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**WORKING PAPER SERIES**  
**No 2013/8**

**THE ‘SINGLE SUPERVISORY MECHANISM’:  
A MAJOR BUILDING BLOCK TOWARDS  
A EUROPEAN BANKING UNION  
(THE FULL EUROPEANISATION OF  
THE ‘BANK SAFETY NET’)**

**by Professor Christos Vl. Gortsos**

**May 2013**





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**The ‘single supervisory mechanism’:  
a major building block towards a European Banking Union  
(the full Europeanisation of the ‘bank safety net’)**

Professor Christos Vl. Gortsos\*

May 2013

Paper to be included in the proceedings of the 2nd Annual Research Conference of the International Association of Deposit Insurers (IADI, 2 April 2013), to be published in the Association's website. Cut-off date for data included therein is 1 May 2013

**Abstract**

The aim of this paper is to analyse the main provisions of the two European Regulations on the creation of the 'single supervisory mechanism', which is a major building block of the European Banking Union.

Section A provides a historical overview of the issues at hand. In section B, the main elements of the proposed institutional framework are presented. Section C discusses, in particular, the specific tasks conferred on the European Central Bank and their discharge within the framework of the 'single supervisory mechanism'. Other provisions of the Council Regulation proposal are briefly outlined in Section D. Concluding remarks are presented in Section E.

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## A. Issues at hand - a historical overview

### 1. Provisions of primary European Union law

The launch on 1 January 1999 of the Economic and Monetary Union (hereinafter ‘EMU’) within the European Union (hereinafter the ‘EU’) did not bring about any changes to the regime on the authorisation and micro-prudential supervision of credit institutions incorporated in euro area Member **States**. Contrary to the definition and implementation of the single monetary and foreign exchange policy, for which competences became supranational, the European Central Bank (hereinafter ‘ECB’) has not shifted into a supranational supervisory authority for the financial system, or even at least one of its sectors, given that relevant competences have remained with Member States.<sup>1</sup>

Competent both for the authorisation and micro-prudential supervision of EU credit institutions are the authorities designated as such by the member states.<sup>2</sup> This was also explicitly provided in **Article 105, para. 5** of the Treaty establishing the European Community (hereinafter ‘TEC’)<sup>3</sup> (carried over *verbatim* in **Article 3.3** of the Statute of the European System of Central Banks and the ECB),<sup>4</sup> stipulating that:

*“the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system”.*<sup>5</sup>

The relevant competence of the ECB was mainly to submit opinions, in accordance with **Article 105, para. 4 of the TEC**, within the limits and under the conditions set out in **Decision 98/415/EC of the Council**,<sup>6</sup> issued on the basis of Article 105, para. 5.<sup>7</sup>

The Treaty of Lisbon did not amend these provisions. They are repeated *verbatim* in **Article 127, para. 5**, and **127, para. 4**, respectively, of the Treaty on the Functioning of the European Union (hereinafter ‘TFEU’)<sup>8</sup> and continue to be in force.<sup>9</sup>

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<sup>1</sup> For a summary of the different proposals with regard to the creation of one or more supranational financial supervisory authorities in the EU, see **Lastra (2006)**, p. 324-328, and **Hadjjemmanuil (2006)**, p. 818-82.

<sup>2</sup> **Directive 2006/48/EC**, article 4, point 4. These supervisory authorities have also (extensive or limited, as the case may be) regulatory powers, as well the power to impose sanctions. Accordingly, it would not be inappropriate to refer to them as supervisory *and* regulatory authorities.

<sup>3</sup> OJ C C 325, 24.12.2002, pp. 33 f.

<sup>4</sup> Protocol No. 4 TEU and TFEU (OJ C 83, 30.3.2010, pp. 230-250).

<sup>5</sup> These provisions were in force since the launch of Stage III of the EMU (Article 116, para. 3, second indent TEC, with a reference to the provisions of Article 105, para. 5). For a historical background of their content, see **Smits (1997)**, p. 334-350, **Andenas, Gormley, Hadjiemmanuil and Harden (1997)**, pp. 386-394, **Lastra (2006)**, p. 216-222., **Louis (2009)**, p. 162-166 (with specific reference to the powers of the ESCB during the recent (2007-2009) international financial crisis), and **Lastra and Louis (2013)**, pp. 82-94..

<sup>6</sup> OJ L 189, 3.7.1998, pp. 42-44.

<sup>7</sup> OJ L 189, 3.7.1998, pp. 42-44.

<sup>8</sup> OJ C 83, 30.3.2010, pp. 47-199.

<sup>9</sup> The provisions of Article 127, para. 6 TFEU do not apply to Member States with a derogation (Article 139, para. 2, point 3 TFEU, and Statute of the ESCB and the ECB, Article 42.1, respectively), including to the United Kingdom (in particular, Protocol No. 15 (OJ C 83, 30.3.2010, pp. 284-286)).

However, the TEC also contained an enabling clause (known as ‘sleeping beauty clause’ (Article 105, para. 6, now **Article 127, para. 6 of the TFEU**)), according to which:

*“The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.*<sup>10</sup>

It is worth noting that:

- any Regulation adopted on the basis of this Article has to be issued by the Economic and Financial Affairs Council (hereinafter ‘ECOFIN Council’) in accordance with a special legislative procedure (Article 289, para. 2 TFEU), in which the European Parliament’s contribution (along with that of the ECB) is limited to an advisory role, and
- such a Regulation must be unanimously approved by the ECOFIN Council.

*The only component of the bank safety net which has already been Europeanised is the macro-prudential oversight of the European financial system in the context of the functioning of the European Systemic Risk Board since 1 January 2011<sup>11</sup> on which specific tasks have been assigned to the European Central Bank.*<sup>12</sup>

*On the other hand, the function of central banks as lenders of last resort lacks a legal basis (following the principle of ‘constructive ambiguity’). Even within the Eurozone, this function is considered to be a task for national central banks. Indeed, ‘Emergency Liquidity Assistance’ (ELA) is granted:*

- *by national central banks of the Member States whose currency is the euro,*<sup>13</sup>
- *to individual solvent credit institutions facing temporary liquidity problems<sup>14</sup>, and*
- *against collateral that is not eligible for the ECB’s monetary policy operations.*

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The fact that micro-prudential supervision of credit institutions does not form part of the ECB’s tasks is one of the two main asymmetries of the EMU. The other is the fact that, while within the framework of the ‘monetary union’, the Union has exclusive competence on monetary policy (Article 3, para. 1(c) TFEU), the same does not hold for fiscal policy within the framework of the ‘economic union’ (ibid., Article 5, para. 1).

<sup>10</sup> On the history of this article, see **Smits (1997)**, p. 355-360, **Andenas. Gormley, Hadjiemmanuil and Harden (1997)**, pp. 402-403, **Lastra (2006)**, **Louis (2009)**, p. 166-168, and **Lastra and Louis (2013)**, pp. 82-94.

<sup>11</sup> Regulation (EU) no. 1092/2010 of the European Parliament and of the Council of 24 November 2010 "on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board", OJ L 331, 15.12.2010, p. 1-11.

<sup>12</sup> Council Regulation (EU) No 1096/2010 of 17 November 2010 "conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board", OJ L 331, 15.12.2010, p. 162-164.

<sup>13</sup> The Governing Council of the ECB is allowed to prohibit this, if it is in conflict with the objectives and the tasks of the ECB, according to Article 14.4 of the Statutes of the ESCB and the ECB.

<sup>14</sup> The ECB remains responsible for providing liquidity to the financial system as a whole through its monetary policy operations.



*ELA has been activated with regard to Irish and Greek credit institutions during the current Eurozone fiscal crisis (2012-2013).*

## 2. The de Larosière Report (2009)

The academic debate on the creation of supranational supervisory authorities for the European financial system can be basically traced back to the mid-2000s.<sup>15</sup> On a political level, this prospect was essentially put forward, for the first time, in 2009 by the *de Larosière Report*,<sup>16</sup> following the onset of the recent international financial crisis.<sup>17</sup> This report concluded that contrary to macro-prudential oversight, micro-prudential supervision of the European financial system should not be assigned to the ECB.<sup>18</sup> On the contrary, it proposed the creation of a European System of Financial Supervisors (hereinafter ‘ESFS’), which is operational since 1 January 2011, and consists of:

- three ‘European Supervisory Authorities’, which are nonetheless mainly regulatory authorities and only exercise supervisory competencies in exceptional circumstances,<sup>19</sup> and
- the above-mentioned European Systemic Risk Board (hereinafter ‘ESRB’), responsible for the macro-prudential oversight of the financial system within the EU (rather than merely the euro area), with regard to which ‘specific tasks’ have been assigned to the ECB pursuant to the above-mentioned Article 127, para. 6 of the TFEU.

As a result, the creation of the ESFS did not  literally speaking  lead to the creation of supervisory authorities of the financial system at EU level.

