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# A brief overview of the European Banking Union

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## 1. THE ESTABLISHMENT OF THE EUROPEAN BANKING UNION AND THE *STATUS QUO*<sup>1</sup>

### 1.1 The political agenda and the European Commission's initiatives

(a) The creation of the EBU was tabled at the Euro Area Summit of 29 June 2012, amidst the current fiscal crisis in the euro area, which became manifest in 2010. The main rationale behind this initiative is summarised in the following sentence of the Summit's Statement: "*We affirm that it is imperative to break the vicious circle between banks and sovereigns.*"<sup>2</sup> The European Summit which was held concurrently on 28-29 June decided to invite the President of the European Council to develop, in close collaboration with the Presidents of the European Commission (the '*Commission*'), the Eurogroup and the ECB, a specific and time-bound roadmap for the achievement of a genuine EMU, in accordance with the

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1. The present paper (and mainly Section 2) is based on the author's more extensive article Gortsos, Ch.V. *Institutional and legal aspects of the European Banking Union: Status quo and the way forward*, 2017, available at: <https://ssrn.com/abstract=3093830>. Due to limitations as to the extent of this paper, references in the footnotes are merely indicative (in certain cases out of a vast existing bibliography).

2. *Euro Area Summit Statement, 29 June 2012*, first paragraph, first sentence, available at: [https://consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131359.pdf](https://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf).

so-called “*Van Rompuy Report*”,<sup>3</sup> submitted a few days earlier (on 26 June) by the President of the European Council. One of the four (4) elements of this Report was the creation of the EBU.<sup>4</sup>

(b) Against this background, the Commission issued on 12 September 2012 an Announcement regarding “A Roadmap for a Banking Union”, a proposal for a Council Regulation “*conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*”, and a proposal for a Regulation of the European Parliament and of the Council “*amending Regulation (EU) No 1093/2010 [...] 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>5</sup> In particular, the establishment of the EBU should lead to the creation of a ‘Europeanised bank safety net’ consisting of three (3) pillars:

1. a Single Supervisory Mechanism (the ‘SSM’) exclusively for the banking sector (*i.e.* not for the other two sectors of the financial system, insurance and securities) and mainly for credit institutions legally incorporated in euro area Member States, with regard to their micro-prudential supervision (the ‘*first pillar*’),
2. a Single Resolution Mechanism (the ‘SRM’) for unviable credit institutions (also mainly incorporated in euro area Member States) and a Single Resolution Fund (the ‘SRF’) to cover any resulting funding gaps, provided that a decision is made on the resolution of such credit institutions (the ‘*second pillar*’), and
3. a single deposit guarantee scheme, which coupled with the Single Resolution Board (a part of the SRM) could form a ‘European Deposit Insurance and Resolution Authority’ (‘EDIRA’) (the ‘*third pillar*’).

These pillars should be coupled with a ‘single rulebook’ containing substantive rules on all the previous aspects, as part of the single market for financial services<sup>6</sup>

3. “Towards a Genuine Economic and Monetary Union”, Report of the President of the European Council in close collaboration with Jose Manuel Barroso, President of the Commission, Jean-Claude Juncker, President of the Eurogroup, and Mario Draghi, President of the ECB, 5 December, available at: [https://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/134069.pdf](https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf).

4. *Ibid.*, Section II.1. The other three (3) elements were the establishment of an integrated budgetary framework (‘*European Fiscal Union*’), an integrated economic policy framework (‘*European Economic Union*’), and a democratic legitimacy and accountability framework (‘*European Political Union*’).

5. COM(2012) 510 final, 511 final and 512 final, respectively.

6. On the link between the EBU and the single market, see Lastra, R.M. : “Banking Union and Single Market: Conflict or Companionship?,” *Fordham International Law Journal*, Volume 36, 2013 pp. 1189-1223, Binder, J.-H. “The European Banking Union – Rationale and Key Policy Issues”, in Binder, J.-H. and Ch.V. Gortsos 2016, *Banking Union. A Compendium*, C.H. Beck, München – Hart, Oxford – Nomos, Baden-Baden, 2016, pp. 13-15, and Alexander, K.: “The ECB and Banking Supervision: Does Single Supervisory Mechanism Pro-

and developed either by the EU institutions (legislative acts under *Article 289* of the Treaty on the Functioning of the European Union (the 'TFEU'), or by the EU institutions with the direct involvement and contribution of the EBA (delegated and implementing acts under *Articles 290-291 TFEU*).<sup>7</sup>

(c) The most significant institutional and regulatory developments towards establishing the EBU took place in the course of 2013 and 2014. Taking into account the normal response time of European institutions, these legislative measures were taken, based on proposals by the Commission, in an exceptionally short timeframe. With the exception of the single deposit insurance scheme, the other components are in place.<sup>8</sup>

The legislative acts which constitute the main *corpus* of the single rulebook are 'children' of the recent international financial crisis. In particular, those on the prudential regulation and supervision of credit institutions and on the deposit guarantee schemes repealed pre-existing legislation in those two issue-areas (see below *under 1.2.1.2 and 1.2.3.2*, respectively), while that on the resolution of credit institutions introduced for the first time such a regime (*under 1.2.2.3*) – all of them under the influence, to a higher or lower degree, from developments in public international banking law after that crisis.

In this respect it is also worth noting the following:

(i) The three main pillars of the EBU, notably the new EU mechanisms and funds, are designed to *apply mainly (but not exclusively) to the euro area Member States*.

(ii) On the other hand, the 'single rulebook', adopted by the European Parliament and the EcoFin Council and further detailed by the Commission and the EBA, is *applicable across all EU Member States*. It is mainly a child of the recent (2007-2009) international financial crisis, is part of the

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vide an Effective Regulatory Framework?," in Andenas, M. and G. Deipenbrock (2016, editors): *Regulating and Supervising European Financial Markets – More Risks than Achievements*, Springer International Publishing: Switzerland, 2016, pp. 258-260.

7. On Articles 289-290 TFEU, see by mere indication Craig, P., *The Lisbon Treaty: Law, Politics and Treaty Reform*, Oxford University Press: Oxford – New York, 2010.

8. For a general overview and assessment of the legal framework on the EBU, see indicatively Binder, J.-H. "Auf dem Weg zu einer europäischen Bankenunion? Erreichtes, Unerreichtes, offene Fragen," *Zeitschrift für Bankrecht and Bankwirtschaft*, 25. Jahrgang, Heft 5, 2013, S. 297-372; Moloney, N. "European Banking Union: assessing its risks and resilience," *Common Market Law Review*, Volume 51, Issue 6, pp. 1609-1670, available at: <https://eprints.lse.ac.uk/60572/>; various contributions in Castaneda, J., Karamichailidou, G., Mayes, D. and G. Wood, *European Banking Union. Prospects and challenges*, Routledge, 2015 eds.; Lastra, R.M. *International Financial and Monetary Law*, second edition, Oxford University Press: United Kingdom, 2015 pp. 355-382; and the contributions of the co-editors in Binder, J.-H. and Ch.V. Gortsos, *Banking Union. A Compendium*, C.H. Beck, München – Hart, Oxford – Nomos, Baden-Baden, 2016. On the specific aspect of how the EBU framework also impacts on private law relationships (duties), see Grundmann, S. "The Banking Union Translated into (Private Law) Duties: Infrastructure and Duties," in Grundmann, S. and J.-H. Binder eds. *The Banking Union and the Creation of Duties*, *European Business Organisation Law Review*, Springer – Asser Press, 2015, pp. 357-382.

single market for financial services and is based on a ‘total harmonisation approach’.

