European Union Towards the Banking Union, Single Supervisory Mechanism and Challenges on the Road Ahead

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The financial crisis in the Eurozone has posed a serious challenge to the viability of the existing legal structure, which serves as the grounds for the European Union's (EU) Member States' economic cooperation. The EU's financial and banking institutions and its decision-making bodies' failure to predict, and to prevent this economic crisis, has led the Union's decision-makers to conclude that they must reinforce the supervisory powers of the European Central Bank (ECB). The consequent establishment of the Single Supervisory Mechanism has increased ECB's expectations from the administration of the European banks. However, as in any attempt at crisis management, the EU Member States face an important question: are the proposed solutions compatible with the existing structures that were put in place by current treaties? On the one hand, the European financial market's vulnerability to each Member State's crises indicates that it requires a higher degree of centralization in supervisory matters. On the other hand, all Member States, including the non-Eurozone EU Member States, reasonably expect that the ECB's powers be limited to the matters in which they have agreed to relinquish their sovereign rights, and that they participate effectively in the decision-making process. The final resolution establishing the Single Supervisory Mechanism seems to meet some of these expectations. However, questions about this mechanism's compatibility with existing treaties, as well as with EU standards for the ECB's accountability, remain far from being fully resolved.

Keywords: Accountability, Banking Regulation, Banking Supervision, Equal Treatment, EU Law, Legitimacy, Single Supervisory Mechanism, Sovereign Debt Crisis.

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I. INTRODUCTION

Economic integration and financial issues have always been central to the European Union's development. There is no doubt that economic interests have been the driving force behind European countries' integration process. It may even be argued that the economic policies' effects have gone far beyond the objectives of economic growth and development, influencing all aspects of the EU states and their citizens' lives. One of the encouraging results of economic integration and collaboration has been the region's increased political stability. The region had previously been the scene of devastating wars and political and economic rivalries.[1] On the other hand, these economic incentives also have negative consequences. Despite its advantages, the monetary union of seventeen European states creates a unique economic situation; a financial crisis in any state crosses national boundaries and affects all other states of the Union. The current sovereign and private sector debt crises in Greece, Ireland, Italy, and Spain, and the attempts of economically stable countries (such as Germany and France) to rescue them, are the best examples of economic integration's undesirable results. The EU Commission, well aware of these problems, has described the debt crisis in the following terms:

> Doubts about the sustainability of public debt, economic growth prospects, and the viability of credit institutions have been creating negative, mutually reinforcing market trends... The situation poses specific risks within the euro area, where the single currency increases the likelihood that developments in one Member State can create risks for economic development and the stability of the

[1] 'How the EU Works' (*European Union website*) <http://europa.eu/about-eu/> accessed 28 May 2014.

Euro area as a whole.[2]

Despite the critical situation that all members of the EU find themselves in, the EU and its members are unwilling to withdraw from the path they have been on for the past five decades. They are determined to overcome the problems they face and have proposed a higher level of cooperation and integration. In order to 'restore confidence in banks and in the euro',[3] EU members have introduced the 'Single Supervisory Mechanism' (SSM), which gives the European Central Bank (ECB) significant regulatory and supervisory powers. The SSM decreases national financial authorities' powers and transfers jurisdiction from the national level to the Union's monetary entity. On March 19th 2013, the Commission's proposal for the SSM was adopted by the joint meeting of the EU Parliament, the Commission, and the Council of Ministers. On September 12th 2013, after a series of consultations and amendments, the EU Parliament adopted a legislative resolution on a proposed Council regulation. This resolution would confer specific tasks on the ECB with regards to policies related to the prudential supervision of credit institutions.

Despite the severity of the debt crisis and the necessity of concerted rescue action by all EU members, it was not easy for the Union to finalize the supervisory plan, and its establishment faced some substantial challenges. One of the EU States main concerns stems from their desire to maintain their internal sovereignty over issues touching upon the interests of national businesses. Needless to say, this is not a new challenge. Since the Union's establishment, some Member States have been reluctant to transfer their authority to EU institutions, although some have also been eager to join the single market of the EU zone. In fact, the economic privileges are not enough motivation for states to limit their national sovereignty.[4] In the case at hand, the German government's resistance to including its regional bank in the SSM sheds light on the problem's complexity. The Council Regulation that conferred specific tasks on the ECB regarding policies on prudential supervision of credit institutions establishes the supervisory mechanism. It states that banks and financial institutions with assets of more than 30 billion euro are under the ECB's supervision. This means Germany has used its leverage to limit the ECB's supervisory jurisdiction's scope, while its government has been a strong

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[2] European Commission, 'Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions', COM (2012) 511 final, para 1.2. ('Commission Proposal').

[3] ibid.

[4] Jurgen Habermas, 'Why Europe Needs a Constitution' (2011) (*October New Left Review*) <www.newleftreview.org/A2343> accessed 28 May 2014.

proponent of the mechanism.[5] The British government's vote against the proposal shows its reluctance to be subjected to the ECB's supervision. The UK prefers to protect its central bank's sovereign rights by limiting them to the financial business conducted in London, the financial capital of Europe.[6]

It is also worth noting that the EU's encroachment upon its Member States' internal sovereignty is not their only concern. Since the Union's foundation, the Member States' internal affairs have come more and more under the control of EU regulations and directives. According to statistics, 70% of national agencies that play a significant role in European citizens' everyday lives are affected by the EU's regulations. These regulations, however, have not been subjected to 'timely and careful public opinion or will-formation' at the national level where these regulations' real effects are felt.[7] Thus, the extent to which the ECB is held accountable for its actions with regards to the EU's members is highly significant.[8]

In light of the above-mentioned arguments, this paper intends to analyze the legal aspects of the Single Supervisory Mechanism (SSM), and to consider its positive and negative effects on the EU. However, prior to the legal analysis, it is necessary to present an outline of the financial crisis the EU is struggling with. Subsequently, the economic and financial crisis that has hit Europe in recent years and the European Union's responses to this problem will be discussed first. Then, because one of these responses has been the establishment of a Single Supervisory Mechanism (which is the main focus of this paper), ways this plan can help the EU overcome the crisis will be discussed.

The majority of this paper will be devoted to arguments about difficulties the Union faces with regards to the SSM's establishment within the EU. It is possible to criticize the existing Treaties' legal structure, and there may also be a conflict with the ECB's mandate. As the established entity for carrying out supervisory tasks, the ECB is also responsible for setting monetary policies. Therefore, achieving these two mandates' objectives is a

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[5] Toby Vogel, 'EU Reaches Deal on Banking Supervision' (*The European Voice*) <www.europeanvoice.com/article/2013/march/eu-reaches-deal-on-banking-supervision/76697.aspx> accessed 28 May 2014.

[6] House of Lords European Union Committee, 'European Banking Union: Key issues and challenges', HL 7th Report of Session 2012-2013, Chapter 2 paras 88-7 ('HL EU Committee Report on EU Banking Union')

[7] Habermas (n 4).

[8] *Gabriele Steinhauser and Laurence Norman,* 'Single Supervisor? Not so Fast' (*The Real Time Brussels,* 27 March 2013) <http://blogs.wsj.com/brussels/2013/03/27/single-supervisor-not-so-fast/> accessed 28 May 2014.

concern for some European countries. The legal boundaries that are set by EU legal principles—such as equal treatment for all EU Member States—are another example of these challenges. This may be another obstacle to conferring supervisory authority to the ECB, because according to the existing treaties, the ECB supervises banks located within the so-called Eurozone.

Another issue that has raised concerns is the mechanism's accountability, which seems difficult to reconcile with the central bank's independence in the EU. The Member States' concerns, and the measures that the Council and the EU Parliament have taken to soothe these concerns, will be discussed in detail.

