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Europe's Single Supervisory Mechanism and the Long Journey Towards Banking Union

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INTRODUCTION

On June 29, 2012, the heads of state and government of the 17 euro area countries issued a landmark statement that started with the sentences "We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB [European Central Bank] for banks in the euro area the ESM [European Stability Mechanism] could, following a regular decision, have the possibility to recapitalize banks directly" (Euro Area Summit Statement 2012). This statement was received by the investor community and the European public as marking the initial step towards a European banking union, i.e., a shift of the key instruments of banking policy from the national to the European level to enable the formation and maintenance of an integrated European banking system.

Discussions have proceeded rather swiftly from this starting point. On September 12, 2012, the European Commission published a proposal for a council regulation to create the single supervisory mechanism (SSM) with the ECB at its core, or "SSM regulation." Simultaneously, the Commission published a proposal for a regulation of the European Parliament and the Council to amend the 2010 text that created the European Banking Authority (EBA) and adapt the EBA's governance to the creation of the SSM, or "EBA regulation." On October 18, a European Council meeting of the European Union's 27 heads of state and government further specified the features of the future SSM and the corresponding timetable (European Council 2012). On November 27, the ECB published its opinion on both the SSM regulation and the EBA regulation, responding to formal requests from the European Council and European Parliament (ECB 2012). The European Parliament also published reports on both proposals, on December 3 following a committee vote on November 29 (European Parliament 2012). Negotiations are ongoing at the time of publication, and a compromise on both regulations is widely expected in January or February 2013, if not by the initially envisaged deadline of end-December 2012.

THE CONTEXT: SINGLE SUPERVISORY MECHANISM AND EUROPEAN BANKING UNION

The notion that a banking union is an important and indispensable component of any strategy to prevent an unraveling of the euro area has gained remarkable political momentum since April 2012, as reflected by the June 29 statement. However, the banking union agenda cannot be considered in isolation from the broader crisis resolution agenda. The late-June report by the President of the European Council *Towards a Genuine Economic and Monetary Union* (Van Rompuy 2012) provides an important and relevant reference for this agenda, with four key dimensions or building blocks. These are now often referred to in the public debate as banking union, fiscal union, economic union, and political union (e.g., Draghi 2012a).

The Long Journey Towards Banking Union

Banking union, defined as the shift of the key instruments of banking policy from the national to the European level, constitutes a major overhaul of Europe's financial and economic policy framework. The radical nature of this endeavor must not be underestimated. It would have been unrealistic to expect it to be achieved in one single move. The creation of the Single Supervisory Mechanism, as outlined in the June 29 statement and developed in the proposed SSM regulation, can only be seen as the first step on a long journey that is set to include other changes to Europe's institutional setting and policies, but also concrete crisis management actions that will have a major impact on the future structures of Europe's banking system. The fact that the creation of the SSM does not immediately lead to a fully consistent and complete banking policy framework should be considered an unavoidable consequence of the ambition and complexity of the banking union project and of its embeddedness in Europe's broader agenda.

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Banking Union, Fiscal Union, and Political Union

In particular, there are strong interdependencies between banking union, fiscal union, and political union that rule out the possibility of completing a European banking union without considerable prior progress on the two other components (Véron 2011)—a condition that is currently not met. This, in a nutshell, is because a fully fledged banking union requires an autonomous European resolution authority and a federal European deposit insurance system, both of which require some sufficient form of backstop from a European level of fiscal authority to acquire credibility (see Trichet (2011) for an early exposition of this vision). The fiscal union that may provide such sufficient backstop, in turn, is difficult to envisage without a political union that would at least partly remedy what Germany's constitutional court once termed the "structural democratic deficit" of the current EU institutions (Federal Constitutional Court of Germany 2009). And the collective discussion on what specific form such a political union may take has barely started, particularly outside of Germany, ostensibly because of the risks involved in treaty change, and more broadly because some member states are deeply uncomfortable with the prospect of reinforcing the political legitimacy of EU institutions (Véron 2012).

