Single Supervisory Mechanism and Single Market

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The road to the SSM

- **The problem/s**: trilemma of financial supervision, vicious circle between banks and sovereigns & and dichotomy of national vs supranational/international (WFO?)
- **The trigger**: the twin financial crisis and sovereign debt crisis in the eurozone (before and after 2010).
- **The solution/s in Europe**
  - 1st wave of responses aimed at the single market - Federalisation of financial supervision via ESAS (De Larosière). Macro prudential supervision (ESRB) - SIFIs. Massive regulatory overhaul (capital etc.)
  - 2nd wave of responses aimed at the eurozone - From federalisation to centralisation – supervision and crisis management – banking union

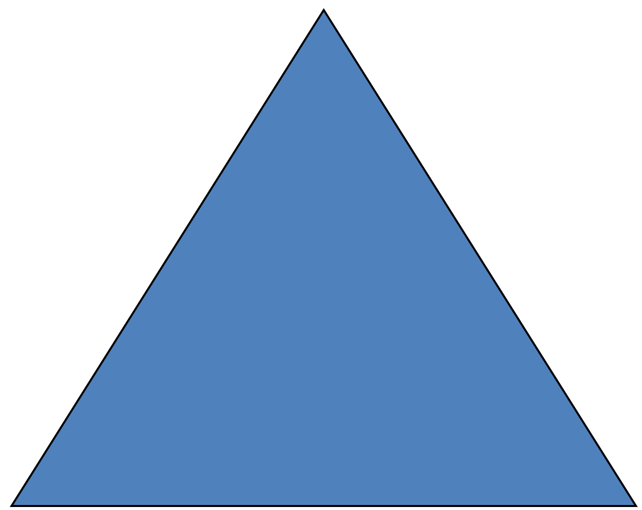
Banking Union

- Scope (SSM, resolution and DI) Treaty basis and Treaty constraints
- Complicating factors: **jurisdictional domain**, state aid, fiscal backstop

The ‘trilemma’ of financial supervision
(Shoenmaker/Thygesen)

Stable financial system (financial stability)

<u>Financial stability is a goal that transcends institutional boundaries and geographic borders</u>