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<sup>15</sup> See, merely by means of indication, **Lastra (2006)**, pp. 324-328 (with extensive further bibliographical references).

<sup>16</sup> *The High-Level Group on Financial Supervision in the EU, Chaired by Jacques de Larosière, Report*, Brussels, 25 February 2009. This Report is available at: [http://ec.europa.eu/commission\\_barroso/president/pdf/statement\\_20090225\\_en.pdf](http://ec.europa.eu/commission_barroso/president/pdf/statement_20090225_en.pdf) (hereinafter the ‘De Larosière Report’).

<sup>17</sup> On this crisis, see indicatively **Gortsos (2012b)**, pp. 127-129, with extensive further references.

<sup>18</sup> **De Larosière Report (2009)**, para. 146. This report (Chapter III, Section V “*Reviewing and possibly strengthening the European System of Financial Supervision*”) also includes a proposal on the possibility of moving towards a system which would rely only on two Authorities – apart from the ECB – mainly following the ‘functional approach’ pattern in relation to the institutional set-up of the financial system’s micro-prudential supervision (currently in use in the Netherlands and, as of April 2013, in the United Kingdom).

As regards this approach, as well as its alternatives, i.e. the ‘sectoral approach’ and the ‘full integration approach’ for supervisory authorities of the financial system, see **Lastra (2006)**, pp. 324-328, **Group of Thirty (2008)**, **Seelig and Novoa (2009)**, and **Central Bank Governance Group (2011)**.

<sup>19</sup> On these Authorities, see below under B.5.

### 3. The impact of the current fiscal crisis on the euro area

#### 3.1 Towards a 'European Banking Union'

The current fiscal crisis in the euro area, which became manifest in 2010,<sup>20</sup> triggered – just a year following the publication of the *de Larosière Report* – a new debate on the need to set up supranational supervisory authorities for the European financial system. At the current juncture, the debate has taken on a broader focus, with a view to creating a 'European Banking Union',<sup>21</sup> which would lead to setting up at European (Union) level a fully Europeanised 'bank safety net'<sup>22</sup> consisting of:

- a single supervisory mechanism exclusively for the banking sector (that is, not for the other two sectors of the financial system),
- a single resolution authority for unviable credit institutions, and a single resolution fund to cover any capitalisation needs or funding gaps, provided that a decision is made in favour of the resolution of unviable credit institutions,<sup>23</sup>
- a single deposit guarantee scheme, and
- a 'single rulebook'<sup>24</sup> that will cover all the above aspects, on the basis of a 'total harmonisation approach'.<sup>25</sup>

*To the author's opinion the only elements of the bank safety net on which provisions are not yet in hand are those on the reorganisation and winding-up of credit institutions. It is also questionable whether the ELA for credit institutions directly supervised by the ECB will remain with the national central banks in the Eurozone, as currently.*

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<sup>20</sup> For an evaluation of this crisis, see **Eichengreen, Feldmann, Liebman, von Hagen and Wyplosz (2011)**, pp. 47-64, and **Stephanou (2012)**.

<sup>21</sup> For arguments in favour or against setting up a European banking union, see (in chronological order) **Carmassi, Di Noia and Micossi (2012)**, **Pisani-Ferry, Sapir, Véron and Wolff (2012)**, **Constâncio (2012)**, and **Pisani-Ferry and Wolff (2012)**.

<sup>22</sup> For an overview of the components of the 'bank safety net', aimed at contributing to the stability of the banking system, see **Gortsos (2012b)**, pp. 90-106.

<sup>23</sup> If, in the context of resolution, the decision is made to have recourse to the tool of a 'bridge bank', this bank has to be capitalised. If the tool of 'asset transfer' to an existing credit institution is preferred, a 'funding gap' emerges as a result of the mismatch between assets and liabilities (the value of the latter is greater) transferred onto the existing credit institution.

<sup>24</sup> The term 'single rulebook' is commonly used, from a *stricto sensu* perspective, to refer to the **total harmonisation** of the rules pertaining to the micro- and macro-prudential regulation of credit institutions, adopted at three levels:

- at 'Level 1' by the European Parliament and the (ECOFIN) Council in the form of Regulations and Directives,
- at 'Level 2' by the European Commission in the form of regulatory and implementing technical standards, and
- at 'Level 3' by the European Banking Authority in the form of recommendations and guidelines (see on this **Gortsos (2011)**).

From a *lato sensu* perspective, however, the single rulebook should also refer to the **full harmonisation** of rules pertaining to the resolution of credit institutions and the operation of the single deposit guarantee scheme.

<sup>25</sup> To the author's opinion, the term 'total harmonisation' denotes a combination of full (in terms of scope) and maximum (in terms of level) harmonisation.

### 3.2 The political decisions of 29 June 2012 and the response of the European institutions

(a) At the 29 June 2012 Euro Area Summit, the euro area Heads of State or Government asked the European Commission to present specific legislative proposals on the establishment of a single supervisory mechanism over credit institutions, in the context of a wider political initiative on the creation of a ‘European Banking Union’. More particularly, the Statement of this Summit reads:

*“We affirm that it is imperative to break the vicious circle between banks and sovereigns.”*<sup>26</sup>

The European Summit which was held later on the same day decided<sup>27</sup> to invite the European Commission to develop, in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the ECB, a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union (in accordance with the relevant report tabled on 26 June of the same year by the President of the European Council),<sup>28</sup> one of the four elements of which was the creation of a European banking union.<sup>29</sup>

(b) In response to this demand, the Commission issued on 12 September 2012:

- an Announcement regarding “A roadmap for a Banking Union”,<sup>30</sup>
- a proposal for a Council Regulation “conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions”,<sup>31</sup> and
- a proposal for a Regulation of the European Parliament and of the Council “amending Regulation (EU) No 1093/2010 establishing the European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No.../... conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions”.<sup>32</sup>

In the above-mentioned Announcement, the Commission called on the European Parliament and the (ECOFIN) Council to proceed with the following:<sup>33</sup>

(i) Firstly, to reach agreement by end-2012 on the two (2) above-mentioned Regulation proposals, as a first step in the creation of a European Banking Union.

*This could play a decisive role in assigning directly to the European Stability Mechanism (ESM)<sup>34</sup> the recapitalisation of credit institutions exposed to insolvency*

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<sup>26</sup> Euro Area Summit Statement, 29 June 2012, first paragraph, first sentence.

<sup>27</sup> European Council Conclusions, 28/29 June 2012, EUCO 76/12, paragraph 4(b).

<sup>28</sup> Van Rompuy Report (2012): Towards a Genuine Economic and Monetary Union, EUCO 120/12. The final relevant report was submitted in December 2012.

<sup>29</sup> Ibid., Section II.1.

<sup>30</sup> COM(2012) 510.

<sup>31</sup> COM(2012) 511.

<sup>32</sup> COM(2012) 512.

<sup>33</sup> COM(2012) 510, section 4.

<sup>34</sup> The ESM, based on an Intergovernmental Treaty signed by the seventeen (17) euro area Member States, has fully replaced the European Financial Stability Mechanism, fully operative since October 2012. For more details on both facilities, see Stephanou (2012), pp. 17-20.

and, consequently, reducing the public debt of Member States in which such credit institutions are incorporated. This prospect is explicitly mentioned in the above-mentioned 29 June 2012 Euro Area Summit Statement:

*“When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly.”<sup>35</sup>*

(ii) Secondly, to approve, also by end-2012, the proposals for the Regulations and Directives (of the European Parliament and of the Council) on:

- amending the applicable framework on micro-prudential regulatory intervention in the banking system,<sup>36</sup>
- setting up a new framework on macro-prudential regulatory intervention in the banking system, reflecting (in both cases) the relevant proposals of the Basel Committee on Banking Supervision (also known as the ‘Basel III framework’),<sup>37</sup>

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<sup>35</sup> **Euro Area Summit Statement, 29 June 2012**, first paragraph, fourth sentence. The underlying premise is to avoid the transfer of consequences of improper national supervisory practices onto the European level and, consequently, to the taxpayers of other Member States.

It should be noted, however, that the Finance Ministers of certain Member States (in particular, Germany, the Netherlands and Finland) argued that *“direct bank recapitalisation by the ESM should take place based on an approach that adheres to the basic order of first using private capital, then national public capital and only as a last resort the ESM”* (**Joint Statement of the Ministers of Finance of Germany, the Netherlands and Finland**, 25 September 2012).

