The vicious circles between sovereign and banking crises: case studies from the euro area and policy responses

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TABLE OF CONTENTS

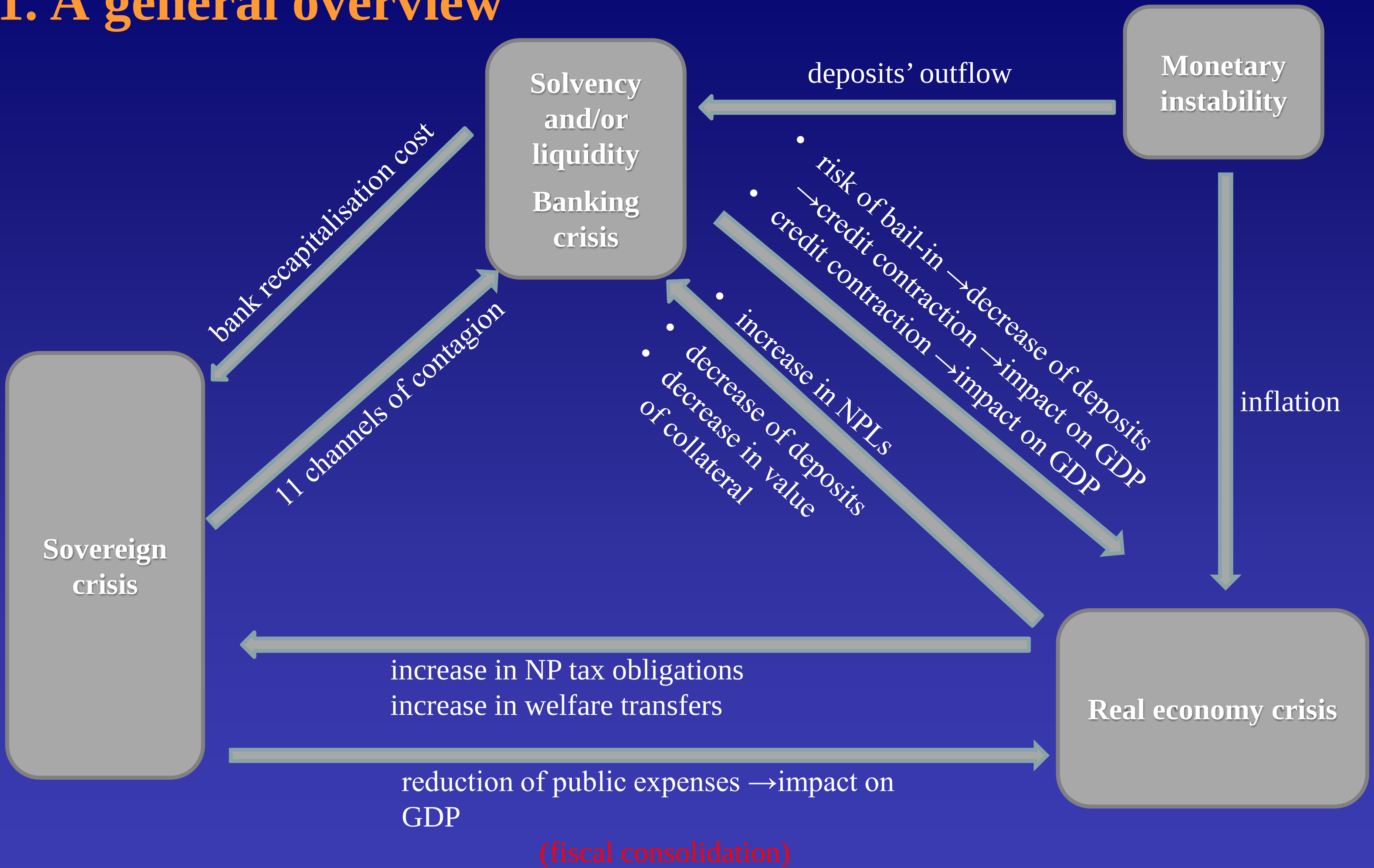
D. The EU response to the recent crises: the European Banking Union (EBU)

1. Adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the EU bank safety net
2. The various components as a by-product of the two crises
3. The impact of public international banking law on the content of the single rulebook
4. Variable perimeter of application
5. Legal sources: a mixture of legal acts adopted on various legal bases – contestability
6. Selected important elements of the institutional framework

E. Concluding remarks

A. Vicious circles between the banking system and the sovereign: an overview

1. A general overview



2. In particular: the channels of transmission from a sovereign crisis to the banking system

a) Direct channels of transmission (see Committee on the Global Financial System (2011):

(i) impact of negative sovereign ratings on (individual) bank ratings and hence to their funding conditions in wholesale markets,
(ii) losses incurred by banks from their sovereign debt holdings,
(iii) the 'collateral/liquidity channel',
(iv) losses from state guarantees granted to banks (explicit and implicit),
(v) the 'risk aversion channel':

- rise in investors' risk aversion may increase the *premia* demanded on banks' securities and hence reduce their funding availability,
- generalised decline in asset prices, triggering losses,

(vi) impact on banks' non-interest (fee and trading) income,
(vii) crowding-out effects on banks' debt issuance (up to the point that markets are closed for both the sovereign and the banks), and
(viii) close correlation between sovereign and financial CDS indices.

2. In particular: the channels of transmission from a sovereign crisis to the banking system

b) Indirect channels of transmission:

- negative impact on the performance of bank loans (in the (most probable) event of a related recession),
- liquidity shortage in the economy, negatively affecting bank liquidity, and
- (in particular) decline in deposits held by households and non-financial corporations (enterprises).

B. The cases of Ireland and Greece as the two extreme opposite examples

1. A general overview

Since 2007, the EU banking system has been hit by two severe economic crises:

(a) The ***recent (2007-2009) international financial crisis***, which was unprecedented in terms of duration, extent and intensity, originated in the US banking system and seriously impacted the banking systems of many other states through a spillover process. The crisis spread to the euro area, mainly through the exposure of large European banks to US investment products, the spillover of the banking crisis to the real economy and the subsequent international capital market distortions.

In particular, the consequence of this crisis, especially after the failure of the US investment bank *Lehman Brothers Inc*., was that several banks and other financial firms around the world (small or big, even ‘systemically important’ institutions) were not able to absorb the losses from their risk exposure. This development:

1. A general overview (cont.)

- resulted, *inter alia*, in negative effects on the real economy, and
- obliged several governments (especially in the United States and the EU) to adopt rescue packages and recovery plans in order to support or even bail out individual banks (and, in some cases, the entire banking system).

Such governmental interventions weighed on state budgets and, in some cases, created serious fiscal imbalances, some of which evolved to fiscal crises, which, in turn, spread to become new financial crises.