## 1.2 The status quo

### 1.2.1 *The first pillar*

#### 1.2.1.1 The Single Supervisory Mechanism (SSM)

(a) The legal basis of the Single Supervisory Mechanism (the ‘SSM’) is *Council Regulation (EU) No 1024/2013* of 15 October 2013 “*conferring specific tasks on the European Central Bank concerning policies relating to the (micro-) prudential supervision of credit institutions*”<sup>9</sup> (the ‘SSMR’), which became operative on 4 November 2014.<sup>10</sup> Taking into account that the political decision was to make use of the existing EU Treaties, its legal basis is *Article 127(6) TFEU*.<sup>11</sup>

(b) The SSMR is based on the following four (4) main elements, which are consistent with *Article 127(6) TFEU* and reflect the compromise achieved between the EU institutions and Member States during its elaboration:

(i) The *first* is the conferral of ‘*specific tasks*’ on the ECB for the micro-prudential supervision of certain types of financial firms, in transfer from national competent (supervisory) authorities, which are exercised within the SSM.<sup>12</sup>

(ii) The *second* main element is the designation of the financial firms, mainly credit institutions with regard to which these specific tasks have been conferred on the ECB. In that respect, *Article 6 SSMR* established, *in principle*, a ‘two-tier system’ with regard to the distribution of powers within the SSM, distinguishing between ‘*significant*’ and ‘*less significant*’ credit institutions, financial holding companies or mixed financial hold-

9. OJ L 287, 29.10.2013, pp. 63-89.

10. SSMR, Article 33(2), first sub-paragraph.

11. On the SSMR see, by mere indication, Ferran, E. and V. Babis, *The European Single Supervisory Mechanism*, Legal Studies Research Paper Series, University of Cambridge, Faculty of Law, Paper No. 10/2013, March, available at: <https://www.law.cam.ac.uk>; Ferrarini, G. and L. Chiarella *Common Banking Supervision in the Eurozone: Strengths and Weaknesses*, European Corporate Governance Institute, Working Paper Series in Law No 223/2013, August 2013; Tröger, H. T. *The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?*, SAFE Working Paper Series No. 27, 19.10.2013 (also available at: <https://www.wipol.uni-bonn.de/lehrveranstaltungen-1/lawecon-workshop/archive/dateien/troeger2013>); Moloney, N. “European Banking Union”; Gortsos, Ch.V. *The Single Supervisory Mechanism (SSM): Legal aspects of the first pillar of the European Banking Union*, Nomiki Bibliothiki – European Public Law Organisation (EPLÖ): Athens, 2015; Wymeersch, Ed. *Banking Union: Aspects of the Single Supervisory Mechanism and the Single Resolution Mechanism Compared*, ECGI Working Paper Series in Law, Working Paper 290, 2015, pp. 50-57 and 61-63.

12. SSMR, Articles 4(1) and 5(2).

ing companies (the ‘supervised entities’). Nevertheless, in accordance with *Articles 4(1), points (a) and (c)* – which make further reference to *Articles 14-15*, the granting and withdrawal of authorisation of credit institutions, as well as acquisition and disposal of qualifying holdings therein is the competence of the ECB for all credit institutions. In addition, if necessary in order to ensure consistent application of ‘high supervisory standards’, the ECB may, at any time, decide to exercise directly the supervision of a less significant supervised entity or group.<sup>13</sup>

(iii) The incorporation of the SSM within the ESFS, without, in principle, touching upon the current tasks of the EBA and the other components of the ESFS constitutes the *third* main element of the SSMR.<sup>14</sup>

(iv) Finally, ‘*Chinese walls*’ have been established within the ECB in order to ensure the effective separation of its monetary policy and other tasks from its (new) supervisory tasks.<sup>15</sup>

#### 1.2.1.2 The single rulebook

(a) On 26 June 2013, the following two legal acts of the European Parliament and of the Council were published in the Official Journal: *Regulation (EU) No 575/2013 “on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012”* (‘Capital Requirements Regulation’ or ‘CRR’),<sup>16</sup> and *Directive 2013/36/EU “on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [...]”* (‘Capital Requirements Directive IV’ or ‘CRD IV’).<sup>17</sup> Both the CRR and the CRD IV apply equally also to investment firms (commonly referred to therein as ‘institutions’), and hence constitute sources of EU capital markets law as well.

(b) These two legal acts, adopted under *Article 114* and *Article 53(1) TFEU*, respectively, and in force since *1 January 2014*, set the framework governing (mainly) access to activity of the business of credit institutions (granting and withdrawal of authorisation, as well as acquisition and disposal of qualifying holdings),<sup>18</sup> the exercise of the right of establishment and the freedom to provide services in the single market,<sup>19</sup> relations to third countries,<sup>20</sup> micro-prudential supervision of credit institutions, both on a solo and on a consolidated basis,

13. *Ibid.*, Article 6(5), point (b).

14. *Ibid.*, Article 3.

15. *Ibid.*, Article 25(1)-(4).

16. OJ L 176, 27.6.2013, pp. 1-337.

17. OJ L 176, 27.6.2013, pp. 338-436.

18. *CRD IV*, Articles 8-27.

19. *Ibid.*, Articles 33-46.

20. *Ibid.*, Articles 47-48.

including the supervisory review and evaluation process (the ‘SREP’),<sup>21</sup> and micro- and (for the first time) macro-prudential regulation of credit institutions.<sup>22</sup>

The rules on micro- and macro-prudential regulation reflect to a large extent the framework developed in 2010 (immediately after the recent (2007-2009) international financial crisis) by the Basel Committee on Banking Supervision<sup>23</sup> on this field (the ‘*Basel III regulatory framework*’).<sup>24</sup>

## 1.2.2 *The second pillar*

### 1.2.2.1 The Single Resolution Mechanism (‘SRM’)

(a) The European Single Resolution Mechanism (the ‘SRM’) was established by *Regulation (EU) No 806/2014* of the European Parliament and of the Council of 15 July 2014 “*establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund [...]*” (the ‘SRMR’).<sup>25</sup> The SRMR was adopted on the basis of *Article 114 TFEU* and (with some exceptions) is applicable from *1 January 2016*.<sup>26</sup>

(b) According to its *Article 1*, the objective of the SRMR is twofold:

(i) *Firstly*, it establishes uniform rules and a uniform procedure for the (orderly) resolution of credit institutions (as well as parent institutions, investment firms and financial institutions, if they are subject to consolidated supervision carried out by the ECB in accordance with *Article 4(1), point (g) SSMR*), established in the euro area Member States and in the Member States which have entered into a ‘close cooperation’ with the ECB

21. *Ibid.*, Articles 49-117 (of which Articles 97-101 refer to the SREP).

22. *CRR* and *CRD IV*, Articles 128-142 (on capital buffers).

23. On this international financial forum, see Gortsos, Ch.V. *The Basel Committee on Banking Supervision through the Lens of Its 2013 Charter*, available at: <https://ssrn.com/abstract=2900107>, 2017.

24. The Basel III framework consists of three (3) Reports of the Basel Committee: “Basel III: A global regulatory framework for more resilient banks and banking systems” (available at: <https://www.bis.org/publ/bcbs189.htm>), “Basel III: The Liquidity Coverage Ratio [LCR] and liquidity risk monitoring tools” (available at: <https://www.bis.org/publ/bcbs238.htm>), and “Basel III: The net stable funding ratio [NSFR]” (available at: <https://www.bis.org/publ/bcbs295.htm>). On the ‘Basel III’ framework, in its original version of 2010, see Gortsos, Ch.V. *Fundamentals of Public International Financial Law: International Banking Law within the System of Public International Financial Law*, Schriften des Europa-Instituts der Universität des Saarlandes - Rechtswissenschaft, Nomos Verlag: Baden-Baden, 2012, pp. 254-281.

25. OJ L 225, 30.7.2014, pp. 1-90.

26. *SRMR*, Article 99(2).

without recourse to taxpayers' money (including public financial assistance by EU facilities) for their recapitalisation.