Furthermore the effect the SSM's establishment has on other agencies with similar mandates in the banking sector (ie the European Banking Authority) will be discussed. There are similarities in the two agencies' mandates; thus, raising the risk of their mandates overlapping, or of the EBA being marginalized as banking supervision becomes centralized. Moreover, non-participating Member States will risk being outvoted by participating Member States, as the latter will follow the same policy the SSM sets for the Eurozone. It is to be noted, however, that, the Commission's proposals have been amended several times since the first draft's publication, and these issues have been addressed as much as possible in the latest version adopted by the Parliament. After explaining the challenges the EU is struggling with, the most recent amendments addressing the above mentioned issues will be discussed in this paper.

II. How Did the Sovereign Debt Crisis Emerge and What Are the European Union's Responses?

Looking back at the history of the financial crisis that hit Europe in 2008, a long period of credit growth and low risk premiums can be seen. This was the result of prospering economic activity and sufficient liquidity in the markets. As the Commission has stated:

> Strong leveraging, soaring asset prices and the development of bubbles in the real estate sector also shaped this financial situation. Stretched leveraged positions and maturity mismatches rendered financial institutions very vulnerable to corrections in asset markets, deteriorating loan performance and disturbances in the wholesale funding markets.[9]

[9] European Commission, 'Economic Crisis in Europe: Causes, Consequences and Responses' DG Economic and Financial Affairs, (2009) 7 European Economy

In response to this situation, banks became worried about their counterparts' creditworthiness. Therefore, the 'intrabank market virtually closed and risk premiums on intrabank loans soared'.[10]

This caused overall credit conditions to deteriorate, which diminished economic activity. Also, the credit market's sudden collapse left many banks unable to repay their loans, thereby forcing governments to intervene in the banking sector. This massive transfer of liability overwhelmed governments' balance sheets and resulted in the EU Member States' debt crisis.[11]

The introduction of the Euro as the common currency for 17 EU members and the establishment of the EMU (European Monetary Union) are two of the major driving factors in aggravating the crisis. The main argument for this idea is the 'Impossible Trinity' which consists of the 'absence of co-responsibility for public debt"[12], the strict 'no monetary financing' [13]rule and the interdependence of bank and sovereign.[14]

This Impossible Trinity makes the Euro-area vulnerable to crisis, because trouble with sovereign solvency will result in shocks to bank solvency. The Central Bank is not empowered to provide liquidity to the sovereigns in order to stall the self-feeding debt crises.[15]

Moreover, by establishing the European Monetary Union (EMU) aimed at creating a single currency and a harmonized monetary policy, the European Union has not made a common fiscal policy one of its mandates. This requires the economically weaker countries to deal with the same monetary policy as the strongest, with no means to adapt their exchange rate in response to their financial situation. On the other hand, deficits in

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<http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf> accessed 28 May 2014, 1-8.

[10] ibid.

[11] Benoite Cœuré, 'Banking Union and Fiscal Union in Europe: Outlook and Implications for Global Partners' Asia-Europe Economic Forum Conference on European Troubles, Bruegel 2013 <www.ecb.int/press/key/date/2013/html/sp130121.en.html> accessed 28 May 2014.

[12] Consolidated Version of the Treaty on the Functioning of the European Union [2010] OJ C83/47 ('TFEU') art 129(1) and Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank [2008] OJ C115/230 art 123.

[13] ibid, art 125.

[14] Jean Pisani-Ferri, 'The Euro Crisis and the New Impossible Trinity' (2012) Bruegel Policy Contribution, 1- 4.

[15] ibid, 9.

troubled countries may contaminate the whole market, as all countries are using the same currency. This was one of the main factors in the spread of the crisis among the Eurozone Member States.

Analyzing the crisis and its roots requires a deep financial approach, which is not feasible within the space of this paper. Leaving this task to the financial policy-makers, it should be mentioned that the European policy makers responded actively to the management of the crisis.

Following the Greek financial rescue package and the establishment of the temporary European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF), a number of different policy options were discussed. These included how to establish financial rescue mechanisms, how to strengthen the Stability and Growth Pact, and how to enhance banking supervision with the goal of making the banking system more robust in the face of sovereign defaults.[16]

Moreover, after the Greek debt crisis, some Member States initiated austerity measures to meet the requirements for bailout loans so that they could receive the loans and overcome financial problems. These measures included reducing public pensions and expenditures on public services and increasing government revenue by imposing higher taxes to compensate for the budget deficit. Over time, these measures inflicted severe economic suffering on troubled countries: 'they resulted in more unemployment and economic activity, the economy of the 17 European Union countries that use the euro descended into more recession.'[17]

As the lender of last resort, the ECB took important standard and non-standard measures to support the states in crisis by injecting liquidity into the market. This was done by giving cheap loans and buying governments bonds, and the ECB was criticized repeatedly for acting outside of its mandate. One of those measures was the Outright Monetary Transactions program, by which the ECB arguably circumvented the prohibition against direct government financing by the central bank. However, undoubtedly, the ECB efficiently ameliorated the crisis, even though its new measures were not compatible with its main mandate, which is safeguarding price stability.

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[16] Deborah Zandstra, 'The European Sovereign Debt Crisis and its Evolving Resolution' (2011) 6 (3) Capital Markets L J 285.

[17] 'European Leaders Change Views on Austerity' (*CBC News,* 15 March 2013) <http://www.cbc.ca/news/business/story/2013/03/15/austerity-eu.html> accessed 28 May 2014.

On September 12th 2012, the European Commission published three documents: a communication entitled 'A Roadmap towards a Banking Union'; a proposal for a Council regulation based on Article 127(6) to create the Single Supervisory Mechanism and conferring a central role on the ECB; and a proposal for a regulation in the European Parliament and the Council amending the 2010 regulation that established the EBA to allow for the creation of the SSM.

Finally, at the Euro summit from December 12-14th 2012 in Brussels, the roadmap for deepening the economic and monetary union in the Eurozone was adopted by the European Council. According to this roadmap, financial ministers agreed to the creation of the Single Supervisory Mechanism as the first step towards building a banking union for Europe, shifting the prudential supervisory task to the ECB. Negotiations continued through the following weeks, and finally the Commission proposal for the 'Single Supervisory Mechanism' was adopted by the joint session of the Commission, the EU Parliament members, and the Council of Ministers on March 19, 2013. Certain issues regarding the creation of the Single Supervisory Mechanism and the ECB's role at the centre of this mechanism will be addressed in the following discussions.

III. How Can the Establishment of a Supranational Supervisor Be a Solution to the Banking Crisis?

In this section, the necessity of establishing the SSM will be considered. The EU banking system's shortcomings, which led to the financial crisis, will be discussed, and the ways in which the SSM's establishment will address these deficiencies will be explained.

There are many reasons why a supranational supervisory mechanism for European banks is necessary. In fact, the EU has felt the need to break the connection between banks and sovereign states since it turned out to be impossible for national governments to maintain financial stability and market integration. This was because the national authorities lacked important information about the activities of financial institutions that cross national boundaries. It has also been proven that national states are unable to deal with the international crisis, and their policies do not provide the solution needed to manage an international financial crisis. These rationales will be discussed in detail below.

As the heads of Member States at the September Euro summit announced, the Euro crisis revealed the need to break the vicious cycle between banks and sovereigns.

