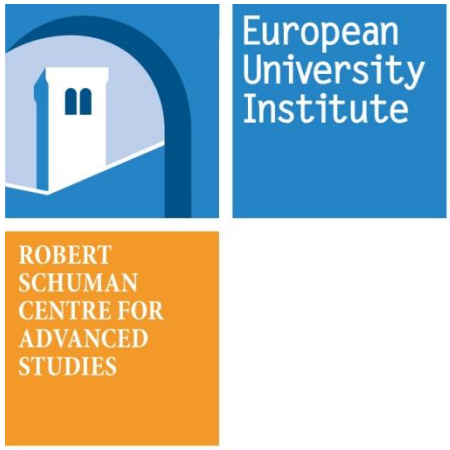

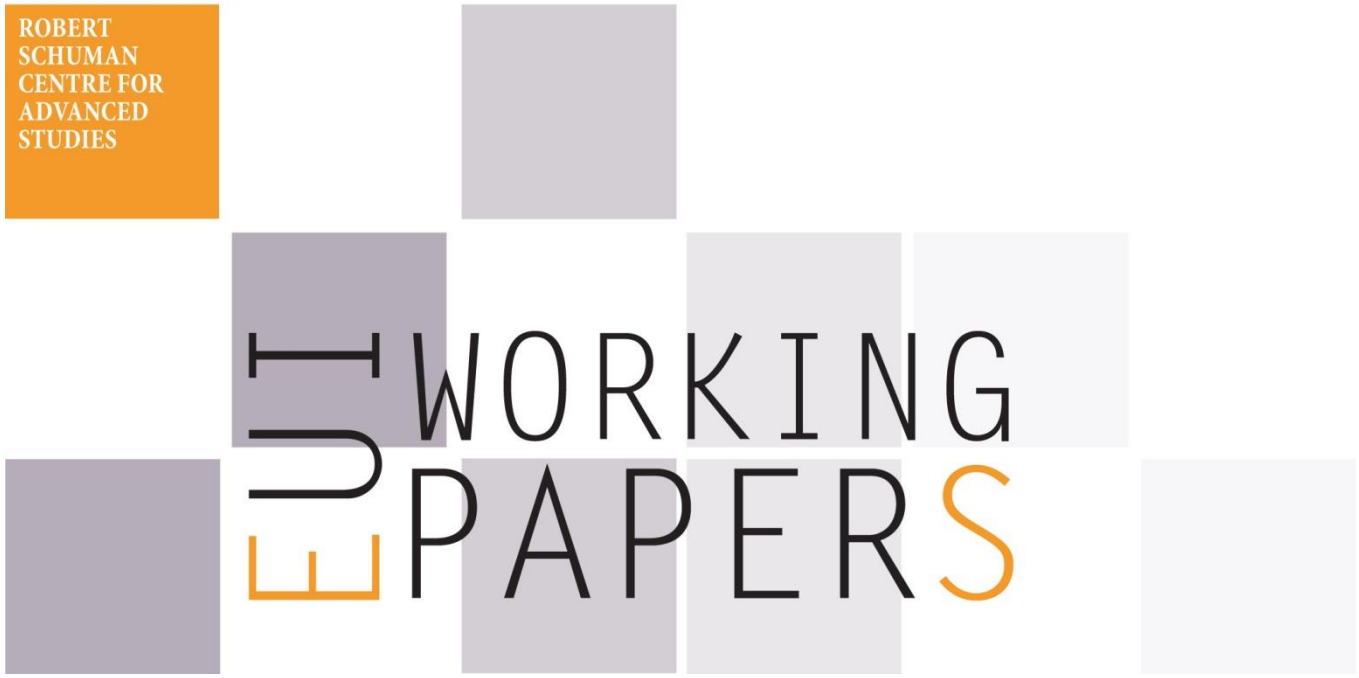

RSCAS 2015/77
Robert Schuman Centre for Advanced Studies

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EUI Working Paper **RSCAS** 2015/77

ISSN 1028-3625

Printed in Italy, October 2015
European University Institute
Badia Fiesolana
I – 50014 San Domenico di Fiesole (FI)
Italy
www.eui.eu/RSCAS/Publications/
www.eui.eu
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Abstract

