Fund will amount to €55 billion in 2024 when it will be fully operational, although it can only be activated after 8 per cent of liabilities have been 'bailed-in'). It is questionable whether the existing resources would be sufficient to carry the strain of another systemic banking crisis.

The SSM and SRM offer at least procedural guidance that had been missing during the previous banking crises. At the same time, there remain questions about the overall credibility, especially in relation to the application of the resolution mechanisms. Its provisions, involving the notion of a bail-in, are supposed to tie the hands of national governments in terms of bailing out banks. Equally, conditions to access recapitalisation by the European Stability Mechanism are very stringent. Whether national governments would really hold back in view of a collapse of a 'national champion' is debatable (at least, the system has not been sufficiently tested yet). In other words, there is a **risk to overall legitimacy,** in that the 'secret myth' of the banking union and banking resolution is that uncoordinated national bail-outs have, at best, been addressed by stricter guidelines rather than have been designed away.

Questions about legitimacy are also linked to issues such as 'who is responsible' and 'who is accountable'? The current complexity of decision-making mechanisms creates a potential 'many hands problem' where dispersed responsibilities and accountabilities are split between various EU institutions (ECB, SRB, SSM and the Commission). Such complexity is problematic when decisions have to be taken within 24 hours and when agreement on the SRB's actions is needed from both the Council and the Commission.

Such complex decision-making processes further extend the gap between EU decision-making and the citizens, as those legally responsible (SSM and SRB) are not those politically accountable to citizens for decisions that directly affect them (such as those on the non-performing loans or bank failures).[19] The **lack of public awareness** about the banking union may have facilitated negotiations on the most important transfer of sovereignty since the adoption of the single currency, but it comes with the costs that citizens are unlikely to be aware about who is making decisions on their banks.

**Number of articles[20] mentioning the 'Single Resolution Mechanism' in:**

**Elite newspapers: 1073**

**Popular newspapers: 31**

**Addressing questions of democratic accountability involves inevitable trade-offs**. Managing crises in one sector may trigger cascading effects, thereby leading to further crises in other policy domains. Similarly, taking decisions at one level of decision-making may have implications for political decision-making elsewhere. Such debates are particularly prominent in terms of the use of fiscal resources at the European level and concerns about the role of national parliaments.

The resolution of **Banco Popular** in 2017 illustrates such concerns. The bank was sold to Santander after having been deemed to be failing (because of a lack of liquidity), and put into resolution by the SRB (on the basis that it was in the 'public interest' in terms of financial stability and use of public money). However, thousands of shareholders in particular small ones, lost their savings. From a financial and economic point of view, the resolution process was seen by commentators as rather effective[21].

In Spain, however the decision to sell the bank to one of the largest national banks (for one euro) was seen as a problematic reduction in competition, leading to potential higher banking charges. These (potential) outcomes were criticised as lacking legitimacy as decisions were taken by an 'obscure' agency in Brussels and executed by a Spanish authority.[22] About 30000 shareholders have lost their savings, and litigation is, at the time of writing, on-going in Spain, the US and the European Court of Justice.[23] The SRB has been accused of relying on incomplete information and a lack of transparency about its decision. Members of the Spanish Parliament have requested documents from the SRB (that were released) and summoned its chair (Elke Konig) to testify.[24] Secrecy is generally perceived as crucial to maintain financial stability when a bank fails, but might become problematic in the aftermaths of a resolution when it comes to dealing with challenges to legitimacy.

Another issue was the role of the Spanish state: Some suggested that Italy was more successful in protecting its own interests by avoiding resolution,[25] raising questions about the actual role of states in a common supervision and resolution system. At the same time, the chosen direction reflected the preferred strategy of the Spanish resolution authority (FROB), and therefore Spain also shaped the decision.

The resolution of Banco Popular therefore highlights a number of **critical questions for the future of the banking union**: Which authority is seen to be in charge and what is its understanding of a 'public interest'? How are resolution plans and decisions prepared, and how do national authorities contribute to that process?

Addressing these questions will also provide answers to broader debates as to how to mitigate the tensions across the deficits identified above, and more general debates about 'completing' the banking union by adding missing pillars. In the current political context, this **lack of legitimacy is a threat to the European Union**, especially if a systemic crisis was to happen.

## Recommendations

Beyond the debates about deposit insurance schemes and common backstops, a closer look at the 'hidden wiring' of the current two pillars of the banking union, the SSM and the SRM, highlights that a number of deficits currently exist. These deficits and resultant tensions can be explained by the evolving nature of these pillars; in part, they reflect also on wider questions of the design of the banking union. Rather than awaiting the sparks and stenches of a breakdown, it is more advisable to fix the existing wiring (and plumbing) beforehand.

