

**ASSESSING THE SINGLE SUPERVISORY MECHANISM:  
PASSING THE POINT OF NO RETURN FOR EUROPE'S  
BANKING UNION**



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**ASSESSING THE SINGLE SUPERVISORY  
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FOR EUROPE'S BANKING UNION**

STIJN VERHELST



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## LIST OF ABBREVIATIONS

CEBS	Committee of European Banking Supervisors
EBA	European Banking Authority
ECB	European Central Bank
EFSF	European Financial Stability Facility
ESFS	European System of Financial Supervisors
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
GDP	Gross Domestic Product
FSB	Financial Stability Board
IMF	International Monetary Fund
QMV	Qualified Majority Voting
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
SSM-country	Country participating in the Single Supervisory Mechanism
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union



## EXECUTIVE SUMMARY

Europe's financial and sovereign debt crises have become increasingly interconnected. In order to break the negative feedback loop between the two, the EU has decided to create a **common supervisory framework for the banking sector: the Single Supervisory Mechanism (SSM)**. The SSM will involve a supervisory system including both the national supervisors and the European Central Bank (ECB). By endowing the ECB with supervisory authority over a major part of the European banking sector, the SSM's creation will result in a shake-up of the way in which the European financial sector is being supervised. Under the right circumstances, this could be a major step forward in addressing Europe's interconnected crises.

While the creation of the SSM makes for a crucial change, it is important to understand the **limits** of its supervisory scope. First of all, it will not cover all EU Member States: while participation is mandatory for the eurozone countries, the other Member States have the option to join or not. Secondly, the SSM only deals with bank supervision. Supervision of the rest of the financial sector (e.g. insurance firms) remains a national competence. Finally, certain aspects of bank supervision that are not deemed essential for financial stability (e.g. consumer protection) remain the sole prerogative of national supervisors.

A **division of labour** has been established **inside the SSM**: the ECB is endowed with final supervisory authority and national supervisors are to play a supporting role. In practice, banks deemed "significant" will be supervised directly by the ECB. A bank's significance is to be determined on the basis of its size, its relative importance in the Member State in which it operates and/or its cross-border operations. In normal circumstances, all banks that are not seen as "significant" (i.e. the vast majority of banks) will be supervised by national supervisors – while the ECB will still have the final supervisory say. Establishing an effective working relation between the ECB and the national supervisors will be challenging and, if not properly managed, risks becoming the weak link in the Banking Union.

A Supervisory Board, mostly composed of the national supervisors, is to draft the ECB's **supervisory decisions**. Subsequent formal decisions are made by the ECB's ultimate decision-making body: the Governing Council. Under the European Treaties, non-eurozone countries do not have the right to vote in the ECB's Governing Council, and in return are not bound by its decisions. As a consequence, non-eurozone countries cannot become *full* members of the SSM, in the sense of having the same rights and obligations as eurozone SSM members. Nonetheless, it seems that the legislators have accommodated for non-eurozone membership of the SSM as much as was legally feasible. In fact, participation in the SSM even risks being overly noncommittal for non-eurozone countries.

A strict administrative **separation** between the ECB's **supervisory and monetary tasks** has been foreseen to protect the ECB's reputation with regard to monetary policy. However, the monetary and supervisory decision-making processes are only partially separated. As a consequence, no genuine "*Chinese Wall*" has been raised between these two tasks: policy concerns in one field will unavoidably have an influence on the ECB's other tasks. This should not be seen as strictly negative. Monetary and supervisory policies need to take each other into account, which calls for some coordination between the two. The main risk for the ECB is therefore not the possible entanglement of supervisory and monetary responsibilities, but the potential reputational damage when inevitable supervisory mistakes occur. This risk is unavoidable – in spite of any attempt to separate responsibilities.

In contrast to the limited **accountability** for its monetary responsibilities, the ECB will have to explain and defend its supervisory policy choices in the Council and the European Parliament. Such accountability will require a different mind-set in the ECB. While this does not have to affect the ECB's independence, it is clear that there is a fine line between holding the institution accountable and attempting to steer its future decisions.

Overall, the SSM's organisational structure reveals the challenge in balancing **legal limits** and political needs. The legal limits have resulted in a sub-optimal design of the SSM. However, it does not appear warranted to proceed to a Treaty revision solely for the sake of the SSM. If a Treaty revision would occur in the future for other reasons, however, legislators should grasp the opportunity to revise those Treaty provisions that impede a better design of the SSM.

The SSM will have an **impact well beyond its borders**, as it will modify the practical functioning of European and international supervisors. Most importantly, the SSM has led to the redrawing of decision-making rules in the European Banking Authority (EBA), the pan-EU supervisory authority. Major decisions in the EBA will require a majority from both the SSM-countries and the Member States outside the SSM. The difficulty of finding a right balance in the EU level supervisory bodies' decision-making reveals the potential tension between supervisory integration in the SSM and the EU-wide single market.

The SSM is an important **first pillar of a future European Banking Union** that aims to improve financial stability. Yet, the SSM in itself is not sufficient to achieve this goal. An effective Banking Union requires several additional pillars: (i) a strategy for current banking problems, (ii) common management of future bank crises, (iii) a form of common deposit guarantee and (iv) far-reaching harmonisation of banking sector rules. If these other pillars are put in place only partially, the Banking Union will remain inherently unstable – as will the European financial sector. The creation of the SSM therefore constitutes a point of

no return for the EU, at least if it wants to have a safe financial sector. The only feasible option left to policymakers, because of the SSM, is the completion of an ambitious Banking Union.

Making the SSM effective will require substantial efforts, as will agreeing on and implementing the Banking Union's other pillars. The envisaged roadmap towards the Banking Union is both overly ambitious (as the deadlines will most likely not be met) and incomplete (as the fate of a common deposit guarantee remains unsure). Yet, Europe will have to persist if it is to reach the Banking Union's **ultimate goal**: a safe banking sector at the service of the European economy and its citizens.



## INTRODUCTION

The financial crisis and its aftermath have hit Europe in its core. While the crisis may not have originated in the European Union, it has laid bare structural weaknesses in the EU's policy framework. Both public finances and the banking sector have been heavily affected. For a long time, the EU failed to take into account sufficiently the perverse link that existed between the two. Negative evolutions in one field of the crisis often dragged along the other in its downward spiral.

In June 2012, in the early hours of a yet another EU Summit, the leaders of the eurozone finally decided to address the link between the banking and sovereign debt crises. Faced with soaring public borrowing costs in Spain and Italy, they decided to allow for the direct European recapitalisation of banks when the Member State itself would no longer be in a position to do so. In exchange, supervision of the banking sector would be lifted to the European level by means of a "Single Supervisory Mechanism", or SSM in the EU jargon.

In March 2013, the European Parliament and the Council informally agreed on the design of the SSM. Once formally approved, the SSM is to become operational in mid-2014. It will group the eurozone countries, as well as some other Member States that agree to participate. Inside the SSM, the European Central Bank (ECB) will become the lead supervisor for the banking sector, with national supervisors essentially in an assisting role only.

The SSM is to be a first step in the broader revision of public control on the European banking sector. The eventual goal is the creation of a Banking Union, which is to carry out effective surveillance and – if needed – crisis management of the banking sector. To achieve this, the EU will have to take a number of vital additional steps. Achieving a genuine Banking Union will not be easy. Yet, as this paper argues, the creation of the SSM makes the completion of the Banking Union indispensable.

Given the importance of the SSM as a point of no return for the Banking Union, this paper provides an analysis of the SSM and its role in the wider creation of the Banking Union. The paper starts with a reminder of why the EU decided to put in place the SSM (§ 1). Subsequently, the supervisory responsibilities of the SSM are detailed, including its scope and the division of labour between the national supervisors and the ECB (§ 2). The internal functioning of the SSM (§ 3) and its relation to the other supervisors (§ 4) are discussed afterwards.

The paper subsequently sheds light on the other building blocks of the Banking Union, arguing that they are essential to the success of the project (§ 5). The

transition towards the Banking Union will prove to be a bumpy ride. Before formulating a number of conclusions, this Egmont Paper therefore provides an overview of the planned road ahead (§ 6).

Stijn VERHELST<sup>1</sup>

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1. The author is Senior Research Fellow at EGMONT – The Royal Institute for International Relations. This Egmont Paper builds on a previous European Affairs Working Paper.

# 1. THE NEED FOR A SINGLE SUPERVISORY MECHANISM

While there are sound long-term arguments for creating a European supervisor (better cross-border supervision, less national biases, etc.), the creation of the SSM is clearly linked to the ongoing crisis. The hope is that the SSM, as part of the move towards a Banking Union, can lessen the short-term problems experienced in Europe. The main aim is to break the “*vicious circle*” between the bank and sovereign debt crises. Indeed, this link has been evident on several occasions during the crisis.

On the one side, the problems in the banking sector have had severe repercussions on public finances. Problems in the banking sector brought along an economic crisis, which led to high deficits. In addition, the weakened banks bought fewer government bonds of those countries whose solvability was put into question (e.g. Greece, Ireland, Portugal and Spain). To make matters worse, several governments had to use public money to prevent banks collapsing in a disorderly fashion. In the cases of Ireland and Spain, the government was not able to provide the money for such interventions. These countries had to request European assistance as a result of the link between the crisis in their public finances and the financial crisis.

Problems in public finances, on the other side, also had a negative impact on the banking sector. Governments’ measures to reduce their deficits hit economic growth, which in turn hit the already weakened profitability of banks. Furthermore, as some countries’ capacity to reimburse their debts was questioned, the market value of such debt decreased. Banks saw the value of their financial buffers diminish as a consequence. In the case of Greece, it was not only the market value that decreased. The Greek public debt “*haircut*” led to heavy immediate losses for the banks.

For the banks in countries that were perceived as potentially insolvent, an additional problem arose. As investors doubted whether these countries would be able to rescue a bank, the perceived solvability of the banks located in their territories deteriorated as well. This resulted in higher interest rates charged to these banks as they borrowed to finance their functioning. This in turn caused a vicious circle in which the solvency of the country was questioned even more, resulting in even higher public borrowing costs and, as a consequence, higher borrowing costs for banks.<sup>2</sup>

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2. ELLIOTT, D., 2012, Key Issues on European Banking Union: Trade-Offs and some Recommendations. Brookings, Global Economy & Development, Working Paper 52; and ECB, 2012, Financial Stability Review.

Eurozone leaders sought to stop this self-reinforcing negative feedback loop by more direct EU-level intervention in the banking sector. First of all, common European supervision was to remove fears of investors and fellow Member States that national supervisors were not being honest about the scale of the problems in their banking sectors. Secondly, the possibility of direct European recapitalisation of banks would improve the perceived solvency of the Member States themselves.

There are indeed reasons to believe that European supervision will be of higher quality than supervision on the national level. National supervision was simply increasingly out of line with the reality of a transnational industry.<sup>3</sup> Yet, it is not a certainty that having a European supervisor by itself will lead to better supervision. The European supervisor will face its own set of challenges.<sup>4</sup> Therefore, beyond the level at which it is carried out, the quality of supervision is pivotal. For this reason, the design of the SSM is of essential importance.

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3. BONNEAU, T., 2012, *Mécanisme de surveillance unique et Union bancaire*. In: *La Semaine juridique entreprise et affaires*, v. 86, n. 43.

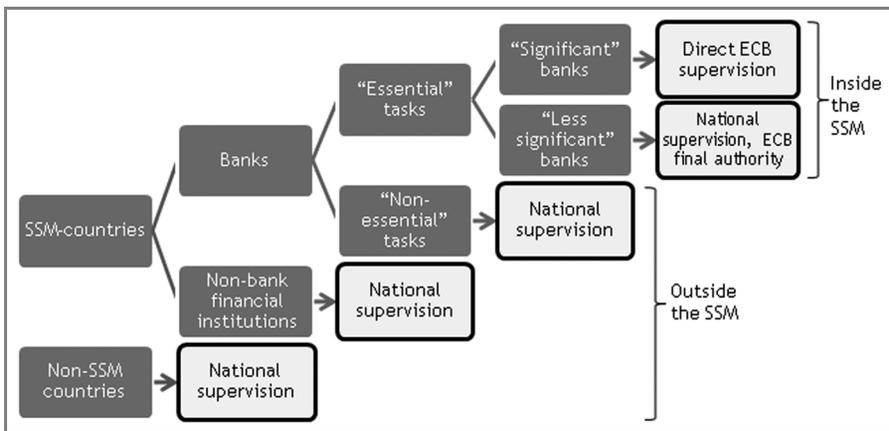
4. ALLEN, F., CARLETTI, E. & GIMBER, A., 2012, *The Financial Implications of a Banking Union*. In: BECK, T. (ed.), *Banking Union for Europe: Risks and Challenges*. Centre for Economic and Policy Research.