In the last five years the European institutional architecture of banking regulation and supervision has undergone sweeping changes, brought about by a number of sequential legislative initiatives. Such a "Copernican revolution" naturally calls for investigating whether and how these different layers of reforms add up to (or can be interpreted in a way that ensure) an overall consistent, efficient and effective design for banking regulation and supervision. This is particularly the case for the European Banking Authority (EBA) and the Banking Union (BU), two new institutional players which in the public debate are sometimes dubbed as overlapping or even conflicting. The paper provides a critical analysis of this interplay and its components, also with the aim to provide food for thought for further exploration, from a private as well as a public law perspective. It starts from the reasons behind the foundation of the EBA and the BU, to show how these new institutional players in fact were created to pursue two distinct and complementary goals, and operate on two separate but interconnected institutional levels. The paper then dwells on the panoply of innovative regulatory tools which the EBA can dispose of in order to accomplish its mission to foster maximum harmonization and the creation of a single set of common rules (the "Single rulebook" or SR): technical standards, guidelines and recommendations, and other "soft law" instruments, such as the Q&A tool. The analysis aims to stimulate further critical thinking on the scope and possible impact of these tools, and their consistency within the overall European framework of legal sources. Hence, the focus moves on the main areas covered by the SR (i.e. prudential rules and resolution) and the priorities followed in its build up, highlighting how these priorities can contribute to the effective functioning of the two current components of the BU, i.e. the SSM and the SRM. The paper concludes with some remarks on areas of possible improvement and development, underlining the need to: i) step up the harmonization of corporate and insolvency laws, given their impact on cross-border banking and cross-border resolution; ii) provide more certainty on the scope and possible effects of EBA's mediation role; iii) rethink the governance of the EBA, if one wants to get to a more balanced interplay between national and European drivers.

Keywords

European Banking Authority (EBA), Banking Union, SSM, SRB, SRM, BRRD, maximum harmonization, cross-border banking, single rulebook, single market, technical standards, guidelines, mediation, Q&A, supervision, resolution, insolvency law.

Introduction[*]

In the last five years the European institutional architecture of banking regulation and supervision has undergone sweeping changes. The magnitude of new actors, powers, and tools is such that one has the impression to be living through a Copernican revolution, rather than an evolutionary stage. As always in the wake of radical changes, the role of scholars and legal interpreters becomes fundamental to rationalize the sequential developments which have made up the new institutional framework, and verify whether and how these layers add up to (or can be interpreted in a way that ensure) an overall consistent, efficient and effective design for banking regulation and supervision. This is particularly the case for the European Banking Authority (EBA) and the Banking Union (BU), two new institutional players which in the public debate are sometimes dubbed as overlapping and partially incompatible, or even conflicting. Drawing from my experience on the ground my goal here is to provide a critical analysis of this interplay and its components, also with the aim to provide food for thought for further exploration of the subject from a private as well as a public law perspective. I will do so by starting from the reasons behind the foundation of the EBA and the BU, to show how these institutional players in fact pursue two distinct and complementary goals, and operate on two separate but interconnected institutional levels. I will then dwell on the innovative legal tools which the EBA can dispose of in order to accomplish its mission to build the "Single rulebook" (SR). I do so to spur further critical thinking on the scope and possible impact of these tools, and their consistency within the overall European framework of legal sources. Hence, the focus will move on the main areas covered by the SR and the priorities followed in its build up, highlighting how these areas can contribute to the work of the two current components of the BU, *i.e.* the SSM and the SRM. Finally, I will conclude with some remarks on possible areas of improvement and further development.

1. The two stages of the crisis, and the creation of the EBA and the BU

To understand the present and foresee the future it is fundamental to start from the past. Likewise to appreciate the different roles assigned to the EBA and the BU one has to make a step back, and move from the beginning of the economic crisis in Europe and the two sequential stages which characterized it.