In other terms, further progress on the path towards fiscal union, including a less limited and more robust framework for jointly issued securities than with the present ESM, and further progress towards political union, including a political setting that would make it possible to back such joint issuance with a credible prospect of future revenue, is required for a completion of European banking union that would compellingly meet the heads of state and government's objective "to break the vicious circle between banks and sovereigns." Absent such progress, the European interbank market can be expected to remain impaired by the perception of credit risk on some of the sovereign securities that provide the collateral of reference; credit rating agencies may not be able to eliminate the "sovereign cap" that keeps the creditworthiness measure of banks at most equal to that of their home member state; and the incentives that prompted many European banks to amass considerable portfolios of sovereign securities issued by their home member state, and to engage in more abrupt deleveraging outside of the home country than inside, are unlikely to disappear. Given these limitations on major dimensions of the European policy and political agenda, the Commission's draft SSM regulation goes about as far in the direction of banking union as is possible at this stage. In particular, it is not possible to create a European resolution authority and a European federal deposit insurance system, two essential components of a fully fledged banking union, without major steps forward in the direction of fiscal union and political union.

Establishment of the SSM and European Bank Crisis Management

As quoted above, the June 29 statement specifies that the ESM will "have the possibility to recapitalize banks directly" only "when an effective single supervisory mechanism is established." In the euro area crisis context, this practically means that no effort at bank crisis management and resolution can be envisaged at the European level until at least some time after the creation of the SSM.

Alas, it is unlikely that Europe's current banking system fragility can be overcome without being addressed in a system-wide, consistent manner by a European-level body. This point was made early in the crisis by Posen and Véron (2009) and was later illustrated by the failure to restore trust in the inter-bank market of subsequent efforts that remained based on the control of banks by their national supervisory authorities, such as the much publicized "stress tests" coordinated by the Committee of European Banking Supervisors in 2010 and by the newly created EBA in 2011. Thus, the decision to make direct bank recapitalizations by the ESM conditional on an SSM that would be "effective" means that system-wide bank crisis resolution efforts are unlikely to happen before late 2013 at the earliest, and 2014 more probably. This delay inevitably adds to the eventual cost of crisis resolution.

The Euro Area, Non-Euro Area Countries, and the Single Market

The geographical perimeter of the SSM and, beyond it, of Europe's future banking union is not a settled question yet. The initial political initiative, as expressed in the June 29 statement, came from euro area member states, even though it was also endorsed the same day by all 27 members of the European Council. But while the euro area crisis has clearly been the trigger for the move towards banking union, the treaty-enshrined aim of a single market for banking services, combined with significant levels of banking-sector integration between euro area and non-euro area member states of the European Union, justify a consideration of all EU member states in the discussion about the establishment of the SSM.

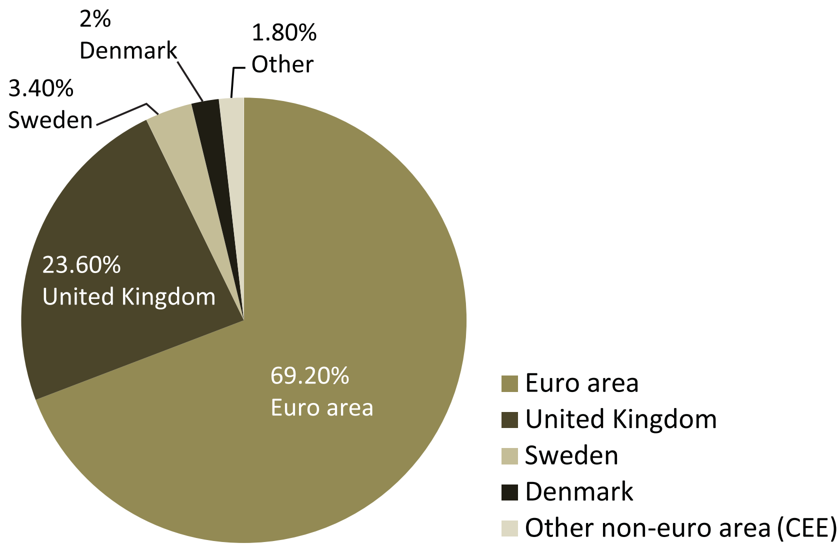
There are technical arguments in favor of having, as much as possible, a coincidence between the respective perimeters of banking union and monetary union (Pisani-Ferry et al. 2012). However, the two policy frameworks are distinct, and there is no inevitability that their geographical coverage should be exactly the same. In other words, having some countries participating in the banking union without adopting the euro as their currency, especially if those countries are relatively small, is possible, even though it adds complexity. In this context, it appears advisable for the European Union to adopt an approach that opens participation in the SSM to all member states that desire it, with an adequate balance of rights and responsibilities. Inclusiveness and flexibility are in order—even though at least one EU member state, the United Kingdom, has made it clear that it would not participate in the SSM. This inclusive vision was endorsed by the European Council meeting on October 18, which insisted both on "the equitable treatment and representation of both euro and non-euro member states participating in the SSM" and on "a level playing field between those member states which take part in the SSM and those which do not" (European Council 2012).