(b) In 2010, Greece’s public deficit, which had been widening over the years, leading to the accumulation of external public debt, accompanied by a continued loss of competitiveness and a worsening of the current account deficit (twin deficits), resulted in a surge in borrowing costs and risk *premia* on Greek sovereign debt, as well as in Greece’s exclusion from international interbank and capital markets. This triggered the ***(current) euro area fiscal and debt crisis***:

1. A general overview (cont.)

- **fiscal crisis**: violation of the (hard limit =3%) deficit/GDP ratio
- **debt crisis**: increase of the (soft limit = 60%) debt/GDP ratio and, mainly, debt non-sustainability

Apart from Greece, three other Member States, for different reasons each, were severely affected by this crisis, were excluded from international interbank and capital markets and resorted, like Greece, to the sovereign lending of last resort facilities of the IMF and newly built (during this crisis) EU facilities (EFSM – EFSF – ESM):

- Portugal,
- Ireland, and
- Cyprus.

(c) A common problem for (almost) all Member States of the euro area (monetary union) – **disaster myopia**: in the absence of 'local' funding foreign exchange risk after the introduction of the euro, it was perceived that banks were bankruptcy remote.

1. A general overview (cont.)

(d) A similar **institutional deficiency**: The Treaty on the Functioning of the European Union (TFEU) did not contain any provision (similar to the IMF financial assistance mechanisms) for financial assistance to euro area Member States having lost their access to international interbank, money and capital markets (even euro-denominated). Accordingly:

- the initial financial support to Greece was provided on the basis of **Article 122(2) TFEU** laid down for national disasters or exceptional circumstances beyond a Member State's control (!),
- the subsequent financial support mechanisms (EFSM, EFSF, ESM) were based on bilateral and multilateral agreements outside the TFEU,
- the TFEU-anchor for the ESM was laid down only in 2014 with the insertion of **Article 136(3)**, and
- the IMF was logically involved.

2. The case of Ireland

2.1 The banking system before the recent (2007-2009) international financial crisis

(a) The situation in the Irish financial system before the crisis can be summarized as follows:

- the Irish banking system was exceptionally large and highly leveraged (like the one in Iceland and Cyprus): the ratio of assets to GDP came to 400%,
- the balance sheet was funded heavily by access to international interbank and debt markets (wholesale funding) at low cost floating rates (exposure to liquidity risk),
- loan-to-deposit ratios were high, with an over-exposure to mortgage loans (encouraged, like in the US, by public policy),
- inadequate collateral of mortgage loans (mainly by personal guarantees), and high degrees of loan-to value (LTV).

2. The case of Ireland

2.2 The crisis and the guarantee

- At the beginning of the Irish banking crisis in 2008, two credit institutions were mainly affected (Anglo-Irish Bank – Irish Nationwide Building Society), even though the entire system was exposed to risks.
- In order to restore confidence to the banking system, despite the existence of an explicit deposit guarantee scheme (operating under the EU rules laid down by Directive 94/19/EC), but in the absence of a mechanism for direct bank recapitalisation, **the Irish Government issued a 'blanket guarantee'** not only for retail deposits **but for all (non-equity) bank liabilities in all credit institutions (including the ailing ones)**.
- The initial guarantee extended for two years.

2. The case of Ireland
2.2 The crisis and the guarantee (cont.)

- Initially, credit institutions did not apply for Emergency Liquidity Assistance (ELA) from the Central Bank of Ireland. However, since 2009 banks relied heavily both on ECB lending facilities and on ELA support, since the *premia* for funding from wholesale interbank, money and capital markets increased,
- During 2010, the Irish government’s access to wholesale funding came under strains as well – its ability to recapitalize banks was reduced.
- The government provided the Irish Bank Resolution Corporation (IBRC), which inherited the Anglo Irish and Irish Nationwide, with €31 of ‘promissory notes - with the government unable to borrow, the scheme relied on the ability of the Central Bank of Ireland to accept the promissory notes as collateral within the ELA mechanism.

TABLE 2

A typical bank balance sheet in Ireland before the recent (2007-2009) international financial crisis

Assets		Liabilities	
Totally liquid assets: • cash • reserve requirements of the Central Bank • ‘deposit facility’ of the Central Bank	3	Liquidity provided by the Central Bank in the course of the conduct of the monetary policy through: • ‘open market operations’ • ‘lending facilities’	2
		Last resort lending from the Central bank	
Loans and credit to: • businesses • households (mortgage and consumer lending) • institutions (public and private)	70	Deposits of: • businesses • households • institutions (public and private)	39

TABLE 2 (cont.)

A typical bank balance sheet in Ireland before the recent (2007-2009) international financial crisis

Assets		Liabilities	
Capital market instruments issued by: • governments • other banks and financial firms • other corporates	15	Debt instruments not included in own funds Interbank deposits	50
Holdings in other banks, financial firms and corporates (including ‘qualified holdings’ and subsidiaries)	8	**Debt instruments included in regulatory own funds**	4
Real estate – other assets	4	**Share capital and provisions**	5
	100		**100**

3. The case of Greece

3.1 The fiscal and sovereign debt problem

(a) The recent (2007-2009) international financial crisis did not directly and particularly affect the Greek banking system. The main reason for this was the low, if not zero, exposure of domestic banks to securitised financial products issued by US banks. In more detail, over that period Greece's fiscal position had started to deteriorate, but the banking system had not yet been affected. It is indicative that Greek credit institutions recorded their second highest profitability level in 2008, just a few months after the collapse of *Lehman Brothers* (15.9.2008), at the height of the international financial crisis.

(b) In 2010, Greece's fiscal and sovereign debt problems directly affected, as reasonably expected, the Greek banking system through all the eleven (11) channels of transmission (**see above under A 2**).

3. The case of Greece

3.2 Greek bank recapitalisations

3.2.1 The first recapitalisation exercise as a result of the debt write-down with private sector involvement (PSI)

- In 2012, in the context of the Greek sovereign debt write-down and debt buyback operation as a result of credit institutions' inclusion in the PSI (Private Sector Involvement), Greek credit institutions suffered losses on account of Greek sovereign bonds held in their portfolios.
- As a result, on 20 April 2012, the four (4) largest and systemically important Greek credit institutions (representing more than 60% of the Greek banking sector's assets at that time and since November 2014 under the direct supervision of the ECB) announced losses of €27.9 billion, which totally depleted their regulatory own funds and led to their recapitalisation by public funds through the Hellenic Financial Stability Fund. Several others were resolved by use of the bridge institution and the sale of business tools (see **Table 3** below).

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.2 The second recapitalisation exercise

- The crisis had a grave impact on credit institutions' liquidity, balance sheets and financial results. In more detail, their assets continued to be negatively affected by the continuing rise in NPLs as a result of the cumulatively big recession that began in late 2008 and has been ongoing to this day.
- At the same time, there was a sharp decline in deposits (deposits held by domestic households and enterprises dropped from €228 billion in December 2008 to €164 billion in November 2014), thus directly impacting bank liquidity. In addition, on account of their low credit ratings, Greek credit institutions lost access to both the interbank market and the capital market and thus their ability to raise funds through bond issuance; as a result, their liquidity shortage further deteriorated.

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.2 The second recapitalisation exercise (cont.)