## 2. THE SSM’S SUPERVISORY COMPETENCES

Supervision of the financial sector has traditionally been a national competence, with only limited cross-border cooperation taking place.<sup>5</sup> The SSM will change this approach by lifting a major part of supervisory responsibilities to the European level. These responsibilities will be given to the ECB, which will at once become the most important financial supervisor in Europe.

However, the SSM will not lift all financial supervisory tasks to the European level. It is therefore important to understand which elements of financial sector supervision fall outside the scope of the SSM (2.1). Furthermore, inside the SSM there will be a division of labour between the national and the European level, leaving a substantial part of the supervisory tasks at the national level – although the European level will exert final control (2.2). Figure 1 provides an overview of future financial supervision in the EU and the role of the SSM in this framework, as will be discussed below.

Figure 1: The place of the SSM in the EU’s financial supervision landscape



### 2.1. Limits to the scope of the SSM’s competences

The scope of the SSM’s supervisory competences is essentially limited in three ways: (i) geographically, (ii) its coverage of the financial sector, and (iii) the tasks it executes. Each of these limits is discussed below.

5. For an overview of the situation after the last reform of EU supervision, see: VERHELST, S., 2011, Renewed Financial Supervision in Europe – Final or transitory? Egmont Paper 44.

### 2.1.1. *Only participating Member States*

The SSM will not become the supervisor for the entire EU. It will encompass only a part of the EU Member States. Its precise scope remains unclear, however, as that depends on the willingness of Member States to join the new project.

Member States inside the eurozone simply do not have a choice. For them, membership of the SSM is obligatory. This modifies the nature of eurozone membership, which now involves not only an Economic Union and a Monetary Union, but also a Banking Union. In the past, economists had already pointed to the fact that the financial sector was closely linked to the currency union and thus benefited from a common approach.<sup>6</sup>

In contrast to the Member States that share the single currency, Member States outside the eurozone are free to join the SSM. This differentiation between eurozone and non-eurozone countries is due to both a lack of political will in some non-eurozone countries to join the SSM, and legal constraints that limit the voice of non-eurozone countries in the ECB (see 3.2). It is not yet clear which non-eurozone Member States will join the SSM. Some of them have made it clear that they will not join the SSM – notably the UK and Sweden. Other countries have shown willingness and have an interest in joining the SSM.

Different scenarios of SSM membership are conceivable. In an inclusive scenario, participation in the SSM could reach 24 or 25 Member States. In a more selective scenario, the eurozone countries and perhaps one or two other Member States would be part of the SSM. The latter would limit the number of participating Member States (hereinafter SSM-countries) to 20 at most. Even in such a selective scenario, the SSM encompasses a large majority of the EU's Member States.

### 2.1.2. *Only banks*

As a second element limiting its scope, the SSM will not cover the financial sector at large. It will deal with only a part of the sector, i.e. credit institutions (and, where relevant, their parent companies). A credit institution is defined by EU legislation as: “*an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account*”.<sup>7</sup> In this paper, the term “bank” is used for all credit institutions that meet this definition.

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6. See for example: BEGG, D., DE GRAUWE, P. (et al.), 1998, The ECB: Safe at Any Speed? Monitoring the European Central Bank. Centre for Economic and Policy Research.

7. See Art 4(1) of Directive 2006/48/EC. Credit institutions also include “electronic money institutions”.

The EU definition of banks covers only part of the financial sector. It notably does not include investment firms. Such firms are active parts of the financial sector. Yet, as they do not receive deposits from the public they are not defined as banks by European law. In contrast, some Member States, e.g. France, do define investment firms as banks. For the SSM, however, only the European definition is relevant.

Numerous other types of financial institutions also fall outside the scope of the EU's definition of a bank. This includes: insurance firms, hedge funds, pensions funds, central counterparties for securities and derivatives, brokers-dealers and asset managers. These types of financial institutions will hence continue to be supervised at the national level.

At one point some prominent EU policymakers tried to enlarge the Banking Union discussion a discussion on a “Financial Union”, which would encompass a larger part of the financial sector.<sup>8</sup> Despite these attempts the project has remained focused on the banking sector in narrow terms. This will result in some odd situations. The insurance arm of a financial institution will be supervised at the national level, while the banking arm of the same institution will be supervised as part of the SSM. In order to function properly, this differentiation will require close supervisory cooperation between the different supervisory levels.

### 2.1.3. “Non-essential” supervisory tasks remain national

The SSM Regulation endows the ECB with specific supervisory competences only (see *infra*). As a consequence, the national supervisors continue to carry out all supervisory functions that are not transferred to the ECB. These tasks can be seen as “non-essential”, in the sense of being not strictly necessary to ensure the stability of the financial sector.

These “non-essential” tasks include, *inter alia*, the following<sup>9</sup>:

- **Supervising banks based in countries outside the EU not having a separate legal entity in the country**, i.e. operating in the Member State by cross-border activity or by a branch. This seems the main exception to the SSM's competences in supervising banks. It implies that non-EU banks would be super-

8. See VAN ROMPUY, H., 2012, Towards a Genuine Economic and Monetary Union. 26 June 2012; and BARNIER, M., 2012, Towards a European financial union and a more solid European banking sector. Speech at the Peterson Institute for International Economics, Washington DC, 12 July.

9. See Recital 22 of COUNCIL OF THE EU, 2013, Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions – Final compromise text, Document No. 7776/13, 25 March (hereinafter: “*March 2013 SSM Agreement*”). The Recital also mentions day-to-day supervision as a competence that should remain at the national level. Yet, it seems that national supervisors will in some cases carry out these functions on behalf of the ECB – the latter thus having financial supervisory authority in the matter.

vised nationally, despite the problems they might provoke. For most citizens it is difficult to distinguish between non-EU banks having a separate legal entity in the country and non-EU banks that do not. As the Icelandic bank Icesave has shown, the risks associated are far from being theoretical.<sup>10</sup>

- **Verifying a bank that seeks to set up a separate legal entity** (i.e. establish itself) in the Member State. This serves to verify whether the bank meets the relevant national legislation. Afterwards, the ECB can still decide not to give an authorisation to a bank (see *infra*).
- Supervision of banks in relation to **markets in financial instruments** (investment services).<sup>11</sup> The supervision of markets in financial instruments is seen as different from the surveillance of banks' operations as such by EU lawmakers. Thus, this competence is left at the national level.
- **Macro-prudential powers.** If financial stability is believed to be at risk, the national supervisor can impose higher capital buffers on their banks. The ECB has similar powers. The fact that both the national supervisor and the ECB can impose capital buffers independently of each other does not necessarily need to be problematic. Yet, it clouds supervisory responsibilities. Which supervisor will/should be blamed if capital buffers are not increased when this ought to be the case?
- Prevention of **money laundering and terrorist financing.**
- **Consumer protection.**

These last two tasks can be seen as linked to financial supervision for safeguarding financial stability, but not essential to it. In any case, it requires other supervisory competences than the competences needed to monitor financial stability. The SSM regulation therefore leaves these competences on the national level.

## 2.2. Supervision in the SSM

Within the limits outlined above, the ECB will become the responsible supervisor for the banking sector. As mentioned, the ECB's supervisory tasks are limited to those expressly mentioned in the SSM Regulation – nonetheless resulting in a vast set of tasks (2.2.1). However, the ECB will not carry out all of these supervisory functions itself. It will only supervise those banks directly which are deemed “significant” (2.2.2). For the banks thought to be “less significant”, supervision will be delegated to the national supervisors – while the ECB retains final supervisory authority (2.2.3).

10. See for example: IMF, 2012, Iceland: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-by Arrangement. IMF Country Report No. 12/91, April.

11. See MiFID, Directive 2004/39/EC; and the Commission Proposals COM(2011) 652 and COM(2011) 656.

### 2.2.1. *The SSM's supervisory tasks*

The European Treaties allow conferring only specific supervisory tasks onto the ECB.<sup>12</sup> Therefore, the SSM Regulation defines a precise list of supervisory tasks that are to be carried out by the ECB. The list mentioned in the Regulation is extensive and concerns the essential components of bank supervision. The ECB's tasks notably cover:

- Supervision of **compliance with EU law**, including national law that transposes EU legislation. This constitutes the core of bank supervision. It notably includes monitoring the liquidity and solvency (i.e. the financial health) of banks.
- Carrying out “**host supervision**” of banks operating in the SSM, but established in an EU Member State that does not participate in the SSM. The role of a host supervisor is limited, and essentially concerns the supervision of liquidity provisions.
- Supervising the **governance arrangements** in banks. Since the financial crisis, corporate governance has become more important and EU law lies down certain requirements. The requirements cover a wide range of issues, including risk management, bonus policies and the selection of management staff.
- **Supervision on a consolidated basis** of (mixed) holding companies and complementary supervision of financial conglomerates. When a bank is part of a larger structure, especially one involved in other financial sectors, the ECB is to carry out supervision at the level of that larger structure in as far as this is relevant for bank supervision.
- **Preparing for crisis situations**. This includes periodic stress tests, supervision of recovery plans (living wills) and carrying out early crisis intervention if needed (see 5.2). By endowing the ECB with early intervention powers, the legislators interpret the Treaty rules broadly. The Treaty Article used for the SSM Regulation allows endowing the ECB with prudential supervisory tasks, not crisis management. Early intervention is situated on the borderline between supervision and crisis management. The ECB is thus not allowed to venture much further into crisis management, at least not on the basis of the Treaty Article used for supervision.
- **Authorising banks and withdrawing bank authorisations**. Banks that request an authorisation to operate in the SSM will require the authorisation of both the national supervisor (see supra) and the ECB. The ECB can withdraw a bank authorisation if it finds that a bank does not respect the EU rules. Withdrawing a bank authorisation is an essential competence for a supervisor, as it constitutes a last resort sanction rendering the supervisor credible. Revoking a bank's authorisation implies the resolution of the bank, which can be

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12. Article 127(6) TFEU.

costly. If bank resolution remains at the national level, this would result in disputes between the ECB and the Member State. Therefore, further steps in European crisis management and bank resolution are needed (5.2).

- **Macro-prudential powers.** The ECB's macro-prudential powers are similar to the national supervisors' powers in the matter (see supra).
- **Assessing mergers and acquisitions** of banks. Beyond the traditional rules of competition, specific assessments are performed for banks that merge or take over other banks (e.g. their financial soundness and reputation). The ECB will have the final say, although the national supervisor is to prepare the initial assessment.
- **Participation in supervisory colleges.** Supervisory colleges are to stimulate cross-border cooperation between supervisors. The ECB will gain a seat in these colleges (see 4.1).

The tasks mentioned above appear to cover the key tasks of bank supervisors.<sup>13</sup> Yet, problems may arise if the SSM-countries wish to endow the ECB with additional supervisory competences after the SSM Regulation has been adopted. Endowing the SSM with further competences is possible only if all EU Member States (including the non-SSM countries) agree to it. This is a cumbersome procedure, hampering the SSM's ability to adapt to changed circumstances. Yet, it is unavoidable in the current legal setting.<sup>14</sup>

### 2.2.2. “Significant” banks: direct supervision by the ECB

Determining whether or not a bank is “significant” is inherently a subjective matter. Even so, it is of the utmost importance in the division of labour between the ECB and the national supervisors. Only those banks that are believed to be “significant” will be supervised directly by the ECB. The Regulation sets out 5 criteria to determine whether a bank is deemed “significant”. If a bank meets one of the following criteria, it will be supervised directly by the ECB:

1. **The value of a bank's assets exceeds € 30 billion.** This first criterion is to ensure that the largest banks in the SSM-countries are supervised directly by the ECB.
2. **The value of a bank's assets exceeds both € 5 billion and 20% of the GDP of the Member State in which it is located.** Due to the 20% of GDP requirement, this criterion only applies to SSM-countries with a GDP of less than € 150 billion.<sup>15</sup> In the eurozone, these smaller SSM-countries are: Cyprus,

13. WYMEERSCH, E., 2012, The European Banking Union, a First Analysis. Ghent University, Financial Law Institute, Working Paper 2012-07.