(ii) In addition, those uniform rules and that uniform procedure must be applied by the Single Resolution Board (the 'SRB' or the 'Board') established in accordance with Article 42, together with the Council, the Commission and the national resolution authorities within the framework of the SRM.<sup>27</sup>

### 1.2.2.2 The Single Resolution Fund ('SRF')

(a) The Single Resolution Fund (the 'SRF') was established by Articles 67-69 SRMR and is also based on the *Intergovernmental Agreement (No 8457/14)* by twenty-six (26) EU Member States "on the transfer and mutualisation of contributions to the Single Resolution Fund" (the 'SRF Agreement').<sup>28</sup> The latter is an instrument of public international law and, as such, the rights and obligations laid down therein are subject to the principle of reciprocity, i.e. the equivalent performance of those rights and obligations by all Parties. It applies to the Contracting Parties whose institutions are subject to the SSM and the SRM<sup>29</sup> also from 1 January 2016.<sup>30</sup>

The only Member States which are not Contracting Parties to the SRF Agreement, which is subject to ratification, approval or acceptance by its signatories under their respective constitutional requirements,<sup>31</sup> are Sweden and the United Kingdom.

(b) Under the SRF Agreement, the Contracting Parties committed to transfer the contributions raised at national level to the SRF in accordance with the BRRD and the SRMR. In addition, they must allocate the nationally raised con-

27. On the SRMR see, indicatively, Gordon, N.J. and W.G. Ringe, *Bank Resolution in Europe: The Unfinished Agenda of Structural Reform*, ECGI Working Paper Series in Law, Working Paper No 282, 2015; Louis J.-V. "La difficile naissance du mécanisme européen de résolution des banques," *Cahiers de droit européen*, 2014, 1, pp. 7-20; Alexander, K. "European Banking Union: A Legal and Institutional Analysis of the Single Supervisory Mechanism and the Single Resolution Mechanism," *European Law Review*, Issue 2, pp. 175-186; Carmassi, J. *New rules for bank crisis resolution in the European Union and the United States*, Istein Istituto Einaudi Regulatory Brief No 3, February 2015; Hadjiemmanuil, Ch. *Bank Resolution Financing in the Banking Union*, LSE Law, Society and Economy Working Papers 6/2015, available at: <https://ssrn.com/abstract=2575372>, pp. 16-18; Wiggins, R., Wedow, M. and A. Metrick *European Banking Union B: The Single Resolution Mechanism*, Yale program on financial stability case study 2014, November 2014 (revised March 2015), pp. 2-35; Dermine, J. *The Single Resolution Mechanism in the European Union: Good Intentions and Unintended Evil*, *Monetary Economics Today, Festschrift in Honour of Ernst Baltensperger*, INSEAD Working Paper No. 2016/69/FIN, also available at: <https://ssrn.com/abstract=2838793>; and Gortsos, Ch.V. *The Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF): A comprehensive review of the second main pillar of the European Banking Union*, e-book, 3rd edition, 2017, available at: <https://ssrn.com/abstract=2668653>, pp. 47-60 and 65-162.

28. The text of this Agreement can be accessed at: [https://register.consilium.europa.eu/content/out?lang=EN&typ=ENTRY&ci=SMP&DOC\\_ID=ST%208457%202014%20COR%201](https://register.consilium.europa.eu/content/out?lang=EN&typ=ENTRY&ci=SMP&DOC_ID=ST%208457%202014%20COR%201).

29. *SRF Agreement*, Article 1(2).

30. *Ibid.*, Article 12.

31. *Ibid.*, Article 11(1).

tributions to the different SRF ‘compartments’ corresponding to each of them during a transitional period of eight (8) years in accordance with the above-mentioned legal acts. The use of these compartments is subject to a ‘progressive mutualisation’, meaning that they will cease to exist at the end of the transitional period with a view to securing the effectiveness of the operations and functioning of the SRF.<sup>32</sup>

(c) The SRF should reach a target level of at least 1% of the amount of ‘covered deposits’ of all credit institutions authorised in all participating Member States (about 55 billion euros).<sup>33</sup> In principle, it is being financed by the participating institutions’ *ex-ante* contributions,<sup>34</sup> while the EU budget or the national budgets may not be held liable for expenses or losses incurred by the SRF.<sup>35</sup> The *ex-post* financing (through raising of extraordinary *ex-post* contributions from institutions, voluntary borrowing between resolution financing arrangements, alternative funding means and access to financial facility) is governed by *Articles 71-74 SRMR*.<sup>36</sup>

### 1.2.2.3 The single rulebook

(a) Concurrently, in April 2014 the European Parliament and the Council adopted *Directive 2014/59/EU “establishing a framework for the recovery and resolution of credit institutions and investment firms [...]”* (the ‘Bank Recovery and Resolution Directive’ or ‘BRRD’).<sup>37</sup> As in the case of the CRR and the CRD IV, it applies equally to credit institutions and investment firms. The impact of public international law on the BRRD was considerable as well. Its content was heavily

32. *Ibid.*, Article 1(1).

33. *Ibid.*, Article 1(1), point (b), with reference to Article 68 *SRMR*.

34. *SRMR*, Article 70.

35. *Ibid.*, Article 67(2).

36. On Article 74 *SRMR*, see also below, *under 2.1.4 (c)*. On the SRF Agreement see, indicatively, Burke, J.V. *Building a bank resolution fund over time: when should each individual bank contribute?*, 2015, available at: <https://ssrn.com/abstract=2535722>; Hadjiemmanuil, Ch. *Bank Resolution Financing in the Banking Union*, LSE Law, Society and Economy Working Papers 6/2015, available at: <https://ssrn.com/abstract=2575372>, pp. 26-29; Zavvos, G. and S. Kaltsouni, “The Single Resolution Mechanism in the European Banking Union: Legal Foundation, Governance Structure and Financing,” in Haentjens, M. and B. Wessels (editors): *Research Handbook on Crisis Management in the Banking Sector*, Edward Elgar Publishing Ltd.: Cheltenham, 2015 (also available at: <https://ssrn.com/abstract=2531907>), pp. 36-49; and Gortsos, Ch.V. *The Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF): A comprehensive review of the second main pillar of the European Banking Union*, e-book, 3rd edition, 2017: available at: <https://ssrn.com/abstract=2668653>, pp. 61-64 and 163-179.

37. OJ L 173, 12.6.2014, pp. 190-348.

influenced by the 2011 Report of the Financial Stability Board (the 'FSB'<sup>38</sup>) entitled "Key Attributes of Effective Resolution Regimes for Financial Institutions".<sup>39</sup>

One of the most important principles contained in that Report is the so-called 'no creditor worse off (NCWO) principle', specified in its Section 5 (paragraphs 5.1-5.3), which stipulates that no creditor should be worse off in a resolution than they would be in liquidation and draws a limit on the application of resolution tools and powers.<sup>40</sup>

(b) The BRRD, adopted under Article 114 TFEU and (with some exceptions) applicable from 1 January 2015,<sup>41</sup> contains provisions on three (3) main aspects:

- preparatory measures, including recovery and resolution planning (also called 'living wills'<sup>42</sup>) and intra-group financial support agreements (Articles 4-26),
- early intervention measures, including the appointment of a special administrator (Articles 27-30), and
- resolution tools and powers (Articles 31-86).<sup>43</sup>

38. On this international financial forum, see indicatively Giovanoli, M. "The International Financial Architecture and its Reform after the Global Crisis," in Giovanoli, M. and D. Devos (editors): *International Monetary and Financial Law: The global crisis*, Oxford University Press: Oxford – New York, 2010 Chapter 1, pp. 19-25; Gortsos, Ch.V, *Fundamentals of Public International Financial Law*, pp. 145-150; and Thiele, A. "Finanzaufsicht," *Jus Publicum* 229, Mohr Siebeck: Tübingen, 2014, pp. 541-545.