<sup>36</sup> This regulatory framework is based on two legal acts of the European Parliament and of the Council:

(a) **Directive 2006/48/EC** *“relating to the taking-up and pursuit of the business of credit institutions (recast)”* (OJ L 177, 30.6.2006, pp. 1-200) (also known as the ‘Capital Requirements Directive’ or ‘CRD’), as amended by:

- **Directive 2007/44/EC** (OJ L 247, 21.9.2007, pp. 1-16),
- **Directive 2007/64/EC** (OJ L 319, 5.12.2007, pp. 1-36),
- **Directive 2009/83/EC** (OJ L 196, 28.7.2009, pp. 14-21),
- **Directive 2009/110/EC** (OJ L 267, 10.10.2009, pp. 7-17),
- **Directive 2009/111/EC** (OJ L 302, 17.11.2009, pp. 97-119, also known as ‘CRD II’), and
- **Directive 2010/76/EC** (OJ L 329, 14.12.2010, pp. 3-35, also known as ‘CRD III’).

(b) **Directive 2006/49/EC** *“on the capital adequacy of investment firms and credit institutions (recast)”* (OJ L 177, 30.6.2006, pp. 201-255), as applicable.

<sup>37</sup> COM(2011) 452 final, and COM(2011) 453 final. More particularly:

- the proposal for a Regulation of the European Parliament and of the Council *“on prudential requirements for credit institutions and investment firms”* (also known as ‘Capital Requirements Regulation’, hereinafter ‘CRR’), and
- the proposal for a Directive of the European Parliament and of the Council *“on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate”* (hereinafter ‘CRD IV’).

- establishing pan-European rules on the recovery and resolution of **ailing** credit institutions (and investment firms),<sup>38</sup> and
- amending the existing regulatory framework<sup>39</sup> on deposit guarantee schemes.<sup>40</sup>

(iii) Finally, to examine, in the medium term, how to shape the conditions for the establishment of:

- a single resolution authority for unviable credit institutions,
- a single resolution fund for covering funding gaps, provided that a decision is made in favour of the resolution of unviable credit institutions, and
- a single deposit guarantee scheme,

enabling the completion of the European Banking Union.

(c) On the basis of the Commission’s proposals, the Council and the European Council have duly worked towards finalising the relevant institutional framework. On 21 March 2013, compromise texts on both Regulations were presented by the three corresponding European institutions in the ‘trialogue’ phase.

#### 4. The subject of this article

The subject of this article is to provide a systematic overview (and, partly also, analysis) of the main provisions of the two above-mentioned Regulation proposals (based on these compromise texts), expected to be adopted in the coming months, i.e.:

- a (longer) proposal for a Regulation of the Council on “*conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*” (hereinafter ‘Council Regulation proposal’), and
- a (shorter) proposal for a Regulation of the European Parliament and of the Council “*amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) regarding its interaction with Council Regulation No.../... conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*” (hereinafter ‘European Parliament and Council Regulation proposal’).

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For a detailed overview of the rules included in the Basel III regulatory framework, see **Gortsos (2012b)**, pp. 264-281.

<sup>38</sup> COM(2012) 280.

<sup>39</sup> **Directive 94/19/EC** of the European Parliament and of the Council (OJ L 135, 31.5.1994, pp. 5-14), as amended by **Directive 2009/14/EC** (OJ L 68, 13.3.2009, pp. 3-7).

<sup>40</sup> COM(2010) 369 final. For more details on the currently applicable European banking law, see **Tridimas (2011)**, and **Gortsos (2012a)**.

<b>TABLE 1</b>		
<b>The bank safety net: the instruments used to safeguard the stability of the banking sector</b>		
<i>(elements in italics denote instruments mainly used after the recent (2007-2009) international financial crisis)</i>		
<b>Policy instruments</b>	<b>Competent institution</b>	<b>Attributes of the institution</b>
<i><b>A. Prevention of crises</b></i>		
Bank authorisation	Supervisory authority	Central bank or other administrative authority
Micro-prudential and <i>macro-prudential regulation</i> of banks	<ul style="list-style-type: none"> <li>• Parliament</li> <li>• Supervisory authority</li> </ul>	<ul style="list-style-type: none"> <li>• General regulator</li> <li>• Upon delegation</li> </ul>
Micro-prudential supervision of banks	Supervisory authority	Central bank or other administrative authority
<i>Macro-prudential oversight of the financial system (including the banking sector)</i>	Specific authority with the active involvement of the central bank (in most cases)	Public authority
<i><b>B. Crisis management</b></i>		
Reorganisation of banks	<ul style="list-style-type: none"> <li>• Supervisory authority</li> </ul>	Central bank or other administrative authority
<i>Provision of state subsidies to systemically important banks (recapitalisation in the context of a 'taxpayers' solution')</i>	Ministry of Finance (funds being part of the public debt)	
<i>Other 'emergency' instruments: debt guarantees, asset purchase and guarantees, liquidity measures</i>	Ministry of Finance and central bank	
<i>Resolution of banks</i>	<ul style="list-style-type: none"> <li>• Resolution authority</li> <li>• Resolution fund</li> </ul>	<ul style="list-style-type: none"> <li>• Public authority</li> <li>• A fund financed either by the public sector (part of its debt) or by credit institutions</li> </ul>
Winding-up of banks	<ul style="list-style-type: none"> <li>• Supervisory or judicial authority</li> </ul>	On an <i>ad hoc</i> basis
Deposit guarantee	Deposit guarantee scheme	Entity of private or public law
Last-resort lending	Central bank	

<b>TABLE 2</b>	
<b>Towards a European Banking Union:</b>	
<b>Elements of change and continuity (<i>italics denote new elements</i>)</b>	
<b>Financial policy instruments</b>	<b>Authority</b>
1. Authorisation and micro-prudential supervision of credit institutions	<ul style="list-style-type: none"> <li>• <i>‘Single supervisory mechanism’: European Central Bank (Article 127, para. 6 TFEU), and national supervisory authorities</i></li> <li>• <i>Single rulebook (adopted by the European Parliament and the ECOFIN Council (Regulations), the European Commission (technical standards), and the EBA (guidelines and recommendations))</i></li> </ul>
2. Micro- and macro-prudential regulation of credit institutions	<i>Single rulebook</i>
3. Macro-prudential oversight of the financial system	European Systemic Risk Board
4. Reorganisation and winding-up of credit institutions	National authorities and mutual recognition between Member States
5. Resolution of credit institutions	<ul style="list-style-type: none"> <li>• <i>Single resolution authority</i></li> <li>• <i>Single rulebook</i></li> <li>• <i>Single European resolution fund</i></li> </ul>
6. Operation of deposit guarantee schemes	<ul style="list-style-type: none"> <li>• <i>Single European deposit guarantee system</i></li> <li>• <i>Single rulebook</i></li> </ul>
7. Last resort lending	No specific legal provision – <i>de facto</i> : national central banks (Emergency Liquidity Assistance (ELA) in the euro area)
8. Provision of subsidies to systemically important credit institutions (recapitalisation in the context of a ‘taxpayers’ solution’)	<i>Potentially the ESM (conditioned on the provisions pertaining to resolution)</i>

## B. The main elements of the proposed institutional framework

### 1. General overview

The new institutional framework, as set out in the provisions of the two above-mentioned Regulation proposals, includes five (5) main elements, which reflect specific policy choices:

- conferring specific tasks *on the ECB* concerning the micro-prudential supervision of certain financial firms, in transfer from national supervisory authorities (see below, under 2),
- specifying the financial firms, mainly credit institutions, with regard to which these specific tasks will be conferred on the ECB (under 3),
- establishing a ‘single supervisory mechanism’ in relation to the *exercise* of the specific tasks conferred on the ECB (under 4),
- incorporating this ‘single supervisory mechanism’ in the European System of Financial Supervision (ESFS), without, in principle, touching upon the current tasks of the newly (2011) established European Banking Authority (under 5), and
- creating ‘Chinese walls’ within the ECB, in order to ensure the effective separation of its monetary and other tasks from its (future) supervisory tasks (under 6).

### 2. Deciding on the actor: conferment on the European Central Bank of specific tasks relating to the micro-prudential supervision of certain financial firms

First of all, the Council Regulation proposal includes a ‘vertical’ transfer, from the Member States to the European Union, of specific tasks concerning policies relating to the micro-prudential supervision of credit institutions,

*“with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage.”<sup>41</sup>*

Among various alternative options that might have been implemented, the Commission opted for conferring the relevant ‘specific tasks’ on the ECB.<sup>42</sup> As a result, the legal basis chosen for the Council Regulation was **Article 127, para. 6 of the TFEU**.<sup>43</sup>

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<sup>41</sup> **Council Regulation proposal**, Article 1, first sentence.

<sup>42</sup> *Ibid.*, Article 1, first sentence.

The alternative options were:

- either assigning micro-prudential supervision to one or more of the European Supervisory Authorities-members of the ESFS,
- or creating a new pan-European supervisory authority.