14. Competences would have to be transferred to the ECB using the same article on which the SSM is based, i.e. Article 127(6)TFEU, which requires unanimity.

15. For countries with a GDP level that exceeds 150 billion, 20% of GDP exceeds € 30 billion. Banks in those countries would already be covered by the € 30 billion criterion.

Estonia, Luxembourg, Malta, Slovakia and Slovenia. The criterion would be relevant for most non-eurozone countries that join the SSM, with the exception of the two largest non-eurozone economies, i.e. Poland and the Czech Republic. The “at least € 5 billion” requirement excludes the smallest banks of the smallest Member States (in the eurozone: Cyprus, Estonia and Malta), which are believed not to be of systemic importance.<sup>16</sup>

3. A bank is among **the three most significant banks** in the country in which it is located. The criterion “significant” is not defined in the Regulation. While the value of assets and cross-border activity seem the most relevant criteria, the precise criteria will have to be defined in more detail. This criterion does not apply when justified by “*particular circumstances*”, which most likely refers to the bank’s limited size.
4. **A bank has large cross-border activities.** In that case, the ECB can decide to supervise a bank centrally. The legislators have left it to the ECB to provide a precise methodology for this criterion.<sup>17</sup>
5. **A bank receives assistance from a eurozone bailout fund.** When direct financial assistance for a bank has been requested from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF), or when a bank already receives such assistance, that bank will automatically be put under ECB supervision. This criterion does not concern banks that receive indirect financial assistance by the EFSF/ESM via the Member State, as is the case for Spain and Cyprus.

These 5 criteria take into account different considerations. Criteria 1 and 4 focus on the importance of a bank on the European level, while criteria 2 and 3 refer to a bank’s relative importance to the SSM-country in which it is located. The final criterion is to be seen in light of the European taxpayers’ money that is at stake.

Beyond these specific criteria, the ECB can decide at any time to supervise a specific bank directly.<sup>18</sup> The possibility for the ECB to take charge of the supervision of a bank is a pivotal element in the credibility of the SSM. Without such a provision, the ECB would not be able to exercise its final supervisory authority. Yet, the ECB will have to dare to use its powers to claw back the delegation of supervision when it has doubts regarding a national supervisor’s actions. This will not be an easy choice as it will likely result in market unrest, but it is nonetheless essential to make the SSM function properly.

The ECB is expected to supervise only about 150 banks directly. While this is a fraction of the more than 6.000 banks in the eurozone, these banks represent

16. When a country’s GDP exceeds € 25 billion, 20% of its GDP is by definition more than € 5 billion.

17. Article 5(4) of March 2013 SSM Agreement

18. Article 5(5) of *ibid.*

approximately 80% of bank assets.<sup>19</sup> The annex provides a tentative overview of banks that will be supervised directly by the ECB.

A major question that remains unresolved is whether the thresholds will be periodically adjusted to inflation. As it stands, this is not foreseen. As a consequence, over time an increasing number of banks are likely to fall under direct ECB supervision.

### ***2.2.3. “Less significant” banks: national supervision on behalf of the ECB***

Banks that do not meet one of the 5 requirements mentioned above are labelled “less significant”. About 98% of banks in the eurozone fall under this definition. They continue to be supervised at the national level. While these banks represent only about a fifth of the banking sector in terms of assets, it is clear that most supervisory operations in the SSM will still be carried out nationally.<sup>20</sup>

As mentioned above, even for banks that are supervised on the national level, the ECB still has final supervisory responsibility within the framework of the SSM. This will require a good working relationship between the national supervisors and the ECB. It will be challenging for the ECB to monitor national supervisors effectively. Detailing reporting requirements is an essential part of this task, but is not in itself sufficient. The ECB will have to determine when and to what extent it interferes with national supervision. If not properly managed, its decentralised functioning could prove to be the SSM’s weak spot.<sup>21</sup>

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19. IMF, 2013, A Banking Union for the Euro Area.

20. Ibid.

21. BABIS, V. & FERRAN, E., 2013, The European Single Supervisory Mechanism. Working Paper, University of Cambridge.

### 3. THE SSM'S ORGANISATIONAL STRUCTURE

The SSM can only exercise its supervisory role adequately if the proper organisational provisions are in place. A major factor is the decision-making structure in the ECB with regard to supervisory matters, which needs to operate within the EU's legal limits (3.1). These legal limits also have an impact on the different nature of the non-eurozone countries' membership of the SSM compared to eurozone countries' membership (3.2). Choosing the ECB as the responsible supervisor furthermore called for special arrangements to prevent an entanglement of its supervisory and monetary tasks (3.3), and measures to ensure the ECB's accountability for its supervisory policy (3.4).

#### 3.1. Supervisory decision-making in the ECB

The EU Treaties provide clear rules on decision-making in the ECB. These rules, however, are designed with the ECB's monetary tasks in mind. As a result, only the eurozone countries have a say in ultimate decision-making. This, of course, conflicted with the desire to include non-eurozone countries in the SSM. In an effort to balance legal requirements and the need for as inclusive as possible decision-making, a procedure had to be devised that respects the Treaty's wording while nonetheless making non-eurozone SSM-countries quasi equal partners in decision-making.

##### 3.1.1. *The general procedure*

Decision-making on supervisory matters in the SSM centres around two ECB bodies: a) the Supervisory Board, mainly composed of national supervisors, and b) the Governing Council, the ECB's ultimate decision-making body.

Under the procedure that has been adopted, the Supervisory Board drafts the ECB's supervisory decisions. Subsequently, the decision is formally adopted by the Governing Council. A draft decision by the Supervisory Board is deemed adopted by the Governing Council, unless the latter objects to the draft decision within less than ten working days.<sup>22</sup> This procedure resembles the reversed qualified majority voting that is used for a number of economic governance decisions in the Council of Ministers.<sup>23</sup>

The Governing Council is hence the only body that can block a decision by the Supervisory Board. Yet, it will do so only very infrequently. Under normal cir-

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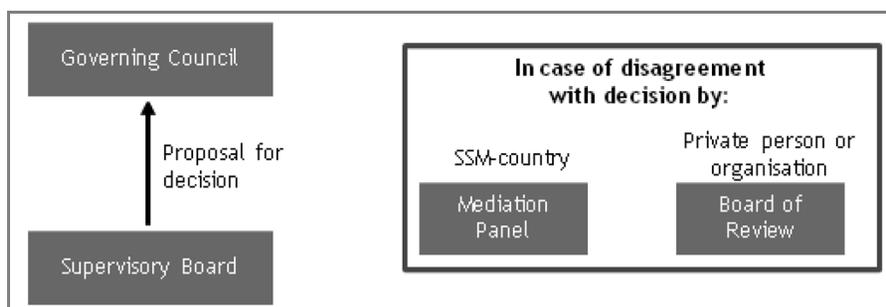
22. This can be less in case of particular urgency.

23. Under reversed qualified majority voting, the Commission make a proposal to the Council. That proposal is subsequently deemed adopted, unless the Council objects to that decision by a qualified majority within a limited timeframe (often ten working days).

cumstances, this makes the Supervisory Board the *de facto* decision-making body.

Besides the Supervisory Board and the Governing Council, two specific bodies deal with supervisory decision-making in the ECB: the Mediation Panel and the Board of Review. These two bodies only enter into play when a dispute arises on a supervisory decision. Figure 2 provides an overview of the four decision-making bodies. Their composition and functioning are discussed below.

Figure 2: Supervisory decision-making in the ECB



### 3.1.2. The bodies involved in decision-making

#### *Supervisory Board*

As mentioned above, the Supervisory Board is to act as the *de-facto* decision-making body. Providing the body with this role allows all SSM-countries to have a say in the supervisory decisions made by the ECB. The voting members of the supervisory board are:

- **The Chair.** The Chairperson is a full-time professional, thus not exercising other major functions on the national, European or international level. A future Chair is first proposed by the ECB and subsequently approved by the European Parliament and the Council.<sup>24</sup>
- **The Vice-chair.** The Vice-chair is selected from among the members of the ECB's Executive Board.<sup>25</sup> The election process is identical to that of the Chair, although the possible candidates are – evidently – more limited.
- **Four ECB Representatives.** These representatives are appointed by the ECB's Governing Council and are not allowed to perform functions linked to monetary policy.

24. In the SSM Regulation, the Council is given only a secondary role in the election process: it merely is to adopt a decision after the approval by the Parliament. However, given that the Council may decide not to adopt such a decision, the Parliament and the Council will in practice have to reach a consensus on any future Chair.

25. This will most likely be the Vice-President of the ECB Executive Board, Vítor Constâncio.

- A **representative of each SSM-country’s national supervisor**. The national supervisors constitute the bulk of the Supervisory Board’s voting members. If the central bank is not the national supervisor, the central bank may be present at meetings. In terms of voting, the two representatives of the same Member State would then be “considered as one member”. The precise meaning of the latter remains unsure. It could imply that each of the two representatives gets half the votes allocated to the country. It could also imply that the representatives have to vote in the same manner.

In addition to these members with voting rights, the European Commission acts as a non-voting observer in the Supervisory Board.

A rather complex voting system in the Supervisory Board has emerged from the legislative negotiations. In principle, decisions in the Supervisory Board are made by a simple majority of the members. In case such voting ends in a draw, the Chair’s vote is decisive.

ECB regulations that are adopted to apply Union law form are an exception to this general rule. These regulations adopted by the ECB will play an important role in streamlining supervisory practices. Such regulations are decided by qualified majority voting (QMV), giving more clout to the bigger Member States. In this case, each of the four ECB representatives will represent the median votes of the other members. The Regulation does not provide for voting rights for the Chair and Vice-chair in case of QMV. Until the end of 2015, however, both a simple majority and a qualified majority are needed to adopt ECB supervisory regulations.

### *Governing Council*

The Governing Council’s role in supervisory decisions will most often be limited, as it can only intervene to block a decision of the Supervisory Board. In exceptional cases, the Governing Council could make use of this possibility. This makes the composition and voting rights of the Governing Council most relevant.

The composition of the Governing Council is as follows:

- The governors of each of the **national central banks of the eurozone**.
- The members of the **ECB Executive Board**. The Executive Board is responsible for the ECB’s operational matters. It has six members (including the President and Vice-president of the ECB), all of whom are appointed by the eurozone Heads of State or Government.

Not all of the Member States and public bodies that are involved in bank supervision in the SSM are members of the Governing Council. First and foremost,

non-eurozone SSM-countries are not part of the Governing Council. In addition, in SSM-countries in which bank supervision is not carried out by the central bank, the national supervisors also do not figure among the Governing Council's members. Hence, these two categories do not have an automatic right to a seat at the table in meetings of the Governing Council. Yet, the ECB's rules of procedure allow inviting external persons for Governing Council meetings when this is deemed necessary.<sup>26</sup> As a result, the exclusiveness of the Governing Council is not to be seen in terms of presence at the meetings, but in respect of the right to vote.

The problem of voting rights in the Governing Council stretches beyond the lack of voting rights for non-eurozone members. As long as the eurozone does not exceed 18 member countries, each member of the Governing Council will have the right to vote. As each member of the Governing Council has one vote, voting powers are until then irrespective of the economic size or population of a Member State. Yet, when the eurozone will have more than 18 members, national central bank governors will have to alternate their voting rights. At any given time, only 15 central bank governors will have voting rights in the Governing Council. Therefore, not all eurozone countries will vote in the Governing Council. Bigger eurozone countries, in terms of GDP, will more frequently have voting rights than their smaller counterparts, which gives them a bigger say.<sup>27</sup>

While these arrangements have been designed for the ECB's monetary policy, the rotational system also applies to decisions with regard to supervisory decisions. Yet, these are not necessarily the best voting arrangements for decisions on supervisory matters. Changing the rules would, however, be most difficult as it would require a Treaty change.

### *Mediation Panel*

Legislators have taken into account the possibility that difference of opinion may arise between the Governing Council and the Supervisory Board. A specific procedure has therefore been foreseen if the Governing Council would block a decision that was proposed by the Supervisory Board. In that case, a national supervisor can appeal to the Mediation Panel. The Mediation Panel is mainly meant to solve disagreements on the impact of a decision on monetary policy. Nonetheless, it can also be consulted in case of other types of disagreement.