39. This Report is available at: [https://www.financialstabilityboard.org/publications/r\\_111104cc.htm](https://www.financialstabilityboard.org/publications/r_111104cc.htm). For an overview, see Grünewald, S.N. "The Resolution of Cross-Border Banking Crises in the European Union – A Legal Study from the Perspective of Burden Sharing," *International Banking and Finance Law Series*, Volume 23, Wolters Kluwer Law & Business, Kluwer Law International, The Netherlands, 2014, pp. 79-80 and Kleftouri, N. *Deposit Protection and Bank Resolution*, Oxford University Press: Oxford, 2015, pp. 160-165.

40. On the NCWO principle and its application under EU resolution law, see Grünewald, S.N. "The Resolution of Cross-Border Banking Crises," pp. 92-93, de Serière, V. and D. van der Houwen: "No Creditor Worse Off in Case of Bank Resolution: Food for Litigation?," *Journal of International Banking Law and Regulation*, Issue 7, 2016, pp. 376-384, also available at: <https://ssrn.com/abstract=2856370> and Haentjens, M. "Selected Commentary on the Bank Recovery and Resolution Directive," in Moss, G., Wessels, B. and M. Haentjens (2017, editors): *EU Banking and Insurance Insolvency*, Chapter IV, Second edition, Oxford University Press: Oxford, 2017, pp. 272-274.

41. BRRD, Article 130(1), second sub-paragraph.

42. See on this Avgouleas, E., Goodhart, C.A.E. and D. Schoenmaker *Living Wills as a Catalyst for Action*, DSF Policy Papers No. 4, Duisenberg School of Finance: Amsterdam, 2009 and Amorello, L. and S. Huber "Recovery Planning: A New Valuable Corporate Governance Framework for Credit Institutions," *Law and Economics Yearly Review*, Vol. 3, Part 2, 2014, pp. 296-317.

43. For a comprehensive overview of the BRRD, see Haentjens, M. "Selected Commentary on the Bank Recovery" and Wold Bank Group, *Understanding Bank Recovery and Resolution in the EU: A Guidebook to the BRRD*, World Bank Group, Finance & Markets, Financial Sector Advisory Center (FinSAC) 2017, available at: <https://pubdocs.worldbank.org/en/609571482207234996/FinSAC-BRRD-Guidebook.pdf>; see also Binder, J.-H. "Resolution Planning and Structural Bank Reform within the Banking Union," in Castaneda, J., Karamichailidou, G., Mayes, D. and G. Wood (editors): *European Banking Union. Prospects and challenges*, Routledge, 2015, available at: <https://ssrn.com/abstract=2540038>, (on resolution planning).

Of particular significance are the rules governing the application of the minimum requirement for own funds and eligible liabilities (the *'MREL'*) in accordance with *Article 45 BRRD* (and *Article 12 SRMR*, currently under amendment).<sup>44</sup> They ensure that, if resolution authorities decide to apply the bail-in instrument in the course of an institution's resolution, there would be sufficient liabilities available (*'bail-in-able instruments'*) to absorb losses.<sup>45</sup>

### 1.2.3 *The third pillar*

#### 1.2.3.1 Toward a Single Deposit Guarantee Scheme

(a) At the initial stage, the prospect of establishing a European deposit guarantee scheme, as the third main component of the EBU, had only been discussed in terms of principles and 'high-level politics'. The prospective of creating a 'European Deposit Insurance Scheme' (the *'EDIS'*) was laid down in the 'Five Presidents Report' of 22 June 2015 "Completing Europe's Economic and Monetary Union", which is included in the framework of the proposals on the creation of an (EU) *'Financial Union'*.<sup>46</sup>

(b) Then, on 24 November 2015, the Commission submitted a proposal for a Regulation of the European Parliament and of the Council "amending Regulation EU No 806/2014 in order to establish a European Deposit Insurance Scheme".<sup>47</sup> This scheme (the *'EDIS'*) should be introduced gradually, in three (3) stages. The proposal includes a series of strict safeguards, according to which the EDIS should be built on the existing system, composed of national DGSs, be overall cost-neutral for the banking sector (since credit institutions' contributions to the EDIS would be deducted from those to the national DGSs), be risk-weighted (with 'riskier' credit institutions having to pay relatively higher contributions), and be accompanied by strict safeguards against moral hazard and inappropriate use (giving

44. See below, under 2.1.2 (a)(i).

45. On the bail-in instrument (in principle and under the BRRD) see, by mere indication, Coffee, J.C. *Bail-ins versus Bail-outs: Using Contingent Capital to Mitigate Systemic Risk*, The Center for Law and Economic Studies, Columbia University School of Law, Working Paper No. 380, 2010 available at: <https://www.law.columbia.edu/lawec>; Huertas, T. *The case for bail-ins*, Wharton Financial Institutions Center, Working Paper No 17," 2012; Conlon, T. and J. Cotter "Anatomy of a bail-in," *Journal of Financial Stability*, Vol.15, December, 2014 pp. 257-263; Goodhart, Ch. and E. Avgouleas, "A Critical Evaluation of Bail-in as a Bank Recapitalisation Mechanism," in Allen, F., Carletti, E. and J. Gray (editors): *Bearing the losses from bank and sovereign default in the Eurozone*, FIC Press, Wharton Financial Institutions Center: Philadelphia, USA, 2014 Chapter 7, pp. 65-97, available at: <https://hdl.handle.net/1814/34437> and Joosen, B. *Bail in mechanisms in the Bank Recovery and Resolution Directive*, Working Paper, Netherlands Association for Comparative and International Insolvency Law, Annual Conference 6 November, 2014.

46. This study is available at: [https://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report\\_en.pdf](https://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf).

47. This proposal is available at: [https://ec.europa.eu/finance/general-policy/docs/banking-union/european-deposit-insurance-scheme/151124-proposal\\_en.pdf](https://ec.europa.eu/finance/general-policy/docs/banking-union/european-deposit-insurance-scheme/151124-proposal_en.pdf).

incentives to national DGSs to manage their potential risks in a prudent way) and by a Communication setting out measures to reduce risks.

A “European Deposit Insurance Fund” (the ‘*EDIF*’) should also be set up from the outset, directly financed through risk-adjusted contributions made by credit institutions. The EDIF’s management would be entrusted to the SRB.<sup>48</sup> According to the proposal, the process of the adoption of which was halted until December 2017,<sup>49</sup> the three (3) phases in the evolution of the EDIS should be as follows:<sup>50</sup>

(i) *Phase 1: re-insurance*: During the first three-year phase (2007-2009), the ‘re-insurance approach’ should apply, whereby a national DGS will have access to EDIS funds only when all its own resources are exhausted and if it fully complies with the *DGS Directive (2014/49/EU)*.<sup>51</sup> EDIS funds would provide additional funds to a national DGS only up to a certain level and the latter would access the EDIS only when justified. Use of EDIS funds would be closely monitored, and any such funds found to have been received inappropriately by a national DGS would have to be fully reimbursed.

(ii) *Phase 2: co-insurance*: In 2020, the EDIS would become a progressively mutualised system (‘co-insurance’), still subject to appropriate limits and safeguards against abuse. During this phase, a national DGS would not be required to exhaust its own funds before accessing EDIS funds and the EDIS would be available to contribute a share of the costs from the moment when the DGS would have been activated and depositors were to be reimbursed, leading to a higher degree of “*risk-sharing between national DGSs through the EDIS*”. The share to be contributed by the EDIS would

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48. *Regulation Proposal, Article 2(34)*, inserting a new Section 1A in Part III, Title V, Chapter 2 to the SRMR (new Articles 74a-74g), *Article 2(35)*, *Article 2(36)*, replacing Article 75 SRMR, *Article 2(37)*, inserting a new Article 77a to the SRMR, and *Article 2(38)-(41)*.