However, tensions between the distribution of powers, competence and capacities can rarely be resolved without side-effects. **Any reform initiative will inherently bring its own trade-offs that need to be taken into consideration and acknowledged**. In view of the coming European Council (28-29 June), we suggest the following recommendations to tackle the above-mentioned deficits and trade-offs in a timely manner.

First, the noted deficits point to calls for more centralised authority as one of the main challenges is to **ensure consistent oversight**, even for the large banks directly supervised by the SSM and the SRB. This relates to questions of how to organise consistent working together in the form of joint supervisory and of resolution teams. Considerable progress has been made; however, consistency cannot merely be prescribed by the single rule book but might emerge as practices become more fully institutionalised. In light of this, the following actions should be taken:

- As regards resolution, a priority would be to undertake a **systematic and comparative review of those resolution (and non-resolution) cases since the launching of the banking union** to get a better understanding and to make more transparent and consistent the pre-requisites of working across different resolution authorities and SRB decision-making process. Such a review of both national and European resolution decisions and practices would be useful in offering a clearer overview to banks, citizens and financial markets.
- One easy and immediately applicable way of improving homogeneity of supervision would be to **reinforce joint training or circulation of banking supervisors** to strengthen shared professional norms.

Secondly, we also note the need to tackle issues about potential differences in capacities across national resolution authorities. Addressing such questions of **confidence in national institutions** is politically complex, but of high priority in order to build confidence in the effectiveness and solidarity of the banking union. Various measures could overcome current concerns:

- One option might be to consider '**stress tests' for national authorities** along similar lines as the kind of stress tests that exist for banks themselves. Such activities would potentially enhance the confidence in national supervisory and resolution authorities and reduce concerns about remaining 'home bias'. This would also greatly add to the cross-cutting work undertaken in the ECB as part of its support for the bank-specific JSTs. Such an exercise could be undertaken as of 2019.

- Another related recommendation would be to **review the conditions under which the ECB does supervise the national supervisory authorities** in undertaking their specific oversight activities. Such ECB oversight remains underexplored and again, a clarification of roles and conditions of oversight would offer much needed transparency.
- This aspect relates in particular to **jurisdictional issues** as banking crises do not just emerge in the context of prudential regulation. This has become apparent with recent cases of Latvian and Maltese banks that were accused of money laundering. These cases highlight that areas that continue to be in the domain of national oversight can have transboundary effects and raise questions about legal loopholes, coordination problems within and between member states. These episodes should give rise to a **wider discussion of the remit of the SSM**. Such discussions should also happen in the coming months.

Third, addressing questions **of flexibility and prescriptiveness** raises both immediate and long-term questions about taking into account local contexts. This is particularly the case when it comes to dealing with the inheritance of national legal diversity, especially in terms of insolvency-related provisions.

One cross-cutting issue is that of the **appropriate level of responsibility**, and the tension between centralisation of authority at EU level *vs*. more reliance on national authority.

- One particular question is whether all decisions currently taken at the SSM board level really need to be taken at that level. This calls for **a review of the distribution of administrative tasks** between European and national supervisors.

Finally, the **democratic deficit of the banking union needs to be addressed**.

- **Improving communication** might offer one way to fix this issue. Such activities should be backed by systematic opinion poll research on the banking union in order to provide leaders with a more comprehensive view of public opinion on this issue. Such activities could be developed by the SSM and the SRB, in conjunction with national relevant authorities (as SRB and SSM may lack sufficient resources to do so, and support of national authorities might make communications more relevant).
- Dealing with the trade-offs between financial and political risks, and between short and long term risks is likely to be more problematic, even though essential. **A debate on who defines 'public interest' and who is accountable is required**, as well as **who pays the costs** (economic or political) for banking restructuring or bail-in operations, and not just when small shareholders and pensioners are affected.

## Conclusion

Despite considerable institutional change, the banking union is said to be incomplete. Many key issues are in the process of implementation (especially regarding questions relating to MREL). Current debates focus on the creation of a deposit insurance scheme and a financial backstop. Debates here focus not on the 'whether' but 'when' and 'how' to introduce such arrangements, especially in terms of the common backstop.

However, there are much wider questions as to whether the current and anticipated arrangements are satisfactory. These are not just questions about speed of reform and finding the balance between risk reduction and solidarity. As we suggested, a number of issues related to the tension between the centralisation of competence and the distribution of administrative capacity, both in supervision and resolution need to be addressed for the banking union to function effectively and legitimately. Therefore, existing problems with the hidden wiring of the banking union need to be addressed before commencing bold attempts at building another pillar. Addressing issues of legitimacy and accountability is key to deal with Europe's poly-crisis and the future of the EU.