It may be relevant in this respect to notice that while the euro area represents the vast majority of the European Union's banking assets, the United Kingdom represents the vast majority of banking assets in the rest of the European Union, as illustrated by figure 1.

One key feature of the June 29 statement is its reference to Article 127(6) of the Treaty on the Functioning of the European Union (TFEU) for the establishment of the SSM. This article reads: "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings." This implies unanimity of all EU member states, and in particular each non-euro area member state has a veto. Simultaneously, it implies that the European supervisor at the center of the SSM is the ECB itself, which potentially makes it more difficult to include non-euro area member states into the banking union with adequate rights and responsibilities. This also potentially limits options in terms of the supervisor's accountability to political authorities and the European public, and of ring-fencing the independence of monetary policy from the distinct constraints of supervisory policy (see next section).

Whether the tensions and limitations associated with Article 127(6) will eventually result in the choice of a different legal basis for the SSM remains to be seen. Possible alternatives that have been referred to in the public debate are Article 114 of the TFEU, which formed the basis for the creation of the EBA; Article 352 of the TFEU, which states that "If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appro-

Figure 1 Total assets of credit institutions in EU member states (June 2011)



CEE = Central and Eastern Europe

Source: European Central Bank.

priate measures" but whose potential scope has been limited by successive rulings of the European Court of Justice; Article 20 of the Treaty on the European Union, which opens the possibility of a subset of EU member states creating common policy frameworks under a process of so-called "enhanced cooperation;" or a targeted amendment to the TFEU itself, as has been proposed among others by Sweden's Finance Minister Anders Borg.[1] None of these options is without serious objections and/or drawbacks though, and the use of Article 127(6), despite all the problems it gives rise to, remains the most likely option for the initial establishment of the SSM. However, it is tempting to believe that the TFEU will be revised at some point in the next decade, and that on this occasion the legal foundations of the SSM will be substantially revisited. The European Parliament's Committee on Constitutional Affairs noted explicitly in its contribution to the Parliament's report that "a Treaty change will be required in the medium term" to overcome the limitations implied by the use of Article 127(6) (European Parliament 2012). The same vision of the SSM's legal grounding being revised by treaty change in the not-too-distant future has also been endorsed by Michel Barnier, the European Commissioner in charge of financial services.[2]

1. Rebecca Christie and Jim Brunsden, "EU Nations Eye New ECB Bank Supervisor Amid German Doubts" *Bloomberg News*, December 4, 2012.

2. Laurence Norman and Riva Froymovich, "EU Barnier: Single Supervisor Could Be Improved Later With treaty Changes" *Wall Street Journal*, November 13, 2012.

CHOICES FOR THE DESIGN OF THE SINGLE SUPERVISORY MECHANISM

This section takes as its reference the European Commission's proposed SSM regulation as published on September 12, 2012, as well as media reports of negotiations and developments that have taken place since that date, keeping the assumption that its legal basis will be Article 127(6) of the Treaty on the Functioning of the European Union.