This element is visible in increasing debt levels of sovereigns that had to provide support for struggling banks as well as losses of banks from being exposed to sovereigns under stress. Therefore, there was the need to weaken the spillover chain between banks and sovereigns by taking responsibility for the stability of the banking system.[18]

There are many ways in which this objective could be better pursued at the EU level. The main reason it is necessary to create a banking union with a supervisory mechanism at the EU level has to do with the importance of financial stability and market integration, which are not occurring at the same time at the national level. This is what Shoenmaker calls 'the financial trilemma.'[19] This theory suggests that policymakers can choose only two of the three following objectives: financial stability, financial integration and national financial policies (such as bank supervision and resolution). This is because 'national financial policies usually fail to recognize the externality generated by cross-border banks in difficulty.'[20] In fact, financial integration at the EU level gives rise to the supranational interdependence of financial agents. Regulating these supranational relations requires extra information about the activities of institutions located outside the jurisdiction of the national authorities. No national central bank or parliament has access to all the required information about financial institutions located outside of its territory. However, the activities of these banks influence the banking sector and they cannot exercise authority over the cross-border financial institution. At the same time, the national supervisory institution does not have enough information about the financial institutions that are established in its territory, and whose activities go beyond national boundaries. Monitoring these institutions is difficult for the national mechanisms. Therefore, the national authorities are not able to extend robust supervisory mechanisms to these cross-border entities, and may provide troubled banks across the border with capital flow while having no control over the capital injection's effects.[21] Another possibility is that the national authorities may not provide enough funds to troubled institutions due to a lack of information and control, which in turn leads to financial instability.[22] Moreover, national supervisors are more vulnerable to regulatory capture.[23] Both of

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18 Vitor Constâncio, 'Establishing the Single Supervisory Mechanism' (The BAFT-IFSA 2013 Europe Bank-to-Bank Forum, Frankfurt, 29 January 2013) <www.ecb.int/press/key/date/2013/html/sp130129_1.en.htmlt > accessed 28 May 2014.

19 Dirk Schoenmaker, 'The Financial Trilemma' [2011] 111 Economics Letters 57 at p 58-59.

20 ibid.

21 ibid.

22 ibid.

23 Benoit Cœuré, 'The Way Back to Financial Integration' (International Financial

these elements undermine financial stability, and therefore, combining these three objectives is not possible at the national level. In this regard, Benoît Cœuré, member of the ECB's executive board stated that:

> 'by setting the incentives correctly, a fully-fledged banking union permits an internalization of this externality, making sure that banks strengthen their capital and liquidity on sunny days and can continue to lend on rainy days.'[24]

Additionally, in a highly integrated financial system such as the European Union, reducing moral hazard[25] and excessive risk-taking requires a consistent set of regulatory incentives, based not only on common rules but also on integrated supranational powers in banking supervision. Therefore, integration in the banking sector that underlies the financial integrated market is necessary to stop reckless risk-taking by banks in the internal market.[26]

Supervision at national levels was fragile during the financial crisis.[27] In fact, the national banking system preferred to protect national banks in crisis, and decided to hide information from the public, which in turn resulted in 'delaying loss recognition', magnifying the eventual losses.[28] The widespread tendency of national regulators and supervisors to side with their troubled banks and to hide information from the public is rooted in the intention to protect creditors, shareholders and managers.

IV. Why Was the ECB Chosen to Act as the Single Supervisor of the European Banking Union?

As the Council's proposals indicate, the SSM will be composed of the

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Integration and Fragmentation: Drivers and Policy Responses Conference, 12 March 2013) <www.ecb.europa.eu/press/key/date/2013/html/sp130312.en.html> accessed 28 May 2014.

[24] ibid.

[25] Moral hazard: A situation where a party will have a tendency to take risks because the costs that could incur will not be felt by the party taking the risk. In other words it is the tendency to be more willing to take a risk, knowing that the potential costs or burdens of taking such risk will be borne, in whole or in part, by others.

[26] Zandstra (n 16), 285-316.

[27] Jacopo Carmassi et al, 'Banking Union: A Federal Model for the European Union with Prompt Corrective Action', (2012) 282 CEPS Policy Briefs 1-6.

[28] Richard J Herring and Charles W Calomiris, 'How to Design a Contingent Convertible Debt Requirement' (2013) 25 J of Applied Corporate Finance <http://fic.wharton.upenn.edu/fic/Policy%20page/25.Calomiris_forthcoming.pdf> accessed 28 May 2014.

European Central Bank and national competent authorities.[29] In fact, the final regulation states that the supervisory board is composed of the ECB Chair, Vice Chair, four other ECB representatives, and a representative from each Member State participating in the supervisory mechanism.[30] However, the question remains: why was the ECB chosen by European authorities to play such an important role in the future banking union?

First, one of the policy makers' main concerns was avoiding the lengthy treaty amendment process. In fact, if they decided to create a new institution, they would have been left with no choice other than to introduce a new treaty. However, at the height of the crisis, the Union needed to take corrective actions in a timely manner, as treaty amendment - from writing the preliminary draft to ratifying the final act by the national authorities - takes a long time, allowing the crisis to deteriorate. As article 127(6) TFEU recognizes the ECB's supervisory powers over the EU's financial institutions, EU Member States believe that it is not necessary to ratify a new treaty to establish the legal basis for the prudential supervisory tasks that are to be assigned to the ECB in 2014. It is also worth noting that some EU members, including Germany, at first believed that the existing legal basis provided by EU treaties falls short of the SSM's demands, and that treaty amendment is inevitable.[31] The UK Parliament holds the same opinion, although the UK has voted against the mechanism. [32] Recently, the German policy has changed. Although Germans still believe that treaty change is essential, they have agreed to the establishment of the mechanism within the current legal regime in order to respond to the crisis in a timely manner. They still believe that treaty amendments should be made in the future. Yet, in their view, resolution of the financial crisis through the SSM is now more important than the existing treaties' inconsistency with the supervision mechanism: 'The need for urgent reactions to the crisis especially after Cyprus bailouts in March 2013, and the long process of making amendment in EU treaties

[29] Council of the European Union, 'Council Agrees Position on Bank Supervision', Press Release*,* December 2012 <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/134265.pdf > accessed 28 May 2014.

[30] Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions' 2013, not yet published in the Official Journal <www.europarl.europa.eu/document/activities/cont/201309/20130912ATT71209/20130912ATT71209EN.pdf> accessed 26 September 2013 ('Council Regulation on Conferring Tasks'), art 19.

[31] Jim Brunsden, 'EU Set to Clash on Bank Deal as Germany Sees Treaty Limit' (*Bloomsberg Business Week,* April 2013) <www.businessweek.com/news/2013-04-13/eu-set-to-clash-on-bank-deal-as-germany-sees-treaty-limit> accessed 28 May 2014.

[32] HL EU Committee Report on EU Banking Union (n 6).

is the reason of this policy change.'[33]

Alternatively, Berlin has proposed a two-stage plan in which treaty change is at first not a requirement. Instead, the 'network of national authorities' will start after three conditions are met: first, the new EU supervisor is operational; second, EU banks are fully capitalized to Basel III levels; and third, new standards are agreed upon for national resolution authorities and funds.

The other reason for choosing the ECB as supervisors is that, according to Art 127(1) TFEU, the ECB's primary mandate is to preserve price stability, and the most important tool the ECB has to achieve this objective is defining and applying monetary policy for Eurozone members. It is arguable that 'this responsibility for monetary policy creates for the central bank an intrinsic and deep interest in a stable functioning system.'[34] In other words, 'confidential information on the health of the banking system is useful in predicting inflation and unemployment', and therefore, in adopting a monetary policy in accordance with the needs of the system.[35] The debt crisis is the best example of the effects the banking system's instability has on the euro's value and on price stability. EU Member States and financial institutions are supposed to conduct their business with one common currency and each state is individually in charge of banking supervision. In this context, it is not plausible to imagine that all of these separate financial policies could lead to the emergence of one common framework guaranteeing the EU monetary system's stability without the intervention of a supranational institution. In other words, without the single supervisory scheme, the ECB is obliged to carry out a task for which it does not have the necessary means. The Commission has presented the same argument in defence of the proposal for the SSM. It states:

> The objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the EU. Recent events have clearly demonstrated that only supervision at the European level can ensure appropriate oversight of an integrated banking sector and a high level of financial stability in the EU and the Euro area in particular. The

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[33] Peter Spiegel, 'Schäuble Warns EU Bank Rescue Agency Needs Treaty Changes' (*Financial Times,* May 2013) <www.ft.com/intl/cms/s/0/366eff18-bb03-11e2-b289-00144feab7de.html#axzz2VkzXp73N > accessed 28 May 2014.