<sup>43</sup> In reality, the European Commission did not have any choice but to opt for this particular legal basis, since the Euro Area Summit of 29 June 2012 had decided that: *“the Commission will present proposals on the basis of Article 127(6) for a single supervisory mechanism shortly”* (*ibid.*, first point, second sentence). This decision was also confirmed by the European



Accordingly, once the Council Regulation is adopted, the scope of the ECB's tasks will be significantly broadened, since its tasks will consist of the following:

- the main tasks set out in **Article 127, para. 2 TFEU**, most notably the definition and implementation of the monetary policy of the Union, as the core of the European System of Central Banks (hereinafter 'ESCB'),
- other duties set out in the TFEU (including those under **Article 128 TFEU** concerning the issuance of euro banknotes and coins),
- the specific tasks assigned to it pursuant to **Council Regulation 1096/2010** (as already mentioned based on Article 127, para. 6 TFEU) concerning the macro-prudential oversight of the European financial system in the context of the functioning of the European Systemic Risk Board, which is one of the components of the ESFS, and
- the specific tasks to be conferred to it pursuant to the Council Regulation proposal concerning issues of micro-prudential supervision of certain financial system participants (the proposed new category of tasks, also based on Article 127, para. 6 TFEU).

<b>TABLE 3</b>			
<b>ECB's tasks following the adoption of the Council Regulation proposal</b>			
Category of ECB tasks	Legal basis	Implementation in euro area Member States	Implementation in Member States with a derogation
1. <i>Basic</i> tasks	Article 127, para. 2 TFEU	Yes	No
2. <i>Other</i> tasks	Several TFEU articles	Yes	As a rule, no
3. <i>Specific</i> tasks on macro-prudential supervision over the European financial system	Regulation 1096/2010 of the Council (based on Art. 127, para. 6, of the TFEU)	Yes	Yes
4. <i>Specific</i> tasks on micro-prudential supervision over credit institutions ( <i>new</i> )	Council Regulation under preparation (based on Article 127, para. 6 of the TFEU)	Yes	Under the conditions of the 'close cooperation' procedure

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Council of the same day (**European Council Conclusions, 28/29 June 2012, paragraph 4(b), in finem**).

### 3. Setting the perimeter: specific tasks conferred on the European Central Bank exclusively in relation to the micro-prudential supervision of certain credit institutions

(a) The conferment upon the ECB of specific tasks in relation to the micro-prudential supervision of financial firms is proposed to cover exclusively:

- credit institutions,<sup>44</sup> and
- two categories of holding companies:
  - ‘financial holding companies’, in the context of the conduct of consolidated supervision of banking groups,<sup>45</sup> and
  - ‘mixed financial holding companies’, in the context of the conduct of supplementary supervision on financial conglomerates<sup>46</sup> including credit institutions, respectively.<sup>47</sup>

By contrast, micro-prudential supervision will remain an exclusive national competence in relation to the following types of financial firms, which are regulated under European financial law:<sup>48</sup>

- financial institutions (e.g., leasing, factoring and credit companies),<sup>49</sup> including, since 2009, electronic money institutions,<sup>50</sup>
- payment institutions,<sup>51</sup>
- investment firms,<sup>52</sup> UCITS management companies,<sup>53</sup> and alternative investment fund managers (mainly hedge funds),<sup>54</sup> as well as

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<sup>44</sup> **Council Regulation proposal**, Article 2, point 3, with a reference to Article 4, point 1, of Directive 2006/48/EC.

<sup>45</sup> *Ibid.*, Article 2, point 4, with a reference to Article 4, point 19, of Directive 2006/48/EC.

<sup>46</sup> *Ibid.*, Article 2, point 6, with a reference to Article 2, point 5, of **Directive 2002/87/EC** of the European Parliament and of the Council “*firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council*” (OJ L 35, 11.2.2003, pp. 1-27).

<sup>47</sup> According to Article 127, para. 6 TFEU, the Council may confer specific tasks upon the ECB relating to the micro-prudential supervision of other types of financial institutions, as well.

It is worth mentioning that the wording of Article 127, para. 6 “*credit institutions and other financial institutions*” is inconsistent with the provisions of existing EU banking law (Directive 2006/48/EC), since the definition of financial institutions is different from that of credit institutions.

<sup>48</sup> **Council Regulation proposal**, Article 2, point 5, with a reference to Article 2, point 15, of Directive 2002/87/EC.

<sup>49</sup> For a detailed definition of the term ‘financial institution’ under EU financial law, see Article 4, para. 5 of Directive 2006/48/EC.

<sup>50</sup> Electronic money institutions were included among financial institutions (although initially falling under credit institutions) by means of Article 20 of **Directive 2009/110/EC**.

<sup>51</sup> For a detailed definition of the term ‘payment institution’ under EU financial law, see Article 4, para. 4 of **Directive 2007/64/EC** of the European Parliament and of the Council (OJ L 319, 5.12.2007, pp. 1-35).

<sup>52</sup> For a detailed definition of the term ‘investment firm’ under EU financial law, see Article 4, para. 1, point 1 of **Directive 2004/39/EC** of the European Parliament and of the Council (OJ L 145, 30.4.2004, pp. 1-44).

- insurance and reinsurance undertakings, the micro-prudential supervision of which could not have been conferred on the ECB without prior amendment of **Article 127, para. 6 TFEU**, as mentioned above.

(b) The scope of the relevant provisions covers mainly (but not exclusively) credit institutions incorporated in euro area Member States (hereinafter ‘participating Member States’).<sup>55</sup> Specific provisions apply to:

- branches in participating Member States of credit institutions incorporated in non-participating Member States (i.e., Member States with a derogation, see under C 1.2 below),
- credit institutions incorporated in non-participating Member States which have opted for this regime, i.e. for specific (supervisory) tasks to be performed by the ECB over their credit institutions (under C 1.3).

(c) The Commission’s proposal was to submit, on a gradual basis, all credit institutions incorporated in participating Member States under the regime of the ECB’s specific tasks. Nevertheless, certain Member States, including Germany, the Netherlands and Finland, voiced their opposition to all credit institutions incorporated within their jurisdiction being subjected to the ECB’s micro-prudential supervision, pointing out that the micro-prudential supervision of smaller credit institutions, mainly those without cross-border activity doing business exclusively at local level (e.g., Sparkassen in Germany), should remain with national authorities.

Accordingly, **Article 5** of the Council Regulation proposal (as also in the March 2013 compromise text) introduces a ‘two-tier system’:

(ca) The ECB will be responsible for the micro-prudential supervision of ‘significant’ credit institutions, financial holding companies or mixed financial holding companies, i.e.:

(i) Unless justified by particular circumstances to be specified in the methodology, those that meet any one of the following conditions:

- the total value of their assets exceeds €30 billion,
- the ratio of their total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below €5 billion, 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 following a comprehensive assessment by the ECB, including a balance-sheet assessment, of these credit institutions.<sup>56</sup>

(ii) The ECB may also, on its own initiative, consider an institution to be of significant relevance where it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a

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<sup>53</sup> For a detailed definition of the term ‘UCITS management company’ under EU financial law, see Article 2, para. 1, point (b) of **Directive 2009/65/EC** of the European Parliament and of the Council (OJ L 302, 19.11.2009, pp. 32-96).

<sup>54</sup> For a detailed definition of the term ‘alternative investment fund manager’ under EU financial law, see Article 4, para. 1, point (b) of **Directive 2011/61/EU** of the European Parliament and of the Council (OJ L 174, 1.7.2011, pp. 1-73).

<sup>55</sup> **Council Regulation proposal**, Article 2, point 1.

<sup>56</sup> *Ibid.*, Article 5, para. 4, third sub-para.

significant part of its total assets or liabilities subject to the conditions laid down in the methodology.<sup>57</sup>

(iii) Those for which public financial assistance has been requested or received directly from the EFSF or the ESM.<sup>58</sup>

(iv) In any case, the three most significant credit institutions in each Member State, unless justified by particular circumstances.<sup>59</sup>

(v) Finally, 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 itself all the relevant powers for one or more other credit institutions, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM.<sup>60</sup>

*In principle, the ECB will assume its specific tasks 12 months after the entry into force of the Council Regulation (presumably in September 2013).<sup>61</sup>*

(cb) The ‘less significant’ credit institutions, financial holding companies and mixed financial holding companies will continue to be supervised directly by their national authorities, subject to the ECB’s regulations, guidelines and general instructions, within the framework of the ‘single supervisory mechanism’.<sup>62</sup>

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<sup>57</sup> Ibid., Article 5, para. 4, fourth sub-para.

<sup>58</sup> Ibid., Article 5, para. 4, fifth sub-para.

<sup>59</sup> Ibid., Article 5, para. 4, sixth sub-para.

<sup>60</sup> Ibid., Article 5, para. 5(b).

<sup>61</sup> Ibid., Article 27, para. 2, first sentence.

<sup>62</sup> Ibid., Article 5, para. 5(a), first sub-para.