- In April 2014, following a stress test conducted by the Bank of Greece, in compliance with a relevant commitment under the second Memorandum of Understanding, the second recapitalisation of the four ‘core’ (systemic) credit institutions was completed. In particular, €8.3 billion were raised through the private sector, compared with capital needs calculated at €5.8 billion under the stress test’s baseline scenario.
- Following the successful completion of the second round of recapitalisation, Greek credit institutions could once again return to international capital markets and raise funds through bond issuance. Gradually, since May 2014, emergency liquidity assistance (ELA) financing, which peaked in November 2012 (at €123.3 billion), essentially fell to zero, albeit temporarily as it would later turn out (see Table 4 below).

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.3 The third recapitalisation exercise

- Since 4 November 2014, Greece's four systemic credit institutions have been directly supervised, pursuant to the new EU regulation on the Single Supervisory Mechanism, by the European Central Bank (ECB). Prior to the assignment of such duties to the ECB, an Asset Quality Review (AQR) and a stress test exercise were conducted. This Comprehensive Assessment, published in October 2014, found that Greece's four systemic credit institutions which took part in the exercise were not short of capital under the dynamic balance sheet assumption.
- Since December 2014, mainly as a result of the political and economic uncertainty, deposit outflows further accelerated. It is indicative that between December 2014 and January 2015, households' and firms' deposits declined by €16.2 billion. This trend continued up to June 2015. On aggregate, in the December 2014-November 2015 period, the deposits held by households and enterprises decreased by €43.4 billion; 97% of this decrease was recorded between December 2014 and June 2015.

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.3 The third recapitalisation exercise(cont.)

- In the meantime, the protracted negotiations between Greece and its lenders, along with the substantial outflow of deposits and the constantly increasing ratio of non-performing loans (NPLs) against the backdrop of a worsening economic climate necessitated another recapitalisation of the Greek banking system, on top of the recapitalisation rounds carried out in 2013 and 2014.
- In October 2015, the ECB conducted a new comprehensive assessment of the four systemic Greek credit institutions, in accordance with the conclusions of the 12 July 2015 EU summit and the Financial Assistance Facility Agreement signed on 19 August 2015 (hereinafter “the Agreement”).

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.3 The third recapitalisation exercise(cont.)

- In the context of the above Comprehensive Assessment another AQR and a second stress test exercise were conducted, the latter containing a baseline scenario and an adverse scenario in order to evaluate the recapitalisation needs of individual credit institutions. In total, the stress test found Greece's four systemic credit institutions and Attica Bank to be short of €5.2 billion under the baseline scenario and €15.4 billion under the adverse scenario, i.e. at 21% and 62% respectively of the amount of €25 billion which was initially included in the Agreement for the Greek banking system's recapitalisation.
- Subsequently, the four systemic credit institutions submitted their respective capital plans to the ECB, detailing how they intended to address their capital shortfalls. Attica Bank submitted its plan to the Bank of Greece, which remains the supervisory authority for non-systemic Greek credit institutions.

3. The case of Greece
3.2 Greek bank recapitalisations
3.2.3 The third recapitalisation exercise(cont.)

- The recapitalisation process was completed successfully with substantial participation by foreign investors, who placed around €5.3 billion in the four ‘core’ banks. An additional €2.7 billion was covered through liability management exercises (voluntary bond swap offers to bank bondholders). The necessary additional funds for the two banks that did not fully cover their capital needs from private sources (€5.4 billion) were drawn from the HFSF.

3. The case of Greece

3.3 Resolution of non-viable credit institutions

(a) Concurrently with the recapitalisation of Greek credit institutions, the Bank of Greece has resolved the credit institutions that were deemed non-viable since late-2011. In Greece, prior to the transposition of Directive 2014/59/EU of the European Parliament and of the Council, of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms, two resolution tools were introduced by legislative means:

- The first resolution tool was the creation of a new interim credit institution (bridge bank), to which all of the non-viable credit institution's deposits would be transferred, the withdrawal of the non-viable credit institution's authorisation and its placing under liquidation.
- The second resolution tool was the transfer of property items, including all deposits, held with a non-viable credit institution to another existing credit institution, the withdrawal of the non-viable credit institution's authorisation and its placing under liquidation.

3. The case of Greece

3.3 Resolution of non-viable credit institutions (cont.)

(b) The above resolution tools were used in fourteen (14) cases, thus completely changing the Greek banking system landscape. The credit institutions under resolution have been placed under liquidation following the withdrawal of their authorisation and their healthy property items (including all of their deposits) have been transferred to the four systemic credit institutions (see Table 3 below).

TABLE 3

Amounts drawn from the HFSF and/or HDIGF towards covering the financing gaps resulting from the transfer of property items of non-viable credit institutions and recapitalising interim credit institutions

Resolved credit institution	**Tool**	**Date (m/y)**	**Amount (€)**	**Purpose**
Proton Bank	Interim credit institution	10/2011	259,621,860	Financing gap
Proton Bank	Interim credit institution	10/2011 01/2013	910,000,000	Capital
T-Bank	Transfer of property items to TT Hellenic Postbank	12/2011	226,956,514	Financing gap
Three cooperative banks *	Transfer of deposits to the National Bank of Greece	03/2012	320,484,481	Financing gap
Agricultural Bank	Transfer of property items to Piraeus Bank	07/2012	7,470,717,000	Financing gap

TABLE 3 (cont.)

Amounts drawn from the HFSF and/or HDIGF towards covering the financing gaps resulting from the transfer of property items of non-viable credit institutions and recapitalising interim credit institutions

Resolved credit institution	Tool	Date (m/y)	Amount (€)	Purpose
TT Hellenic Postbank	Interim credit institution	01/2013	3,732,554,000	Financing gap
TT Hellenic Postbank	Interim credit institution	01/2013	500,000,000	Capital
FBB	Transfer of property items to the National Bank of Greece	05/2013	456,970,455	Financing gap
PROBANK	Transfer of property items to the National Bank of Greece	07/2013	562,733,502	Financing gap
Three cooperative banks ***	Transfer of deposits to Alpha Bank	12/2013 07/2014	458,970,259	Financing gap

TABLE 3 (cont.)

Amounts drawn from the HFSF and/or HDIGF towards covering the financing gaps resulting from the transfer of property items of non-viable credit institutions and recapitalising interim credit institutions

Resolved credit institution	Tool	Date (m/y)	Amount (€)	Purpose
Panellinia Bank ***	Transfer of property items to Piraeus Bank	04/2015	273,214,450	Financing gap
Cooperative Bank Of Peloponnese ***	Transfer of property items to the National Bank of Greece	12/2015	99,583,000	Capital
TOTAL AMOUNT (€)			**15,271,805,521**	
Total amount of financing gap covered (€)			13,861,805,521	
Total amount of capital (€)			1,410,000,000	

* Achaiki Cooperative Bank, Cooperative Bank of Lamia and Cooperative Bank of Lesvos-Lemnos ** Cooperative Bank of Western Macedonia, Cooperative Bank of Dodecanese and Cooperative Bank of Evia *** Financing gap covered through the HFSF

Sources: HFSF, Interim Financial Statements (30-9-2014), December 2014 & Bank of Greece on Panellinia Bank and the Cooperative Bank of Peloponnese.