[34] Constâncio (n 18).

[35] Vasso Ioannidou, 'A First Step Towards a Banking Union' in Thorsten Beck (ed) *Banking Union for Europe Risks and Challenges* (Centre for Economic Policy Research, Tilburg University 2012) available at <www.voxeu.org/sites/default/files/file/Banking_Union.pdf> accessed 5 June 2014, 90.

> provisions of this proposal do not go beyond what is necessary to achieve the objectives pursued. The ECB is entrusted with the supervisory tasks, which need to be exercised at EU level to ensure uniform and effective application of prudential rules, risk control and crisis prevention. National authorities will continue to carry out certain tasks, which can be better performed at national level.[36]

On the other hand, conferring supervisory competence on the ECB will help it fulfil its central banking duties; a central bank, as 'the lender of last resort', should be able to provide a huge amount of money in a short period of time during crises. In order to do this, the central bank must know the banks' financial situations. Therefore, equipping it with supervisory authorities is undoubtedly beneficial, given that information submitted to the ECB by other institutions is not sufficiently reliable, as they are not responsible for the EU zone's financial stability and their actions are not motivated by the same incentive.[37]

V. What Tasks Are Conferred on the ECB?

As mentioned earlier, implementing the new roadmap will shift specific supervisory tasks to the Union level in the Euro area, notably those that are key to preserving financial stability and detecting risks to banks' viability. The ECB will become responsible for tasks such as authorizing credit institutions, compliance with capital, leverage and liquidity requirements, and supervising financial conglomerates. The ECB will be able to intervene early by requiring banks to take remedial action when they breach or risk breaching regulatory capital requirements.[38]
Prior to the Council's adopting of the SSM, the legal basis for conferring tasks of prudential supervision to the ECB was article 127(6) TFEU. Since the March 19th 2013, the Council Directive has been another legal document establishing supervisory jurisdiction. Therefore, in addition to pursuing its primary mandate of maintaining price stability by defining and applying monetary policy within the Eurozone, the ECB's mandate will be extended to preserving financial stability through prudential supervisory mechanisms.

According to article 4(1)(a) to (k) of the Regulation, the ECB will be given 'exclusive competence' for a specific list of key supervisory tasks

[36] Commission Proposal (n 2), 2.
[37] Ioannidou (n 35), 92.
[38] European Commission, 'Commission Proposes New ECB Powers for Banking Supervision as Part of a Banking Union' Press Release IP/12/953, 12 September 2012 <http://europa.eu/rapid/press-release_IP-12-953_en.htm> accessed 28 May 2014.

contemplated by the CRD IV package, including: authorizing and licensing credit institutions, assigning acquisitions and disposals of holdings in credit institutions, ensuring compliance with the EU capital, liquidity and related requirements. In particular cases, these tasks will also include the following setting higher or additional requirements; applying capital buffers; overseeing robust and sound internal governance; internal assessment and risk management arrangements; strategies; processes and mechanisms, carrying out stress tests; conducting consolidated supervision; participating in supplementary supervision of financial conglomerates, and carrying out supervisory tasks related to early intervention (in coordination with national resolution authorities).

Under the Commission's proposal, the ECB's list of 'exclusive competences' would also have extended to coordinating and expressing the common position of the competent authorities of Member States participating in EBA decision-making contexts on issues related to tasks conferred on the ECB. The other difference between the Council and the Commission's view of the list of tasks entrusted to the ECB is that under the Council's proposal, it is the national authorities – not the ECB – that have the power to apply capital buffers and other macro-prudential tools. The reason for this division of tasks can be seen from the Council's point of view: The national authorities are in a better position to assess the specific circumstances faced by local financial systems. Meanwhile, national authorities have to duly consider any objections from the ECB. Furthermore, if necessary, the ECB has the power to apply higher capital buffers and more stringent macro-prudential measures than those applied by national authorities.

According to the Council's amendments, national supervisors would remain in charge of tasks not conferred on the ECB, for instance, those related to consumer protection, money laundering, payment services, and branches of third country banks. The EBA would retain its power to further develop the single rulebook and ensure convergence and consistency in supervisory practice, which will be discussed shortly.

VI. THE ECB'S NEW MANDATE AND ITS CHALLENGES

In the previous sections, the practicality of choosing the ECB as the single supervisor of the EU banking system was discussed, as was the existing treaties' compatibility with the Single Supervisory Mechanism, with the ECB having the mandate to preserve price stability and set monetary policies according to the treaties. However, now that EU members are determined to enforce such a drastic change in the ECB's structure and mandate, consequences are inevitable. These challenges will be briefly discussed in this section, and the resolutions proposed by EU bodies in response to these concerns will be presented.

First of all, when the Commission proposed the SSM, there were concerns about the hazards of bringing monetary policy and prudential supervision together. The fear was that a 'central bank's concern for the health of banks jeopardizes its price stability objective.'[39] Also, conducting monetary policy could affect the central bank's supervisory responsibilities. A good example of this can be seen during recessions, when instead of putting pressure on credit institutions and making credit conditions more demanding, central banks would lower supervision to support monetary policy objectives. In the case of the recent financial crisis, some experts believe that central banks are tempted to provide crisis-ridden banks with funds as they try to prevent the financial system's collapse. Yet, such a lax monetary policy can lead to 'generating an inflationary bias impairing its credibility, and also contribut[ing] to more risk-taking by banks (moral hazard), and in turn breed[ing] future financial instability.'[40]

EU legislators have not disregarded this potential conflict. In the proposal the Commission stressed the importance of exercising these two functions separately.[41] To properly divide the tasks, the Commission's proposal has created a supervisory board within the ECB, whose role is to plan and execute the supervisory tasks conferred on the ECB. The Council draft, on the other hand, conferred the responsibility of preparing supervisory tasks on the supervisory board and their adoption on the ECB's governing council.[42]

Some critics regard the structure and legality of these bodies with suspicion. However, the key point is that the difficulty of the tasks conferred on the ECB is still a matter that is up for discussion, notwithstanding the structure of the decision-making process that the Commission and Council have proposed. Even though a special body is in charge of preparing decisions related to supervision, in the end, decisions will not be adopted if the governing council objects. The governing council, which is the decision-making body of the ECB, is primarily responsible for formulating monetary policy for the Eurozone Member States. Therefore, the division of tasks between supervisory measures and

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[39] Carmassi (n 27).
[40] Benoit Cœuré, 'Monetary Policy and Banking Supervision' ('Central Banking: Where Are We Headed?' Symposium in honor of Stefan Gerlach's contribution to the Institute for Monetary and Financial Stability, Frankfurt, February 2013) <www.ecb.int/press/key/date/2013/html/sp130207.en.html> accessed 28 May 2014.
[41] Commission Proposal (n 2), art 18(2).
[42] Council Regulation on Conferring Tasks (n 30).

monetary policymaking is not guaranteed under the current legislation.

One of the main criticisms of conferring supervisory tasks on the ECB has to do with the conflict of interest that arises from the tension between the adoption of monetary policy and the exercise of macro prudential supervision. The Commission's opinion was that special bodies should be designated for decision-making. However, the Council has amended this resolution to create more equal rights for those Member States who are outside of the banking system.