**TABLE 4**

**Setting the perimeter: specific tasks conferred on the European Central Bank exclusively in relation to the micro-prudential supervision of certain credit institutions**

**A. The perimeter in respect of different types of financial firms**

<b>Included</b>	<b>Excluded</b>
<ul style="list-style-type: none"> <li>• credit institutions</li> <li>• ‘financial holding companies’, in the context of the conduct of consolidated supervision of banking groups,</li> <li>• ‘mixed financial holding companies’, in the context of the conduct of supplementary supervision on financial conglomerates including credit institutions</li> </ul>	<ul style="list-style-type: none"> <li>• financial institutions (e.g., leasing, factoring and credit companies), including, since 2009, electronic money institutions and payment institutions</li> <li>• investment firms, UCITS management companies, and alternative investment fund managers (mainly hedge funds), as well as</li> <li>• insurance and reinsurance undertakings</li> </ul>

**B. The perimeter in respect of Member States**

<b>Euro area Member States</b>	<b>Non-participating Member States</b>
Yes	<p>Specific rules on:</p> <ul style="list-style-type: none"> <li>• branches in participating Member States of credit institutions incorporated in non-participating Member States</li> <li>• credit institutions incorporated in non-participating Member States which have opted for this regime, i.e. for specific (supervisory) tasks to be performed by the ECB over their credit institutions</li> </ul>

**C. The perimeter in respect of specific credit institutions**

1. In principle: those that meet any one of the following conditions:
  - the total value of their assets exceeds €30 billion,
  - 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 , 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 following a comprehensive assessment by the ECB, including a balance-sheet assessment, of these credit institutions.
2. The ECB may also, on its own initiative, consider an institution to be of significant relevance where it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities subject to the conditions laid down in the methodology.
3. Those for which public financial assistance has been requested or received directly from the EFSF or the ESM.
4. In any case, the three most significant credit institutions in each Member State, unless justified by particular circumstances.
5. 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 itself all the relevant powers for one or more other credit institutions, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM .

#### 4. Establishment of a ‘single supervisory mechanism’ in relation to the performance of the specific tasks conferred on the ECB

The specific tasks to be conferred on the ECB will be carried out within the framework of a ‘single supervisory mechanism’ (hereinafter ‘SSM’) consisting of two (2) pillars:<sup>63</sup>

- the ECB, and
- the competent national supervisory authorities, not necessarily national central banks, given that in many euro area Member States, micro-prudential supervision has been assigned to independent national authorities (other than the central bank) (hereinafter ‘national competent authorities’).<sup>64</sup>

As a result, these tasks will be carried out based on the ‘decentralisation principle’, according to which national competent authorities will be the ECB’s ‘executive arm’, exactly as in the case of euro area Member State central banks in the context of the implementation (and not definition of course) of the single monetary policy (for more detail see below, under C 2).<sup>65</sup> The national competent authorities will carry out day-to-day inspections, while all tasks not conferred on the ECB will remain with them.

In addition, the ECB will work in coordination with national competent authorities on the micro-prudential supervision of the less significant credit institutions (as mentioned above, under B 3).

#### 5. The ‘single supervisory mechanism’ as part of the European System of Financial Supervisors (ESFS)

(a) The provisions of the two above-mentioned Regulation proposals are aimed at incorporating the SSM in the ESFS, which is in operation since 1 January 2011.<sup>66</sup> In this respect:

- the SSM will become responsible for the micro-prudential supervision of credit institutions,
- the ESRB will continue to be responsible for the macro-prudential oversight of the European financial system, including the ECB (to which specific tasks have been assigned as already mentioned), and
- the ‘European Banking Authority’ (hereinafter ‘EBA’) established by **Regulation (EU) 1093/2010** of the European Parliament and of the Council<sup>67</sup> will continue to be responsible for contributing to the evolution of European banking law (with regard to micro- and macro-prudential regulation), as well as discharging the specific supervisory tasks conferred on it, in accordance with the provisions of its statutory Regulation.

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<sup>63</sup> Ibid., Article 5, para. 1.

<sup>64</sup> Ibid., Article 2, point 2.

<sup>65</sup> **Statute of the ESCB and of the ECB**, Article 14.3, point (a).

<sup>66</sup> On the composition of the ESFS, see **Gortsos (2011)**, pp. 10-14.

<sup>67</sup> **Regulation (EU) No 1093/2010** of the European Parliament and of the Council of 24 November 2010 “*establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC*”, OJ L 331, 15.12.2010, pp. 12-47.

Within this context, the ECB is called upon to work closely with the three ‘European Supervisory Authorities’,<sup>68</sup> i.e.:

- the EBA,
- the European Insurance and Occupational Pensions Authority (hereinafter ‘EIOPA’) established by **Regulation (EU) 1094/2010** of the European Parliament and of the Council,<sup>69</sup> and
- the European Securities and Markets Authority (hereinafter ‘ESMA’) established by **Regulation 1095/2010** of the European Parliament and of the Council.<sup>70</sup>

(b) In accordance with the proposed regulatory framework, the ECB will not take on the EBA’s tasks. It was, however, deemed necessary to introduce changes to certain provisions of Regulation 1093/2010 in order to bring EBA’s functions (basically a regulatory, rather than supervisory, authority)<sup>71</sup> in line with the ECB’s function as a (future) supervisory authority over credit institutions.<sup>72</sup> In this context, the proposal for a Regulation of the European Parliament and of the Council includes amendments to Regulation 1093/2010 on several aspects, such as:

- (i) the reassessment of EBA’s concrete tasks,<sup>73</sup>
- (ii) EBA’s powers as regards action in emergency situations and mediation between competent authorities in cross-border situations,<sup>74</sup> and its powers to collect information from its national competent authorities,<sup>75</sup>

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<sup>68</sup> **Council Regulation proposal**, Article 3.

<sup>69</sup> **Regulation (EU) No 1094/2010** of the European Parliament and of the Council of 24 November 2010 “*establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC*”, OJ L 331, 15.12.2010, pp. 48-83.

<sup>70</sup> **Regulation (EU) No 1095/2010** of the European Parliament and of the Council of 24 November 2010 “*establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC*”, OJ L 331, 15.12.2010, pp. 84-119.

<sup>71</sup> This is why the author is of the view that these are ‘quasi’-supervisory authorities (**Gortsos (2011)**, pp. 15-16). To put this into perspective, there are two innovative elements which point to a tendency for a gradual, albeit substantial, further strengthening of these Authorities’ powers *vis-à-vis* national competent authorities:

(a) First of all, a partial reversal can be seen in the EBA’s (as well as the other Authorities’) right to replace national competent authorities, if the latter fail to comply with the European Commission’s opinions or EBA’s decisions, as laid down in **Articles 17-19** of Regulation 1093/2010.

(b) Furthermore, the supervision of credit rating agencies operating in the European Union has been specifically (and directly) assigned to ESMA, in accordance with Regulation (EU) No **1060/2009** of the European Parliament and of the Council ‘*on credit rating agencies*’ (OJ L 302, 17.11. 2009, pp. 1-31), as modified by **Regulation (EU) No 513/2011** (OJ L 145, 31.5.2011, pp. 30-56) (*ibid.*, p. 16-17).

<sup>72</sup> The legal basis of this Regulation proposal is Article 114 **TFEU**, which is also the legal basis of Regulation 1093/2010.

<sup>73</sup> **European Parliament and Council Regulation proposal**, Article 1, point 1, amending Article 1 of Regulation 1093/2010.

<sup>74</sup> *Ibid.*, Article 1, points 2 and 3, amending Article 18(1) of Regulation 1093/2010, and adding a new paragraph (3a) to Articles 18 and 19.

(iii) EBA's Board of Supervisors, and in particular:

- the composition of its two 'independent panels', their voting modalities and rules of procedure,<sup>76</sup>
- the independence of the Board of Supervisors' members,<sup>77</sup> and
- the voting modalities in the Board of Supervisors,<sup>78</sup> as well as

(iv) the term of office of the members of EBA's Management Board.<sup>79</sup>

Furthermore, in view of future developments, the Commission has to submit by 1 January 2016 a report on the suitability of the voting modalities of EBA's Board of Supervisors, the composition of the above-mentioned independent panels and the composition of EBA's Management Board.<sup>80</sup>

(c) It should also be pointed out that **Article 7 of the Council Regulation proposal** stipulates that, without prejudice to the respective competences of the Member States and the other Union institutions and bodies, including the EBA, in relation to the tasks conferred on the ECB by the proposed Regulation, the ECB may develop contacts and enter into administrative arrangements with supervisory authorities, international organisations and the administrations of third countries, always subject to coordination with the EBA.<sup>81</sup> Those arrangements shall not create legal obligations in respect of the EU and its Member States.<sup>82</sup>

## 6. Creation of 'Chinese walls'

In the author's view, the creation of 'Chinese walls' within the ECB is an essential element in order to ensure the effective separation of its monetary and other tasks from its (future) supervisory tasks.