1.1 The first wave of the crisis

The first stage (2007-2010) was driven by a number of factors – the global macroeconomic imbalances, the wave of financial innovation, the disconnection between macro and microprudential supervision – which originated and built up out of Europe. The crisis nevertheless hit hard the European Union, revealing the frailty of a Single market for banking and financial services built upon the pillars of "minimum harmonization and mutual recognition". In fact, one has to acknowledge that these pillars had initially served well, during the seventies and the eighties of the previous century[1], the purpose of setting in motion the building of the Single market for banking services. However, the pace of integration at the turn of the century – on the thrust of the Single currency – made these same pillars outdated to sustain the critical dimension and interconnections reached by the Single market

[*] The opinions expressed are exclusively personal. The article draws on a presentation given, and benefits of the discussion held, at the symposium "The Banking Union and the creation of duties" at the European University Institute on 19-20 March 2015.

[1] For a more articulated description of the various stages of the integration process and the different institutional drivers, see Texeira 2013, p 533

and its players[2]. Indeed, the unheard warning that had been given ahead of the economic crisis by Tommaso Padoa-Schioppa on the inadequacy of the minimum harmonization principle was eventually learned in the hard way: a long lasting integration of markets and a single monetary policy cannot be achieved while keeping regulation and supervision at national level (the inconsistent triad)[3].

How minimum harmonization impaired the resilience of the Single Market ? At least through three different and interconnected drivers: (a) loopholes and regulatory arbitrage; (b) lack of comparability of key prudential and accounting aggregates; (c) obstacles to the effective functioning of integrated risk-management of cross-border groups.

1.1.1 Regulatory arbitrage

On the first count, the crisis showed that the increasing competition brought about by the Single market – and sustained by the single currency – put national regulators and supervisors under pressure to use national prudential regulation as a competitive lever to support national interests, creating an unlevel playing field and negative spill-over effects across Europe. A clear example of this kind of "collective action problem" can be identified in the classification as "own funds" granted at national level to financial instruments which later on, in the run up to the crisis, proved not to have the required loss-absorbing features. A topic on which we will come back later on in this contribution. Suffice here to flag that this shortcoming in turn forced national authorities to step in with significant injections of public funds (bail-outs), in an uncoordinated fashion across the Union and with obvious negative externalities.

1.1.2 Hurdles for cross-border supervision and market discipline…

It is fair to acknowledge that the call for minimum harmonization was not always motivated by regulatory arbitrage. As anticipated, legitimate concerns for different national economic specificities and local banks were also behind it, and undoubtedly during the eighties and nineties of the past century the principle of minimum harmonization proved to be a powerful means to reduce national gaps and open up national markets to cross-border competition, while taking into account these local specificities. However, minimum harmonization proved not to be anymore a sustainable solution once the integration of the Single market took off spurred by the Single currency. Indeed, the policy makers' decision to stick to minimum harmonization – rather than shifting to truly common European rules, with adequate space to the principle of proportionality to address national specificities – led to the unintended consequence of an uncoordinated "regulatory patchwork". Even in those cases where they were not stemming from regulatory arbitrage, different key national definitions of the prudential framework ended up to be a major obstacle for effective coordination of supervision on cross-border banks, as well as for the correct functioning of market pricing and related discipline. In particular, it is self-evident that as long as key banking aggregates such as the definition of own funds, non-performing loans, forebearance, asset encumbrance (to mention some on which will dwell later on) are not harmonized through fully fledged common rules (covering also those details where often the devil rests), effective coordination of national supervisors is significantly impaired, as well as the capacity of market participants to assess and compare the effective conditions of the banks operating across the Single Market. Again, the crisis confirmed in all its magnitude the consequences of this regulatory and institutional flaw.

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2 As Enria 2013, p 48 remarks "In building up the Single Market and the Economic and Monetary Union (EMU), European policy makers gave a clear signal to the banks: they were invited to consider the EU as their domestic market and to create a dimensional and organizational structure reflecting the new institutional setup. The wave of mergers that characterized European banking in the early 2000s effectively brought European banks to a dimension commensurate with the new boundaries of their reference market".

