# Banking union: challenges

Presentation at the summer conference of the
***CIRSF***
*– Research Centre on Regulation and Supervision of the Financial Sector*
*– Centro de Investigação em Regulação e Supervisão do Sector Financeiro*
**Current Challenges of Regulation and Supervision of the Financial Sector**

Lisbon (P), Friday 28 June 2013

**Professor Dr. René Smits**
Jean Monnet Professor of the
Law of the Economic and Monetary Union,
*Universiteit van Amsterdam*, Amsterdam (NL)
Visiting Professorial Fellow, Centre for Commercial Law Studies,
Queen Mary, University of London, London (GB),
Consultant on monetary law and EU banking supervision, RS Law & Society Consulting B.V.,

# Introduction

1. Definition of “banking union”
2. Some legal issues of SSM
   a) Competences to enact “banking union” legislation
   b) Objectives of SSM
   c) Application of national law
   d) Review of decisions and supervisory liability
   e) Openness of banking market to newcomers
   f) Exchange of information
   g) Accountability
   h) And: structure of banks – practical issues – ethics
3. Single Resolution Mechanism
4. Legal, political, cultural challenges

# Banking union

1. Single Supervisory Mechanism, term for ECB assuming operational tasks in prudential supervision, together with national competent and designated institutions // micro-prudential next to macro-prudential supervision (ESRB)
2. Recovery and Resolution at EU level (via ESM?)
3. Deposit Insurance at EU level

All this based on:

- Single rulebook (CRD IV + CRR):

http://register.consilium.europa.eu/pdf/en/13/pe00/pe00014.en13.pdf#page=2
http://register.consilium.europa.eu/pdf/en/13/pe00/pe00015.en13.pdf#page=2

# Why is banking union necessary?

- Euro Area Summit 29 June 2012: “to break the vicious link between banks and sovereigns”
- Guaranteeing and injecting capital into banks negatively affects government’s finances and market standing (Ireland as the worst example)
- Banks in States with a government in financial need pay a premium on inter-bank borrowing

# ECB's definition of "banking union"

Benoît Coeuré, ECB Board member, speech, 23 May 2013:

- "(…) for there to be a genuine banking union, by which I mean a situation where confidence in deposits is independent of the jurisdiction in which they are located, all three pillars have to be in place"
- "From the ECB's point of view, only if the SSM is complemented by a Single Resolution Mechanism with a common backstop can the negative feedback loop between sovereigns and banks be broken, ensuring thereby that monetary policy transmission is fully restored."

# Single Supervisory Mechanism

# Competence: Article 127(6) TFEU

- Clear competence to make ECB responsible for day-to-day operational tasks in prudential supervision: text, context and intention of Treaty authors
- Sufficient competence for additional decision-making provisions (Governing Council effectively 'rubber-stamping' Supervisory Board decisions)?
- Risk of challenges when decisions addressed to banks will be reviewed by courts

# Objectives - 1

- Safety and soundness of credit institutions
  (preamble paras. 17, 30, 65, Article 1)
- Stability of the financial system (idem)
- "full regard and duty of care to" unity and integrity of the internal market"
- Also a "duty of care" towards depositors?
  > para. 30 preamble: ", thereby ensuring also the protection of depositors"
  > relevant for assumption of supervisory liability vis-à-vis depositors
- Further objectives: "Since the objectives of this Regulation, namely setting up an efficient and effective framework for the exercise of specific supervisory tasks over credit institutions by a Union institution, and ensuring the consistent application of the single rulebook to credit institutions" (preamble para. 87)