Geographical Perimeter

The Commission's initial proposal suggested that the geographical perimeter of the SSM is the euro area, and added the possibility of "close supervisory cooperation" for those non-euro area member states which may desire it, but with no representation in the supervisory mechanism's governance. Predictably, this was not seen as inclusive enough given the legitimate aspiration of some non-euro area countries to participate in the future banking union on an equitable footing. The European Council's reference on October 18 to "equitable treatment and representation of both euro and non-euro area Member States participating in the SSM" suggests at least the possibility of a broader membership. Given the clear intent of both the Czech Republic and the United Kingdom to stay outside the SSM, this could potentially include any of the eight other non-euro area member states of the European Union, namely Bulgaria, Denmark, Hungary, Latvia, Lithuania, Poland, Romania, and Sweden. None of these has yet irreversibly committed to SSM membership, which is to be expected as long as the exact conditions remain under negotiation, but none of them has ruled it out either. The final SSM regulation may specify the process through which non-euro area member states would voluntarily become part of the SSM, including possibly the adoption of adequate domestic legislation.

In the same spirit, the termination of SSM membership should be seen as a political rather than technical decision. As a consequence it should be subjected to a high threshold and be a responsibility of the European Council, rather than of the ECB as suggested in the initial version of the SSM regulation (Article 6.5 of the Commission's proposal). It is also likely that non-euro area participants could be given the possibility of initiating their own voluntary withdrawal from the SSM.

Mandate and Authority

The Commission's proposal for the SSM regulation confers broad powers on the ECB to supervise banks based in the SSM's geographical perimeter, to access relevant information, and to take appropriate remedial action when necessary. This is appropriate and necessary to ensure the effectiveness of the SSM. The experience of the EBA in 2011–12 suggests that the objectives of the SSM cannot be attained if the main supervisory authority, and specifically the licensing authority, remains at the member state level. Furthermore, the proposal makes appropriate provisions to enable existing national supervisory bodies to carry out a significant share of the actual supervisory tasks and assessments, in an adequate relationship with the ECB so that the ECB retains ultimate authority. The conditions for such decentralization of tasks should be left flexible, as it is likely that its scope will vary over time and across member states. There is no reason to expect the ECB to always reach the same level of trust in its relationship with respective national supervisory authorities—if only because the respective powers, mandates, and resources of these authorities currently vary widely from one member state to another.

One aspect in which the European Commission's text arguably requires revision, however, relates to macro-prudential policy instruments, including the ability to impose additional prudential buffers on banks with regard to national credit conditions. Article 4.1(e) of the Commission's proposal states that the ECB shall be "exclusively competent" to impose requirements such as countercyclical capital buffers "and any other measures aimed at addressing systemic or macro-prudential risks." While coordination by the ECB is certainly in order, further capacity for initiative by national authorities in this matter would be more consistent with the principles suggested by the European Systemic Risk Board (ESRB) in the context of the legislative discussion on capital requirements (ESRB 2012), and by the ECB itself in its opinion on the SSM regulation, which notes that "the national authorities should have sufficient tools at their disposal to address macro-prudential risks related to the particular situation of participating Member States" (ECB 2012).

Also, non-euro area member states participating in the SSM could be granted a higher degree of autonomy from the decisions of the central supervisor than euro area member states, to take into account interactions with their national monetary and fiscal policies, including the fact that they are not covered by the ESM. This could take the form of a safeguard clause that could be invoked, with due justification and an appropriate procedure, to limit the direct application of ECB decisions as currently set out in Article 6 of the proposal. Such a safeguard clause should be designed so that its triggering would be possible only under exceptional circumstances and with public disclosure of the corresponding motivations.

Banks Brought Under the SSM's Authority

The proposal includes all euro area-based banks and credit institutions within the SSM's scope of authority. This is consistent with the heads of state and government's stated aim "to break the vicious circle between banks and sovereigns." This aim cannot be attained if significant sections of individual member states' banking systems remain within a purely national policy framework, even if these sections are composed of small- or medium-sized banks. The ECB, for example, estimates that about 30 percent of total bank assets in the euro area are held by smaller banks (Draghi 2012b). Thus, the Commission's proposal on this aspect is based on a rigorous application of the principle of subsidiarity in accordance with the stated policy objective.