3 Padoa-Schioppa 2004.

1.1.3 …and for the functioning of cross-border banking groups

Last, but not least, the lack of fully fledged common European rules proved to be a major obstacle for the free flows of capital and effective management of risk *within* banking cross-border groups. Different national rules and requirements not only led to the imposition of unnecessary burdens and duplications for the operations of these banking groups, but also turned out to constrain their legitimate business strategy to manage risk in an integrated fashion across the group, due to the imposition of national requirements which would overlook the consolidated management of these groups. In a nutshell, minimum harmonization seriously affected: (i) the capacity of the latter to move in "good times" capital across the Union to finance the real economy (*i.e.* the ultimate social and economic goal underlying the Single market for banking services), (ii) as well as their capacity during the crisis to mobilize capital and liquidity to respond to the distressed conditions of certain components of the group.

1.1.4 The leap to maximum harmonization

It was the recognition of the failures of minimum harmonization against the first wave of the crisis, as evidenced in the so called De Larosière Report, which prompted policy makers to step up the previous initiatives towards maximum harmonization (on the basis of the Financial Services Action Plan of 1999) and take the leap towards the creation of a single set of European rules directly applicable in the Union without the need (and the possibility) of any national transposition (the so called Single Rulebook). And it is this move from minimum to maximum harmonization which gave birth in 2010 to the European Banking Authority and the other two European Supervisory Agencies (ESAs), with the tasks to build the Single Rulebook and ensure its uniform application across the Union through consistent and convergent supervisory practices by national authorities.

1.2 The second wave of the crisis

However, the second wave of the crisis, which kicked-off in 2011, proved that maximum harmonization and coordination of supervision were necessary, but not sufficient to overcome the heavy inheritance of the previous stage of the crisis. Indeed, this second wave showed that the lack of a common response – *i.e.* of common resolution procedures, a shared safety net and effective coordination among Members States – in the wake of the crisis led inevitably by backward induction to: the fragmentation of the Single market through ring-fencing measures along national borders; the creation of the vicious circle between banks and the national budgets on which banks rely in case of failure; serious obstacles to the conduction of a single monetary policy[4]. In conclusion, the roots of this second – exclusively European – part of the crisis were to be tracked down in the decision to go *chacun pour soi* (to use the words of the de Larosière Report) and reject the proposals (that in fact had been put on the table already in the first years of the crisis) to respond through a common European safety net.

However, as it was once told by a founding father of the European Union, "the strength of an idea is revealed not by the fact that it imposes itself without friction at its first appearance, but from its capacity to be reborn out of defeat"[5]. And also in this case the lesson was eventually learned. The *integration* of the national supervisory and resolution systems became reality with the approval of the project of the BU in the Euro Area Summit of June 2012[6].

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4 For an articulated description of these issues, also in quantitative terms, see Enria 2013, p 51.

5 Spinelli (1999), at p 348.

6 For a detailed account of the events and decisions taken in this context, see Texeira 2014 p 542; Brescia Morra 2014 p 3.

1.2.1 The complementary levels on which the EBA and BU operate

It is not the purpose of this paper to analyze the elements and characteristics of the BU. What is important here is to verify whether the institutional mission of the EBA still maintains its *raison d'etre* following the creation of the BU, and whether the latter affects the modalities through which the EBA carries out its tasks. I believe that both questions deserve a positive answer.

The EBA and BU do not have overlapping goals, they rather operate complementary levels, the first working on the rulemaking ground, the second acting as an integration mechanisms. The EBA has an *horizontal* function, which is to provide the common regulatory ground on the basis of which the BU provides a *vertical* integration mechanisms of the previously national supervisory and resolution arrangements and mechanisms. Using a metaphor, one could say that the EBA provides the *software* which is necessary for the *hardware* (*i.e.* the supervisors and the resolution authorities) to operate and deliver on their goals, and at the same time allows the different hardware (*i.e.* the BU with the other non-BU authorities within the Union) to interact one with the other through a *common language*.
Out of the metaphor, as regards the internal functioning of the SSM and the SRM, it is clear that the higher is the degree of harmonization achieved through the Single Rulebook, the lower is the risk that the internal operations and the level playing field of the SSM and the SRM will be hampered by those areas of prudential regulation and resolution rules which are still subject to minimum harmonization and discretionary (and different) choices by national legislators in the transposition stage (see article 4(3) of the SSM Regulation[7] and Articles 10(12), 12(14) and 29(1) and (2) of the SRM Regulation[8]). At the same time, the SR – and the tools that the EBA can use to foster its uniform application through convergent and consistent practices – are fundamental to avoid a polarization of the SM between BU and non-BU[9]. If we consider that vast majority of the largest cross-border groups operate and intermediate capitals in and out of the BU area, it becomes self-explanatory why it is so important to keep together on the same ground the BU and non-BU components of the Single market, overcoming the thrust to fragmentation and ring-fencing which is active anytime coordination-enforcing mechanisms are lacking.