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26. Article 3 of the Rules of Procedure of the European Central Bank (Decision ECB/2004/2).

27. See Article 10.2 of Protocol No 4 of the TFEU on the Statute of the ESCB and the ECB. The ECB Statutes foresee a rotational system from the moment the eurozone has more than 15 members. The Statutes, however, also provide the possibility to postpone the rule until the eurozone has more than 18 members. This possibility was used by the ECB in 2008 (Decision ECB/2008/29). The Treaty does not allow for an exception once the eurozone has more than 18 members.

This panel comprises a member of each SSM-country, either the governor of the national central bank or a representative of the national supervisor. Each member of the Mediation Panel has one vote and decisions are made by simple majority. As all SSM-countries have a vote in the Mediation Panel, its composition is more similar to the Supervisory Board than it is to the Governing Council. As a result, it is rather probable that the Mediation Panel would object to a decision by the Governing Council if that decision does not correspond with the decision originally made in the Supervisory Board.

The role of the Mediation Panel is limited, as its decisions are in no way binding on the Governing Council. Nonetheless, a decision of the Mediation Panel is likely to have moral authority, making it difficult for the Governing Council not to take it into account.<sup>28</sup>

### *Board of Review*

A Board of Review is created for the contestation of a Governing Council decision by private and legal persons, including banks. This is to allow for a timely challenging of supervisory decisions, which are to limit the lengthy procedures before the European Court of Justice. The Board comprises five members, who must not be employed by the ECB or a national supervisor.

Any person to whom a supervisory decision is addressed may appeal to the Board, as well as any person who is directly and individually affected by such a decision. The Board subsequently casts a verdict on the matter at hand. It takes its decision by a majority vote (i.e. at least three members approve the verdict). After this verdict, the Supervisory Board re-examines the case. It subsequently submits a new draft decision to the Governing Council, for which the normal decision-making procedure applies. As for the Mediation Panel, the verdict of the Board of Review does not commit the ECB's decision-making bodies beyond its moral authority.

## **3.2. Non-eurozone membership of the SSM**

While the Treaty provides for a viable legal base for making the ECB the supervisor for the eurozone, it has proven legally more difficult to include non-eurozone countries in the ECB's supervisory scope. In a nutshell, the Treaty stipulates that non-eurozone countries are not allowed to vote in the final decision-making body of the ECB (see *supra*), nor are non-eurozone countries bound by decisions made by the ECB.<sup>29</sup> As a consequence, non-eurozone Member States cannot

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28. Article 18(3b) of the March 2013 SSM Agreement.

29. Article 139(1)b of TFEU.

become *full* members of the Banking Union, in the sense of having the same rights and obligations as eurozone countries.

Due to these limits, a specific membership has been foreseen for non-eurozone Member States, referred to as a “close cooperation agreement” with the ECB. Most importantly, entering into such an agreement is voluntary. If a non-eurozone country decides to do so, it needs to respect three important conditions that also apply to eurozone countries: a) all its banks need to be part of the SSM, b) the Member State needs to fully cooperate in sharing information with the SSM, and c) the country needs to abide by ECB decisions in supervisory matters.

Even when a non-eurozone country has entered into an agreement, the ECB is not allowed to take a decision that directly applies to a bank of that country. The ECB is to address its decisions to the national supervisor, who in turn needs to ensure that the bank applies the decisions. This is a distinct difference with banks that are based in the eurozone, which can receive direct instructions from the ECB.

Due to both the voluntary nature of the close cooperation agreement and the ECB’s inability to enforce supervisory decisions outside the eurozone, the close cooperation agreement can be terminated quite easily. Such a termination would typically be the result of a disagreement on a supervisory decision. Both the ECB and the non-eurozone SSM-country can decide on such termination:

- **Termination of the agreement by the ECB.** Two options exist. Firstly, the ECB issues a warning to a country stating that the country does not respect one of the three conditions mentioned above (all banks involved, information sharing, and abiding by ECB decisions). If the country does not take sufficient action after such a warning, the ECB can end the close cooperation agreement. A second option applies in case the Governing Council objects to a decision by the Supervisory Board. The non-eurozone country can then notify the Governing Council that it objects to the decision. If the Governing Council nonetheless sticks to its decision, the non-eurozone country can choose not to apply the supervisory decision. The Governing Council is then to evaluate the impact of the country’s non-implementation and could decide to suspend or terminate the close cooperation agreement.
- **Termination by a non-eurozone country.** Terminating the close cooperation agreement is easier for the non-eurozone country than it is for the ECB. A non-eurozone SSM-country can end the agreement whenever it disagrees with a draft decision by the Supervisory Board. If a country has been part of the SSM for more than 3 years, it can even choose to end the close cooperation agreement without the need for any specific motivation. The catch, however, is that if a country has terminated the agreement, it cannot enter

into a new close cooperation agreement for a period of three years.<sup>30</sup> The latter should deter a country from stopping the close cooperation in the spur of the moment. Using these provisions could even delay a Member States' entry into the eurozone, as the eurozone would surely not accept a country to enter the Monetary Union without being part of the SSM.

The flexible close cooperation agreement was inspired by the desire to include willing non-eurozone countries in the SSM. The final Regulation is much more accommodating than the original Commission Proposal. It could even be asked whether the SSM-membership for non-eurozone countries is not too flexible. Too much flexibility can have a negative impact on the ECB's supervisory authority in non-eurozone countries, as these countries could at any point threaten not to apply a supervisory decision, or leave the SSM altogether.

### 3.3. Separation monetary and supervisory tasks

A major concern of some Member States, notably Germany, was the risk that endowing the ECB with supervisory responsibilities might have a negative effect on the ECB's monetary policy. Two arguments support this concern.

Firstly, supervisory and monetary responsibilities might conflict with each other. For example, providing liquidity to distressed banks may stabilise the financial system, but it can also lead to higher inflation.<sup>31</sup> As the ECB becomes a bank supervisor, it might take such supervisory considerations into account in its monetary policy, to the detriment of inflation targeting. Secondly, mistakes in bank supervision seem unavoidable, as this often requires a judgment call by the decision-makers. Such supervisory mistakes can have a reputational impact on the ECB in general, and thus also on its monetary policy reputation.<sup>32</sup>

To prevent supervisory decisions influencing monetary policy and vice versa, legislators aimed to fully separate monetary and supervisory decision-making. In the words of the German Finance Minister Wolfgang Schäuble, the EU should create a "*Chinese wall*" between the two policies.<sup>33</sup> This has only partly been achieved.

30. Article 6 of the March 2013 SSM Agreement.

31. DE GREGORIO, J., 2010, Recent challenges of inflation targeting. In: Perspectives on inflation targeting, financial stability and the global crisis, BIS Papers No 51.

32. The risk of reputational damage was illustrated by the problems in the Italian bank Monte dei Paschi di Siena. As the President of the ECB Mario Draghi was Governor of the Bank of Italy when questionable operations took place in that bank, his track record came under fire. See for example, DIXON, H., 2013, Mario Draghi's poisoned banking chalice. Reuters, Opinion, 4 February.

33. SCHÄUBLE, W., 2012, How to protect EU taxpayers against bank failures. Financial Times, Commentary, 30 August.

The SSM Regulation states that the ECB is to separate its supervisory tasks from its monetary tasks, notably including a separation of the staff involved in the different tasks. The separation is also reflected in decision-making, where supervisory decisions are essentially taken by the Supervisory Board that has no role to play in other ECB policies (see *supra*). The Governing Council, for its part, has to organise separate meetings discussing either bank supervision or monetary policy.

Despite these measures, there is no full separation between supervision and monetary policies on either the national or European level. On the national, bank supervision is carried out by the national central bank in a majority of the Member States – i.e. the same body that deals with monetary policy.<sup>34</sup> In national central banks, the organisational separation between the supervision and monetary policy is not as strict it is the case at the ECB. Requiring the national central banks of SSM-countries to introduce such separation could be considered.

Even on the level of the ECB, there is no full separation in decision-making. First of all, decisions are elaborated in the Supervisory Council, which is mainly composed of national supervisors. As there is a less strict separation at the national level, this influences decision-making in the Supervisory Council as well. Furthermore, the Governing Council deals with decisions concerning both bank supervision and monetary policy. Despite the obligation to organise separate meetings for the two policies, it is simply impossible for the members of the Governing Council to strictly avoid concerns regarding one matter influencing the other.

Both on the national and the European level there is hence no Chinese wall between bank supervision and monetary policy. Under a pessimistic view, the separation between the monetary and supervisory functions can be perceived as just as faulty as the separation between the compartments on the Titanic.<sup>35</sup> Yet, it is unsure whether perfect separation is truly desirable.

Cross-cutting issues (literally in case of the Titanic, metaphorically for the SSM) are of importance. In this respect, the main problem for the ECB's monetary policy during the current financial crisis is precisely the lack of detailed information on the financial health of the banking system. Allowing for information flows between the monetary and the supervisory arm of the ECB would largely overcome this issue.<sup>36</sup> Instead of aiming for a full-blown separation, it thus

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34. In 11 out of 17 eurozone countries, bank supervision is carried out by the central bank.

35. For a pessimistic view, see: VAUBEL, R., 2012, Economic and legal problems of European banking supervision. Europolis.

36. BECK, T. and GROS, D., 2012, Monetary Policy and Banking Supervision: Coordination instead of separation. CEPS, Policy Brief No 286.

seems more important to be clear on when supervisory decisions are influenced by monetary policy concerns, or vice versa.

Furthermore, whether or not there is a full separation between the ECB's monetary and supervisory powers, the reputational risk will remain. The ECB will at some point undoubtedly make mistakes in the supervision of the banking sector. While a formal separation of tasks might hold back some of the reputational damage for monetary policy, it will at a certain stage be affected. The latter is an unwanted, but unavoidable side-effect of central banks carrying out financial supervision.

### 3.4. Accountability

The creation of the SSM implies a shift in the accountability of the ECB towards national governments and European institutions. When the ECB was created, much attention was given to its independence. This was to reassure Germany that the ECB would be able to perform its monetary policy in a similar vein as the German Bundesbank. As a result of the insistence on independence, the reporting requirements and general accountability of the ECB were limited. The ECB became one of the most independent central banks in the world.<sup>37</sup>

Supervisory decision-making is more prone to subjective elements than monetary policy. Therefore, bank supervisory tasks call for a substantial degree of accountability, which is to a certain extent in contrast to the accountability that is needed for monetary policy. This requires a change in the ECB's openness about its policy decisions, as compared to former practices. While supervision should also be carried out independently, the supervisor needs to be open on the decisions it makes and the reasons behind those decisions.<sup>38</sup> Accountability does not necessarily have to result in a less independent supervisor, as long as accountability does not mask an attempt to steer supervisory decisions. Of course, there is a fine line between holding the ECB accountable and attempting to steer its future decisions.<sup>39</sup>

The accountability of the ECB is to be ensured by different instruments. A somewhat indirect form of accountability consists of an annual report by the ECB on its supervisory operations. Beyond the annual report, a more direct form of accountability consists of interaction between the ECB and other public bodies.

37. CHALMERS, D, DAVIES, G & MONTI, G, 2010, *European Union Law*. Cambridge University Press, p. 732.

38. See principle 2 of Basel Committee on Banking Supervision, 2012, *Core Principles for Effective Banking Supervision*.

39. QUINTYN, M., RAMIREZ, S. & TAYLOR, M., 2007, *The Fear of Freedom: Politicians and the Independence and Accountability of Financial Sector Supervisors*. IMF Working Paper, WP/07/25.

Such interaction mainly concerns the European level:

- The Chair of the Supervisory Board of the ECB is obliged to appear at least annually in the European Parliament and the Council<sup>40</sup>. These institutions can also request an ad hoc hearing of the Chair when this is felt to be necessary;
- The Chair of the Supervisory Board can be required to have a private discussion with the Chair and Vice-chairs of the European Parliament's ECON Committee;
- The ECB is to reply to oral and written questions from the Parliament and the SSM-countries.

To a lesser extent, the ECB is also accountable to national parliaments:

- National parliaments can ask the ECB to appear in their parliament, but only concerning a bank based in that Member State. In contrast to the EU-level accountability arrangements, the ECB is not obliged to accept the invitation.
- National parliaments can ask the ECB oral and written questions. The ECB is, however, not obliged to respond. Yet, it would be politically difficult for the ECB not to do so.