This aspect, however, is uniquely contentious in Germany. The primary reason is the strong opposition of German local banks, particularly the savings banks (*Sparkassen*) and also the cooperative banks (mainly *Volksbanken*) which, together with the public-sector Landesbanken which are part of the so-called Savings Bank Finance Group (*Sparkassen-Finanzgruppe*), add up to about half of the German banking system.[3] Given their local, decentralized activity and the presence of elected officials on their boards (for whom, among other factors, such board membership in many cases represents a not insignificant

3. James Wilson, Gerrit Wiesmann and Alex Barker, "Germany's small banks fight shake-up," *Financial Times*, December 3, 2012.

share of their personal income), the *Sparkassen* in particular wield considerable influence in the German political community. Germany's federal finance Minister Wolfgang Schaeuble's remark that "it would be very difficult to get an approval by the German Parliament if you would leave the supervision for all the German banks to European banking supervision"[4] must be understood in this specific political context.

There is much irony in this situation. Unlike their ill-fated Spanish equivalents (known as *cajas*), the German *Sparkassen* rely on regional and national mechanisms of full mutual guarantees that mean that if one *Sparkasse* fails, it is not left to its own devices but is comprehensively bailed out by fellow *Sparkassen*. As a result, while the management of each *Sparkasse* is effectively decentralized at the local level, from a systemic risk perspective the entire *Sparkassen* system has to be seen as one very large financial institution that is arguably of systemic importance not only for Germany but also for the entire euro area. Nevertheless, given Germany's central political position in this as in all other euro area negotiations, it is likely that a compromise will need to be found on this issue to accommodate German domestic constraints—even as no other member state appears to display an interest in small-bank exemptions that would come close to the German insistence on this issue.

Governance, Accountability, and Independence

One lesson from the EBA experience is that governance arrangements matter a great deal to the success of a newly established supervisory authority at the European level. In this area, the Commission's initial proposal leaves ample scope for improvement.

Part of the debate is about the relationship between the SSM and the ECB. On the one hand, the ECB is widely viewed as a strong and credible institution, and it is understandable that this credibility should be leveraged to the benefit of the new SSM. Furthermore, there are multiple connections between monetary policy and supervisory policy, not least in the operation of the ECB's lender-of-last-resort function to the euro area banking system as illustrated in 2012 by the three-year Long-Term Refinancing Operations (LTRO) program. These factors have certainly contributed to the choice of Article 127(6) as legal basis for the creation of the SSM. On the other hand, supervision can involve individual decisions with high political impact and its medium-term compatibility with an independent conduct of monetary policy is open to question. This would suggest that the European supervisor may need some autonomy from the ECB, and more direct accountability to political authorities at the EU level than the ECB itself. The question of whether to separate banking supervision from monetary policy is old and unresolved (e.g., Goodhart and Schoenmaker 1995), and it has an additional twist in the European case because of the lack of strong political institutions at the EU level (Véron 2012). On October 18, the European Council acknowledged "a need to ensure a clear separation between ECB monetary policy and supervision functions" (European Council 2012). An optimal response to all these considerations requires careful fine-tuning and institutional creativity.

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A useful guiding vision could be to consider the medium-term relationship between the ECB and the SSM along the lines of that between the Bank for International Settlements (BIS) and the Financial Stability Board (FSB) in Basel, even though the organizations have a very different set of institutional constraints and responsibilities. The BIS hosts and finances the FSB but there is considerable autonomy, and the more political nature of the FSB does not encroach on the independence of the BIS. Partly for reasons of expediency, the FSB started operations without an autonomous legal personality or independent funding, but there is now a process to gradually modify these features. Similarly, and especially in a context of possible future treaty changes, in a medium-term perspective the ECB could be considered the incubator of a European supervisory function that may gradually gain autonomy.

At the present stage, the following improvements may be considered.

First, the supervisory function within the ECB could be given a specific name (say, "European Banking Supervisor"), which would clearly mark its separation from the rest of the ECB's activities.

4. James Kanter, "European Finance Ministers Deadlock on Plan to Oversee Banks," *New York Times*, December 4, 2012.

Second, the decision-making structure should be adjusted to ensure a high quality of the supervisory process. In the Commission's proposal, the key decision-making body is a Supervisory Board[5] composed of four ECB representatives and one representative of each national supervisory authority (thus 21 members if no non-euro area member state is included). It is doubtful that such a large body, the overwhelming majority of which would be composed of representatives of specific national viewpoints, would be able to make quick supervisory decisions in the best common interest of all participating European countries, as should be the aim of the SSM.