49. See also below, *under 2.1.3*.

50. *Regulation Proposal, Article 2(10)* inserting a new Part IIa to the SRMR (new Articles 41a-41c, 41d-41g and 41h, respectively).

51. On this legal act, see just below, *under 1.2.3.2*.

start at a level of 20% and gradually increase to 100% over a four-year period.

(iii) *Phase 3: full insurance*: The EDIS should fully insure national DGSs as of 2024. This is the same year when the SRF and the requirements of the DGS Directive will be *fully* phased in.

### 1.2.3.2 The single rulebook

(a) The operation of national DGSs is governed by *Directive 2014/49/EU* of the European Parliament and of the Council “*on deposit guarantee schemes*”,<sup>52</sup> which was adopted on 16 April 2014 as part of the single rulebook (the ‘*DGSD*’) and repealed *Directive 94/19/EC* of the same EU institutions as of 3 July 2015.<sup>53</sup> Its legal basis being *Article 53(1) TFEU*, it lays down rules and procedures on the establishment and functioning of national deposit guarantee schemes in Member States.<sup>54</sup>

The impact of public international financial law on the content of the DGSD is less important than in the case of the CRR, the CRD IV and the BRRD, since the majority of the principles contained in the “Core Principles for Effective Deposit Insurance Systems” adopted by the International Association of Deposit Insurers (the ‘*IADI*’<sup>55</sup>) on 1 November 2014<sup>56</sup> were already incorporated into EU law.

(b) The DGSD substantially modified certain aspects of *Directive 94/19/EC*, while concurrently containing several innovative elements:<sup>57</sup>

(i) As to the *elements of continuity*, it is noted that DGSs remain national, that Member States are not liable for the funding adequacy of their DGSs, (their responsibility being confined to the establishment and official recognition of at least one DGS in their territory, the ‘mandatory membership rule’ for credit institutions and the fact that DGSs are activated when a credit institution’s deposits become ‘unavailable’). In addition, the main

52. OJ L 173, 12.6.2014, pp. 149-178.

53. *DGSD*, Article 21. For a brief overview of this legal act, Klefouri, N. *Deposit Protection and Bank Resolution*, pp. 64-75.

54. *Ibid.*, Article 1(1).

55. On this international forum and a brief overview of these Principles, see Gortsos, Ch.V. *Deposit Guarantee Schemes: General Aspects and Recent Institutional and Regulatory Developments at International and EU Level*, Lecture at the IZMIR University of Economics, Izmir, 29 March, 2016, available at: <https://ssrn.com/abstract=2758635> pp. 8-15.

56. This report is available at: [https://www.financialstabilityboard.org/2014/11/cos\\_090618](https://www.financialstabilityboard.org/2014/11/cos_090618).

57. For an analysis of the DGSD, see Gortsos, Ch.V. *The new EU Directive (2014/49/EU) on deposit guarantee schemes: an element of the European Banking Union*, Nomiki Bibliothiki: Athens, 2014.

function of DGSs, the ‘paybox function’, has been retained, but ranks first among four (4) functions that DGSs may serve.

(ii) On the other hand, *elements of change* include (*inter alia*) the rules adopted on the supervision of DGSs by designated authorities with regard to their operation, the introduction of provisions pertaining to the financing of DGSs (in that respect *ex ante* financing is the rule, while *ex post* financing arrangements, including borrowing between DGSs, are also prescribed and regulated), the fixing of the level of coverage at 100,000 euros (minimum *and* maximum), and the gradual reduction of the repayment period from twenty (20) to seven (7) working days at the latest by the end of 2023. Of particular interest is the fact that DGSs may be called upon to contribute to the financing of the resolution of unviable credit institutions.

## 2. THE WAY FORWARD

### 2.1 The Commission’s current reform agenda

#### 2.1.1 General overview

(a) The legal framework governing the EMU and (mainly) the underlying single rulebook is currently under (partial) amendment. The *Commission Communication of 11 October 2017 “on completing the Banking Union”*,<sup>58</sup> which is broadly based on the conclusions of the *Commission Reflection Paper “on the deepening of the economic and monetary union”* of 31 May 2017<sup>59</sup> (the ‘*EMU reflection paper*’) (as well as in previous documents submitted by the Council and by the Commission), laid down in this respect the following six (6) priorities, which can be categorised in two (2) groups:

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58. COM(2017) 592 final.

59. This Paper is available at: [https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union\\_en](https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en).

- (i) The *first* group contains ‘*risk reduction*’ measures, including:
- the (quick) adoption of the legislative 2016 “banking package” (for details see below, *under 2.1.2*),
  - the creation of sovereign bond-backed securities, an aspect currently dealt with mainly by the European Systemic Risk Board (the ‘*ESRB*’),<sup>60</sup>
  - the undertaking of actions to address non-performing loans (the ‘*NPLs*’), in accordance with the *Council Action Plan* “on Non-Performing Loans” of July 2017,<sup>61</sup> and
  - the continuation of the attempt to ensure high quality supervision.
- (ii) The *second* group comprises two ‘*risk sharing*’ measures (the implementation of which might follow the effective application of the above-mentioned risk reduction measure), and in particular:
- the establishment of the EDIS (see below, *under 2.1.3*), and
  - the creation of a ‘common backstop’ to the EBU (*under 2.1.4*),

(b) The priority character of the above-mentioned actions was further reinforced in the *Commission Communication of 6 December 2017* “Further steps towards completing Europe’s Economic and Monetary Union: A roadmap”,<sup>62</sup> which outlines the comprehensive package of six (6) proposals to strengthen the EMU – including the EBU and the Capital Markets Union, which constitute the two pillars of the ‘*Financial Union*’.

### 2.1.2 Finalisation of the legislative 2016 “banking package”

(a) On 23 November 2016, the Commission tabled, on the basis of its *Communication of 24 November 2015* “Towards the completion of the Banking Union”,<sup>63</sup> a legislative “banking package” concerning the amendment of the SRMR, the

60. European Systemic Risk Board *Survey on sovereign bond-backed securities, Background document, European Systemic Risk Board High-Level Task Force on Safe Assets*, 22 December, 2016, available at: [https://www.esrb.europa.eu/pub/pdf/surveys/161222\\_survey\\_background\\_document.en.pdf](https://www.esrb.europa.eu/pub/pdf/surveys/161222_survey_background_document.en.pdf); See also Brunnermeier, M.K., Langfield, S., Pagano, M., Reis, R. Van Nieuwerburgh, S. and D. Vayanos, *ESBies: Safety in the tranches*, ESRB Working Paper Series, No 21, September, 2016, available at: <https://www.esrb.europa.eu/pub/pdf/wp/esrb-wp21.en.pdf?78c259326d82ec15a0918ff5a094373> and Demary, M. and J. Matthes *An Evaluation of Sovereign-backed Securities (SBSs) – Potentials, Risks and Political Relevance for EMU Reform*, Institut der deutschen Wirtschaft Köln, IW policy paper 12/2017, 23 June, 2017, available at: [https://www.iwkoeln.de/fileadmin/publikationen/2017/347407/IW-policy-paper\\_2017\\_12\\_SBS\\_evaluation\\_basis.pdf](https://www.iwkoeln.de/fileadmin/publikationen/2017/347407/IW-policy-paper_2017_12_SBS_evaluation_basis.pdf).

61. The conclusions of this Action Plan are available at: <https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans>. The Commission’s proposals are laid down in pp. 17-18 of its Communication.

62. COM(2017) 821 final, 6.12.1017, pp. 11-12.

63. COM(2015) 587 final.

CRR and the CRD IV with a view to reducing risks and further strengthening the resilience of EU credit institutions.<sup>64</sup> In particular:

(i) A combined legislative proposal refers to the amendment of both the SRMR and the BRRD. While the *Proposal for a Regulation* of the European Parliament and of the Council amending the SRMR regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms<sup>65</sup>, the *Proposal for a Directive* of the same institutions amending the BRRD “on loss-absorbing and recapitalisation capacity of credit institutions and investment firms [...]”<sup>66</sup> is reviewing the MREL and implementing the total loss-absorbing capacity (the ‘TLAC’) standard of the FSB in the EU legal framework.