# Objectives - 2

- Consumers not found except in two paragraphs of the preamble:
  - Exclusion: "Supervisory tasks not conferred on the ECB should remain with national authorities. Those tasks should include (…) (…) and consumer protection." (preamble para. 28)
  - Inclusion: "The ECB should cooperate, as appropriate, fully with the national authorities which are competent to ensure a high level of consumer protection and the fight against money laundering *[where's terrorist financing?, RS]*" (preamble para. 29)
- Exclusion of payment services remarkable: this is a basic task
- Compare Article 127(2), 4th indent, TFEU / Article 3.1, 4th indent, Statute ("to promote the smooth operation of payment systems.") with preamble para. 28: "to supervise payments services"
- 'Systems' vs. 'services'? Cf. limited SEPA role for ECB, regrettably
- Further exclusions: prudential supervision of central counterparties (Article 1) and no discrimination on currency grounds: London (Article 1)

# Application of national law

- ECB to apply all relevant EU law and, where EU law consists of directives, “the national legislation transposing those Directives” – where a regulation grants Member States options, ECB to apply national legislation exercising those options (Article 4 (3))
- Preamble para. 34: “Such options should be construed as excluding options available only to competent or designated authorities. This is without prejudice to the principle of the primacy of EU law. It follows that the ECB should, when adopting guidelines or recommendations or when taking decisions, base itself on, and act in accordance with, the relevant binding Union law.” **????**

# Review of supervisory decisions: who's liable?

- Case law on liability for acts effected by national authority at instruction of EU (*Krohn*: who is "the true author of the decision from which the damage resulted"?)
- Clear demarcation line between ECB/NCA?
- ECB acting on basis of national law (implementing EU directives): complication
- Link with (full) supervisory liability

# ECB instructing NCAs

- Article 9 (1):

  "To the extent necessary to carry out the tasks conferred on it by this Regulation, the ECB may require, by way of instructions, those national authorities to make use of their powers, under and in accordance with the conditions set out in national law, where this Regulation does not confer such powers on the ECB. Those national authorities shall fully inform the ECB about the exercise of those powers."
- Instructions: Articles 6(3) and (5), 7(1) and (4) [participating <outs>], 30 (5) [supervisory fees],

# Paragraph 61 preamble

"In accordance with Article 340 TFEU, the ECB should, in accordance with the general principles common to the laws of the Member States, make good any damage caused by it or by its servants in the performance of their duties.

This should be without prejudice to the liability of national competent authorities to make good any damage caused by them or by their servants in the performance of their duties in accordance with national legislation."

# Supervisor's dilemma

- Early intervention? Shareholders will sue
- Late intervention? Depositors will sue
- Duty of care vis-à-vis depositors? (*Peter Paul* [ECJ], *Icesave* [EFTA], national case law, notably *Three Rivers Council vs. Bank of England*, but also *Vie d'Or*)
- Trend towards limiting supervisory liability

# Review of supervisory decisions: who decides?

- ECJ
- National court
- Interplay (preliminary rulings)

# Will ECB be able to allow newcomers? Or will national authorities keep them out?

- ✓ ECB is to control entry to and exit from market
- ✓ ECB called in to ensure "supervision of the highest quality, unfettered by other, non-prudential considerations" (preamble, paras. 12 and 83)
- ❑ Do the arrangements laid down in Article 14 lead to such exclusive ECB control? NCA to submit draft authorisation decision to ECB but NCA to reject authorisation if not all conditions are met.
- ❑ How will ECB ensure that NCAs do not keep newcomers/mavericks out? Important for dynamism in banking market and reviving competitive conditions

# Information exchange in SSM sufficient?

- Mandatory information exchange and full, appropriate information of ECB
- Information exchange dried up during crisis:
  (Fortis, Dexia, other cases)
- Some questions:
  - Are the requirements sufficient?
  - Paragraph 47 preamble, Article 6(2) and (5) (e))
  - Who determines which information is 'necessary'?
  - Why isn't there a requirement for NCAs like the one for market parties subject to supervision (Article 10(2))?
  - Is there the equivalent in the SSM Regulation of the requirement vis-à-vis the EBA ("The information must be accurate, coherent, complete and timely")

# Article 35 (draft) EBA Regulation

"At the request of the Authority, the competent authorities shall provide the Authority with all the necessary information in specified formats to carry out the duties assigned to it by this Regulation, provided that they have legal access to the relevant information. The information must be accurate, coherent, complete and timely."