Besides accountability of the ECB to national parliaments, Member States can still provide for their own accountability arrangements with their national supervisors. Yet, as these national supervisors do not have final supervisory responsibility in SSM supervision, such accountability will become less relevant.

The fact that accountability arrangements of the SSM lie essentially at the European level, matches lifting bank supervision to that level. This is in line with the December 2012 Report of the European Council President that states that “*democratic control and accountability should occur at the level at which the decisions are taken*”.<sup>41</sup> This principle is, of course, most sensible. However, Member States should realise that this reduces the role of their national parliaments in the policies concerned. National Parliaments can still be involved in the accountability, but this will inevitably be a more indirect form of accountability than when bank supervision was a national competence. The issue above will arise for other transfers of competences as well.

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40. This meeting would only include the SSM-countries.

41. VAN ROMPUY, H., 2012, Towards a Genuine Economic and Monetary Union. 5 December 2012.

## 4. RELATION SSM WITH EUROPEAN AND INTERNATIONAL SUPERVISORY BODIES

The creation of the SSM has repercussions beyond the borders of its participating countries. It will, first of all, modify the role of cross-border supervisory cooperation (4.1). Furthermore, as a majority of the Member States will join the SSM, this step in differentiated European integration is bound to have an impact on the EU-wide bodies (4.2). The SSM can even have an influence on the functioning of the international supervisors (4.3).

### 4.1. Cross-border supervisory colleges

#### *About cross-border supervisory colleges*

A cross-border supervisory college groups the different supervisors of the main countries in which a given bank operates. Each supervisory college thus deals with a specific cross-border bank. In the EU, supervisory colleges are established for all banks with subsidiaries or significant branches in other Member States.<sup>42</sup> Internationally, colleges are to be set up for all major cross-border financial institutions.<sup>43</sup> While the creation of these colleges is a step forward in cross-border coordination, they remain non-binding. National supervisors thus do not have to take into account the result of discussions in the supervisory colleges.

#### *Impact of the SSM*

The impact the creation of the SSM has on supervisory colleges depends on whether the college deals with a bank that operates in the SSM-countries only, or with a bank that operates beyond the borders of the SSM.

For banks operating inside the SSM only, supervisory colleges have lost much of their added value. For matters that are considered “essential” supervisory tasks (see 2.2.), the ECB becomes the supervisor with final authority. While there will still be coordination among national supervisors on these matters, this will take place inside the SSM. In case of disagreement, the ECB can enforce its decisions. This will substantially improve cross-border coordination. For “non-essential” supervisory tasks, the supervisory colleges remain useful (the ECB has no supervisory authority with regard to these tasks). However, taking into account the

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42. Article 131a of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions [recast], OJ L 48, 30.3.2010, pp.1-252.

43. This is a result of the G-20 Washington Summit of 14-15 November 2008.

limited competences that are left at the national level, it seems that the supervisory colleges for SSM-banks will become much less relevant.<sup>44</sup> It might be more useful to coordinate the “non-essential” supervisory tasks within the framework of the SSM-structure as well, even though the ECB would not have final authority on those tasks.

For banks that operate beyond the borders of the SSM, not much should change in principle. The ECB will gain a seat at the table of the supervisory colleges, but this will not be to the detriment of the role played by the national SSM-supervisors in the colleges. However, it is to be expected that the SSM-countries will defend a common point of view in the supervisory colleges. Especially for those banks that operate mostly within the SSM and in only a few other countries, this is likely to change the dynamics in supervisory meetings. Nonetheless, as mentioned earlier, discussions in the supervisory colleges will remain non-binding on the supervisors. Even if the SSM-countries should dominate a meeting, the other supervisors remain free to adopt a different supervisory approach.

## 4.2. EU-level bodies

Two EU-level bodies have a substantial role to play in bank supervision. On the one hand, the European Banking Authority (EBA) deals with supervision on the level of individual banks (i.e. micro-prudential supervision). On the other hand, the European Systemic Risk Board (ESRB) deals with overall risks in the financial sector (i.e. macro-prudential supervision). Both are impacted by the creation of the SSM, but the EBA’s operations are undoubtedly influenced the most.

### 4.2.1. *European Banking Authority*

#### *About the EBA*

The EBA was created in 2010 in the aftermath of the financial crisis and replaced an existing committee that proved insufficiently effective in light of the crisis.<sup>45</sup> As the pan-EU bank supervisory body, it groups the bank supervisors of all EU Member States.

The EBA has a variety of tasks. Some of these are limited in scope and essentially aim to improve supervisory coordination in a non-binding manner. Yet, in other fields, the tasks of the EBA are more substantial. The EBA has three main tasks:

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44. WYMEERSCH, E., 2012, op. cit. footnote 13.

45. The EBA replaces the Committee of European Banking Supervisors (CEBS), established by Commission Decision 2004/5/EC of 5 November 2003.

1. **Working towards a single rulebook for the financial sector.** This implies harmonising rules that apply to the banks operating in the EU. The main instrument for this purpose is setting technical standards that further detail EU legislation.
2. **Ensuring respect of the EU legislation.** The EBA can counteract a breach of EU law, or settle disagreements between supervisors on the application of the European rules.
3. **Prepare for and deal with crisis situations.** This involves contingency planning and stress tests, as well as powers in crisis situations to impose decisions<sup>46</sup> on supervisors and banks. The EBA can also suspend certain financial activities.

When the EBA was created, it was thought necessary to move away from the consensus-based approach that was in place before, and which had hampered decision-making.<sup>47</sup> As no cross-Member State supervisory integration was foreseen when the EBA was created, the EBA was designed with national supervisors in mind. Decisions in the EBA are hence taken by the supervisors of the Member States. Before the creation of the SSM, the EBA was to take its normal decisions by simple majority. Qualified majority applied for the EBA's more comprehensive competences (see Table 1).<sup>48</sup>

### *Impact of the SSM*

Member States that preferred to stay outside of the SSM feared that this would lead to them having less say in the EBA, or even no say at all. Such a fear is based on the possibility that the SSM-countries would vote as a single entity in the EBA. If this were the case, the SSM would indeed dominate decision-making.

Voting as a single entity, the SSM-countries would hold a simple majority in the EBA. They would thus be able to push through any simple majority decision. For votes by qualified majority, the situation is more complex. Until November 2014, the eurozone as a whole will not have a qualified majority of votes, but it would possess a blocking minority. The SSM-countries would therefore be able to block any decision in the EBA. In November 2014, qualified majority rules will change. As a result, the eurozone as a whole is set to have a qualified majority in decision-making. A transition period will nonetheless apply until 2017,

46. Such a decision may, however, not have an impact on (“impinge” in the wording of the Regulation) the financial responsibilities of the Member States.

47. Decisions by the CEBS were to be made by unanimity as much as possible. Only when a consensus was not feasible could decisions – by way of exception – be taken by a qualified majority.

48. VERHELST, S., 2011, op. cit. footnote 5.

during which a Member State can ask for the previous rules to be used.<sup>49</sup> If several non-eurozone countries would join the SSM, the latter would certainly dominate the EBA if voting as a single entity.

Despite the weight of SSM-countries in the EBA, the fears of non-SSM countries are for a large part exaggerated: neither the eurozone nor the SSM-countries will vote as single entities in the EBA. Voting rights will still lie with the national supervisor and the ECB will not even gain the right to vote. While the Commission's proposal stated that the SSM-countries should coordinate their voting in the EBA, this requirement has been dropped in the final text.

Yet, though this is not a legal obligation, it is clear that the creation of the SSM calls for more coordination among its members with regard to some decisions that are made in the EBA. In certain fields prior coordination and convergence in voting seem needed. If a disagreement arises between the ECB and a non-SSM country on supervisory practices, it seems natural that the SSM-countries would adopt the ECB's stance on the matter. The same goes for declaring an emergency situation and suspending financial activities.

To accommodate for the fears of non-SSM countries, additional safeguards in the EBA's decision-making have therefore been provided for. The major novelty is the double majority that is necessary for the approval of several types of decisions. This double majority implies that a decision needs to be approved by both a majority of SSM-countries and a majority of non-SSM countries. A decision cannot be adopted if one of these majorities is lacking. The double majority will be introduced for three types of decisions:

- Matters that were previously approved by qualified majority. Here, the double majority comes in addition to the existing qualified majority requirement.
- Decisions concerning a breach of EU law and the settlement of disagreements between supervisors. In addition to the double majority rule, a panel procedure has been introduced. This panel needs to draft a preliminary decision. The panel would be composed of the Chair of the EBA and six national supervisors.<sup>50</sup> The panel's decision can subsequently be approved by a double simple majority of Member States.

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49. From November 2014 onwards, a qualified majority consists of 55% of Member States and 65% of the EU population. See Article 16(4)TEU. All eurozone countries combined represent 60% of the Member States and 66% of the population. As a block, they will thus acquire a qualified majority. Given the narrow majority, changes to the membership of the eurozone or the EU can tilt the balance in a certain direction.

50. Before, a preliminary panel was used only exceptionally, i.e. for the binding settlement of disagreements with regard to consolidated supervision, which concerns the overall supervision of a banking group.

- Decision-making on crisis management switches from a simple majority to a double simple majority.

The remainder of the decisions, which involves mostly low-key decisions, would still be adopted by a simple majority. Table 1 provides an overview of the former majority rules and the modified rules.

**Table 1: Revised Decision-making in the EBA**

Matter	Old majority rule	New majority rule
Technical standards	QMV	QMV & double simple majority
Guidelines and recommendations		
Financial provisions		
Reconsideration of a decision to ban or restrict a financial activity		
Breach of EU Law	Simple majority	Panel proposal, adopted by double simple majority
Settlement of disagreements	Simple majority, panel proposal for the binding settlement of disagreements on consolidated supervision*	
Crisis management	Simple majority	Double simple majority
Other decisions	Simple majority	Simple majority

**Notes:**

Double simple majority: simple majority of both (a) countries in the SSM and (b) countries outside the SSM.

\* Panel proposal, adopted by simple majority, unless blocking minority.

These voting rules allow the EBA to function normally for as long as a substantial number of non-eurozone countries stay out of the SSM. However, if only a handful of Member States would stay out of the SSM, the system would become hardly functional. The few non-eurozone countries would gain a disproportionate say in the EBA decision-making, as they would easily be able to block decisions. For these reasons, the voting mechanisms in the EBA are to be revised when four or fewer Member States are not members of the SSM.

If the non-SSM countries would block progress that is wanted by the members of the SSM, it might bring SSM-countries to carry out some of the EBA's functions inside the SSM itself. This could notably be the case for the move towards a single rulebook (see 5.4). In this sense the double majority requirement might actually have a negative impact on the single market, instead of preserving it. This risk has been acknowledged by the legislators, as the majority rules are to be a prime element in a future review of the EBA.

Besides these precise changes to the voting rules, a general, non-binding provision is added to the EBA's legal framework. This provision states that, in its decision-making, “[the] EBA shall strive for consensus when taking its deci-

sions”.<sup>51</sup> This implies a subtle, but manifest return to consensus decision-making, despite the fact that this was seen as one of the weak points of the former EU-level committee. It appears that Member States are again – unfortunately – heading in that direction.

#### 4.2.2. *European Systemic Risk Board*

##### *About the ESRB*

Like the EBA, the European Systemic Risk Board was created as a response to the financial crisis. Preceding the crisis, supervisors had focused mostly on the health of individual financial institutions. Much less attention was paid to the overall stability of the financial system. This led to an underestimation of the risks in the financial sector as a whole. As a response to this failure, the focus on the overall stability (“macro-prudential supervision”) was stepped up noticeably around the world. At EU-level, the ESRB is responsible for such supervision.

The essential task of the ESRB is to supervise the financial system in order to detect potential risks that can affect the financial system and the real economy. When such a risk is detected, the ESRB can emit warnings and recommendations to the Member States and other EU bodies. The ESRB, however, lacks the competence to make decisions that are binding on others, as the Member States and EU bodies are not obliged to act upon the warnings and recommendations issued by the ESRB.

In its present configuration, the ESRB is a rather bloated body. In an EU with 28 Member States, the ESRB has 67 members of which 38 have voting rights. Voting members comprise representatives of all Member States, the President and Vice-president of the ECB and other representatives of EU bodies.<sup>52</sup> Most decisions in the ESRB are made by simple majority. A 2/3rds majority is needed only when a recommendation or warning is to be made public.