TABLE 4

Lending to Greek credit institutions related to monetary policy operations denominated in euro and other claims (emergency liquidity assistance-ELA)
(in million euro)

End-December	2008	2009	2010	2011	2012	2013	2014	2015
Lending to Greek credit institutions related to monetary policy operations denominated in euro	38,355	49,655	97,669	76,120	19,347	63,226	56,039	35,918
Other claims on Greek credit institutions denominated in euro (emergency liquidity assistance-ELA	76,800	72,800	71,600	52,009	101,851	9,791	1,095	77,488
TOTAL	**38,432**	**49,728**	**97,740**	**128,129**	**121,198**	**73,017**	**56,040**	**113,406**

Source: *Bank of Greece, Financial Statements, Annual Accounts and Monthly Balance Sheets*

TABLE 5
A typical bank balance sheet in Greece before the current fiscal crisis in the euro area

Assets		**Liabilities**	
Totally liquid assets: • cash • reserve requirements of the Central Bank • 'deposit facility' of the Central Bank	5	Liquidity provided by the Central Bank in the course of the conduct of the monetary policy through: • 'open market operations' • 'lending facilities'	2
		Last resort lending from the Central bank	
Loans and credit to: • businesses • households (mortgage and consumer lending) • institutions (public and private)	73	Deposits of: • businesses • households • institutions (public and private)	79

TABLE 5 (cont.)

A typical bank balance sheet in Greece before the current fiscal crisis in the euro area

Assets		**Liabilities**	
Capital market instruments issued by: • governments • other banks and financial firms • other corporates	10	Debt instruments not included in own funds Interbank deposits	10
Holdings in other banks, financial firms and corporates (including ‘qualified holdings’ and subsidiaries)	8	**Debt instruments included in regulatory own funds**	2
Real estate – other assets	4	**Share capital and provisions**	7
	100		**100**

C. Adequate regulatory actions in order to break the vicious circles

1. The bank safety net: the sum of policy instruments employed with regard to the preservation of the stability of the banking system

TABLE 6 The 'bank safety net'		
Policy instruments	**Competent institution**	**Attributes of the institution**
Bank authorisation	Supervisory authority	Central bank or other administrative authority
Micro-prudential and macro-prudential regulation of banks	Parliament Supervisory authority	General regulator upon delegation
Micro-prudential supervision of banks	Supervisory authority	Central bank or other administrative authority
Macro-prudential oversight of the financial system (including the banking sector)	Central bank or monetary authority/agency (in most cases)	

TABLE 6 (cont.)
The 'bank safety net'

Policy instruments	Competent institution	Attributes of the institution
Specific crisis prevention and resolution of banks	Supervisory or judicial authority Resolution authority and resolution fund	On a case-by-case basis
Deposit guarantee	Deposit guarantee scheme	Entity of private or public law
Last-resort lending	Central bank or monetary authority/agency	
Provision of state subsidies to banks (government 'bailout') in form of equity participation and/or liquidity guarantees	National Ministry of Finance or other delegated governmental agency	

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

I. Micro-prudential regulation

(a) Micro-prudential banking regulation seeks to enforce the safety and soundness of banks by limiting their exposure either to insolvency or to liquidity risk (which might lead to insolvency under certain circumstances) and by curbing their risk vulnerability through:

- limiting their exposure to various categories of financial risks, and all other risks associated with the conduct of their business to which they might be exposed, and
- increasing their capacity to absorb losses incurred in the event of such risks.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

I. Micro-prudential regulation (cont.)

(b) Micro-prudential banking regulation is mainly performed by laying down rules on:

- banks' capital adequacy ratios against exposure to risks associated with the conduct of their business,
- a leverage ratio,
- the organisation and operation of in-house risk management units,
- the limitation of banks' holdings in other companies, mainly outside the financial system,
- provisioning for future exposure to risks,
- portfolio diversification (namely rules on 'large exposures'),
- liquidity ratios, and
- public disclosure of information on those matters.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation

(a) Macro-prudential policies seek to address the two dimensions of systemic risk:

(i) The first is the **'time dimension'**, namely the systemic risk's evolution through time. In this context, macro-prudential policies seek to strengthen the resilience of the financial system at times of economic downturn by limiting procyclicality, which can accentuate systemic risk because of the interactions developed either within the financial system, or between the financial system and the real sector of the economy.

The objective is to **'lean against the financial cycle'**, bearing in mind that it has been proven historically that failures caused by credit expansion are generated on the upside of the economic cycle, but become apparent on the downside, especially when the economic cycle is in a downturn.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation (cont.)

(ii) The second dimension is the **‘cross-sectional dimension’**, namely allocation of risk in the financial system at any given point in time. In this case, macro-prudential policies are aimed at limiting systemic risk concentration, which could result:

- either from the concurrent exposure of multiple financial institutions to risks arising from similar exposures, or
- from the interconnectedness of such institutions (and the contagion of problems among them), especially if they are systemically important financial institutions (SIFIs).

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation (cont.)

(b) A mix of instruments is adopted in order to meet the objective for addressing these two dimensions of systemic risk. In this respect, it is necessary to adopt macro-prudential regulations, which are:

- addressed to banks and/or other financial firms, as well as money and capital markets, and
- differentiated depending on the systemic risk dimension they are called upon to address.

(ba) The policy instruments used in order to achieve the objective of addressing the systemic risk's time dimension, and notably the financial system's procyclicality issue, mainly include the following macro-prudential regulations:

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation (cont.)

(i) First of all, it is necessary to adopt rules imposing an obligation on banks to set ‘capital conservation buffers’ and ‘countercyclical buffers’, and take ‘forward-looking provisions’.

(ii) Included are also other prudential measures which:

- either affect the prices of services provided by banks (‘price-based prudential tools’) such as introducing, when the economic cycle is on the upside, stricter risk weights for calculating the capital adequacy ratio on specific exposures (e.g. loans denominated in foreign exchange, mortgage loans or loans for the purchase of securities and positions in derivatives), or

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation (cont.)

- affect the quantity of services provided (‘quantity-based prudential tools’), such as time-variation, depending on the phase of the economic cycle, the loan-to-value ratios of mortgage loans, and the debt-to-income ratios in mortgage and consumer loans.

(iii) Finally, the systemic risk’s time dimension (and notably the procyclicality caused by leveraging capital markets) can be addressed by stricter rules imposing margins and haircuts on positions in securities and derivatives during economic upturns.

(bb) The policy instruments used in order to achieve the objective of addressing the systemic risk’s cross-sectional dimension mainly include the following macro-prudential regulations:

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

II. Macro-prudential regulation (cont.)

(i) The key measure is to adopt rules on the resolution of systemically important banks (and other category of financial firms) exposed to insolvency that will enable (in part or in whole) the suspension of their operations without jeopardising the stability of the banking (and, more generally, the financial) system, or making state intervention necessary for their bailout, invoking the argument that they are too-big-to-fail.

(ii) The second measure is ancillary and consists in adopting appropriate specific micro-prudential regulations (such as rules to cover banks against exposure to credit risk from specific portfolio items, included within the regulatory framework on capital adequacy), thus making it possible to address the systemic risk's cross-sectional dimension.