In this regard, the Commission's proposal anticipated the establishment of a supervisory board in the ECB. This board consisted of representatives from all participating Member States who would have the power to make supervisory decisions and carry out tasks of prudential supervision.[43] The Governing Council, or the ECB's decision-making body would still have been in charge of making decisions, but the Commission has envisioned the possibility of delegating 'clearly defined supervisory tasks and related decisions' about an individual institution or set of institutions to the Supervisory Board under the Governing Council's authority. [44]

According to the Council's proposal, the supervisory board will carry out preparatory supervisory tasks and propose draft decisions, which will be formally adopted by the Governing Council. The definition of participating Member States also includes those non-Eurozone members that have entered into close cooperation with the SSM.[45] However, the Council's text does not delegate tasks and related decisions about specific institutions from the Governing Council to the Supervisory Board. The Governing Council is in charge of making final decisions that are prepared by the supervisory board.

Critics consider this close relationship between the Governing Council and the supervisory board (more precisely, the dependence of the latter on the former) problematic. As the Governing Council's primary responsibility is to formulate monetary policy,[46] granting the Governing Council exclusive decision-making power 'appears to breach the ring-fence that should be maintained between supervision and monetary policy.'[47]

[43] ibid, art 19.
[44] Commission Proposal (n 2), art 19(3).
[45] Council Regulation on Conferring Tasks (n 32), arts 1(1) and 19(1).
[46] ibid, art 12.
[47] Ellis Ferran and Valia SG Babis, 'The European Single Supervisory Mechanism' (2013) University of Cambridge Faculty of Law Research Paper 10/2013, <http://ssrn.com/abstract=2224538 or http://dx.doi.org/10.2139/ssrn.2224538> accessed 26 September 2013, 14.

There are also some concerns about the impracticality of multiple layers of governance arrangements, keeping in mind the members of the Governing Council's expertise and qualifications in setting monetary policy.[48]

Furthermore, it should be noted that while TFEU and ECB statutes authorize the Governing Council and the executive board of the ECB to conduct monetary policy,[49] no equivalent institutional structure is provided in legal texts for the ECB's supervisory tasks. Therefore:

> Establishment of a new body with wide discretionary decision making powers such as the supervisory board can reasonably be considered to be a step beyond the modalities of internal organization. That the space for institutional creativity does not extend that far appears to be the reasoning behind the approach followed by the Commission and the Council; Indeed the Council has been more conservative in its views than the Commission, because its text does not allow for the delegation of specifically defined supervisory tasks.[50]

Similarly, even a secret opinion from the EU Council's top legal advisor revealed by the Financial Times shows that the plan goes 'beyond the powers permitted under law to change governance rules at the European Central Bank, and without altering EU treaties it would be impossible to give a bank supervision board within the ECB any formal decision making power suggested by the Council.'[51]

VII. THE SCOPE OF THE SSM AND ITS CHALLENGES

Another crucial criticism of the Commission's proposal for establishing the Single Supervisory Mechanism is that this mechanism's scope may threaten the internal market's integrity and the equal treatment of the states within and outside of the Eurozone. There is also disagreement on the type and number of financial and credit institutions that the SSM should have authority over in those states that are already Eurozone members. The Commission has amended its proposal to compensate for problems arising due to the SSM's scope.

In terms of scope, the most important point is that the Supervisory

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[48] ibid.

[49] TFEU (n 12), art 9(3).

[50] Ferran and Babis (n 47).

[51] Alex Barker, 'Europe Banking Supervisor Plan Illegal' (*The Financial Times,* October 2012) <www.ft.com/intl/cms/s/0/d62db344-179f-11e2-9530-00144feabdc0.html#axzz2RKFcVPMR> accessed 28 May 2014.

Mechanism, as the Lisbon Treaty (articles 127-133) states, is responsible for supervising the banking systems of those Member States whose currency is the Euro. Therefore, the Council and the Commission's legislative texts do not provide for the ECB's supervision of non-Eurozone Member States. However, the Council's proposal provides for cooperation arrangements with limited participation rights in the SSM, and this is bolstered by the Council, as the unequal treatment of non-Eurozone Member States in the former is partially remedied by the latter. The treatment of the ins and outs of the SSM's proposed design will be discussed in further detail, but for now it is important to point out the risk of fragmenting the internal market that may be caused by the non-unified model of banking system supervision among Member States.

It is argued that this division between participating states and states that opt out of the mechanism is not covered by the Treaty. Article 127(6), which grants the ECB supervisory powers, is not restricted to the Eurozone and may therefore apply to all Union members because the transitional provisions of Article 139(2c) make it explicit that Article 127(6) is not subject to provisional measures and Member States are not allowed to deviate from the rule in Article 127(6). In other words, under the Treaty, the ECB is a Union institution, while restricting its monetary functions to certain Member States is a 'temporary' situation permitted by the deviation from treaty obligations. The Roadmap called for 'an integrated financial framework that covers all EU Member States, whilst allowing for specific differentiations between Euro and non-Euro area Member States; but it is neither consistent with this objective nor the common European objective of preserving the internal market.'[52]

As previously mentioned, the SSM was introduced as the supervisor of banks within the Euro area. However, Member States whose currency is not the euro are also invited by the Commission proposal to participate in close cooperation agreements with the SSM. The Commission proposal included some unequal elements with respect to non-Eurozone members that voiced their discontent and their reluctance to cooperate with the system. For example, a Member State that enters into a close cooperation agreement with the SSM is bound to bring its national regulations in line with the ECB's guidelines and instructions and provide information requested by the ECB. It must also agree to adopt national legal acts to ensure that its bank prudential supervisor will be obliged to adopt any measures the ECB requests in relation to credit institutions. The ECB can decide to terminate close cooperation but the Member State has no such right. Most importantly, articles 19(1) and 19(5) of the Commission's

[52] Carmassi (n 27), 3.

proposal limit the supervisory board's decision-making authority to participating Member States. Obviously, the fact that the proposal did not recognize the right of these states to participate in supervisory board activities and did not provide any incentive for EU members to join the SSM means it would not help to reach the objective of financial integration and stability.

In order to help reach its objectives, the Council agreed to make some amendments to the Commission's draft. It decided to assign every participant Member State a seat on the supervisory board, and to grant them equal voting rights in preparing drafts of decisions. It has left the task of adopting these decisions to the Governing Council as provided by ECB regulations. Other than the aforementioned doubts about the legality of establishing a new board within the ECB's institutional framework, the non-Eurozone members' concerns do not seem to have been alleviated yet.

The Governing Council of the ECB is composed of the ECB's six-member executive board and the governors of the participating national central banks, and there are no voting rights for national competent authorities whose currency is not the euro. This resulted in further dissatisfaction among some officials involved in the talks who were 'unimpressed with the prospect of voting powers for a committee that cannot take decisions, arguing it fell well short of a realistic political solution.'[53]

A number of safeguards have been prepared to compensate for the non-Eurozone Member States' lack of decision-making authority on the governing council. First, the supervisory board's draft decisions are communicated to the Member States concerned. If one Member State objects to the decision, the governing council will invite that Member State's representative to the meeting. Also, all Member States may appeal to the European Court of Justice. In any case, contrary to the Commission's proposal, which only provided the ECB with the right to terminate cooperation,[54] the right to exit the cooperation agreement is provided for Member States under certain circumstances.[55] The expedited exit procedure provided in article 6(6abb) of the Council's regulation applies in those situations where a non-Euro area country has a major objection to a supervisory decision impacting the country. These safeguards are only intended to be used in 'duly justified, exceptional cases.' However, the regulatory bodies may only extend participation rights to non-Eurozone Member States this far under the existing legal

[53] ibid.
[54] Commision Proposal (n 2), art 6(5).
[55] Council Regulation on Conferring Tasks (n 30), art 6(6).

framework, and the decision-making right of states which intend to participate in the system cannot be afforded due to legal obstacles.
Moreover, some non-Euro area Member States were concerned that centralizing macro-prudential tools in the ECB would prevent them from taking appropriate macro-prudential regulatory action in response to issues specific to countries outside the Euro area, especially with regards to capital buffers. The Council's regulation in response to this concern gives national regulators wide discretionary power, and gives the ECB no authority to block their measures.[56] Meanwhile, the ECB can apply more stringent requirements for capital buffers to Euro area Member States. This seems to violate the EU's legal principle of equal treatment; setting regulations that better serve countries out of the area sounds 'counter intuitive'[57] and raises the question of whether or not a safeguard against unequal treatment and an incentive for tying Europe to a plan to make a more robust union justifies differential treatment.