##### *Impact of the SSM*

In contrast to the EBA, no formal changes to the tasks or membership of the ERSB are foreseen as part of the creation of the SSM. This is despite the fact that the ECB will obtain major competences and expertise in the field of macro-prudential supervision in the SSM.

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51. Article 1(7a) of COUNCIL OF THE EU, 2013, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1093/2010 establishing a European Supervisory Authority – Final compromise text, Document No. 7775/13, 25 March.

52. The other voting members from EU bodies are: a member of the European Commission; the Chairpersons of the three European Supervisory Authorities; the Chair and two Vice-Chairs of the ESRB’s Advisory Scientific Committee and the Chair of ESRB’s the Advisory Technical Committee.

While this will not *de jure* be the case, it is possible that SSM-countries will in practice frequently take the same stance in the ESRB, due to the ECB's expertise. If this is the case, the position of the SSM-countries is likely to be the determining factor in the ESRB's decisions.<sup>53</sup> If only eurozone members are part of the SSM, the SSM will be just short of a simple majority – it would have 19 out of the 38 votes. Yet, it would be able to stop any decisions being adopted. Whether the SSM-countries will have an outright majority in the future will depend on evolutions in EU and SSM memberships.

Despite the apparent threat of a caucus by the SSM that determines the decisions in the ESRB, this does not seem a genuine risk. First of all, national supervisors and the ECB will not always vote in a similar fashion. There continues to be an element of discretionary judgement in assessing the scale of a macro-prudential risk, which will lead to diverging voting behaviour. Secondly, the ESRB's decisions are non-binding. Even if the SSM would impose its view on the others in the ESRB, this would not have any major consequences.

It is likely that the functioning of the ESRB will be altered as part of a review that is to be carried out by mid-December 2013.<sup>54</sup> This review could involve the role of the ECB in the ESRB as well as the balance of power between the SSM and non-SSM countries in the decision-making process.

### 4.3. International bodies

As was the case inside the EU, the financial crisis resulted in changes in international bodies that deal with financial supervision. Besides the supervisory colleges for individual banks that were discussed above, macro-prudential supervision has gained importance.

In this respect, the FSB is of significance. The FSB is to perform macro-prudential supervision by monitoring market developments and assessing vulnerabilities. It can issue warnings when needed. The FSB makes its decisions by unanimity. Its extensive membership (64 members covering 21 countries and several international bodies) complicates decision-making, rendering tough decisions unlikely.<sup>55</sup> Despite the creation of the SSM, no changes in FSB membership are foreseen. This seems regrettable.

53. BABIS, V. & FERRAN, E., 2013, op. cit. footnote 21.

54. Article 20 of Regulation (EU) No 1092/2010 of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010.

55. LOMBARDI, D., 2011, The Governance of the Financial Stability Board. Brookings, Global Economy & Development, Issues Paper.

The countries participating in the SSM should reconsider their membership in the FSB. The ECB is already a member of the FSB. It therefore makes little sense for the FSB to include national financial supervisors of SSM-countries, as is currently the case for France, Germany and Italy. An even more comprehensive reform would be to let the ECB represent not only the national supervisors, but also the national central banks of the eurozone. This would reduce the SSM representation in the FSB by 8, creating room for the ESRB to join the FSB. Such a move would both improve the FSB's ability to spot financial risks in Europe and facilitate its decision-making, rendering its supervision more effective.

## 5. THE OTHER NECESSARY PILLARS OF THE BANKING UNION

Setting up the SSM is the first important step in the direction of a European Banking Union. More is needed, however, for a well-functioning Banking Union. Besides the SSM, the Banking Union is to be based on 4 other essential pillars. These pillars are: 1) addressing short-term banking problems; 2) arrangements for long-term crisis management; 3) a form of European deposit insurance; and 4) harmonised rules for banks. Each of these additional pillars is discussed in this chapter.

With the agreement on the SSM, the EU sets in motion a dynamic that will inevitably have to lead to significant steps in these other fields of the Banking Union. Without sufficient progress on the other pillars, the Banking Union would be incomplete and therefore unstable. A half-finished European Banking Union risks being worse than the existing national approach.<sup>56</sup> The agreement on the SSM signals a point of no return for Europe to establish a genuine Banking Union. The question thus seems not to be *if* the EU will put in place the elements mentioned below, but *when*.<sup>57</sup>

### 5.1. Short-term banking problems and direct recapitalisation

While the SSM can help in preventing or limiting future crises, it is no solution to the already existing problems in the banking sector. Certain instruments have already been put in place to deal with these short-term problems, such as national public bailouts and the ECB's lending facilities. Yet, these instruments seem to have hit their limits. Due to the "*vicious link*" between banking and sovereign debt problems, national public support is not always the appropriate solution. Once a country's solvency has come into question, the promise of potential public support loses its credibility (see 1).

In June 2012, direct European recapitalisation of banks was put forward by European leaders as an answer to the banking woes in Spain and elsewhere. Such direct recapitalisation was to mitigate the Spanish public fiscal problems, as the country would not have to carry the burden of rescuing its financial sector alone anymore. In their statement, eurozone leaders declared that the direct recapitalisation is possible only "*[w]hen an effective single supervisory mecha-*

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56. WYPLOSZ, C., 2012, Banking union as a crisis-management tool. In: BECK, T. (ed.), Banking Union for Europe: Risks and Challenges. Centre for Economic and Policy Research.

57. VERHELST, S., 2012, Banking Union: Are the EMU design mistakes being repeated? Egmont, European Policy Brief 12.

*nism is established*".<sup>58</sup> Although the wording allows for multiple interpretations, it seems that direct recapitalisation will be possible only when the SSM is fully operational, i.e. in 2014. In the meantime, an operational framework for such direct recapitalisation has to be agreed upon.

It is useful to note that direct recapitalisation is to serve as a last-resort option, only to be used when a country risks insolvency. This is different from the common crisis management that is suggested for dealing with future crises, when a European approach could be pursued from the moment problems arise (see *infra*).

Direct recapitalisation by the EU is not without risks for the eurozone countries. Losses due to such operations could be shouldered by all eurozone countries, not only the country in which the bank is located. This had led the most creditworthy countries in the eurozone to push for three limits to direct recapitalisation.

Firstly, they seek to exclude problems that have arisen in the past.<sup>59</sup> These problems are referred to as "legacy issues". Such legacy issues are to some extent due to past policies in the countries in question. Certain other eurozone countries do not feel that they should carry the burden attached to the problems. Common liability for legacy issues is therefore likely to be limited. Member States with problems in their banks try to introduce a difference between, on the one hand, "legacy issues" in a narrow sense and "retrospective loans" on the other. In their view, "legacy issues" refer to banks that have already been closed down, while "retrospective loans" could be used for banks that are still operating.

Beyond legacy issues, a second limit sought by the most creditworthy countries concerns the general risk-sharing in direct recapitalisation operations. As a way of compromise, Member State in which a bank is located will remain accountable for a more substantial part of potential losses due to direct recapitalisation than the other countries.

Creditor countries fear that these operations could quickly deplete the ESM's lending capacity, requiring them to put in additional funds. Therefore, the final limit that is set to be introduced is a limit on the amount that the ESM can spend on direct recapitalisations. This will entail a pre-determined cap, which should ensure that the ESM has sufficient resources to carry out its other functions.

The exact scope of these three limits will depend on the outcome of the negotiations. While the limits all make sense, they also entail risks. Putting too strong a limit on direct banks recapitalisations will hollow out their purpose. The likely

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58. Euro Area Summit Statement, 29 June 2012.

59. See notably the Joint Statement issued by the Ministers of Finance of Germany, the Netherlands and Finland, 25 September 2012.

consequence of limits that are too strict would be that the link between banking and sovereign debt problems would not be broken after all. This would be most detrimental to Ireland and Spain, where this link is preventing a recovery from the crisis.

## 5.2. Future crisis management

Even with the best of bank supervisors, crises in the banking sector will occur. Most Member States did not have a well-elaborated crisis management strategy when the financial crisis hit Europe. The EU needs to be better prepared for dealing with future crises. Discussions on future crisis management will basically have to answer three questions: which rules are needed, who is responsible and who pays?

### *Which crisis management rules? The need for a common legal framework*

In order to better withstand turbulence in the financial sector, crisis management provisions have to be improved. After many deferments, the Commission finally published a proposal on harmonised crisis management rules in June 2012, on which an agreement is to be reached between the Council and the Parliament.<sup>60</sup>

If adopted, the crisis management rules would apply to all EU Member States. They would kick-in starting in 2018 (some Member States prefer an earlier date). The overarching aim of the proposal is to allow banks to fail with minimal influence on financial stability and without bailouts by public authorities. To achieve this, three sets of crisis management tools would be introduced, each aimed at a different stage of crisis management:

- **Preparatory planning** for crisis situations. Such planning is to occur in normal times, so as to be ready when problems arise. Preparatory planning essentially centres on drawing up recovery and resolution plans for banks (so-called living wills) and making sure the plans can be applied during a crisis.
- **Early intervention powers.** Supervisors are to be able to intervene from the moment problems are detected in a bank. Under the Commission's proposal, supervisors would be able to require the bank to implement its recovery plan,

60. EUROPEAN COMMISSION, 2012, Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM/2012/280, 6 June.

convene a shareholders' meeting to decide on actions and even replace (part of) the management of a bank.

- **Bank resolution.** When a bank's problems reach a point where there is no realistic prospect of recovery, a resolution authority would be endowed with extensive powers. The authority would be able to break up and/or sell a bank without the consent of its shareholders. The resolution authority would furthermore be able to impose losses on the bank's shareholders (by reducing the value of shares) and "bail in" creditors (by reducing the value of their claims on the bank<sup>61</sup>).

### *Which level is to be responsible for crisis management? The need for a European resolution authority*

Agreeing on how crisis management should take place is not enough. It is crucial to determine which level is to carry out these tasks. Traditionally, this has been a national responsibility. Yet, as supervision is lifted to the European level, the same should be done for crisis management.<sup>62</sup> In line with the expression "*you break it, you own it*", the same level of government should both deal with bank supervision and the consequences of failed bank supervision. If this is not the case, disagreements are bound to arise during crises, which will only make matters worse.

In December 2012 European leaders committed to creating a European Single Resolution Mechanism (SRM), though staying vague about what this SRM would entail. The fact that they refrained from committing to creating a European Resolution Authority is not a positive sign.<sup>63</sup> While national authorities can be involved, it is important to create a body at the European level with final authority on the matter – as is the case for the SSM.

Setting up a resolution authority at the European level will, however, have to take into account the EU's legal limits. It will notably be difficult to set up a separate EU body, as case law limits the powers that can be delegated to an executive EU agency.<sup>64</sup> Nonetheless, certain legal options seem possible, notably: the enhanced cooperation procedure, Article 352 TFEU<sup>65</sup>, a new inter-governmental agreement or endowing the Commission with crisis management

61. This can take the form of a reduction in the creditor's claim or a conversion of the claim into equity (e.g. shares).

62. BOFINGER, P., BUCH, C. et al., 2012, Stable Architecture for Europe – Need for Action in Germany. German Council of Economic Experts, Annual Report.

63. A draft version of the December 2012 Conclusions of the European Council made reference to the need to create a "European Resolution Authority". Yet, this wording was toned down to "European Resolution Mechanism" in the final version.

64. See the Meroni doctrine: Joined Cases 9-56 and 10-56 Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community.

65. Article 352 TFEU allows the EU to adopt measures to obtain a Treaty objective for which the Treaty itself has not explicitly endowed the EU with the needed powers. Such measures need to be adopted by unanimity in the Council and with the consent of the European Parliament.

responsibilities.<sup>66</sup> The German Finance Minister has indicated that he believes these legal options to be insecure, therefore pleading for changing the Treaty before creating a common authority. While this would increase legal certainty, it would also delay a full-fledged Banking Union.<sup>67</sup>

### *Who pays for crisis management? The need for a European backstop*

Managing a bank crisis has fiscal implications. Deciding on who bears these costs is a sensitive matter. As mentioned above, the Commission proposed rules that allow the bank's shareholders and creditors to bear losses when needed. Uninsured depositors will likely also be called upon. These are useful steps in financing crisis management, but will not always be sufficient. Other means to find the necessary resources therefore have to be put in place.