(ii) In addition, the *Proposal for a Directive* of the same institutions “on amending [the BRRD] as regards the ranking of unsecured debt instruments in insolvency hierarchy”<sup>67</sup> provides for the amendment of Article 108 BRRD.<sup>68</sup>

(iii) The amendments to the CRR refer to several aspects (including the leverage ratio, the net stable funding ratio, counterparty credit and market risk, exposures to central counterparties and to collective investment undertakings, large exposures, as well as reporting and disclosure requirements),<sup>69</sup> while those to the CRD IV refer mainly to financial holding companies and mixed financial holding companies, remuneration, supervisory measures and powers, as well as capital conservation measures.<sup>70</sup>

The vast majority of the proposals on the amendment of the CRR and the CRD IV are broadly based on aspects of the above-mentioned “*Basel III regulatory framework*” of the Basel Committee on Banking Supervision,<sup>71</sup> which were not included in these two EU legal acts at the time of their adoption (in 2013). It is noted, however, that the Basel Committee’s regulatory framework is again under amendment after the endorsement, on 7 December 2017, by its oversight body, the Group of Central Bank Governors and Heads of Supervision (the ‘GHOS’) of the Report “Basel III: Finalising post-crisis reforms”.<sup>72</sup>

64. The Commission’s proposals, currently under finalisation, are available at: [https://europa.eu/rapid/press-release\\_IP-16-3731\\_en.htm?locale=en](https://europa.eu/rapid/press-release_IP-16-3731_en.htm?locale=en).

65. COM(2016) 851/2 final.

66. COM(2016) 0852/2 final.

67. COM(2016) 0853 final.

68. On this Article, see Haentjens, M. “Selected Commentary on the Bank Recovery”, pp. 312-313.

69. COM(2016) 850 final.

70. COM(2016) 854 final.

71. See above, under 1.2.1.2 (b).

72. This Report is available at: <https://www.bis.org/bcbs/publ/d424.htm>.

Accordingly, it is expected that in 2018 or 2019 the Commission will submit new proposals for further amendments to the CRR and the CRD IV.

### 2.1.3 *Establishment of the EDIS*

The progress on adopting the Regulation establishing the EDIS on the basis of the above-mentioned 2015 Commission's proposal<sup>73</sup> has been slow. In view of this development, the Commission identified in its *EMU reflection paper* the establishment of the EDIS (ideally by 2019, with a view to be in place and fully operational by 2025) as one of the key outstanding components for the completion of the EBU.<sup>74</sup> In this respect, in its above-mentioned *Communication of 11 October 2017* concerning the completion of all parts of the EBU by 2018,<sup>75</sup> the Commission submitted a compromise solution, proposing a more gradual introduction of the EDIS compared with the original proposal in only two (2) phases. In particular:

(a) During the more limited '*reinsurance phase*', the EDIS would only provide liquidity coverage to national DGSs, temporarily providing the means to ensure full payouts if a credit institution's deposits were to become unavailable. National DGSs would need to pay back this support, ensuring that any losses would continue to be covered at national level.

(b) During the following '*coinsurance phase*', the EDIS would also progressively cover losses. Nevertheless, the migration to this phase should be conditional on progress achieved in reducing risks.

### 2.1.4 *The 'common backstop' to the EBU*

(a) One of the elements of the above-mentioned comprehensive package of measures proposed by the Commission in its *Communication of 6 December 2017* to strengthen the EMU<sup>76</sup> is the proposal for a Council Regulation "*on the establishment of the European Monetary Fund*"<sup>77</sup> (hereinafter the '*EMF Regulation*'). The EMF Regulation, to be adopted on the basis of *Article 352 TFEU*, provides for the establishment of a European Monetary Fund (the '*EMF*') based thereon<sup>78</sup> and hence anchored in the EU institutional framework. The Statute of the EMF (the '*EMF Statute*') is set out in the Annex to the Regulation and forms an integral

73. See above, under 1.2.3.1 (b).

74. *EMU reflection paper (2017)*, pp. 19-20.

75. See above, under 2.1.1 (a).

76. See above, under 2.1.1 (b).

77. COM(2017) 827 final, 6.12.2017.

78. *EMF Regulation*, Article 1(1).

part thereof.<sup>79</sup> The Commission proposes that the Regulation should be adopted by *mid-2019*.

(b) The objective of the EMF, which will succeed to and replace the European Stability Mechanism (the '*ESM*'), including its legal position and assuming all its rights and obligations, with its current financial and institutional structures essentially preserved, will consist in the contribution to safeguarding the financial stability of the euro area and of the participating Member States within the meaning of *Article 2 SSMR*.<sup>80</sup> For the achievement of its objective, the EMF will be assigned two tasks:<sup>81</sup>

(i) The *first* task is to mobilise funding and provide stability support under strict policy conditions, appropriate to the financial assistance instrument chosen, to the benefit of its Members which are experiencing, or are threatened by, severe financing problems. This will include, *inter alia*, the provision of direct public financial assistance to credit institutions by the ESM through the "Direct Recapitalisation Instrument" (the '*DRI*').<sup>82</sup>

(ii) The *second* task consists in providing credit lines or setting guarantees in support of the SRB (the '*common backstop*').

Hence, the EMF Regulation and the EMF Statute will establish the EMF as a *comprehensive crisis management EU body* with legal personality,<sup>83</sup> which will serve as a 'lender of last resort' both for the Member States whose currency is the euro, and for the SRF as well, in the form of the 'common backstop'. On the other hand, the EMF is not designed to have any early-intervention powers.

It is worth noting that the function of last-resort lending to credit institutions operating in the euro area is and will remain with the national central banks – members of the Eurosystem, under the conditions laid down in *Article 14.4 of the ESCB/ECB Statute*.<sup>84</sup>

(c) The legal basis for the provision of financial support to the SRF by the EMF is *Article 22 EMF Statute*, which provides that such support must be jointly provided by the EMF *and* the participating Member States within the meaning of *Article 2 SSMR* whose currency is not the euro, on equivalent terms and conditions, through 'credit lines or ceilings', or both, for guarantees on liabilities

79. *Ibid.*, Article 1(2) and recital (18).

80. *EMF Statute*, Article 3(1).

81. *Ibid.*, Article 3(2).

82. *Ibid.*, Article 19(1), second sentence and *EMF Regulation*, recital (46). On this instrument, see Gortsos, Ch.V. *The Single Resolution Mechanism*, pp. 37-39, with further references.

83. *Ibid.*, Article 1, first sentence.

84. See just below, *under 2.2.1*.

of the SRB.<sup>85</sup> Nevertheless, its ultimate legal basis is *Article 74 SRMR* (entitled ‘*access to financial facility*’), which provides that the SRB can contract for the SRF public financial arrangements regarding the *immediate availability* of ‘*additional financial means*’ to be used (in accordance with *Article 76* on the SRF’s mission) if the bank contributions raised or available are not sufficient to meet the SRF’s obligations. Such amounts of support must be provided in proportion to a key to be communicated by the SRB when requesting the support.

In order to ensure that the EMF will continue to be able to provide financial support to its Members when needed, it is proposed that the combined amount of outstanding commitments available for the purposes of support to the SRB arising from decisions adopted under the above provisions will be subject to an ‘*initial ceiling*’ of *EUR 60 billion*.<sup>86</sup> However, in order to also ensure that the EMF will be able to respond flexibly to unforeseen funding needs arising from resolution operations, the Board of Governors should have the power to increase the ceiling accordingly.<sup>87</sup>

## 2.2 Two additional elements: the “uncompleted agenda”

### 2.2.1 *The ECB as a lender of last resort in the euro area*

(a) In the author’s opinion, the completion of the EBU presupposes, two (2) further elements, which are not yet high (or even at all) on the agenda. The first is the provision of last resort lending directly by the ECB, under the “Emergency Liquidity Assistance Mechanism” (the ‘*ELA*’), which *Lastra and Goodhart (2015)*, at p. 16, correctly consider to be the “*missing fourth pillar of the banking union*”.