Amongst Eurozone Member States, the SSM's scope is still a source of disagreement between the mechanism's proponents and some Member States. Supervisory authority, as established by the Commission's proposal on the prudential supervision of all credit institutions established in Member States whose currency is the Euro, is conferred on the ECB.[58] Germany first raised the idea of the Single Supervisory Mechanism[59] because it was not satisfied with bailing countries out of debt when they failed to abide by the fiscal compact and endangered financial stability within the Union. The mechanism was originally designed for a banking system in which there was supervision at the EU level. On the other hand, the German Chancellor did not agree with the scope of the supervision the Commission proposed, which France and the ECB advocated. The German government believes that national Member States should still bear the responsibility of day-to-day supervision of the smaller banks, leaving only large banks under the ECB's direct supervision.[60] The Council adopted the German point of view and narrowed the scope of the SSM's

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[56] ibid, art 4(1).
[57] Zsolt Darvas and Guntram B Wolff, 'Should Non-Euro Area Countries Join the Single Supervisory Mechanism?' (*Bruguel Policy,* March 2013) <www.bruegel.org/publications/publication-detail/publication/773-should-non-euro-area-countries-join-the-single-supervisory-mechanism/> accessed 28 May 2014.
[58] Commission Proposal (n 2), art 4 (1).
[59] Finnish Ministry of Finance, 'Joint Statement of the Ministers of Finance of Germany, the Netherlands and Finland', Press release 175/2012, September 2012 <http://www.vm.fi/vm/en/03_press_releases_and_speeches/01_press_releases/20120925JointS/name.jsp> accessed 28 May 2014.
[60] Valentina Pop, 'Banking Union: The German Way or No Way' (*EU Observer,* 10 December 2012) <http://euobserver.com/economic/118468> accessed 28 May 2014.

supervision to banks whose total assets (balance sheet) were more than €30 billion, whose assets exceeded 20% of the GDP of the Member State of establishment participating in the SSM, unless the total value of these assets was below €5 billion, or credit institutions considered by the competent national authority to be significant to the national economy. In addition, 'unless justified by particular circumstances,' the ECB will directly supervise the three most significant credit institutions of each participating state. Although the day-to-day supervision of less significant banks is left to national authorities, according to the Roadmap the ECB would still be ultimately responsible for the Union's financial stability, which would include these banks. In addition, the ECB would have been given supervisory authority and power to pre-emptively intervene with all banks.[61]

The reason for this narrowing lies in concern over the ECB's capacity to manage the prudential supervision of 6200 banks and institutions in the Eurozone.[62] It can also be regarded as questioning the sovereignty of Member States, with a view that centralizing the oversight of banks violates the Member States' sovereign rights. This interference with sovereignty should be minimized as much as possible. As a case in point, to ensure that financial institutions meet the required standards, the ECB is entitled to pre-emptively intervene and require institutions to execute its directives. These micro-level interventions can overlap with the national authorities' powers.[63] However, Member States that use the common currency have already voluntarily surrendered their monetary sovereignty to the Union level,[64] and in keeping with the previous changes and the creation of the EMU, further centralization appears to be the only way to escape the crisis at this level.

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[61] Carmassi (n 27), 5.

[62] The German Finance Minister has stated in December 2012 that 'I think it would be very difficult to get an approval by the German Parliament if you would leave the supervision for all the German banks to European banking supervision... Nobody believes that any European institution will be capable to supervise 6,000 banks in Europe.' James Kanter, 'European Finance Ministers Deadlock on Plan to Oversee Banks' (*New York Times*, 4 December 2012) <www.nytimes.com/2012/12/05/business/global/daily-euro-zone-watch.html> accessed 28 May 2014.

[63] European Parliament, 'Banking Union and Single Supervisory Mechanism, Monetary Dialogue' Directorate General for Internal Policies PE 492/449, October 2012 <http://www.europarl.europa.eu/document/activities/cont/201210/20121024ATT54390/20121024ATT54390EN.pdf> accessed 28 May 2014, 54.

[64] Rosa Maria Lastra, 'The Evolution of the European Central Bank' Mary School of Law, Legal Studies Research Paper No. 99/2012, 1267 <http://ssrn.com/abstract=2020545> accessed 28 May 2014.

One of the major concerns, stemming from the two-level supervisory design the Council proposes, is that the 'allocation of supervision of less significant banks to national authorities or the outsourcing of labour from the ECB to national authorities may not afford the ECB with sufficient visibility of emerging problems quickly enough for timely intervention.'[65] Therefore, the home bias that can lead to supervisory forbearance will not be eliminated, and that was one of the main objectives of establishing a supervisory mechanism at the EU level. Thus the only resolution the Council proposes is that the ECB be in charge of issuing regulations, guidelines and general instructions to guide supervision by national authorities. Furthermore, the ECB retains some direct supervisory powers with regards to 'less significant' banks. These include bank authorizations and withdrawal of authorization, assessment of acquisitions and disposal of holdings.[66]

Additionally, the ECB's initial remit will not extend to insurers, investment firms, central counterparties, other providers of market infrastructure or entities engaged in 'shadow banking' activities. This is due to the fact that Article 127(6) TFEU only allows for the ECB to be conferred with tasks related to credit institutions and other financial institutions while insurance undertakings are specifically excluded. This issue is a matter of questioning the system, as these institutions' functions pose a risk to the whole mechanism. However, extending the system's remit to include these bodies is not possible within the current treaty's framework and requires treaty amendment. Since the amendment process is normally lengthy, it is not possible to predict whether or not these institutions' activities will be covered by the ECB's supervisory jurisdiction.

VIII. The Impact of the Establishment of the SSM on Other EU Institutions (the EBA)

The European Banking Authority (EBA) is established by Regulation (EU) 1093/2010. It is in charge of writing non-binding guidelines and recommendations, conducting peer reviews, mediating disputes between supervisors on a non-binding basis, promoting supervisory cooperation, convergence and coordination, facilitating home/host Member State relations, and providing opinions to Union Institutions.

Therefore, it could be anticipated that centralizing banking supervision in

[65] Ferran (n 47).
[66] Council Regulation on Conferring Tasks (n 30), art 5(4).

the Eurozone would have an effect on the EBA. For this reason, when the Commission issued the single supervisory proposal, it also proposed an amendment to the EBA's regulation. First of all, there is the risk of conflict and overlap between the two bodies' mandates with respect to rule-making power, which both the EBA and the ECB enjoy. In recital 26 of the ECB's regulation, the Commission confines the ECB's exercise of its rule-making powers to situations in which the EBA's technical standards are not detailed enough to provide for the ECB's functions. Moreover, the ECB is to develop a 'supervisory manual' for national authorities under its remit, while the EBA is responsible for developing the single supervisory handbook for the entire Union. Ferran argues that '[u]navoidably, the larger degree of supervisory convergence within the SSM will call for arrangements different from those that are applied at EU27 level.'[67] Therefore, the mandate of each should be more precisely determined and the ECB's impact on the EBA should not be underestimated.