A first element is the creation of a resolution fund that can be used to finance crisis management. Such a fund is to be financed by contributions from the banking sector itself. As crisis management should take place on a European level, it is preferable to create a single fund that covers all SSM-countries, rather than putting different national funds in place.

Even the accumulation of the instruments above (shareholders, creditors, uninsured depositors and a resolution fund) is not certain to provide adequate financial resources for dealing with a large-scale banking crisis. When there is a large need for financial means to deal with a crisis, turning to public (i.e. the taxpayer's) resources is inevitable. Such a possible recourse to public funding is referred to as a public backstop.

In line with the need for a European crisis manager, such a backstop should ideally also be organised at the European level. If not, discussions on who pays will hamper any effective use of the available resources. Furthermore, countries individually might not always be able to bear the costs. Designing a public backstop on the European level will, however, not be a simple matter, as the EU does not have the ability to levy taxes in the way that national governments do. Different options are available to finance crisis management at the European level, including: a) an ex-ante agreement on burden-sharing among the SSM-countries, b) ESM-lending and c) ex-post European taxation to finance crisis management. A combination of certain of these options seems most likely. If the ESM were to be used as a public backstop for the SSM, its relation with the non-eurozone SSM-countries will have to be redefined.<sup>68</sup>

66. BABIS, V. & FERRAN, E., 2013, op. cit. 21.

67. SCHÄUBLE, W., 2013, Banking union must be built on firm foundations, Financial Times, Commentary, 12 May.

68. IMF, 2012, A Banking Union for the Euro Area: Technical background notes. 13 February. And PISANI-FERRY, J., SAPIR A. (et al.), 2012, What kind of European banking union? Bruegel, Policy Contribution 2012/12.

### 5.3. Deposit guarantees

Deposit guarantees serve to protect depositors. If a financial institution fails, this guarantee is to ensure depositors that their savings can be redeemed up to a predetermined amount. In the EU, deposit guarantees are provided by each Member State separately – with certain common minimum requirements set at EU level. This involves for example protection up to € 100.000.<sup>69</sup>

In July 2010, the Commission proposed to go a step further than those minimum requirements by fully harmonising the rules on deposit guarantees. In addition, it proposed the possibility for one national deposit guarantee scheme to lend to another national scheme when needed. A single European Deposit Guarantee Scheme, however, was not proposed.<sup>70</sup>

It is doubtful whether national level deposit guarantees can be compatible with a European Banking Union. If a government's financial health is put into question, depositors will question the government's ability to guarantee deposits. This can lead to a "national bank run", in which depositors move their savings away from the banks in that country.<sup>71</sup> National deposit guarantees thus would not break the negative feedback loop between sovereign debt and bank crises. The problems around the Cypriot bailout highlighted the problems of country based deposit insurance.

For this reason, a SSM-wide form of deposit guarantees is often deemed necessary, although less pressing than common crisis management.<sup>72</sup> Yet, a European deposit guarantee is a delicate political subject, given the fact that it can potentially involve large transfers from one Member State to another. As a result of the lack of urgency and the political resistance, no concrete official proposals on the matter have been made.

Avoiding discussions on the matter is, however, a hazardous strategy. There is a genuine risk that there will not be sufficient willingness to create a SSM-wide deposit guarantee once the peak of the ongoing crisis is behind us, which would result in a flawed Banking Union.

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69. See Directive 94/19/EC [consolidated version].

70. European Commission, Proposal for a Directive on Deposit Guarantee Schemes [Recast], 12 July 2010, COM(2010)368 final.

71. Like the evolutions of national savings that we have seen in Spain and Greece. See ELLIOTT, D., 2012, *op. cit.* footnote 2.

72. CONSTÂNCIO, V., 2013, Towards the Banking Union, Speech by the Vice-President of the ECB at the 2<sup>nd</sup> FIN-FSA Conference on EU Regulation and Supervision "Banking and Supervision under Transformation" organised by the Financial Supervisory Authority, Helsinki, 12 February; and PISANI-FERRY, J. & WOLFF, G., 2012, The Fiscal Implications of a Banking Union. Bruegel, Policy Brief 2012/02, September.

## 5.4. Harmonised rules for banks

While the EU level already defines national rules for the financial sector to a large extent, substantial differences persist. Such differences in national regulation hamper effective supervision at the European level. More harmonised rules therefore need to be put in place to facilitate the task of the SSM and hence improve the quality of its supervision. In EU jargon, such harmonisation takes the form of a single rulebook.

National policy actions after the Liikanen Report on Bank Structural Reform illustrate the difficulties of achieving common rules. The main recommendation of the Report was to separate investment and retail banking to a certain extent (“ring-fencing”).<sup>73</sup> The two biggest countries in the SSM, France and Germany, both pursued their own, separate approach in response to these recommendations, even though the SSM requires a common approach.

A major step in the harmonisation of financial sector legislation was the agreement on the Capital Requirements IV Package (CRD IV) in March 2013.<sup>74</sup> This package mainly translates the Basel III agreement into European law, although it also contains rules on other matters such as bankers’ bonuses.

In other fields, regulatory convergence is needed as well. Here, the EBA has a role to play. However, harmonised rules are more important for the SSM-countries than for the countries outside the SSM. For the EU as a whole, the single rulebook essentially serves to improve the single market in financial services. For the SSM, the single rulebook is needed for the stability of the banking system.

Tensions can arise between the SSM-countries and the other Member States. A tendency could develop in the SSM to agree on rules on which the EBA was not able to reach a (prompt) agreement. The double majority rules in the EBA actually push the SSM-countries to develop their own rules (see 4.2). Such closer integration with regard to financial sector legislation in the SSM alone does not unavoidably need to affect the EU single market, as long as non-SSM countries’ branches can continue to operate in the SSM and setting up subsidiaries in the SSM does not become too cumbersome for banks in non-SSM countries. The compatibility between the EU-wide single market and closer integration in the SSM will certainly be put to the test, however.

73. High-level Expert Group on reforming the structure of the EU banking sector, 2012, Final Report “Liikanen Report”. October.

74. See COUNCIL OF THE EU, 2013, Press release. 3227th Council meeting, Economic and Financial Affairs, 5 March.



## 6. THE ROADMAP TOWARDS THE SSM AND THE BANKING UNION

Just as Rome wasn't built in a day, it will take time to get the Banking Union up and running. The EU is to act on several different fronts to achieve a full-fledged Banking Union (see 5). During their December 2012 Summit, European leaders have committed themselves to a most ambitious roadmap to advance the Banking Union. While the steps towards a Banking Union are intertwined, the nature of the roadmap for the SSM is different from that of the other pillars of the Banking Union. For the SSM, the essential task will be to take practical measures in order to make the project work. For the other Banking Union pillars, the legislative framework is still far from finalised.

### 6.1. The SSM

While the European Parliament and the Council have reached an agreement on the legislative framework of the SSM, a lot needs to be done to make the SSM operational and effective. The SSM is to be fully operational 12 months after the legislative text enters into force, thus mid-2014. Before that, the ECB needs to build up its supervisory capabilities, recruit qualified staff and establish working relations with the national supervisors. This will be an arduous task.<sup>75</sup>

The ECB can already start carrying out supervisory tasks before it obtains actual final responsibilities. It will thus be able to monitor the banking sector, but cannot intervene in the banking sector. The only exception to this rule is for a bank that is directly recapitalised by the ESM. For these banks, the ECB would already be able to take up supervisory responsibilities before the full entry into force of the SSM. However, this stipulation conflicts with the planned timing for direct recapitalisation, which is foreseen only for when the SSM is fully established (see *infra*).

### 6.2. The other pillars of the Banking Union

Besides an agreement on the SSM, legislators are to find common ground on several other aspects of the Banking Union. This includes agreements on the procedure for direct bank recapitalisation for short-term crisis management, longer-term crisis management rules and harmonised rules on deposit guarantees. Initially, the goal was to reach a full agreement on these matters in the first half of 2013.<sup>76</sup> These ambitions had to be diluted.

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75. IMF, 2012, A Banking Union for the Euro Area.

76. See the European Council Conclusions of December 2012.

The revised goal is to have, by the end of June 2013, an agreement in the Council on the rules for longer-term crisis management and deposit guarantees. Agreements with the Parliament will have to follow later on. With respect to direct recapitalisation of banks, Member States will only agree on “*the essential elements*” before the end of June. A full detailed agreement is to be reached later on, after an agreement on the legislative texts for longer-term crisis management and deposit guarantees.<sup>77</sup>

Besides the elements discussed above, the Single Resolution Mechanism will be a vital element in building-up the Banking Union. The Commission is to make a proposal on a Single Resolution Mechanism in the first half of 2013. The EU is to reach an agreement on the Single Resolution Mechanism before the European elections of May 2014.

In addition to all the measures, the European supervisors are to progress in creating a single rulebook, which will be a continual project for the EBA. All the elements taken together clearly provide for a very packed EU agenda.

### **6.3. A roadmap that is both overly ambitious and incomplete**

The European calendar for putting in place the Banking Union is, in all likelihood, too ambitious in terms of timing – even after a first postponement of the deadlines. Past experiences have shown that reaching an agreement between the European Parliament and the Council takes longer than foreseen. In addition, the European and national (notably German) election calendars are likely to interfere with the legislative work. Politicians will be less willing to compromise, or simply lack the time due to campaigning.

Besides the currently overly ambitious calendar, a major issue has not yet been included in the Banking Union’s planning: a European deposit guarantee. Some form of European deposit guarantee will be needed in the long term to complete the Banking Union. It is therefore likely (and desirable) that the next Commission will table proposals on the matter.

As the EU’s agenda is both overly ambitious and incomplete, it is to be expected that only a partial Banking Union will be put in place at first. The mismatch between the level of supervision and the level of crisis management can be partly overcome by allowing for the direct European recapitalisation of banks. However, this is only a temporary solution (as direct recapitalisation is a last-resort instrument, limited in size and only available for eurozone countries). A Single

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77. French-German Contribution, 2013, La France et l’Allemagne ensemble pour renforcer l’Europe de la Stabilité et de la croissance. 30 May.

Resolution Mechanism would therefore have to be put in place shortly after the SSM becomes operational. Progress on harmonising banking sector rules will also be of importance. While this will undoubtedly not have resulted in a single rulebook before the SSM is operational, more harmonisation would allow for a less perilous journey towards European level control over the banking sector.



## CONCLUSION

By agreeing on a Single Supervisory Mechanism, the EU took one of its boldest decisions since the financial crisis started. Overall, the SSM presents a rather satisfactory first step towards the Banking Union. Under the right circumstances, the SSM has the potential to improve the quality of supervision and can contribute to addressing Europe's interlinked financial and sovereign debt crises.

On the positive side, the EU has agreed on a SSM that covers nearly all banks operating in the participating countries. Policymakers thus withstood the temptation of creating a partial SSM that would have covered only the largest banks. Another positive element of the agreement is the large role that is offered to non-eurozone countries in the SSM, within the scope of what is legally feasible. Furthermore, without setbacks, the relation between the SSM-countries and the other Member States will not pose significant problems in the near future.

The creation of the SSM, however, raises several challenges as well. Whether the SSM will indeed prove to be a better supervisor than the previous supervisory structures remains unsure. It will be quite a task for the ECB to take up its supervisory role, as it needs to quickly develop supervisory competences. Furthermore, practical arrangements are needed with regard to the tasks that national bank supervisors carry out on behalf of the ECB. The ECB will have to be able to monitor national supervisors and spot potential problems. Once operational, it will have to exert its final supervisory authority on national supervisors, even though the latter often have a long tradition. Crucially, the ECB will have to dare to take away the supervisory functions of a national supervisor when necessary.

Non-eurozone countries' membership of the SSM will remain delicate. In several ways, they will not be full members of the SSM. While the concern about a lack of voice has been taken into account, the fact remains that non-eurozone countries do not have a say in the final decision-making body. An arguably bigger problem is the fact that the membership of non-eurozone countries remains rather noncommittal. At any given point, such countries will be able to leave the SSM. This could make effective ECB supervision in those countries more difficult, as the possible exit of the non-eurozone country from the SSM will always be an option and/or threat.

Treaty provisions limit not only the role played by non-eurozone countries in decision-making; they also implicate smaller eurozone countries, which in the future will lose permanent voting rights in the ECB's final decision-making body. While such arrangements may be appropriate for monetary policy, this is not necessarily the case for supervision.