The current role of the ECB in this respect (with regard to all credit institutions established in the euro area) is confined to the approval or rejection of relevant decisions taken by the national central banks – members of the Eurosystem in accordance with *Article 14.4 of the ESCB/ECB Statute* which reads as follows: “*National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be*

85. *EMF Statute*, Article 22(1), first sub-paragraph.

86. *Ibid.*, Article 22(2).

87. *Ibid.*, Article 22(4), point (b) and *EMF Regulation*, recital (61). For a systematic presentation and an assessment of the proposed legal framework on the EMF, see Gortsos, Ch.V. *The proposed legal framework for establishing a European Monetary Fund (EMF): a systematic presentation and a preliminary assessment*, and in particular pp. 28-31 and 53 on the common backstop available at: <https://ssrn.com/abstract=3090343>.

performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.<sup>88</sup>

The procedural arrangements governing the provision of emergency liquidity assistance under the ELA are contained in an *ECB Communication of October 2014*,<sup>89</sup> which is not an ECB legal act nor legally binding, but merely registers its procedural practices. These procedures relate to the actions necessitated by the ECB's Governing Council and to the data to be provided to the ECB in order to make the assessment, pursuant to *Article 14.4 of the ESCB/ECB Statute*, whether the provision of emergency liquidity by a national central bank to individual credit institutions interferes with the objectives and tasks of the Eurosystem.

(b) Within this context, the author has proposed and continues to support the view that the ECB *should* act as a lender of last resort *at least* to the solvent but illiquid 'significant' credit institutions which are directly supervised by it within the SSM.<sup>90</sup>

Despite the absence of a general and *direct* financial stability mandate both in the TFEU (*Article 127 TFEU* included) and in the ESCB/ECB Statute, which would constitute a solid legal basis for the assumption by the ECB of this function, he also argues that the ECB *could* act as a lender of last resort to those credit institutions, since *Article 18.1 (second indent), of the ESCB/ECB Statute* (even broadly interpreted<sup>91</sup>) constitutes a solid legal basis as regards the instruments to be used.<sup>92</sup>

### 2.2.2 Harmonisation of rules on the winding-up of credit institutions

(a) Another important missing element in the architecture is the harmonisation at EU level of the rules on the winding-up of credit institutions. In partic-

88. This Article is analysed in Smits, R. *The European Central Bank – Institutional Aspects*, Kluwer Law International, The Hague, 1997, pp. 99-101.

89. See European Central Bank, *ELA Procedures (the procedures underlying the Governing Council's role pursuant to Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank with regard to the provision of ELA to individual credit institutions)*, October, 2014, available at: <https://www.ecb.europa.eu/mopo/ela/html/index.en.html>.

90. See Gortsos, Ch.V. "Last-resort lending to solvent credit institutions in the euro area: a detailed presentation of the Emergency Liquidity Assistance (ELA) mechanism," in: *ECB Legal Conference 2015 – From Monetary Union to Banking Union, on the way to Capital Markets Union: New opportunities for European integration*, European Central Bank, December, 2015 pp. 53-76 (also available at: <https://ssrn.com/abstract=2688953>), with further reference to Brescia Morra (2014) – citing De Grauwe (2013) – and Lastra, R.M. *International Financial and Monetary Law*, p. 378.

91. Nevertheless, the author wishes to highlight the extreme caution with which the ECB (just like central banks in general) accepts to perform tasks and powers based on an expansive reading of regulatory provisions. A case in point is the remark in Lastra, R. M. *The Evolution of the European Central Bank*, Queen Mary University of London, School of Law Legal Studies Research Paper No. 99/2012, at p. 9, that the recourse to Article 14.4 of the Statute as a legal basis for the ELA is a result of "a restrictive reading" of the ECB's tasks by the ESCB. See also Lastra, R.M. and Ch. Goodhart *Interaction between monetary and bank regulation: in depth analysis*, European Parliament, Directorate General for Internal Policies, IP/A/ECON/2015-07, September 2015, p. 16.

92. See on this also Smits, R. *The European Central Bank*, p. 269 (under (I)).

ular, the regime for the winding-up of insolvent credit institutions is governed by *Directive 2001/24/EC* of the European Parliament and of the Council of 4 April 2001 “on the reorganisation and winding-up of credit institutions”<sup>93</sup> (as in force after its amendment, *inter alia*, by *Article 117 BRRD*). This legal act, which also governs the reorganisation of credit institutions, does not provide for a minimum harmonisation of national reorganisation measures and winding-up proceedings.<sup>94</sup>

It mainly introduced the principle of mutual recognition, whereby (as applied to winding-up proceedings) the administrative or judicial authorities of the home Member State, which are responsible for winding-up, are solely competent to decide on the opening of winding-up proceedings concerning a credit institution, including its branches established in other Member States.<sup>95</sup>

(b) The discussions on setting up the EBU did not touch upon the prospect of amending this regime. Accordingly, credit institutions’ winding-up proceedings remain national and are expected to remain so at least for the foreseeable future, also activating the repayment procedure of national deposit guarantee schemes (albeit upon an ECB decision for the withdrawal of an authorisation<sup>96</sup>).

It is noted that, under the DGSD, in the vast majority of cases, the repayment procedure of deposit guarantee schemes is activated by a decision to withdraw a credit institution’s authorisation and wind it up, rendering its deposits ‘unavailable’ and activating the repayment procedure of *national DGSs*.

(c) This aspect became nevertheless topical in June 2017, when the SRB decided not to take resolution action in respect of two Italian credit institutions, namely *Banca Popolare di Vicenza S.p.A.* and *Veneto Banca S.p.A.* For both the Board assessed that, while the conditions for resolution action of *Article 18(1), first sub-paragraph, points (a) and (b) SRMR* were met, the condition of *point (c)* of that sub-paragraph was not satisfied.<sup>97</sup> These credit institutions are currently

93. OJ L 125, 5.5.2001, pp. 15-23.

94. The term ‘winding-up proceedings’ is defined broadly to mean collective proceedings opened and monitored by a Member State’s administrative or judicial authorities with the aim of realising assets under the supervision of those authorities (*Directive 2001/24/EC*, Article 2, ninth point).

95. This Directive is analysed in Peters, G. “Developments in the EU,” in Lastra, R.M. (editor): *Cross-Border Bank Insolvency*, Oxford University Press: Oxford – New York, Chapter 6, 2011, pp. 128-160 and Wessels, B. “Commentary on Directive 2001/24/EC on the Reorganisation and Winding-up of Credit Institutions,” in Moss, G., Wessels, B. and M. Haentjens (editors): *EU Banking and Insurance Insolvency*, Chapter II, Second edition, Oxford University Press: Oxford, 2017, pp. 61-117, who uses the abbreviation ‘CIWUD’ (Credit Institutions Winding-Up Directive).

96. *SSMR*, Article 4(1), point (a) with reference to Article 14.

97. The Board’s notice summarising the effects of the decisions taken in respect of these two (2) credit institutions is available at: [https://srb.europa.eu/sites/srbsite/files/23.6.2017\\_summary\\_notice\\_banca\\_popolare\\_di\\_vicenza\\_s.p.a.\\_20.00.pdf](https://srb.europa.eu/sites/srbsite/files/23.6.2017_summary_notice_banca_popolare_di_vicenza_s.p.a._20.00.pdf) and [https://srb.europa.eu/sites/srbsite/files/23.6.2017\\_summary\\_notice\\_veneto\\_banca\\_s.p.a.\\_20.00.pdf](https://srb.europa.eu/sites/srbsite/files/23.6.2017_summary_notice_veneto_banca_s.p.a._20.00.pdf).