Integrated financial market

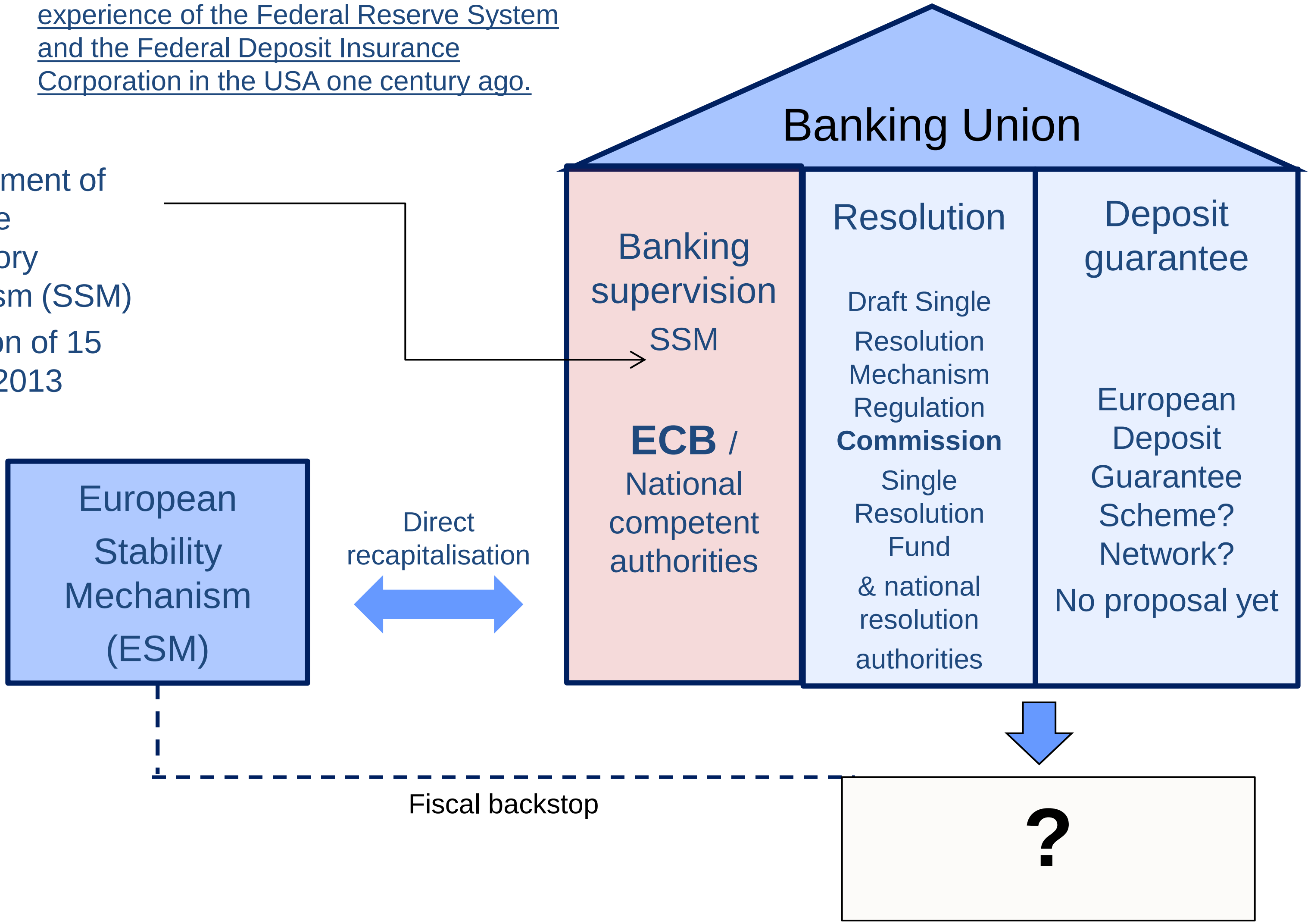
National financial supervision

Banking union

Interestingly, this process replicates the experience of the Federal Reserve System and the Federal Deposit Insurance Corporation in the USA one century ago.

Establishment of the Single Supervisory Mechanism (SSM)

Regulation of 15 October 2013



Drawing upon Antonio Sainz de Vicuna (Lecture 2012)

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The Legal Foundations of the SSM

- Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013

  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:287:0005:0014:EN:PDF

- According to Article 33, The ECB shall assume the tasks conferred on it by this SSM regulation on 4 November 2014 (subject to the implementation arrangements).

- Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions

  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:287:0063:0089:EN:PDF

Treaty basis (for SSM, Resolution & DI)

- The legal basis for the transfer of supervisory responsibilities to the ECB, and the legislative basis for the SSM Regulation, is Article 127(6) TFEU, which allows the Council to confer "specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings" and requires for its adoption unanimity by the Council, after consulting with the Parliament and the ECB.
- Resolution does not fall under scope of competences that can be conferred upon ECB by Article 127 (6), unless one interprets the supervisory process in a very broad sense. Of the options available, such as Article 136 TFEU (basis for the ESM Treaty) and Article 114 (basis for establishing the ESAs - secondary law), the latter has been preferred:
- **Back to the single market ...**- Article 114 of the Treaty on the Functioning of the European Union (TFEU) is the legal basis for the proposed SRM. It allows the EU to adopt measures for the approximation of national provisions laid down by law, regulation or administrative action aiming at the establishment and functioning of the Internal Market.
- Question: do we need a Treaty revision for resolution?

The doomed loop or vicious link

- A banking crisis can lead to a sovereign debt crisis (Ireland, Iceland). Sovereign debt crises can lead to banking crises (Greece).
- Breaking the vicious link between bank and sovereign debt is at the root of the political agreement [EU] that led to the creation of the banking union:
    - <u>In order to receive ESM assistance banks have to be subject to European supervision</u> (conditionality).
    - Banks are often reluctant to engage into the debt restructuring process because the recognition of a loss in their balance sheet will have adverse capital implications. For this reason, Sean Hagan writes, ‘vigilant supervision ... is a necessary feature of any effective debt restructuring process.
- But banking union is not enough to break this vicious link. We also need to address – as Jens Weidman writing in FT on 1st Oct 2013 suggested – the regulatory treatment of sovereign exposures. Under current capital rules, sovereign debt carries low or zero risk weighting and there is no limit on a bank’s exposure to a single sovereign. We need to end the ‘fiction of risk-free assets’ which receive favourable ratings by credit rating agencies.