(iii) Finally, addressing the systemic risk's cross-sectional dimension can also be achieved with the introduction of restrictions on the range of services provided by systemically important financial institutions (especially banks).

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

III. Micro-prudential supervision

Micro-prudential banking regulation can only be effective if coupled with micro-prudential supervision by competent authorities, with a view to assessing the quality of banks’ portfolios, and ascertaining compliance with the applicable regulatory framework, in order to prevent banks’ exposure to exceptional, unmanageable risk levels.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.1 Crisis prevention elements of the bank safety net

IV. Macro-prudential oversight

It is necessary to set up institutions and procedures for ensuring 'macro-prudential financial oversight', thus enabling the identification, measurement and assessment of systemic risk. The objective of macro-prudential oversight is to limit the distress of the financial system as a whole in order to protect the overall economy against significant losses in real output.

Macro-prudential oversight cannot be meaningful, unless it can somehow impact on supervision at the micro-level, whilst micro-prudential regulation and supervision cannot effectively safeguard financial stability without adequately taking account of macro-level developments.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.2 Crisis management elements of the bank safety net

I. The trilemma in the case of banks' exposure to insolvency – the importance of resolution actions

If insolvency problems arise, competent authorities are faced with a 'trilemma':

- to bail-out undercapitalised (usually systemically significant) banks by using taxpayers' money, judging that a withdrawal of their authorisation would have significant 'systemic consequences',
- to resolve insolvent banks through the competent resolution authorities, or
- to withdraw their authorisation and subsequently activate deposit guarantee schemes.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.2 Crisis management elements of the bank safety net

I. The trilemma in the case of banks’ exposure to insolvency – the importance of resolution actions (cont.)

In order to ward off the moral hazard in case of ‘too-big-to-fail’ or ‘systemically important’ banks, the failure/closing down of which would endanger the stability of the banking (and, more generally, financial) system (and in addition to prevent resort to a government bailout) **‘crisis management measures’ in the form of resolution actions** must be put in place.

2. Designing the bank safety net in order to prevent banking crises having spillover effects to the sovereign and contain their impact

2.2 Crisis management elements of the bank safety net

II. Explicit vs. implicit deposit guarantee schemes – funding conditions

Deposit guarantee schemes must be explicit, be entirely funded by the participating banks, and the coverage level provided therein must not be the subject of ‘political leverage’.

The negative effects of the Irish experience are illustrative.

3. Designing the bank safety net in order to prevent sovereign fiscal and/or debt crises having spillover effects to the banking system

I. Micro-prudential regulations

Micro-prudential regulations must be in place, which do not give perverse incentives to banks to invest in government bonds.

In this respect, there is a need to amend, in due course, the provisions of the international regulatory framework which stipulate, in relation to the calculation of capital requirements for credit risk (mainly under the Standardised Approach, still used by several credit institutions, especially the least sophisticated ones), that claims on Member State governments, if denominated in the local currency, have a zero percent (0%) risk weight.

The experience from the 'voluntary' haircut on Greek government bonds has shown that these provisions are now ineffective.

3. Designing the bank safety net in order to prevent sovereign fiscal and/or debt crises having spillover effects to the banking system

II. Macro-prudential regulations

In addressing the systemic risk's time dimension, and notably the financial system's procyclicality issue, it is necessary to adopt rules imposing an obligation on banks to set 'capital conservation buffers' and 'countercyclical buffers', and take 'forward-looking provisions'.

3. Designing the bank safety net in order to prevent sovereign fiscal and/or debt crises having spillover effects to the banking system

II. Macro-prudential regulations

'Capital conservation buffers' must be created outside periods of stress (namely during times of economic growth and credit expansion) in order to absorb losses generated in times of stress of the economic cycle. These buffers, calculated as a percentage of banks' total risk-weighted assets (according to provisions on the capital adequacy ratio, see above under 2.3.1.2) may be used to avoid recourse to other regulatory capital elements for absorbing losses.

'Countercyclical capital buffers' must be created in order to ensure that capital requirements take into account the macro-financial environment in which banks operate. Such a buffer requirement must be put in place when national supervisory authorities consider that excess aggregate credit growth is deemed to be associated with a build-up of systemic risk. In this context, authorities are called upon to:

- monitor credit growth and other indicators that may signal a build-up of systemic risk, and
- assess whether (and to what extent) credit growth is excessive and is leading to the build-up of systemic risk.

3. Designing the bank safety net in order to prevent sovereign fiscal and/or debt crises having spillover effects to the banking system

IV. Independence of banking supervisory authorities

Once the authorisation and micro-prudential supervision of banks is assigned to an independent supervisory authority, government influence over banks will be significantly weaker. The conditions, for example, under which these banks will invest in domestic sovereign bonds is expected to change substantially, since their dependence on Member States' influence (where applicable) will be kept under bounds. Weaning national banking systems from government influence could thus become an important springboard for financial stability.

3. Designing the bank safety net in order to prevent sovereign fiscal and/or debt crises having spillover effects to the banking system

IV. Independence of banking supervisory authorities (cont.)

Independence has four features:

- institutional,
- personal,
- financial,
- operational

V. Corporate governance rules as part of micro-prudential supervision

Constraints on ‘politically exposed persons’ as members of the Board of Directors of banks

D. The EU response to the recent crises: the European Banking Union (EBU)

The **six (6) main elements** of European banking law after the establishment of the European Banking Union:

- adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the bank safety net
- the various components as a by-product of the two crises
- the impact of public international banking law on the content of the single rulebook
- variable perimeter of application
- legal sources: a mixture of legal acts adopted on various legal bases - contestability
- selected important elements of the institutional framework

1. Adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the EU bank safety net:

1.1 Crisis prevention

- authorisation of credit institutions ('single rulebook' with minimum harmonisation – fully centralised within the Single Supervisory Mechanism (SSM))
- micro-prudential supervision of credit institutions ('single rulebook' with minimum harmonisation – partly centralised within the SSM)
- micro- and macro-prudential regulation of credit institutions ('single rulebook' with minimum vs. maximum harmonisation)
- macro-prudential oversight of the financial system (fully centralised within the European Systemic Risk Board (ESRB))
- evaluation of credit institutions' recovery plans ('single rulebook' with minimum harmonisation – partly centralised within the SSM)
- resolution planning of credit institutions ('single rulebook' with minimum harmonisation – partly centralised within the Single resolution Mechanism (SRM))

1. Adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the EU bank safety net:

1.2 Crisis management

- early intervention in credit institutions (minimum harmonisation – partly centralised within the SSM)
- resolution of credit institutions (‘single rulebook’ with minimum harmonisation – partly centralised within the SRM)
- recapitalisation of credit institutions by public funds (partly centralised under the Direct recapitalisation Instrument (DRI) of the European Stability Mechanism (ESM))
- ‘winding-up’ (not necessarily bankruptcy) of non-viable credit institutions (no harmonisation – decentralised)
- deposit guarantee (‘single rulebook’ with minimum harmonisation – still decentralised)
- last resort lending (no rules (‘constructive ambiguity’) – decentralised, but subject to the agreement (lack of objection) of the ECB Governing Council under Article 14.4 of the Statute of the European System of Central banks and of the ECB)

1. Adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the EU bank safety net:

1.2 Crisis management (cont.)

The EU response to the 'trilemma' in the case of credit institutions' exposure to insolvency: Article 32(1) BRRD:

Resolution authorities must take a resolution action in relation to a credit institution only if the resolution authority considers that all the following conditions are met:

(a) The determination that the institution is failing or is likely to fail has been made by the competent authority or by the resolution authority.