The ECB Press Release deeming these credit institutions as failing or likely to fail is available at: <https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html>.

subject to winding-up under the insolvency proceedings of Italian law, which does not prevent the bail-out of senior creditors.

This development has obviously raised the urgency of the need to harmonise at EU level the rules on the winding-up of credit institutions, which is an element of the unfinished EBU agenda.<sup>98</sup> Hence, the author is skeptical about the accuracy of the comment made concerning the “circumvention of EU law” by the Italian government;<sup>99</sup> in his opinion, it is the “absence of EU law” which permitted the bail-out of senior creditors in this particular case.

It is noted that during the same period (on 7 June 2017), the Board has taken its first resolution action in respect of Banco Popular Español (“*Banco Popular*”), after having assessed that the conditions for resolution in accordance with *Article 18(1) SRMR* were met.<sup>100</sup>

### **2.3 A final remark: the link between a more robust EMU and a well-functioning and financial stability-enhancing EBU**

(a) The establishment of the EBU was *mainly* driven by the need to correct ‘*supervisory failures*’ in the banking system of the euro area Member States, with a view to enhancing its stability, eliminating thus ‘*market failures*’ in the form of negative externalities. Sound macro-economic policies (both monetary and fiscal), nevertheless, are of primary importance as well for securing financial stability. The current fiscal crisis in the euro area has demonstrated in a manifest way how poor fiscal policies, a source of ‘*macroeconomic failure*’, may lead to the destabilisation of the financial system. In fact, fiscal crises tend to spread to become financial crises through the activation of several channels of transmission.

A study of the Committee on the Global Financial System (the ‘*CGFS*’)<sup>101</sup> identifies four (4) such channels: the impact of negative sovereign ratings on (in-

98. See on this Gortsos, Ch.V. *The Single Supervisory Mechanism (SSM): Legal aspects of the first pillar of the European Banking Union*, Nomiki Bibliothiki – European Public Law Organisation (EPLO): Athens, 2015, pp. 36-37.

99. See, by mere indication, Köhler, L. “Regulators’ commitment to bail-in – is it credible? The case of MPS, V&V and Banco Popular,” *Oxford Business Law Blog*, 2017, available at: <https://www.law.ox.ac.uk/business-law-blog/blog/2017/07/regulators-commitment-bail-it-credible-case-mps-vv-and-banco-popular>. It goes without saying that the author fully subscribes to the main concern raised in that paper on the credibility of regulators’ commitment to bail-in.

100. The Board’s notice summarising the effects of the resolution action taken in respect of this credit institution is available at: [https://srb.europa.eu/sites/srbsite/files/note\\_summarising\\_effects\\_07062017.pdf](https://srb.europa.eu/sites/srbsite/files/note_summarising_effects_07062017.pdf). On this case, see Binder, J.-H. “Wunderkind is Walking? The Resolution of Banco Popular as a First Test for the Single Resolution Mechanism,” *Oxford Business Law Blog*, 14 June, 2017, available at: <https://www.law.ox.ac.uk/business-law-blog/blog/2017/06/wunderkind-walking-resolution-banco-popular-first-test-single> and Haentjens, M., “Selected Commentary on the Bank Recovery and Resolution Directive,” in Moss, G., Wesels, B. and M. Haentjens (editors): *EU Banking and Insurance Insolvency*, Chapter IV, Second edition, Oxford University Press: Oxford, 2017, pp. 177-318.

101. See Committee on the Global Financial System *The impact of sovereign credit risk on bank funding conditions*, CGFS Papers, No 43, Bank for International Settlements, Basel July. 2011 For more details, see also *Base*

dividual) bank ratings, losses incurred by banks from their sovereign debt holdings, the ‘collateral/liquidity channel’, and losses from state guarantees granted to banks (explicit and implicit). Adding to these channels is the negative impact on the performance of bank loans (in the event of an economic recession).

(b) The improvement (even at an optimal point) of the functioning of the EBU on the basis of the legislative and other proposals discussed above is *per se* not sufficient for achieving the objective of financial stability; macroeconomic stability is a *conditio sine qua non* as well. It is thus expected that the implementation of the Commission’s above-mentioned proposals of 6 December 2017<sup>102</sup> on the deepening of the EMU will pave the way for the necessary institutional arrangements which are necessary in order to enhance efficiency in the conduct of macro-economic (and mainly fiscal) policies in the euro area and are of primary importance for a sustainably smooth operation of the banking (and in general financial) system of participating Member States and the euro area as a whole. The link between a more robust EMU (under the current circumstances by establishing, in particular, a Fiscal Union<sup>103</sup>) and a well-functioning and, hence, financial stability-enhancing EBU is indispensable.

### Abstract

The aim of this paper is to briefly present and assess the institutional framework governing the (and some main legal aspects related to the) European Banking Union (EBU), as in force, and the proposals made or suggested in order to enhance it. The paper is structured in two Sections:

(1) A brief historical overview of EU institutional arrangements pertaining to the stability of the banking system in the European Union before the establishment of the EBU, the conditions that led to its establishment as a response to the current fiscal crisis in the euro area, a brief description of the current content of its main pillars and their link to the (underlying) single rulebook (the status quo) are the subject matter of Section 1.

(2) The following Section 2 provides an overview, with some assessments, of the Commission’s current reform agenda on the EBU, the two elements which the author considers as the “uncompleted agenda” and the link between a (more) robust Economic and Monetary Union (EMU) and a well-functioning and (hence) financial stability-enhancing EBU.

The cut-off date for information contained in this study is 23 December 2017.

### Résumé

L’objectif de cet article est de présenter et évaluer brièvement le cadre institutionnel (ainsi que certains des principaux aspects juridiques liés) qui gouverne l’Union bancaire européenne (UBE), tel qu’il est en vigueur, ainsi que les propositions faites ou suggérées pour l’améliorer. L’article comporte deux sections :

(1) Un aperçu historique des dispositions institutionnelles de l’UE relatives à la stabilité du système

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and Shambaugh, J.C. *The Euro’s Three Crises*, Brookings Papers on Economic Activity, Spring, The Brookings Institution, 2012 pp. 157-231, available at: [https://www.brookings.edu/-/media/Projects/BPEA/Spring%202012/2012a\\_Shambaugh.pdf](https://www.brookings.edu/-/media/Projects/BPEA/Spring%202012/2012a_Shambaugh.pdf) pp. 157-162 and 187-190.

102. See above, *under 2.1.1 (b)*.

103. On this aspect and, in particular, on the economic rationale and the design challenges of such a Union, see indicatively Thirion, G. *European Fiscal Union: Economic rationale and design challenges*, CEPS Working Document, No. 2017-01, January, 2017: available at: <https://www.ceps.eu/system/files/WD2017-01GT%20FiscalUnion.pdf>. (containing, *inter alia*, a comprehensive literature review).

bancaire dans l'Union européenne avant la création de l'UBE, les conditions qui ont conduit à son établissement en réponse à la crise budgétaire actuelle dans la zone euro, une brève description du contenu actuel de ses principaux piliers et de leur lien avec le (sous-jacent) règlement unique (le statu quo) font l'objet de la section I.

(2) La section II donne un aperçu, accompagné de quelques évaluations, du programme de réforme actuel de la Commission concernant l'UBE, les deux éléments que l'auteur considère comme le "programme inachevé" et le lien entre une Union Économique et Monétaire (plus) solide et une UBE qui fonctionne bien et qui (par conséquent) renforce la stabilité financière.

Les informations contenues dans cette étude précèdent la date du 23 décembre 2017.