One major concern of non-participating Member States regarding the SSM's establishment and its effect on EBA is the risk that non-Eurozone states may be outvoted by SSM Member States that follow the same policy:

> Authorities of the SSM Member States that vote in the EBA's Board of Supervisors may retain their autonomy, but in practice, it is likely that coordination will be sought in a manner that their votes are in line with policies adopted by the SSM as a whole.[68]

It is predictable that:

> Eurozone national authorities will increasingly coalesce around a common position as the ECB puts its stamp on Euro Area supervisory practices, procedures, policies, and philosophies, since this growing uniformity can be expected to spill over into regulatory thinking as well.[69]

This raises the risk that non-Eurozone Member States may be outvoted by SSM Member States in EBA decision-making in cases that require simple majority in Articles 41 and 44 of the EBA's regulation. This includes decisions about breach of law, settlement of disagreements, and the election of the Management Board. Thus, the Commission proposed an independent panel to take charge of decision-making, whose decisions are

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[67] Ferran (n 47), 22.
[68] HL EU Committee Report on EU Banking Union (n 6).
[69] Ferran (n 47), 25.

to be adopted unless rejected by at least three votes from participating Member States and three from non-participating Member States. Under the Council's regulation the independent panel consists of seven members, which do not represent the authorities concerned and which do not have any interest in the case. There is no minimum number of panel members from non-participating member States. In Article 1(7a), the Council introduces a new provision that the Board of Supervisors of EBA shall strive for consensus when making its decision, notwithstanding the voting arrangements set out for the EBA in this Regulation.

However, decisions about technical standards continue to be made by Qualified Majority Voting. In the Council's regulation, meeting the QMV requirement calls for at least a simple majority from representatives of participating Member States and a simple majority from representatives of non-participating Member States.

The Commission's proposal also emphasizes the EBA's power to resolve cross-border disputes between supervisors. According to the proposal, the EBA's decisions are not binding on the ECB, although it has to show proper justification in case of non-compliance.[70] This regulation again casts doubt on the equality of Ins and Outs, but it was not possible to eliminate inequality because of the principle of the ECB's independence, which is found in TFEU Article 130 and which prohibits the ECB from taking instructions from EU institutions or bodies. Therefore, Eurozone Member States are in a better position than non-Euro Member States when it comes to compliance with EBA instructions, due to the ECB's independence.

Generally, it has been argued the ECB's emergence as a powerful coordinating force in supervision could still have disturbing long term implications for the EBA, notwithstanding all the required amendments with respect to equal treatment and preventing mandates from overlapping. Rather than being a crucial single market cohesion mechanism, the EBA itself may become marginalized.[71] In order to prevent this, certain organizational and structural amendments must be made to ensure that the EBA can operate effectively when the interests of Member States participating in the SSM diverge from those of Member States, which do not join the SSM. Therefore, legislative proposals need to provide more guarantees for the two institutions' coexistence and their successful operation in their own remit.

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[70] Council Regulation on Conferring Tasks (n 30), art 3.
[71] Ferran (n 47), 23.

These guarantees seem to be provided in the latest draft of a proposed amendment to EBA regulation adopted by the EU Parliament, according to these amendments:

> The EBA Regulation will ensure that the EBA can continue to fulfil its mission effectively as regards all Member States. In particular, the EBA is enabled to exercise its powers and tasks not only vis-à-vis national supervisors but also vis-à-vis the ECB as a European institution. Voting arrangements that ensure that the EBA decision-making structures continue to be balanced and effective and preserve the interests of all its members will be adopted as well.[72]

IX. Is the Single Supervisory Mechanism Adequately Independent and Accountable?

The SSM's effects on the Central Bank's independence, which has been provided for in Article 130 TFEU, have led scholars to question the wisdom of conferring supervisory authority to the ECB. Whether or not the SSM meets the accountability requirement is another major concern for European countries, since the ECB's new mandate requires a higher level of accountability. The new initiative may cause conflict between these two issues, and the important question is how to strike a balance between them. The Commission has taken measures to address the accountability concerns in its proposal and in forthcoming amendments. These concerns and measures are discussed below.

The second of the Basel Committee's core principles for effective banking supervision recognizes operational independence, transparent processes, sound governance, adequate resources, and accountability as the essential parameters for central banking systems.

Safeguarding the ECB's independence from any other union institutions, bodies, offices or agencies, and any government of a Member State is a principle laid out in Article 130 of TFEU. The ECB's independence has been strongly emphasized since its establishment, and as a result, the reporting requirements and general accountability of the ECB were limited. The ECB was following the German Bundesbank and became one

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[72] Legislative Observatory, '2012/0242(CNS) - 12/09/2013 Text adopted by Parliament' (*EU Parliament Website*, 12 September 2013) <http://www.europarl.europa.eu/oeil/popups/summary.do?id=1302957&t=d&l=en> accessed 28 May 2014.

of the most independent central banks in the world.[73]

The Commission's proposal restates the guarantee of the ECB's independence in the Single Supervisory Mechanism (Article 16 of the ECB regulations). This may seem controversial with respect to tasks conferred on the ECB under the new supervisory mechanism, since the new mandate requires a substantial level of accountability to provide for the objectives of effective banking supervision for the Euro area. This is not comparable to the degree of accountability required for setting monetary policy. Therefore, creating the SSM necessitates a shift in the ECB's accountability to national and Union authorities.[74]

The new legal framework should provide a balance between independence and accountability for the ECB in the new context. The question is, to what extent have the proposals been successful in achieving this aim?
The Commission proposal has made the SSM accountable to the European Parliament, and to the Council. It also requests annual reports to the Parliament, the Council, the Commission and the Eurogroup. It gives European Parliament committees the power to require the Chair of the Supervisory Board to appear before them, and it imposes an obligation on the ECB to respond to questions put forward by the European Parliament or the Eurogroup.[75] In addition to these grounds, the Commission's proposal has added reporting requirements for evaluating supervisory fees. It has also obliged the Chair of the Supervisory Board to appear before the Eurogroup and the representatives of non-Euro participating Member States upon their request. Finally, it requires the European Court of Auditors to take the supervisory tasks conferred upon the ECB into account when examining the operational efficiency of the ECB's management.[76]

Since the supervisory authority has been transmitted to the Union level in the new plan, the Commission paid attention to the ECB's accountability at that level as well, resulting in a lack of accountability for the ECB at the national level. The Council's regulation, on the other hand, has filled this gap by requiring the ECB to forward annual reports to the members' national parliaments. Also, according to the Council's regulation, Member

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[73] Damien Chalmers, Gareth Davies and Giorgio Monti, *European Union Law* (2nd ed, Cambridge University Press 2010), 732.
[74] Stijen Verhelst , 'The Single Supervisory Mechanism: A Sound First Step in Europe's Banking Union?' (2013), Egmont Institute, March 2013 <http://www.egmontinstitute.be/papers/13/eur/1303-Single-Supervisory-Mechanism.pdf > accessed 26 September 2013.
[75] Commission Proposal (n 2), arts 17 and 21.
[76] Council Regulation on Conferring Tasks (n 30), arts 17(2), 17(4), 17(8).