## Endnotes

[1] W. Münchau 'Germany is frustrating Emmanuel Macron's grand ambitions, *Financial Times*, 15 April 2018, « Euro Area's Banking Union Heads for 'Critical Phase' ». Financial Times, 10 April 2018. 'French Central Bank Chief Urges Eurozone Reform'. Financial Times, 14 March 2018; Carmassi, J. et al. 'Completing the Banking Union with a European Deposit Insurance Scheme: Who Is Afraid of Cross-Subsidisation?' Occasional Paper Series 208. Frankfurt: ECB, April 2018. Bénassy-Quéré, A., and et al. 'Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform'. *CEPR Policy Insight*, January 2018. '*Spanish Position on Strengthening the EMU*'. General Secretariat of the Treasury and Financial Policy, Spanish Ministry of Economy, Industry and Competitiveness, April 2018. "Top ECB Official Calls for Accelerated Banking Union Drive." *Financial Times*, May 16, 2018.

[2] European Court of Auditors. « Single Resolution Board: Work on a challenging Banking Union task started, but still a long way to go ». Luxemburg, 2017; European Court of Auditors « The operational efficiency of the ECB's crisis management for banks ». Luxemburg, 2018.

[3] European Commission. *Communication on completing the banking union* (2017).

[4] Carletti, E., Dell'Arricia, G. and Marquez, R. 'Supervisory Incentives in a Banking Union'. *Working Paper 16/186*. Washington: IMF, September 2016.

[5] This paper is based upon 37 interviews with experts and policy-makers across relevant EU institutions and national competent authorities carried out during 2017-18.

[6] Véron, Nicolas. « Europe's radical Banking Union ». Bruegel essay and lecture series. Brussels: Bruegel, 2015.

[7] Council Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

[8] Regulation (EU) No 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund

[9] European Court of Auditors, *op.cit.* 2018.

[10] The defined deficits are drawn from the Transcrisis White Paper, *Dealing with Transboundary Crises in the European Union: Options for enhancing effective and legitimate transboundary crisis management capacities*, 2018. https://www.transcrisis.eu/wp-content/uploads/2018/02/TransCrisis-White-Paper.pdf

[11] These four deficts emerge from two fundamental questions in the design of transboundary regimes, one concerns the level of authority, and the other the level of prescriptiveness.

[12] " « Projet Daphne » : Pilatus, la banque maltaise qui recycle l'argent de l'Azerbaïdjan dans toute l'Europe." *Le Monde*, April 18, 2018. "Latvia Banking Scandal Leaves Europe's Regulators Red-Faced." *Financial Times*, April 4, 2018.

[13] European Court of Auditors, *op.cit.*

[14] European Court of Auditors, 2017, *op.cit.*

[15] European Parliament Think Tank. 'The Orderly Liquidation of Veneto Banca and Banca Popolare Di Vicenza'. *Briefing*. Brussels, 25 July 2017.

[16] At the same time, the examples of (non-) resolution (noted earlier) highlighted the presence of flexibility.

[17] « EU Banks Rush to 'Have Cake and Eat It' with Bad Loan Sales ». *Financial Times*, 23 April 2018.

[18] "Re-Energising Europe. A Package Deal for the EU27." *A New Pact for Europe.* Brussels: King Baudouin Foundation, Bertelsmann Stiftung, Open Society Initiative for Europe, European Policy Centre., 2017.

[19] Even though the Council needs to approve SRB resolution decisions, it is often perceived as a distant institution by citizens, and does not intervene in the supervision policies.

[20] Eurobarometer does not run questions on the EU banking policies (which in itself is telling). Questions related to economic matters generally refer to the euro and employment policies. We therefore performed a search in media outlets from 7 member states (one left leaning, one right leaning, one popular from: France, Germany, UK, Spain, Italy, Sweden, Hungary) between 2000 and 2016.

[21] "Banco Popular Process Is a Model for Failing Banks." *Financial Times*, June 8, 2017. European Parliament Think Tank. "The Resolution of Banco Popular." Briefing. Brussels, August 28, 2017. "EU Banking Resolution Rules Pass Credibility Test with Banco Popular." *Euractiv.com*, June 7, 2017.

[22] 'König, el cómplice necesario en el caso Popular... «The show must go on»'. *abc.es*, 18 December 2017.

[23] Investors File 51 Lawsuits against EU for Shutting Banco Popular." *Reuters*, August 30, 2017.

[24] "Un rapport controversé sur le sauvetage de Banco Popular publié à Bruxelles." *La Libre Belgique*, 02 February 2018.

[25] Díez, José Carlos. "Unión bancaria: España versus Italia." *Cinco Días*, June 27, 2017. "Moody's insinúa que si el Banco Popular fuera italiano no se hubiera intervenido." *El Español*, June 22, 2017.