(b) There is no reasonable prospect that:

- any alternative private sector measures or supervisory action, including early intervention measures or
- the write down or conversion of relevant capital instruments taken in respect of the institution,

1. Adoption of EU rules and (in some cases) establishment of EU institutions pertaining to the various components of the EU bank safety net:

1.2 Crisis management (cont.)

would prevent the failure of the institution within a reasonable timeframe.

(c) A resolution action is necessary in the public interest = it is not advisable to wind it up.

2. The various components as a by-product of the two crises:

2.1 Children of the recent (2007-2009) international financial crisis

- the 'single rulebook' on authorisation, prudential regulation and supervision, early intervention – resolution planning – resolution, and deposit guarantee
- the European Systemic Risk Board (ESRB), as the hub for macro-prudential financial oversight, and
- the EBA as regulator with limited supervisory powers

2.2 Children of the current euro area fiscal and debt crisis

- the EU 'Single Mechanisms and Funds' (SSM, SRM and Single Resolution Fund (SRF)),
- the ESM

2.3 The only element adopted before the crises which is still in force: the regime governing the winding-up of credit institutions (mutual recognition, no harmonisation)

3. The impact of public international banking law on the content of the single rulebook:

- the standards of the Basel Committee on Banking Supervision (BCBS) on micro-and macro-prudential regulation
- the standards of the Financial Stability Board (FSB) on resolution
- the standards of the International Association of Deposit Insurers on deposit guarantee

4. Variable perimeter of application:

4.1 The perimeter in respect of credit institutions and groups within the SSM and the SRM: ‘significant’ vs. ‘less significant’

4.2 The perimeter in respect of Member States

- the single rulebook applies to all (28) EU Member States
- the EU ‘Single Mechanisms and Funds’ component pertains mainly to the euro area Member States
- option for Member States with a derogation to join the ‘Single Mechanisms and Funds’ upon the conclusion of a ‘close cooperation’ agreement = *if activated, the perimeter of the EBU will be larger than that of the euro area*

5. Legal sources: a mixture of legal acts adopted on various legal bases - contestability:

5.1 Primary legal acts

- Regulations of the ECOFIN Council (Article 127(6) TFEU)
- Regulations of the European Parliament and the ECOFIN Council (Article 114 TFEU)
- Directives of the European Parliament and the ECOFIN Council (Article 53(1) TFEU)
- Intergovernmental Agreement (due to the lack of a solid legal basis in the TFEU)

5.2 Secondary legal acts

- Regulations and Decisions of the ECB
- European Commission delegated and implementing acts (Articles 290-291 TFEU)
- Guidelines and Recommendations of the European Banking Authority (EBA)
- Recommendations of the ESRB

6. Selected important elements of the institutional framework:

- The ECB as a licensing authority – supervisor – regulator – contributor in macro-prudential oversight
- Relation between the ECB and the EBA
- The ECB’s Supervisory Board as a body not anchored in the TFEU
- The Single Resolution Board (SRB) as an institution not anchored in the TFEU
- The ECB and the SRB as hubs in the SSM and the SRM (respectively) – division of powers between the hub and the spokes (national supervisory and resolution authorities)

TABLE 7
The key legal sources of the three main pillars of the EBU

	Prudential supervision and regulation of credit institutions	Resolution of non-viable credit institutions	Deposit guarantee schemes
European 'Single Mechanisms and Funds'	Single Supervisory Mechanism: • Council Regulation (EU) No 1024/2013 **('SSMR')** • ECB Regulation (EU) No 468/2014 **('ECB Framework Regulation')** • other ECB legal acts (see below Table 3)	Single Resolution Mechanism and Fund: • Regulation (EU) No 806/2014 of the European Parliament and of the Council **('SRMR')**, and Commission delegated and implementing acts • Intergovernmental Agreement (2014) **('SRF')**	Proposal for a Regulation of the European Parliament and of the Council "amending Regulation EU No 806/2014 in order to establish an **'EDIS'**"

TABLE 7 (cont.)
The key legal sources of the three main pillars of the EBU

	Prudential supervision and regulation of credit institutions	Resolution of non-viable credit institutions	Deposit guarantee schemes
Harmonisation of substantive rules (‘single rulebook’)	• Regulation (EU) No 575/2013 of the European Parliament and of the Council **(‘CRR’)**, and Commission delegated and implementing acts • Directive 2013/36/EU of the European Parliament and of the Council **(‘CRD IV’)**, and Commission delegated and implementing acts	• Directive 2014/59/EU of the European Parliament and of the Council **(‘BRRD’)**, and Commission delegated and implementing acts	• Directive 2014/49/EU of the European Parliament and of the Council, and a Commission delegated act **(‘DGSD’)**

TABLE 8 Addressees of and date by which the main provisions of the key legal sources pertaining to the EBU are applicable		
A. Authorisation - prudential supervision - prudential regulation		
Legal act	**Addressees**	**Date of start of (full) application**
Regulation (EU) No 1024/2013 **(‘SSMR’)**	19+ Member States	4 November 2014
ECB ‘SSM Framework Regulation’	19+ Member States	15 May 2014
Regulation 575/2013 **(‘CRR’)**	28 Member States	1 January 2014
Directive 2013/36/EU **(‘CRD IV’)**	28 Member States	1 January 2014

TABLE 8 (cont.)
Addressees of and date by which the main provisions of the key legal sources pertaining to the EBU are applicable

B. Recovery and resolution		
Regulation (EU) No 806/2014 (**‘SRMR’**)	19+ Member States	1 January 2016 *(upon ratification of the SRF Intergovernmental Agreement by Contracting Parties)*
Intergovernmental Agreement on the **‘SRF’**	19+ Member States	1 January 2016 *(upon ratification by Contracting Parties)*
Directive 2014/59/EU (**‘BRRD’**)	28 Member States	1 January 2015
C. Deposit guarantee		
Directive 2014/49/EU on deposit guarantee schemes (**‘DGSD’**)	28 Member States	4 July 2015

TABLE 9
European banking law before and after the EBU:
Elements of continuity and change

A. Prudential requirements		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
1. Authorisation and micro-prudential supervision of credit institutions	• National supervisory authorities • Minimum harmonisation of rules (Directive 2006/48/EC)	• *Single Supervisory Mechanism ('SSMR') (for euro area +)* • National supervisory authorities (for Member States with a derogation) • *Single rulebook ('CRD IV') (for all Member States)*
2. Micro- and macro-prudential regulation of credit institutions	Minimum harmonisation of rules (Directives 2006/48/EC and 2006/49/EC)	*Single rulebook ('CRR' and 'CRD IV') (for all Member States)*