The lack of full non-eurozone membership and the issue of voting rights are not

the only fields in which the Treaty has rendered the task of designing the SSM more difficult. This is also the case for the delegation of supervisory tasks to the ECB and the required unanimity among Member States that is needed for approving and modifying the SSM legislation (with, in addition, little say for the European Parliament).

The Treaty's limitations have resulted in a sub-optimal design of the SSM. Despite these issues, the SSM can function within the existing Treaty. It is not worth changing the Treaty merely for the sake of the SSM. However, if, in the future, the Treaty is changed for other reasons, EU legislators would be wise to revise the Treaty provisions that impede a better design of the Banking Union.

Apart from it being a good or bad evolution, the SSM marks a clear additional step in the EU's multi-speed integration. It strengthens the differentiation between a) the eurozone core, b) the non-eurozone tier that is willing to participate in closer integration, and c) the outer tier of Member States that prefer to stay out of closer integration. The main concern here is the SSM's impact on the single market. With proper care, the SSM can be compatible with the single market. Nonetheless, frictions seem unavoidable. Countries outside the SSM have gained the power to block EU-wide decisions on the harmonisation of rules for the banking sector. If non-SSM countries use this power too often, it is to be expected that the SSM-countries will agree on rules that only apply to them. This will encourage cross-border banking activities in the SSM, but could make it more cumbersome for banks from other Member States to be active inside the SSM-countries.

Perhaps more important than the creation of the SSM itself is the fact that it represents a point of no return towards a European Banking Union. As a consequence of the SSM, the EU will have to put in place the other essential pillars of the Banking Union, namely: (i) a common answer to short-term banking problems, (ii) long-term crisis management arrangements, (iii) some form of a European deposit guarantee and (iv) harmonised banking rules. These issues will require tough decisions and risk sharing. A lack of bold decisions would result in a dysfunctional Banking Union that will not be able to achieve or maintain financial stability. A new crisis in the banking sector would seem inevitable. The major question is therefore not *if* a genuine Banking Union will be achieved, but *when*.

The task of achieving a Banking Union will not be easy. However, when the challenges and difficulties in advancing the Banking Union prove substantial, the EU and its Member States should keep in mind the ultimate goal: a safe banking sector that is able to contribute to the prosperity of European citizens. The importance of this goal should convince decision-makers to push ahead and refrain from stopping half-way. With the creation of the SSM, the first decisive step towards the Banking Union is taken. It is up to the EU to do the rest.

## ANNEX: TENTATIVE LIST OF EUROZONE BANKS UNDER DIRECT ECB SUPERVISION

The list below contains 117 eurozone banks that are likely to be considered as “significant” and, as a consequence, supervised directly by the ECB supervision. The list does not aim to be exhaustive or fully precise. Rather, it provides a preliminary overview of the future supervisory landscape in the SSM.<sup>78</sup>

Bank	Size of total assets (in bn EUR) <sup>1</sup>	Reason for direct supervision <sup>2</sup>	Note
<b>Austria</b>			
1) Erste Group	217	(A)	
2) Bank Austria	205.3	(A)	Subsidiary of UniCredit (Italy)
3) Raiffeisen Zentralbank Group	157.2	(A)	
4) BAWAG P.S.K.	43.4	(A)	
5) Hypo Group Alpe Adria	33.7	(A)	
<b>Belgium</b>			
1) Dexia	411.2	(A)	
2) BNP Paribas Fortis	352.3	(A)	Subsidiary of BNP Paribas (France)
3) KBC Group	270	(A)	
4) Belfius Bank	223	(A)	
5) ING Belgium	169.1*	(A)	Subsidiary of ING Group (the Netherlands)
6) AXA Bank Europe	41.8*	(A)	
7) Argenta	35.2*	(A)	
<b>Cyprus</b>			
1) Bank of Cyprus	36.2	(A)	
2) Cyprus Popular Bank / Laiki Bank Group	30.4	(A)	Will be resolved following the financial assistance programme for Cyprus
3) Eurobank EFG Cyprus	14.1°	(B)	Subsidiary of Eurobank EFG (Greece)
4) Hellenic Bank	8.7	(B)	
5) Alpha Bank Cyprus Group	6.2*	(B)	Subsidiary of Alpha Bank (Greece)
<b>Estonia</b>			
1) Swedbank Estonia	8.8	(B)	Subsidiary of Swedbank (Sweden)
2) SEB Pank Estonia	4.1	(C)	Subsidiary of SEB Group (Sweden)
3) Krediidipank	0.4	(C)	

78. Many thanks go to Esther Tonnaer for collecting and analysing the information necessary to draw-up this list.

Bank	Size of total assets (in bn EUR) <sup>1</sup>	Reason for direct supervision <sup>2</sup>	Note
<b>Finland</b>			
1) Nordea Bank Finland	389.7	(A)	Subsidiary of Nordea Bank (Sweden)
2) OP-Pohjola Group	99.8	(A)	
3) Danske Bank Finland (formerly Sampo Bank)	28.3	(C)	Subsidiary of Danske Bank (Denmark)
<b>France</b>			
1) Crédit Agricole	1,918.8	(A)	
2) BNP Paribas	1,907.3	(A)	
3) Société Générale	1250.7	(A)	
4) Groupe BPCE	1190.9	(A)	
5) Natixis	507.7*	(A)	
6) CM11-CIC Group	483.4	(A)	
7) Dexia Crédit Local	362.3	(A)	
8) HSBC France	240.3	(A)	Subsidiary of HSBC Holdings (United Kingdom)
9) Banque Postale	185.7*	(A)	
10) Crédit Immobilier de France	41.6*	(A)	
<b>Greece</b>			
1) National Bank of Greece	103.1	(A)	
2) Piraeus Bank Group	75.3	(A)	
3) Eurobank Ergasias	71.3	(A)	
4) Alpha Bank	57.1	(A)	
<b>Ireland</b>			
1) Bank of Ireland	157.8	(A)	
2) Allied Irish Bank	129.9	(A)	
3) Permanent TSB	43.8	(A)	
4) Ulster Bank	40.9	(A)	Subsidiary of The Royal Bank of Scotland (United Kingdom)
<b>Italy</b>			
1) UniCredit	969.2	(A)	
2) Intesa Sanpaolo	668.7	(A)	
3) Monte dei Paschi di Siena	224.1	(A)	
4) Banco Popolare	136	(A)	
5) UBI Banca	132.1	(A)	
6) Banca Nazionale del Lavoro	92.1	(A)	Subsidiary of BNP Paribas (France)
7) Mediobanca	79.4	(A)	
8) Banca Popolare dell'Emilia Romagna	59.6	(A)	
9) Banca Popolare di Milano	53	(A)	
10) Banca Carige	47.5	(A)	
11) Credito Emiliano	30.6	(A)	

Bank	Size of total assets (in bn EUR) <sup>1</sup>	Reason for direct supervision <sup>2</sup>	Note
<b>Luxembourg</b>			
1) Deutsche Bank Luxembourg	95.9*	(A)	Subsidiary of Deutsche Bank (Germany)
2) BGL BNP Paribas	52	(A)	Subsidiary of BNP Paribas (France)
3) Société Générale Bank and Trust	50.7*	(A)	Subsidiary of Société Générale (France)
4) Banque et Caisse d'Épargne de l'État	39.7*	(A)	
5) CACEIS Bank Luxembourg	36.8*	(A)	Subsidiary of Crédit Agricole Group (France)
6) UniCredit Luxembourg	26*	(B)	Subsidiary of UniCredit (Italy)
7) Hypothekenbank Frankfurt International	22.7	(B)	Subsidiary of Commerzbank (Germany)
8) Banque de Luxembourg	17.6*	(B)	
9) DZ PRIVATBANK	16.5*	(B)	Subsidiary of DZ Bank (Germany)
10) Deutsche Postbank International	16.1*	(B)	Subsidiary of Deutsche Postbank (Germany)
11) Norddeutsche Landesbank Luxembourg	15.4*	(B)	Subsidiary of Norddeutsche Landesbank (Germany)
12) Eurobank Private Bank Luxembourg	15*	(B)	Subsidiary of Eurobank Ergasias (Greece)
13) KBL European Private Bankers	13.4	(B)	
14) Société Européenne de Banque	12*	(B)	Subsidiary of Intesa Sanpaolo (Italy)
15) ING Luxembourg	11.6*	(B)	Subsidiary of ING Group (the Netherlands)
<b>Germany</b>			
1) Deutsche Bank	2,185.6	(A)	
2) Commerzbank	675.6	(A)	
3) KfW Bankengruppe	494.8*	(A)	
4) DZ Bank	406.8	(A)	
5) HypoVereinsbank	399.4	(A)	Subsidiary of UniCredit Bank (Italy)
6) Landesbank Baden-Württemberg	372.8	(A)	
7) BayernLB	300.9	(A)	
8) Hypo Real Estate Holding	236.6*	(A)	
9) Norddeutsche Landesbank	225.2	(A)	
10) Deutsche Postbank	199.1	(A)	
11) Portigon (formerly WestLB)	170.8	(A)	
12) Helaba Landesbank Hessen-Thüringen	166.5	(A)	
13) DekaBank Group	138.4	(A)	

Bank	Size of total assets (in bn EUR) <sup>1</sup>	Reason for direct supervision <sup>2</sup>	Note
14) HSH Nordbank	136.4	(A)	
15) Landesbank Berlin Holding	125.7	(A)	
16) WGZ-Bank	96.2	(A)	
17) IKB Deutsche Industriebank	31.6	(A)	
<b>Malta</b>			
1) Bank of Valletta	7	(B)	
2) HSBC Malta	6	(B)	Subsidiary of HSBC Holdings (United Kingdom)
3) APS Bank Malta	0.8*	(C)	
<b>The Netherlands</b>			
1) ING Group	1,248.1	(A)	
2) RaboBank Group	770.9	(A)	
3) ABN AMRO Group	430.4	(A)	
4) Bank Nederlandse Gemeenten	143.3	(A)	
5) SNS Reaal (SNS Bank)	134.2	(A)	
<b>Portugal</b>			
1) Caixa Geral de Depósitos	116.9	(A)	
2) Banco Comercial Português	89.7	(A)	
3) Banco Espírito Santo	83.7	(A)	
4) Banco Português de Investimento	44.6	(A)	
5) Banco Santander Totta	41.4	(A)	Subsidiary of Santander Group (Spain)
<b>Slovakia</b>			
1) Slovenská Sporitelna	11.3*	(C)	Subsidiary of Erste Group (Austria)
2) VUB Banka	10.8*	(C)	Subsidiary of Intesa Sanpaolo (Italy)
3) Tatra Banka	9.2*	(C)	Subsidiary of Raiffeisen Group (Austria)
<b>Spain</b>			
1) Santander Group	1,269.6	(A)	
2) Banco Bilbao Vizcaya Argentaria	637.9	(A)	
3) CaixaBank	348.3	(A)	
4) Bankia	301.9	(A)	
5) Banco Popular Español	130.9*	(A)	
6) Banesto	106.2*	(A)	
7) Banco Sabadell Group	100.4*	(A)	
8) Nova Caixa Galicia Banco	70.3	(A)	
9) Bilbao Bizkaia Kutxa	69.4	(A)	
10) Banco Mare Nostrum	68.4	(A)	
11) CatalunyaCaixa	67.5*	(A)	
12) Bankinter	59.5*	(A)	

Bank	Size of total assets (in bn EUR) <sup>1</sup>	Reason for direct supervision <sup>2</sup>	Note
13) Liberbank	51.5	(A)	
14) Grupo Ibercaja	45.2*	(A)	
15) Caja España-Duero	42.4*	(A)	
16) Banco Unicaja	38.3*	(A)	
<b>Slovenia</b>			
1) NLB Group	14.3	(B)	
2) Nova KBM	5.8*	(C)	
3) Abanka Vipava	4.2	(C)	

#### Remarks

Source: Financial reporting by relevant banks and data collected by KPMG for the banks CACEIS Bank Luxembourg, Deutsche Postbank International and Norddeutsche Landesbank Luxembourg.

(1) 2012 data, unless indicated otherwise:

\*: 2011 data

°: 2010 data

(2) Reasons for direct ECB supervision:

(A) The value of a bank's assets exceeds € 30 billion.

(B) The value of a bank's assets exceeds both € 5 billion and 20% of the GDP of the Member State in which it is located.

(C) A bank is among the three most significant banks in the country in which it is located.