*It is worth noting that although micro-prudential supervision over credit institutions has historically been the main competence of central banks in many countries (with the exception of a few central European states), in the course of the last twenty years, an ever increasing number of countries across the world have assigned this supervision to independent authorities other than the central bank.<sup>83</sup>*

*This was based on the rationale that the exercise of supervisory powers by the central bank may give rise to conflicts of interest as far as the achievement of its monetary objectives is concerned (not least in terms of maintaining price stability).<sup>84</sup> However,*

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<sup>75</sup> Ibid., Article 1, point 4 (amending Article 35, paras. 1-3 of Regulation 1093/2010).

<sup>76</sup> Ibid., Article 1, point 5 (amending Article 41 of Regulation 1093/2010).

<sup>77</sup> Ibid., Article 1, point 6 (new paragraph added to Article 42 of Regulation 1093/2010).

<sup>78</sup> Ibid., Article 1, point 7, amending Article 44, para. 1 of Regulation 1093/2010 and adding a new paragraph 4(a).

<sup>79</sup> Ibid., Article , para. 8 (amending Article 45, para. 1, of Regulation 1093/2010).

<sup>80</sup> Ibid., Article 2.

<sup>81</sup> Ibid., Article 7, first sentence.

<sup>70</sup> Ibid., Article 7, second sentence.

<sup>83</sup> See **Herring and Carmassi (2008)**.

<sup>84</sup> For a more detailed overview of arguments in favour and against the principle of separation of monetary and supervisory competences in central banks, see the fundamental work of **Goodhart and Schoemaker (1993)**, as well as **Goodhart (2000)**.



*this trend tends to be reversed in the aftermath of the recent international financial crisis as a result of the relevant failures attributed to independent supervisory authorities in many states.*<sup>85</sup>

The Council Regulation proposal lays down the following two (2) principles in this respect:

(a) When carrying out the specific tasks conferred upon it by the Regulation, the ECB must pursue exclusively the objectives set therein.<sup>86</sup>

(b) The ECB must also carry out these tasks ‘separately’ from both the tasks relating to the definition and implementation of the single monetary policy and its other tasks, avoiding any interference between them. In particular:<sup>87</sup>

*“The ECB shall carry out the tasks conferred upon it by this Regulation without prejudice to and separately from its tasks relating to monetary policy and any other tasks. The tasks conferred upon the ECB by this Regulation shall neither interfere with, nor be determined by, its tasks relating to monetary policy. The tasks conferred upon the ECB by this Regulation shall moreover not interfere with its tasks in relation to the European Systemic Risk Board or any other tasks. The ECB shall report to the European Parliament and to the Council as to how it has complied with this provision. The tasks conferred by this Regulation to the ECB shall not alter the ongoing monitoring of the solvency of its monetary policy counterparties. The staff involved in carrying out the tasks conferred on the ECB by this Regulation shall be organisationally separated from, and subject to, separate reporting lines from the staff involved in carrying out other tasks conferred on the ECB.”*

(c) For the above purposes, the ECB will adopt and make public any necessary internal rules, including rules regarding professional secrecy and information exchanges between the two areas of functions.<sup>88</sup>

(d) The ECB will have to ensure that the operation of the Governing Council is completely differentiated as regards monetary and supervisory functions. Such differentiation must include strictly separated meetings and agendas.<sup>89</sup>

(e) With a view to ensuring separation between monetary policy and supervisory tasks, the ECB will have to create a mediation panel. This panel:

- will resolve differences of views on the part of competent authorities of interested participating Member States regarding an objection of the Governing Council to a draft decision by the Supervisory Board,
- include one member per participating Member State, chosen by each Member State among the members of the Governing Council and the Supervisory Board, and
- decide by simple majority, with each member having one vote.<sup>90</sup>

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<sup>85</sup> See **Davies and Green (2010)**, pp. 187-213.

<sup>86</sup> **Council Regulation proposal**, Article 18, para. 1.

<sup>87</sup> *Ibid.*, Article 18, para. 2.

<sup>88</sup> *Ibid.*, Article 18, para 3.

<sup>89</sup> *Ibid.*, Article 18, para 3(a).

<sup>90</sup> *Ibid.*, Article 18, para 3(b).

## C. In particular: specific tasks conferred on the ECB and their discharge within the framework of the ‘single supervisory mechanism’

### 1. Individual specific tasks conferred on the ECB

#### 1.1 Specific tasks in relation to credit institutions incorporated in participating Member States

The Council Regulation proposal confers on the ECB an extensive range of specific tasks in relation to credit institutions incorporated in participating Member States, covering the principal areas of micro-prudential supervision. More particularly, the ECB will be assigned tasks in relation to such credit institutions in accordance with the provisions of:

- the above-mentioned Directives 2006/48/EC and 2006/49/EC of the European Parliament and of the Council, as these will be replaced in the course of the coming months (and definitely before the full entry into operation of the SSM) by the above-mentioned proposals for a Regulation of the European Parliament and of the Council (hereinafter ‘CRR’), and a Directive of the European Parliament and of the Council (hereinafter ‘CRD IV’), and
- the above-mentioned proposal for a Directive of the European Parliament and of the Council on the recovery and resolution of unviable credit institutions, and, more specifically, its provisions on recovery measures.

The proposed specific tasks are the following:<sup>91</sup>

(a) Authorisation and withdrawal of authorisation of credit institutions.<sup>92</sup>

(b) For credit institutions established in a participating Member State, which want to establish a branch or provide cross-border services in a non-participating Member State, the performance of tasks which would fall upon the competent authority of the home Member State under existing EU banking law.

(c) Assessment of acquisitions or disposals of qualifying holdings in credit institutions, except in the event of a bank resolution.<sup>93</sup>

(d) Ensuring compliance on the part of credit institutions with EU banking law provisions on:

- micro-prudential regulation (rules on capital adequacy,<sup>94</sup> securitisations, large credit exposures,<sup>95</sup> liquidity,<sup>96</sup> and leverage of credit institutions<sup>97</sup>), as well as
- public disclosure of information and data on those matters (‘Pillar 3’ of the current regulatory framework).<sup>98</sup>

(e) Monitoring the implementation of EU banking law provisions by credit institutions, as to the existence of:

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<sup>91</sup> **Council Regulation proposal**, Article 4, para. 1. The range of the tasks as in the March 2013 compromise text is narrower than in the proposal of Commission in September 2012.

<sup>92</sup> **Directive 2006/48/EC**, Articles 6-18, to be modified by Articles 9-21 of the CRD IV.

<sup>93</sup> **Directive 2006/48/EC**, Articles 19-21, to be modified by Articles 22-27 of the CRD IV.

<sup>94</sup> **Directive 2006/48/EC**, Articles 56-105, to be modified by Articles 22-399 of the CRR.

<sup>95</sup> **Directive 2006/48/EC**, Articles 106-119, to be modified by Articles 376-392 of the CRR.

<sup>96</sup> **CRR**, Articles 400-415.

<sup>97</sup> *Ibid.*, Articles 416-417.

<sup>98</sup> **Directive 2006/48/EC**, Articles 145-149, to be modified by Articles 418-440 of the CRR.

- robust corporate governance arrangements, including the fit-and-proper requirements as regards persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices,<sup>99</sup> as well as
- effective internal capital adequacy assessment processes, including Internal Ratings Based models.<sup>100</sup>

(f) Conduct of supervisory reviews of credit institutions, including, where appropriate, in coordination with the EBA, stress tests and their possible publication, and imposing (*ad hoc*) – on the basis of relevant findings and in accordance with EU banking law provisions (‘Pillar 2’ of the current regulatory framework) – specific additional own funds requirements, disclosure obligations, liquidity obligations and other micro-prudential measures.<sup>101</sup>

(g) As regards the micro-prudential supervision of banking groups on a consolidated basis:

- supervision on a consolidated basis over credit institutions’ parent companies incorporated in one of the participating Member States, and
- participation in the supervision on a consolidated basis (including in colleges of supervisors) in relation to parent companies not incorporated in one of the participating Member States.<sup>102</sup>

(h) In the area of supplementary supervision of financial conglomerates:

- participating in supplementary supervision in relation to the credit institutions included in such financial conglomerates, and
- assuming the tasks of a coordinator where the ECB is appointed as the coordinator for a financial conglomerate in accordance with relevant EU law provisions (Directive 2002/87/EC).<sup>103</sup>

(i) Carrying out supervisory tasks in relation to recovery plans and ‘early intervention’, where a credit institution or group in relation to which the ECB is the consolidating supervisor does not meet or is likely to breach the applicable micro-prudential supervision requirements (including recovery plans and intra-group financial support arrangements) in coordination with competent resolution authorities.