States' national parliaments can request Member States to respond to their observations and questions when they are sent to them. Moreover, a national parliament may invite the Chair or a member of the Supervisory Board to participate in an exchange of views with a representative of the national competent authority.[77]

As it has been illustrated, national parliaments can still be involved in bank supervision in the future; however, this will impose a more indirect form of accountability compared to their authority over the national supervisory institutions. Therefore, the Member States are left with no option other than to surrender their sovereignty and transfer competence to the supranational level within the Union. Specifically, the ECB's measures related to individual supervision decisions have a significant impact on an individual Member State's banking sector, and therefore decisions should be made based on a high degree of credibility with respect to national authorities. What has been provided so far is indirect accountability to governments of the Member States. The 'transfer of the competence from the national to the Union level without transferring the accountability'[78] was a source of concern for the European Member States. This concern has been addressed in the latest agreement between members of the European parliament and the Council's joint session. The agreements include amendments on a variety of aspects of democratic accountability.

First, a stronger accountability mechanism was developed through the co-appointment and dismissal of the chair and vice-chair by the EP, as well as by the European Parliament providing better access to information. Also the new deal gives a more powerful role to the national parliaments. Another improvement is that it provides 'better access to documents for the EU supervisory authorities vis-à-vis banks and for the EP and national parliaments vis-à-vis the EU supervisor authorities'[79]. Moreover, this agreement also divides staff between monetary policy and supervision and ensures the accountability of the ECB's supervisory arm, as well as strengthening the EBA in relation to the ECB to obtain information.[80]

Democratic accountability is essential to the Parliament; as seen a month after the deal with the Council was reached, it delayed the final vote on the

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[77] Council Regulation on Conferring Tasks (n 30), art 17aa(3).

[78] European Parliament, 'Banking Supervision Deal Struck by EP Negotiators and Irish Presidency' Press Release Economic and Monetary Affairs, 19 March 2013, www.europarl.europa.eu/news/en/pressroom/content/20130318IPR06653/html/Banking-supervision-deal-struck-by-EP-negotiators-and-Irish-Presidency accessed 28 May 2014.

[79] ibid.

[80] ibid.

proposal's adoption 'until an agreement [was] reached with the ECB ensuring due democratic accountability of the ECB's supervisory arm.'[81] Finally, the regulations adopted by the Parliament on September 12th, as envisioned in Article 17(b) and 17 (c) of the Council regulation amended by the Parliament, provide for:

> arrangements on the practical modalities to exercise scrutiny, including on access to information including summaries of discussions in the Supervisory Board, cooperation in investigations and information on the selection procedure of the Chair of the Supervisory Board.[82]

The role of national parliaments is strengthened in the regulation's latest amendments, and the adopted regulation ensures that:

> The ECB when submitting reports to the European Parliament and the Council shall simultaneously forward that report directly to the national parliaments of the participating Member States. National parliaments may address to the ECB their reasoned observations on that report and may request the ECB to reply in writing to any observations or questions submitted by them to the ECB in respect of the tasks of the ECB.[83]

X. Conclusion

The recent financial and economic crisis has clearly shown that the financial market's integration in the EU requires greater supervision of the banking system. However, this example does not necessarily suggest that the new level of supervision can only be achieved by transferring supervisory competence from the national authorities to EU institutions such as the ECB. Some experts have fought for the reinforcement of existing national supervision schemes and the improvement of communication among these national entities, enabling them to extend

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[81] Alliance of Liberalism and Democrats for Europe Groups (ALDE), 'No Single Supervisory Mechanism Until an Agreement is Reached with the ECB' (March 2013) <www.alde.eu/press/press-and-release-news/press-release/article/no-single-supervisory-mechanism-until-an-agreement-is-reached-with-the-ecb-41491/> accessed 28 May 2014.

[82] European Commission, 'Legislative Package for Banking Supervision in the Eurozone – Frequently Asked Questions', MEMO/13/780, 12 September 2013 <http://europa.eu/rapid/press-release_MEMO-13-780_en.htm?locale=en> accessed 26 September 2013.

[83] ibid, 73.

their supervisory powers to supranational financial activities. However, as it has been discussed, this is not the path the European countries have chosen. As a matter of fact, they have decided to strengthen the ECB's competence as the ultimate supervisor of the EU banks and greatly increase its supervisory power.

There are arguments in support of as well as against the ECB's appropriateness for such a purpose. It is worth mentioning that both proponents and detractors' arguments are rooted in the same line of thought. The SSM's proponents have focused on its legal basis, which is derived from Article 127 of TEFU. Opponents point to the same treaty and argue that the existing legal body cannot authorize the extension of the ECB's powers. Those experts who have supported the SSM also argue that enforcing monetary policies is not practically possible, particularly in times of crisis. Unless the ECB as the monetary policy maker was endowed with the power to supervise the banking system whose fate is so closely tied to monetary policies' stability, enforcement would not be possible. The SSM's opponents believe that the enforcement of monetary policy should not be mixed with the supervision of the banking system as these two roles may require incompatible plans of action.

The range of the ECB's supervisory powers can be discussed from two points of view. First, the subject matter over which the ECB has jurisdiction has been broadened as its supervisory role is not limited to macro-prudential powers, but rather now includes many different micro-prudential functions. Although it has been stated that the national authorities are still in charge of regulation and supervision at the national level, the ECB's powers allow it to require national entities recognize its assessments and obey its demands. Due to the vast scope of the ECB's supervisory authority, there is concern about the overlap between the ECB and the EBA's roles and it is quite possible that the EBA will be gradually marginalized.

The personal jurisdiction of the ECB's prudential powers has also been extended. The ECB is now empowered to deal directly with hundreds of financial institutions, which are established in the territory of the states participating in the SSM. Political matters do influence the ECB's personal jurisdiction to some extent. The German government is not willing to relinquish supervisory authority over the German regional bank, and it has managed to impose its will on other Member States. The Commission and the Council have proposed some solutions for the asymmetry of power between the Member States, which join the SSM, and those, which opt out of the scheme, and for the unequal treatment of states not in the Eurozone. In fact, the Council's regulation has attempted to compensate for these states' disadvantaged position by introducing a new mechanism in the decision making process. Only time will tell whether these solutions will be able to strike a balance between the ins and outs, or between the Eurozone states and other Member States. For now, it can only be predicted that the Eurozone Member States will have greater leverage in the ECB's decision-making process.

The ECB will take over as the supervisor of euro area banks in November 2014 as part of the Single Supervisory Mechanism. Alongside with the creation of the SSM, the European Parliament has recently passed pieces of legislation with the intention to pursue the idea behind the creation of the banking union which is 'making banks safer and more transparent, and to lift the burden of bank bailouts from taxpayers' shoulders.'[84] This package consists of Bank Recovery and Resolution Directive (RRD), Single Resolution Mechanism (SRM) and Deposit Guarantee Schemes (DGS).

According to these regulations the

> basic salary-to-bonus ratio will be raised to curb speculative risk-taking by banks. EU banks will also be required to set aside more and better capital as a cushion against hard times. The costs of a bailout will be absorbed by a bank-financed €55 billion single resolution fund, to be established gradually over 8 years.[85]

However, the efficiency and practicality of these measures in complementing the single supervisory mechanism is yet to be discovered. Arguably, 'even if a full framework is implemented, the ultimate key to successful reform and financial stability lies in the attitude of banks.'[86] As has been said,

> '[t]he changes must be matched with real willingness by the financial sector to learn from the crisis... Any attempt to clean up the financial sector's malpractices will fail when the roulette with people's money is allowed to continue.'[87]

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[84] European Parliament, 'Parliament votes reform package to strengthen EU Banks' Press Release, 16 April 2014, <www.europarl.europa.eu/news/en/news-room/content/20130416IPR07333/html/Parliament-votes-reform-package-to-strengthen-EU-banks> accessed 28 May 2014.

[85] ibid.

[86] Emily McGregor, 'A Super Tuesday for the EU?' (*Lexology,* May 2014) <www.lexology.com/library/detail.aspx?g=1cb0b1fb-e6f2-4e1c-b1eb-b8c437b37828> accessed 28 May 2014.

[87] ibid.