Assuming that the EBA maintains its *raison d'etre* does not mean that the operational functioning and the directions of work of the EBA are not going to be affected by the set-up of the BU. The impact is evident as soon as we consider the change of the decision-making rules of the governing body of the EBA, adopted in parallel with the BU. But the impact goes beyond the governance of the EBA. It is clear that the BU changes the institutional landscape against which the EBA was originally set-up, and hence affects its strategic direction of work. Suffice it to think how the BU made redundant the EBA's coordination and convergence initiatives which were previously carried out among national supervisory and resolution authorities within the BU area, while increased the importance of these same initiatives for the purpose of bridging the BU and the non-BU authorities within the Single Market.

2. The new regulatory tools.

I do not think that the term Copernican revolution is an overstatement when used with respect to the impact that the creation of the ESAs and the SR project have had on the European system of sources of law in the financial sector and its rulemaking process. A thorough analysis of the subject goes well beyond the limits of this article, and would probably require a specific volume. My purpose is definitely more modest, and it is to provide a critical bird's eye view of the main innovations and the open issues which they raise for the legal interpreter.

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7 Council Regulation (EU) No 1024/2013 of 15 October 2013.

8 Regulation (EU) No 806/2014 of the European Parliament and of the Council 0f 15 July 2014.

9 For a thorough discussion of this risk, see Ferran 2014.

2.1 Scope of the SR

A preliminary remark to define the scope of the subject is necessary. The SR for the banking sector is often identified in the public debate with the so called level 1 (L1) legislation[10], as complemented by: either (a) the delegated and implementing acts issued by the Commission (or the Council in case of the implementing acts) on the basis of specific mandates provided by the L1; or (b) Commission's delegated or implementing acts which are based – again, pursuant to the mandates provided in the L1 text – respectively on draft regulatory or implementing technical standards (TS) submitted by the EBA to the Commission, in line with the process set out by Articles 10 to 15 of the EBA Founding Regulation[11]. I reckon that this conventional definition of the perimeter of the SR is in fact too narrow, since it overlooks the wider range of different tools which, even though not legally classifiable as binding, nevertheless contribute in different ways and with different effect to the creation of the SR, in this wider conception of the expression[12].

2.2 The EBA draft technical standards

It is however clear that the TS represent the more powerful innovation in the new unchartered territory of the rulemaking power of the ESAs. An innovation which poses a number of interesting challenges which I have the impression have not been so far explored to their full extent by the legal doctrine. A first area worth further reflection seems to be the legal implications of the TS which further specify the content of directives of minimum harmonization, as in the case of TS based on provisions of the CRD, or the BRRD as well as the DGSD. What are the effect of these TS on the power of the MSs to provide further elements and requirements on the top of those already set forth by the directive and the accompanying TS ? Up to what point these national prerogatives can extend without jeopardizing the ultimate goal underlying the provision of a TS, *i.e.* to ensure that the same regulation is directly applicable across the Union without national differences which may impair the level playing field ? These are questions which probably cannot be answered in a general way, but only on the basis of a case by case analysis, juxtaposing the wording and the aims of the L1 text and the extent to which any national rules impinge on the former.

It is however important to raise the issue also in general terms and keep it on the radar, in order to spur the L1 legislators to reflect and specifically address on next occasions the issue of the effective degree of maximum harmonization that can be achieved through TS specifying the content of directives, which in fact allow MS to add national provisions complementing them. As much as it is important to flag and draw the attention on the degree of national discretions and options which are left in the folds of the L1 regulations. Also in this case the risk is to impair the construction of the level playing field which in fact is the goal underpinning the legislator's choice to adopt a regulation.