There would be a strong case for replacing this Supervisory Board with a two-tier structure: a compact SSM Executive Board, comprising somewhere between five and nine members to make effective supervisory decisions affecting individual credit institutions in the European interest; and a larger Prudential Council of representatives of national supervisors, including those of non-euro area member states participating in the SSM, voting either on the basis of one vote per country or on a weighting similar to that used in European qualified-majority voting decisions.[6] The Prudential Council would exercise oversight over the action of the SSM Executive Board on individual cases, and decide on broader matters of policy, such as the positions recommended by the ECB in the elaboration of binding technical standards at the EBA.[7]

Such a two-tiered setup would ensure the indispensable effectiveness of individual supervisory decisions that should not be held up by diplomatic balances, while safeguarding the interests and engagement of all participating member states in setting supervisory policy. In turn, both the SSM Executive Board and the Prudential Council would be adequately subjected to the ultimate authority of the ECB's Governing Council, as is currently being envisaged for the Supervisory Board.

Third, the appointment process for the members of the SSM Executive Board (or in the currently envisaged setup, the four non-national members of the Supervisory Board) should be made more akin to that of the members of the ECB's own Executive Board, i.e., appointment by the European Council after consultation of (or preferably, approval by) the European Parliament. Even so, it would be desirable to keep the Commission's suggestion that the Chair should be one of the ECB's Executive Board members, to preserve the need for consistency of action within the ECB.[8] However, in this case it is not indispensable that the Vice Chair should be a central banker selected by and from the ECB's Governing Council (Article 19.2 in the Commission's proposal). Removing this condition would enlarge the pool of qualified candidates, and it could possibly include candidates from the private sector.[9]

Fourth, the possible length of tenure of the Board's members, including its Chair, should be extended from the Commission's proposed maximum of five years nonrenewable (Article 19.7), which appears exceedingly short and not in line with international good practice.

REFORM OF THE EUROPEAN BANKING AUTHORITY

The consolidation of the supervisory frameworks of at least 17 member states under the authority of the ECB is bound to have a disruptive impact on the fledgling institutional balance of the EBA and justifies an immediate reform of its governance. However, it is unlikely that fully consistent responses to the corresponding institutional challenges can be found in the current phase of reform given the lingering uncertainty about major elements of Europe's future banking policy framework. Therefore, it appears reasonable at this stage to adopt incremental, ad hoc adjustments that keep the functioning of the EBA viable if not optimal in the immediate future, and to delay any more fundamental changes to the 2014 review of the three European Supervisory Authorities (including the EBA), which is inscribed in the legislation that established these authorities. This is broadly the approach adopted in the Commission's proposal of a new EBA regulation, but it can be further improved.

Even under this stopgap approach, the Commission does not appear to have gone far enough to address the legitimate concerns of member states that would not participate in the Single Supervisory Mechanism. In principle, authorities of SSM member states that vote in the EBA's Board of Supervisors may retain their autonomy, but in practice, it is likely that coordination will be sought so that their votes

5. This choice of vocabulary is confusing, as "supervisory board," in many European countries including France, Germany, the Netherlands, and others, suggests a board that supervises a more executive "management board," but in this case "supervisory" is intended to refer to an executive responsibility for prudential bank supervision. "Prudential board" would have been a less ambiguous wording.

6. If non-euro area participating member states were to be granted a safeguard clause as suggested above, a logical quid pro quo may be to reduce their voting weight, say by half, in the prudential council's voting formula.

7. A comparable setup with an Executive Board of nine members is proposed in Carmassi, Di Noia, and Micossi (2012).

8. Recent media reports suggest that this should not be taken for granted, e.g., Rebecca Christie and Jim Brunsden, "EU Finance Chief to Meet Next Week as Banking Talks Bog Down," *Bloomberg News*, December 4, 2012.

9. It would also help introduce some degree of gender balance, as the current Governing Council is an all-male body, and only two of 17 euro area national supervisors are female (in France and Slovenia).

are in line with policies adopted by the SSM as a whole. In particular, according to the proposal, it will be very difficult for non-euro area member states to oppose a position that would be shared by all SSM member states (even assuming that the geographical perimeter of the SSM is limited to the current euro area) in a decision made by qualified majority voting (QMV).