## 1.2 Specific tasks concerning branches of credit institutions incorporated in non-participating Member States

As regards credit institutions incorporated in non-participating Member States, which have established a branch or provide cross-border services in a participating Member State (in accordance with the provisions of EU banking law),<sup>104</sup> it is proposed that the ECB should exercise the specific tasks mentioned above in cases where

<sup>99</sup> Ibid., Article 22, to be modified by Articles 72-74 and complemented by Articles 86-91 of the CRD IV.

<sup>100</sup> Ibid., Article 123, to be modified by Article 72 of the CRD IV.

<sup>101</sup> Ibid., Article 124, to be modified by Article 105 of the CRD IV.

<sup>102</sup> Ibid., Articles 125-143, to be modified by Articles 106-121 of the CRD IV.

<sup>103</sup> For more details on this Directive’s provisions, see **Gortsos (2010)**.

<sup>104</sup> **Directive 2006/48/EC**, Articles 23-28, as modified by Articles 35-39 of the CRD IV.

national authorities are competent as host supervisors in accordance with the provisions of EU banking law.<sup>105</sup>

### 1.3 Specific tasks in relation to credit institutions incorporated in non-participating Member States

Credit institutions incorporated in a non-participating Member State may also be subject to the supervisory authority of the ECB, once the procedure of ‘close cooperation’ provided for in **Article 6, para. 1 (first sentence) of the Council Regulation proposal** has been established.<sup>106</sup> This ‘close cooperation’ procedure will be established by an ECB Decision, if a non-participating Member State so wishes, provided that the other requirements under **Article 6, para. 2 of the Council** are met.

*Paras. 4-6b of Article 6 set additional procedural requirements for the implementation of this ‘close cooperation’ procedure.*

### 1.4 Regulatory powers

Without prejudice to the legal acts that constitute the sources of EU banking law (applied on credit institutions) and in compliance with the tasks to be conferred on it, the ECB will have the power to adopt guidelines and recommendations and take decisions to implement or apply these provisions, to the extent necessary to carry out these tasks.<sup>107</sup>

## 2. The manner in which the specific tasks are to be performed within the framework of the ‘single supervisory mechanism’

As already mentioned (under B 4 above), the specific **tasks to be assigned to the ECB** will be performed (according to **Article 5** of the Council Regulation proposal) within the framework of the SSM, consisting of the following pillars: the ECB itself and the national competent authorities (and not necessarily the national central banks) of the euro area Member States.<sup>108</sup> The same Article of the Regulation proposal lays down the following specific provisions establishing the ‘decentralisation principle’:

**(a)** Both the ECB and national competent authorities shall be subject to a ‘duty of cooperation in good faith’, and an obligation to exchange information. Without prejudice to the ECB’s power to receive directly or have direct access to information reported, on an ongoing basis, by credit institutions, the national competent authorities shall in particular provide the ECB with all information necessary for the purposes of carrying out the tasks conferred upon the ECB. National competent authorities will have to assist the ECB on its request with the preparation and implementation of any acts relating to the specific tasks to be conferred on it.<sup>109</sup>

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<sup>105</sup> **Council Regulation proposal**, Article 4, para. 2. See **Directive 2006/48/EC**, Articles 29-37, to be modified by Articles 40-46 of the CRD IV.

<sup>106</sup> In accordance with the provisions of Article 6, para. 1 (second sentence) of this Regulation proposal, the ECB may address instructions to the national competent authorities of these Member States.

<sup>107</sup> *Ibid.*, Article 4, para. 3. The ECB’s regulatory power is based on **Article 132, para. 1 TFEU**.

<sup>108</sup> *Ibid.*, Article 5, para. 1.

<sup>109</sup> *Ibid.*, Article 5, para. 2.

(b) Where appropriate and without prejudice to the responsibility and accountability of the ECB for the tasks conferred on it, the national competent authorities will:

- be responsible for assisting the ECB with the preparation and implementation of any acts relating to these tasks concerning all credit institutions, including assistance in verification activities,
- have to follow the instructions given by the ECB when performing these tasks.<sup>110</sup>

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<sup>110</sup> Ibid., Article 5, para. 3.

## D. Other provisions of the Council Regulation proposal: an overview

The Council Regulation proposal's provisions, apart from those mentioned above, regulate the following aspects of the ECB's function as supranational supervisory authority over the EU banking sector:

(a) They detail the ECB's and national competent authorities' investigatory powers (including requests for information, general investigations, on-site inspections, the authorisation by a judicial authority) and supervisory powers (such as those with regard to authorisation and the assessment of acquisitions of qualifying holdings, the powers of host authorities and cooperation in the case of consolidated supervision, and the right to impose administrative sanctions).<sup>111</sup>

(b) They provide for the creation and operation, within the ECB's framework, of an 'internal body', the Supervisory Board, responsible for "planning and executing" the ECB's specific tasks.<sup>112</sup> The Supervisory Board will be composed of:<sup>113</sup>

- a Chair, appointed by the Council (upon a proposal of the ECB and approval of this proposal by the European Parliament), and chosen on the basis of an open selection procedure from among individuals of recognised standing and experience in banking and financial matters (albeit excluding the members of the ECB Governing Council),<sup>114</sup>
- a Vice-Chair, appointed according to the same procedure and chosen from among the members of the Executive Committee of the ECB,
- four (4) representatives of the ECB appointed by the Governing Council of the ECB, and
- one representative of the national authority competent for the micro-prudential supervision of credit institutions in each participating Member State (given the current membership of the euro area, the Supervisory Board will have twenty-three (23) members).

A representative of the European Commission (but not of the EBA as was provided for in the Commission's proposal) may participate as observer in the meetings of the Supervisory Board, upon invitation.<sup>115</sup>

The Supervisory Board will establish a Steering Committee from among its members with a more limited composition. The main task of the Steering Committee, which will have no decision-making powers, will be to support the Board's activities, including preparation of its meetings.

As specified in the Explanatory Memorandum of the Council Regulation proposal, as submitted by the Commission in September 2012, the ECB Governing Council will be ultimately responsible for taking decisions, but may decide to delegate certain tasks or decision-making powers to the Supervisory Board.<sup>116</sup>

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<sup>111</sup> Ibid., Articles 8-15.

<sup>112</sup> Ibid., Article 19, para. 1. Consequently, the Supervisory Board is not promoted to an ECB body, obviously in order to avoid an amendment to the TFEU.

<sup>113</sup> Ibid., Article 19, paras. 1-2.

<sup>114</sup> The Chair's proposed term of office is five (5) years and will not be renewable (ibid., Article 19, para. 2, last sentence).

<sup>115</sup> Ibid., Article 19, para. 6.

<sup>116</sup> Explanatory Memorandum, section 4.5.2, fourth sentence, along with Article 19, para. 3.

(c) Finally, the proposal also includes specific provisions on:

- the institutional independence of the ECB (including the members of its Supervisory Board) and the national competent authorities acting within the SSM with regard to the specific tasks conferred upon the ECB,<sup>117</sup>
- the accountability of the ECB before the European Parliament, national Parliaments, and the Council,<sup>118</sup>
- the professional secrecy of the members of the Supervisory Board and of the ECB staff carrying out the specific tasks to be conferred upon the ECB, as well as the exchange of information,<sup>119</sup>
- the ECB's obligation to devote the necessary financial and human resources to the exercise of the specific tasks to be conferred upon it,<sup>120</sup>
- its budget and annual accounts,<sup>121</sup>
- its power to roll the cost of micro-prudential supervision over to credit institutions subject to supervision ('supervisory fees'),<sup>122</sup> and
- the exchange and secondment of staff, under the responsibility of the ECB, with and among national competent authorities.<sup>123</sup>

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<sup>117</sup> **Council Regulation proposal**, Article 16. The ECB's institutional independence, in relation to its main tasks, is laid down in **Article 130 of the TFEU**.

<sup>118</sup> *Ibid.*, Article 17, 21 and 23, para. 2. The ECB's accountability, in relation to its main tasks, is laid down in **Article 284, para. 3, of the TFEU**.

<sup>119</sup> *Ibid.*, Article 20.

<sup>120</sup> *Ibid.*, Article 22.

<sup>121</sup> *Ibid.*, Article 23, para. 1.

<sup>122</sup> *Ibid.*, Article 24.

<sup>123</sup> *Ibid.*, Article 25.

## E. Final remarks

(a) The European Commission's proposals tabled on 12 September 2012 initiated a process – on the basis of the political decisions taken on 29 June – that will bring about a significant breakthrough in the functioning of the banking system in the euro area, without TFEU amendment.<sup>124</sup> Although the implementation timeframe for the proposals is still pending, there is no doubt that the micro-prudential supervision of certain credit institutions incorporated in euro area Member States is going to be conferred on the ECB, which will carry out the relevant specific tasks in cooperation with the national competent (supervisory) authorities, along with the other tasks already conferred upon it (particularly in relation to the definition and implementation of the single monetary policy in the euro area and the contribution to macro-prudential oversight of the European financial system).