TABLE 9 (cont.) European banking law before and after the EBU: Elements of continuity and change		
A. Prudential requirements		
Financial policy instruments	Institutions/rules	
	Until 31 December 2013	By 2014 (gradually) *(italics denote change or new element)*
3. Evaluation of recovery plans	–	• *Single Supervisory Mechanism ('SSMR') (for euro area +)* • *National supervisory authorities (for Member States with a derogation)* • *Single rulebook ('BRRD')*

TABLE 9 (cont.)
European banking law before and after the EBU: Elements of continuity and change

A. Prudential requirements		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
4. Resolution planning	_	• *Single Resolution Mechanism ('SRMR') (for euro area +)* • *National resolution authorities (for Member States with a derogation)* • *Single rulebook ('BRRD')*
5. Macro-prudential oversight of the financial system	European Systemic Risk Board	European Systemic Risk Board

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

B. Crisis prevention		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
1. Adoption of ‘alternative measures’ within the framework of recovery plan evaluation	_	• *Single Supervisory Mechanism (‘SSMR’) (for euro area +)* • *National supervisory authorities (for Member States with a derogation)* • *Single rulebook (‘BRRD’)*
2. Repair or removal of impediments to resolvability	_	• *Single Resolution Mechanism (‘SRMR’) (for euro area +)* • *National resolution authorities (for Member States with a derogation)* • *Single rulebook (‘BRRD’)*

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

B. Crisis prevention		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
3. Early intervention - special administrator	_	• *Single Supervisory Mechanism ('SSMR') (for euro area +)* • *National supervisory authorities (for Member States with a derogation)* • *Single rulebook ('BRRD')*
4. Write-down and conversion (without bail-in)	_	• *Single Resolution Mechanism ('SRMR') (for euro area +)* • *National resolution authorities (for Member States with a derogation)* • *Single rulebook ('BRRD')*

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

C. Crisis management		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
1. Reorganisation of credit institutions	• National authorities (Directive 2001/24/EC) • No harmonisation of rules	• National authorities (Directive 2001/24/EC) • No harmonisation of rules
2. Winding-up of credit institutions	• National authorities (Directive 2001/24/EC) • No harmonisation of rules	• National authorities (Directive 2001/24/EC) • No harmonisation of rules

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

<table>
<tr><th colspan="3">C. Crisis management</th></tr>
<tr><th>Financial policy instruments</th><th colspan="2">Institutions/rules</th></tr>
<tr><th></th><th>Until 31 December 2013</th><th>By 2014 (gradually)
(italics denote change or new element)</th></tr>
<tr><td>3. Deposit guarantee schemes</td><td>• National schemes
• Minimum harmonisation of rules (Directive 94/19/EC)</td><td>• From national schemes to the EDIS (proposal)
• Single rulebook (Directive 2014/49/EU) (for all Member States)</td></tr>
</table>

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

C. Crisis management		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
4. Resolution of credit institutions	–	• *Single Resolution Mechanism ('SRMR') (for euro area +)* • *National resolution authorities (for Member States with a derogation)* • *Single Resolution Fund (Intergovernmental Agreement) (for euro area +)* • *Single rulebook ('BRRD') (for all Member States)*

TABLE 9 (cont.)
European banking law before and after the EBU:
Elements of continuity and change

C. Crisis management		
Financial policy instruments	**Institutions/rules**	
	Until 31 December 2013	**By 2014 (gradually)** ***(italics denote change or new element)***
5. Provision of state subsidies to systemically important credit institutions	• Member States • Indirectly the ESM	• Member States • Indirectly the ESM • *Directly the ESM ('DRI')*
6. Last resort lending to solvent but illiquid credit institutions	• National central banks (Emergency Liquidity Assistance (ELA) in the euro area)	• National central banks (Emergency Liquidity Assistance (ELA) in the euro area)

TABLE 10
The partial Europeanisation of the 'bank safety net' (even) with regard to significant credit institutions

Financial policy instruments	Scope of application	Level of action (*italics* denotes national)
Granting and withdrawal of authorisation	Euro area (+ Member States under close cooperation)	**ECB** within the SSM (also applicable to less significant credit institutions)
Macro-prudential oversight	EU	**ESRB** and **ECB** (specific tasks)
Micro-prudential supervision	Euro area (+ Member States under close cooperation)	**ECB** within the SSM (with regard to the specific tasks conferred on the ECB)
Recovery planning and early intervention	Euro area (+ Member States under close cooperation)	**ECB** within the SSM
Recapitalisation by public funds	• EU • Euro area • Euro area	• *National governments* • *Indirectly by the ESM* • Directly by the **ESM** ('DRI')

TABLE 10 (cont.)
The partial Europeanisation of the 'bank safety net' (even) with regard to significant credit institutions

Financial policy instruments	Scope of application	Level of action (*italics* denotes national)
Drawing up of resolution plans, assessment of resolvability and resolution	Euro area (+ Member States under close cooperation)	Single Resolution Board ('**SRB**') within the SRM *(as of 1 January 2016)*
Winding up	EU	*National administrative or judicial authorities*
Deposit guarantee	EU	*National deposit guarantee schemes* European Deposit Insurance Scheme (**EDIS**) *(proposal)*
Last resort lending ('ELA')	Euro area	*National central banks-members of the Eurosystem*

TABLE 11
The regulatory perimeter

A. The perimeter in respect of different types of financial firms	
Included	Excluded
• credit institutions • ‘financial holding companies’, in the context of the conduct of consolidated supervision of banking groups, • ‘mixed financial holding companies’, in the context of the conduct of supplementary supervision on financial conglomerates including credit institutions • branches established in a participating Member State by a credit institution incorporated in a non-participating Member State	• credit institutions excluded from the field of application of the CRD IV • financial institutions (*e.g*., leasing, factoring and credit companies), including payment institutions and asset management companies • insurance and reinsurance undertakings • investment firms, • central counterparties • UCITS management companies, and alternative investment fund managers (including hedge funds)

TABLE 11 (cont.) The regulatory perimeter	
B. The perimeter in respect of Member States	
Euro area Member States	Member States with a derogation
Yes	Specific rules on: • branches in participating Member States of credit institutions incorporated in non-participating Member States • credit institutions incorporated in Member States with a derogation which have established a 'close cooperation'

TABLE 11 (cont.)
The regulatory perimeter

C. The perimeter in respect of credit institutions and other supervised entities and groups - direct supervision by the ECB

1. *Size criterion*: in principle (unless particular circumstances justify otherwise), supervised entities and groups if the total value of their assets exceeds 30 billion euros.

2. *Economic importance criterion*: in principle (unless particular circumstances justify otherwise), supervised entities and groups meeting any one of the following criteria:

- the ratio of their total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of their assets is below 5 billion euros, or
- following a notification by their national competent authority that it considers such institutions of significant relevance with regard to the domestic economy, the ECB takes a Decision confirming such significance.