Or did I overlook something similar in the SSM regulation?

# Accountability: MoUs // EP

- MoUs: useful instruments? public?
- European Parliament / ECB arrangements for scrutiny of supervisory role and confidentiality of supervisory data: Article 20 (8) and (9)

  – cf. *Hillegom/Hillenius* Case 10/84, [1985] ECR 3947 and parliamentary scrutiny of Dutch central bank

  (crisis investigation and investigation into bank failures)

# Some other issues

- Structural issues (separating investment and commercial banking) outside scope of action for SSM – Liikanen Report (EU) // Vickers Report (UK)
- Practical matters: time constraints for preparing decisions between national competent authority and ECB: ECB ‘Framework Regulation’
- Ethics of banking / bankers

  Evelyn de Rothschild (FT), John Kay (FT), Herman Wijffels (NL commission on banking), British Commission on Banking Standards

# Single Resolution Mechanism

# Single Resolution Authority

(SSM Regulation, preamble, paragraph 70)

# Single Resolution Mechanism - 1

- Role / status of the resolution authority unclear
  - Joined network of national authorities?
  - Separate legal entity?
- Sufficient EU competence for new authority?
  - Article 114 TFEU narrow legal basis even for ESAs (ESFS: EBA, ESMA, EIOPA, ESRB)
  - *Meroni* doctrine: no discretion for agency beyond Treaty
- Commission: 'natural' authority:
  - ✓ Union institution (no *Meroni* difficulty)
  - ✓ Effective resolution authority for banks since 2008

# Single Resolution Mechanism - 2

- Bail-in of shareholders, creditors: what is their share?
- Should even depositors contribute? Not if < € 100,000!
- Cyprus ‘template’
- Moral hazard

# ESM direct bank recapitalisation instrument

- Agreed 20 June 2013
- Preserving financial stability euro area as a whole and its Member States
- Criteria for direct financing:
  1. Very adverse effects on fiscal sustainability / endangering continuous market access for MS
  2. Indispensable for financial stability of Euro area / MS
  3. Bank in breach of ECB's capital requirements
  4. Bank is of systemic relevance / poses serious threat to financial stability
- € 60 billion
- ESM operates via subsidiaries
- Conditionality: institution-specific and for MS (MoU)
- ESM influence balanced: independent commercial business practices (application of merger control)

# Single Resolution Mechanism - 3

- Insolvency law harmonisation or single resolution regime for EU banks: uphill task

  ECB Opinion (CON 2012/99) on draft directive harmonising national R&R rules: preferential ranking of deposits paid-out by deposit guarantee systems (as in Portugal and 5 other States) // “Efforts to further minimally harmonise insolvency rules across Member States should be continued”

- Sufficient ESM funding (€ 60 bn)?

  Wolfgang Münchau (FT, 23 June 2013):

  “Europe is ignoring the scale of bank losses”

# Cultural challenges SSM

- ✓ Diversity (among staff and banks) & languages
- ✓ “Highly motivated, well-trained and impartial staff is indispensable to effective supervision” / geographical diversity (preamble, para. 79)
- ✓ Staff exchanges // conflicts of interest rules (‘capture’) (Article 31)
- ✓ “the ECB should have full regard to the diversity of credit institutions and their size and business models, as well as the systemic benefits of diversity in the banking industry of the Union” (preamble, para. 17)

# Political & legal challenges

- Idea of banking union (to 'break the vicious circle between banks and sovereigns') accepted, applying it proves hard
- 'Ratification' of SSM regulation: Germany
- German elections
- *Bundesverfassungsgericht* may decide fate of 'banking union'
- Resolution requires common insolvency framework for finance industry
- Position of the <outs> (non euro area States)
- Treaty change?