These proposals are the first substantial step for the creation of a European Banking Union, the final stage of which will include setting up – as already mentioned in Section A of this article – at euro area level:

- a single supervisory authority over certain credit institutions (the ECB, as stipulated in the Council Regulation proposal),
- a single resolution authority,
- a single resolution fund for covering funding gaps, provided that a decision is made for the resolution of unviable credit institutions, and
- a single deposit guarantee scheme (which could be combined with the single resolution authority, by creating a 'European Deposit Insurance and Resolution Authority' or EDIRA).

(b) Once the Council Regulation is adopted in its current form, the ECB will be asked to submit proposals, *inter alia*, for:

- a Framework Regulation with regard to the SSM perimeter and the relations between the ECB and the national supervisory authorities (according to Article 5 of the Council Regulation proposal),
- a Decision on close cooperation (according to Article 6 of the Council Regulation proposal),
- a Regulation on supervisory fees,
- a Regulation on sanctions, and
- a Regulation setting up a mediation panel and its rules of procedure (according to Article 18, para. 3b of the Council Regulation proposal).

(c) There is no doubt that the above-mentioned proposals constitute a development of utmost importance to the EU internal market, and beyond. Once the authorisation and micro-prudential supervision of participating credit institutions is assigned to the ECB, government influence over credit institutions in these Member States will be significantly weaker.

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<sup>124</sup> In the author's view, it would be necessary, for reasons of legal certainty, to amend **Article 3, para. 1(c) TFEU**, in order to specify that the Union now has exclusive competence on micro-prudential supervision over credit institutions incorporated in the euro area. The author understands, however, that such an amendment could be deemed excessive (particularly given the political difficulties that would arise from amending the TFEU merely for this reason), since the conferment upon the ECB of specific tasks concerning micro-prudential supervision of credit institutions may reasonably be argued to be based on **Article 107, para. 6 TFEU**, and thus covered, to a great extent, by the existing institutional framework of the EU.



*The conditions under which credit institutions will invest in sovereign bonds will change substantially in future, since banks' dependence on Member States (where applicable) will be kept under bounds.<sup>125</sup> Weaning national banking systems from government influence could thus become an important springboard for creating institutional conditions that could lead to an EU fiscal union, provided the necessary political will exists.*

(d) In accordance with the above-mentioned provisions of the Council Regulation proposal, mergers and acquisitions in the banking sector will be subject to approval by the ECB rather than national competent authorities. With this in mind, the European banking landscape will be shaped at supranational level in the next few decades, and, most definitely, this decade. In the author's view, this would lead to a greater degree of concentration in the European banking system and, as a result, to a very significant decline in the number of credit institutions operating across euro area Member States.

(e) The ECB's function as supervisory authority over participating credit institutions will have many positive effects. Without doubt, the ECB has the necessary expertise for discharging supervisory tasks over euro area credit institutions, particularly taking account of:

- its unquestionably successful contribution to the management of the recent international financial crisis, and
- its substantial contribution to addressing the current fiscal crisis in the euro area.

In this respect, the provisions of the Council Regulation proposal are positively evaluated by the author.

(f) However, these proposals need to be treated with some scepticism as well. There are two main reasons for this:

(i) Conferring supervisory competences over financial system participants to a monetary authority generally raises issues of potential conflicts of interests, particularly putting into question the ECB's ability – in its capacity as monetary authority – to consistently pursue its primary objective of maintaining price stability.<sup>126</sup>

(ii) One cannot preclude the (undesirable) eventuality of one or more systemically important financial institutions under ECB supervision becoming insolvent in the first few years of the ECB's term of office as supervisory authority – which might also be attributed to a deficient performance of its duties –.<sup>127</sup> In that case, the ECB's reliability as monetary authority would be strongly called into question (not in terms of substance, but from a political point of view), with all the negative consequences that this would entail for the sustainability of the euro area.

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<sup>125</sup> Here, it is worth pointing out the need to amend, in due course, the provisions of **Directive 2006/48/EC** (to be modified by the CRR), which stipulate, in relation to the calculation of capital requirements for credit risk, that claims on Member State governments in the form of bonds have a zero percent risk weight. The experience from the 'voluntary' haircut on Greek government bonds (see **Stephanou (2012)**, pp. 25-28) has shown that these provisions are now ineffective (apart from the fact that credit institutions are given perverse incentives when implementing capital adequacy rules).

<sup>126</sup> Article 127, para. 1, first sentence **TFEU**.

<sup>127</sup> This is, of course, a visible risk for all central banks with statutory competence on micro-prudential supervision over credit institutions, and it is one of the main concerns as to the assignment of such competencies to central banks.

(g) In conclusion, there must be quite an efficient planning of the institutional, organisational and operational framework governing the ECB's exercise of supervisory tasks over euro area credit institutions, including most notably 'Chinese walls' (as detailed above, under B 6), in order to ensure that the ECB's stature as institutional body is fully safeguarded. At the end of the day, the *onus* of the successful performance of these tasks will be on the ECB itself.

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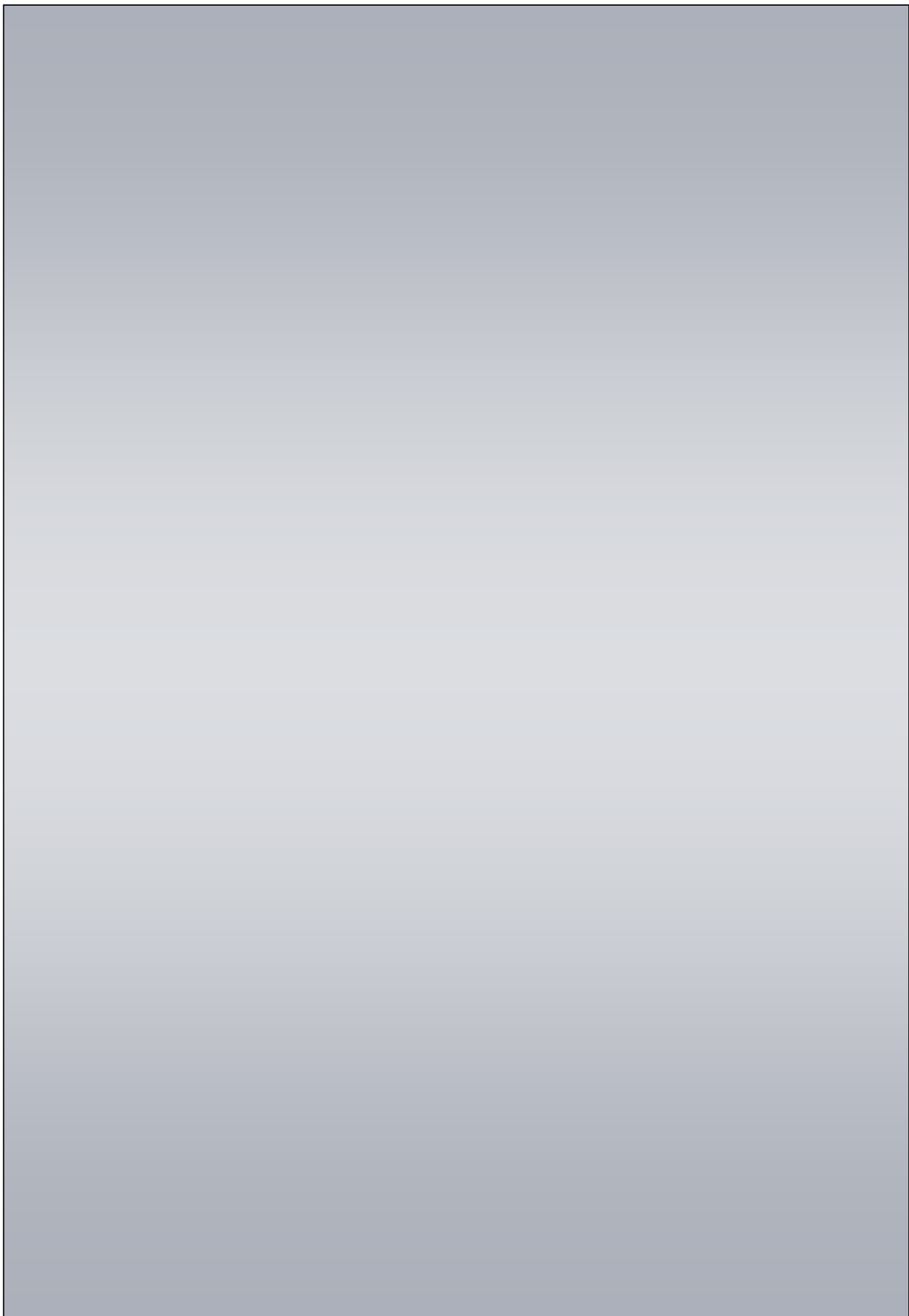
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