3. *Cross-border activities criterion*: those considered by the ECB, on its own initiative, to be of significant relevance if:

- they have established banking subsidiaries in more than one participating Member States, and
- their cross-border assets or liabilities represent a significant part of their total assets or liabilities.

TABLE 11 (cont.)
The regulatory perimeter

C. The perimeter in respect of credit institutions and other supervised entities and groups - direct supervision by the ECB

4. *Direct financial assistance criterion*: those for which public financial assistance has been requested or received directly from the EFSF or the ESM.

5. In any case, the three most significant credit institutions or supervised groups in each Member State, unless otherwise justified by particular circumstances.

6. When necessary to ensure consistent application of high supervisory standards, the ECB may at any time, on its own initiative after consulting with national authorities or upon request by a national competent authority, decide to exercise directly the supervision of a less significant supervised entity or group, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM.

TABLE 12
Allocation of tasks between the ECB and the national competent authorities (NCAs)

	Significant supervised entities	Less significant supervised entities
Granting and withdrawal of authorization	ECB	ECB
Assessment of applications for the acquisition and disposal of ‘qualifying holdings’	ECB	ECB
Conduct of micro-prudential supervision	ECB	NCA
Conduct of macro-prudential regulation	ECB/ NCA or NDA	NCA or NDA
Carrying out supervisory tasks in relation to recovery plans and early intervention	ECB	NCA
Conduct of stress-tests	ECB	NCA

TABLE 12 (cont.)
Allocation of tasks between the ECB and the national competent authorities (NCAs)

	Significant supervised entities	Less significant supervised entities
Participation in colleges of supervisors	ECB	NCA
Protection of the economic interests of consumers transacting with financial service providers	NCA	NCA
Supervision of (retail) payment services	NCA	NCA
Prevention of the use of the financial system for the purposes of money laundering and terrorist financing	NCA	NCA

TABLE 13

Classification of members of the Basel Committee on Banking Supervision according to their competences in micro-prudential banking (financial) supervision

		Members of Basel Committee (reference to the relevant state)	
		National central banks (14)	**National administrative authorities (14)**
Approaches on micro-prudential financial supervision	**Sectoral approach**	Argentina Brasil Hong Kong SAR India Italy Russia Saudi Arabia Singapore South Africa Spain (SSM: euro area) United Kingdom	***Only for banking:*** China Turkey United States ***Both for banking and capital markets:*** Luxembourg Mexico

TABLE 13 (cont.)
Classification of members of the Basel Committee on Banking Supervision according to their competences in micro-prudential banking (financial) supervision

		Members of Basel Committee (reference to the relevant state)	
		National central banks (14)	**National administrative authorities (14)**
Approaches on micro-prudential financial supervision	**Functional approach**	Belgium Netherlands	France
	Full integration approach	–	Australia Canada Germany Indonesia Japan Korea Sweden Switzerland

TABLE 14
A comparison: ECB (as a supervisory authority), EBA and ESRB

	ECB	EBA	ESRB
Objective	contribution to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State (SSM Regulation, Article 1)	protection of the public interest by contributing to the stability of the financial system, for the EU economy, its citizens and businesses (EBA Regulation, Article 1, paragraph 5)	contribution to the prevention/mitigation of systemic risks to financial stability in the EU arising from developments within the financial system (ESRB Regulation, Article 3, paragraph 1)
Tasks	micro-prudential supervision of credit institutions (SSM Regulation, Articles 4 and 5)	various (EBA Regulation, Articles 8-9), but *not a supervisory authority*	macro-prudential oversight of the financial system (ESRB Regulation, Article 3, paragraph 1)
Seat	Frankfurt	London	Frankfurt

TABLE 15

SRB submits resolution scheme to the Commission (**COM**)

COM within 24 hours endorses the resolution scheme

COM within 24 hours objects to the resolution scheme concerning discretionary aspects of it

COM within 12 hours proposes to **ECOFIN** to object to the resolution scheme on the grounds that the resolution scheme does not fulfil the criterion of public interest

COM within 12 hours proposes to **ECOFIN** to approve or object to a material modification of the amount of the Fund provided for in the resolution scheme

SRB within 8 hours modifies the resolution scheme on accordance with the reasons expressed

No objection by the **ECOFIN** to the resolution scheme within 24 hours from its transmission by the SRB

Objection by the **ECOFIN** to the resolution scheme within 24 hours from its transmission by the SRB

ECOFIN objects to material modification of the amount of the Fund provided for in the resolution scheme within 24 hours from its transmission by the SRB

ECOFIN approves a material modification of the amount of the Fund provided for in the resolution scheme within 24 hours from its transmission by the SRB

Adoption of the resolution scheme

winding up of the entity concered

Adoption of the resolution scheme

SRB within 8 hours modifies resolution scheme in accordance with the reasons expressed

E. Concluding remarks

1. Breaking the vicious circles between the banking system and the sovereign may partly be achieved through an appropriate design of the ‘bank safety net’.

2. In the EU (mainly but not exclusively in the euro area), through the ‘European Banking Union’ project, the focus has been on:

2.1 In terms of rules:

- enhancing micro- and macro-prudential banking regulation,
- establishing a framework for the resolution of credit institutions,
- harmonizing the level of deposit guarantee at a maximum level

2.2 In terms of institutions:

- creating a European Systemic Risk Board for macro-prudential financial oversight,
- creating pan-European mechanisms and funds for banking micro-prudential supervision and resolution, and
- planning the Europeanisation of deposit guarantee

3. Sound fiscal and monetary policies are, however, indispensable (outside the reach of this presentation).

- Monetary policy has been centralized within the euro area **(Article 127 TFEU) – monetary union**
- Fiscal policies, even within the euro area, remain still national **(Article 120 TFEU)**, under the constraints laid down by the principles of economic coordination **(Article 121 TFEU)** and fiscal discipline **(Articles 123-126 TFEU) – economic union**

4. A point of concern: the accuracy and forward-looking perspective of the monitoring mechanism provided by pan-European and international institutions and bodies and potential adverse implications.

An important remark by **B. Eichengreen (2015)**: *"Ireland was blessed by external surveillance of its financial regulation, and of its economic and financial policies generally, by the European Union and the IMF"*:

- between 2004 and 2010 the Irish banking system was subject to the oversight of the Committee of European Banking Supervisors (the predecessor of the European Banking Authority (EBA)) – CEBS reports were confined to defining standards and best practices rather than examining the conformance of individual member states with those standards and practices - hence the excesses of banking practice in Ireland seem to have received little scrutiny,
- surveillance by the European Commission, for its part, focused on fiscal policy under the provisions of the TFEU and the Stability and Growth Pact – Ireland's budget surpluses thus freed it of serious criticism,

- the September 2007 Article IV consultation of the IMF with Ireland (based on the Financial Sector Stability Assessment (FSAP) undertaken in 2006) pointed to rapid loan growth as a source of potential vulnerabilities, however, these observations did nothing however to challenge the impression that the banking system was fundamentally sound,
- the staff report for the 2007 Article IV consultation praised the banks for their *"relatively high degree of arm's length transactions….[and] high standards in areas such as bank competition, investor protection, and corporate transparency…"*