Supervision & crisis management

- The ‘seamless process’: <u>from supervision to crisis management</u> (LOLR, D.I., Resolution, insolvency)
- **The example of Fed and FDIC. Federalisation of liquidity assistance (1913) and resolution/deposit insurance (1933)**
- **Liquidity support** – first line of support
  - Central banks as lenders of last resort
    - Market liquidity
    - Individual liquidity assistance
- **Solvency support/guarantees/recapitalization**
  - Governments – capital of last resort
  - ‘Political fact’ of government assistance in a crisis
- **Fiscal problems – sovereign debt problems**

From the SSM to Single Resolution and DI

- **RESOLUTION -** While the ECB has powers for early intervention and withdrawal of licenses under the proposals, we need to clarify how we go from early intervention to resolution and insolvency. Resolution is a highly legal, highly technical, highly complicated task- very micro and resource-intensive. It requires legal certainty and clear powers. On 10 July 2013, the Commission published the proposed Single Resolution Mechanism (SRM) Regulation. As highlighted by the European Council <u>it is not feasible to have a single European mechanism for the supervision of banks but to leave the resolution of banks to national authorities.</u>
- **DEPOSIT INSURANCE** - With perfect capital mobility, in order to prevent a flight of deposits from troubled countries to countries perceived to be 'safe', one needs to convince ordinary citizens that a euro in a bank account in one Euro area Member State is the worth the same and is as secure as a euro in a bank account in another Euro area Member State. This is a real challenge, as the experience in Cyprus evidences. (Tom Huertas warns, Reuters, 21 September 2012 that 'such a scheme would potentially have an enormous contingent liability'). Someone has to pay . Bail in? Ring fence?

ECB – SSM Regulation – Legal Foundations

- Independence (Art. 19) and accountability (Art. 20-24)
- Separation between monetary policy and supervision (and primacy of the price stability mandate) - Mediation panel - Article 25 SSM
- Governance issues (Supervisory Board, secondary law)
- Recourse to national authorities (art. 6) staff exchange, Art. 31)
- LOLR (the elephant in the room?)
- Macro-prudential tasks and tools (article 5) and ESRB
- Conduct of supervision
  - Very demanding task – resources and personnel
  - Potential reputational damage
  - Very litigious (Panel of review) (?)
  - Not cheap – supervisory fees (Article 30)
  - Thankless task!

Complicating factors: jurisdictional domain

- The Euro area, the SSM area, the EU and the EEA represent concentric circles of integration, subject to differentiation and conditionality.
- Uneasy co-existence between banking union and single market
- While the framework for recovery and resolution - RRD - and a single rule-book relate to the EU as a whole (needs of a single market), the Single Supervisory Mechanism - SSM - single deposit insurance and single Resolution relate more specifically to the needs of the euro area (SSM area). Furthermore, state aid rules are a fundamental component of the Single Market, and are intrinsically related to the area of resolution. Hence the pivotal role of the Commission in the Proposed SRM Regulation.
- Coordination amongst different entities – ESRB, EBA, ESMA EIOPA, ESM and ECB, national authorities – is problematic as the tripartite arrangement in the UK showed in Northern Rock. <u>Complexity frustrates accountability</u>.
- **The needs of a well functioning single market in financial services cannot be disentangled from the design of the banking union.**

Other issues

- Legitimacy (elite driven process?)
- Subsidiarity and centralisation
- **The pursuit of financial stability**
  - The simplicity of one goal, one main policy instrument (monetary policy) and one authority (central bank) that characterizes the monetary architecture contrasts with the multiple goals, multiple instruments, multiple authorities that characterize the pursuit of financial stability.
  - Central banks should plays a key role in the pursuit of financial stability, because of (1) their role in the conduct of monetary policy in the pursuit of monetary stability and (2) because of their lender of last resort responsibility.
  - With or without supervisory responsibilities the central bank always acts as bankers' bank, centralizing reserves, providing payment services, and fundamentally acting as lender of last resort.
  - **And we still have SIFIs and TBTF**

The Little Prince
Antoine de Saint Exupéry
'The baobabs'

SIFIs - systemic risk is as likely to arise from securities and derivatives markets as it is from banking markets. Different solutions in different jurisdictions...

There were some terrible seeds on the planet that was the home of the little prince, and these were the seeds of the baobab. (...) A baobab is something you will never be able to get rid of if you attend to it too late. It spreads over the entire planet. (...) And if the planet is too small and the baobabs are too many, they split it into pieces. (...) After explaining how he cleaned the seeds of the baobabs everyday he added: 'Sometimes, there is no harm in putting off a piece of work until another day. But when it is a matter of baobabs, that always means a catastrophe. (...) [T]he danger of the baobabs is so little understood, and such considerable risks would be run by anyone who might get lost on an asteroid, that for once I am breaking through my reserve. (...) I say plainly, 'watch out for the baobabs'.

'The Little Prince' by Antoine du Saint-Exupéry