One way to overcome this obstacle would be to subject such decisions, including the approval of binding technical standards, to a higher threshold of majority than the usual EU QMV formula (say 300 instead of the current 255 out of a total 345 voting weights). Other similar further adjustments may be in order in other areas of the EBA's activity, including decisions on binding mediation, actions in emergency situations, and appointment decisions. All things equal, such adjustments may make it more difficult to reach the voting threshold and thus may have a negative impact on the quality of EBA decision making, but this may be seen as an inevitable consequence of the creation of the SSM, at least until the 2014 review.

OTHER EU LEGISLATION CURRENTLY UNDER CONSIDERATION

In a communication titled *A Roadmap towards a Banking Union,* published simultaneously with its proposals for the SSM regulation and the EBA regulation, the European Commission links the establishment of the SSM and EBA reform to the adoption "before the end of 2012" of three additional pieces of legislation, namely on capital requirements (proposal of July 2011), deposit guarantee schemes (proposal of July 2010), and recovery and resolution tools for banks in crisis (proposal of June 2012). It also indicates that "the Commission envisages notably making a proposal for a single resolution mechanism which would govern the resolution of banks and coordinate in particular the application of resolution tools to banks within the banking union." Furthermore, the conclusions of the High-Level Expert Group on possible reforms to the structure of the EU banking sector, chaired by Bank of Finland Governor Erkki Liikanen, were published shortly afterwards and are intended to give rise to additional legislative projects (Liikanen 2012). These various legislative processes, however, should be considered with different degrees of urgency.

A natural sequence would be to prioritize the legislation on capital requirements, not least because of the internationally agreed deadline of January 2013 for the start of implementation of the Basel III Accord. This deadline now appears unlikely to be met by several important members of the Basel Committee on Banking Supervision, including the United States. But an adoption of the so-called Fourth Capital Requirements Directive (CRD4) and Capital Requirements Regulation (CRR), with content that would remove the elements of material noncompliance with Basel III (BCBS 2012), is highly desirable in the first quarter of 2013.

The other draft texts are less urgent, and it would be natural to envisage their reconsideration in the new context created by the prospect of a European banking union. Specifically, the issue of recovery and resolution tools could be examined together with the Commission's future proposal on a single resolution mechanism, which is expected to be published in the course of 2013. Similarly, the reform of deposit guarantee schemes may be voted on in a form that keeps only the less controversial provisions, or alternatively may be delayed until a clarification of how the issue of deposit insurance is to be addressed on a supranational basis in the future banking union framework. Such rescheduling of course would be without prejudice of the possible adoption of legislation on special resolution regimes and/or reform of deposit insurance systems in individual member states, which may be imposed by circumstances on an emergency basis, and for which the above mentioned EU legislative proposals may provide a source of inspiration if not a binding framework.

As with regards to the Liikanen Report and the issue of banking structures, it would appear logical to delay the corresponding debate until after the key features of Europe's permanent banking union have been decided, which is unlikely to be before 2014 at the very earliest. This is because the regulation of banking structures is an issue that is very important but not urgent, and is highly dependent on the features of the banking market that is considered for regulation—in other terms, there is no global one-size-fits-all solution for this policy challenge, and whether it applies to the addition of 27 national banking systems or to an integrated European one would lead to fundamentally different choices. The Liikanen Report itself is a timely and valuable contribution to the European policy reflection, but the European Union would be ill-advised to seek to implement it into legislation before having first decided on the structures of its own supervisory and resolution system.

CONCLUSION

It is to be hoped that a workable compromise for the initial establishment of the SSM based on Article 127(6) and corresponding EBA reform can be reached in the next few weeks. The establishment of the Single Supervisory Mechanism is only one step on a longer path towards European banking union, which itself cannot be considered in isolation from the challenges of fiscal union and political union. Losing the current momentum for the completion of this early step would be unfortunate, not only in itself but because it would reinforce the current doubts of the European public and global investors about the very ability of European leaders to make effective decisions. The June 29 statement contains a promise of supervisory integration and centralized bank crisis management. Europe's leaders now need to deliver on this promise if they are to maintain, or regain, the trust of their constituents.

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