2.2.1 Strategic decisions, policy choices, and technical nature of the TS

The second area on which I would like to draw the attention concerns the scope of these TS. According to ESAs founding regulation, the content of the TS "*shall be technical, shall not imply*

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[10] E.g., for prudential rules see the Directive 2013/36/EU of the European Parliament and of the Council "on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms" (known as CRD IV), and the Regulation (EU) No 575/2013 of the European Parliament and of the Council "on prudential requirements for credit institutions and investment firms" (known as CRR). For the crisis management part see the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (known as BRRD), and the Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (known as DGSD).

[11] 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).

[12] For a thorough analysis of the EBA regulatory toolkit see also Chiti 2015 p 9.

strategic decisions or policy choices and their content shall be delimited by the legislative acts on which they are based". If we now look of the mandates provided for the TS by the legislative acts we are confronted with a reality which does not match with this description, on two opposite counts.

On the one hand, the L1 legislative acts – for example the CRR or the BRRD – cover extensively and in many cases excessively a number of specific details, which seem to fit more appropriately in the scope of TS, given the technical knowledge they require or the procedural aspects that they cover. On the other hand, the same L1 legislative acts often delegate to the TS key political and strategic decisions, sometimes because a certain degree of political content is inevitable, as I'll argue hereafter, sometimes because the delegation to the TS is in fact used as a means to break political deadlocks and postpone to a later stage the political solution of the issues at stake.

I think that following these initial years of operation of the ESAs, the time has come to acknowledge that "the king is naked", *i.e.* that also the TS inevitably imply strategic decisions and policy choices. Any legal rule by definition establishes a certain ranking among competing interests and objectives, and the drafting of the TS cannot escape to make these choices. On the contrary, denying that would simply mean to hide policy choices behind the screen of the technical choice. And the text of the L1 legislation establishing the ESAs should be revised accordingly, by acknowledging that TS can imply policy choices or strategic decisions *as long as the latter are cast within the ranking of values and goals which has to be identified in high level terms by the L1 mandate*.

Following this line of reasoning, the question becomes whether this new rulemaking process is consistent with the institutional architecture designed by the Treaty, and whether due process and accountability are respected throughout it. On both issues I reckon that we can get to positive responses. As regards the first one, the implications and scope of the Meroni doctrine are progressively being reviewed in a direction which clearly allows for an expansion of the delegation of powers[13], and the policy decisions to be taken by the TS should be in any case constrained by the goals set by the L1 text. Moreover, in the case of the TS we are not in presence of a fully fledged delegation, given that the Commission retains the power of scrutiny and following endorsement. Likewise, due process and accountability seem to be fully respected by the process followed for the drafting of TS, a process which entails the participation of all national authorities in the drafting and decision-making stages, a public consultation and several formal and informal interchanges with the stakeholders (including the EBA Banking Stakeholders Group), an intense interaction with the Commission for the endorsement of the draft, and a constant dialogue with the Council and the Parliament, who at the end of the game retain the power to claw back the delegated acts adopted by the Commission following the regulatory technical standards.

2.3 EBA guidelines and recommendations

Moving on to the other tools which contribute to the SR in the wide meaning of the expression clarified above, I think that also the guidelines and recommendations that the ESAs can adopt offer interesting considerations for the legal interpreter. The main one regards in my opinion their possible classification as source of private and public law positions, and their ranking in the European and national hierarchy of law[14]. On the one hand, interesting cues in this direction can be found in the Decision of the Board of Appeal of the ESAs on 24 June 2013[15], which seems to rest on the premise that legally relevant consequences stem from the decision of a competent authority to comply with a

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[13] See e.g. Chiti 2015, p 5; Moloney 2014, p 1660; Scholten and Van Rijsbergen 2014, p 389.

[14] Another interesting feature regards the preconditions under which guidelines and recommendations can be issued on an own initiative basis, *i.e.* without a specific mandate by the L1. On this issue see Chiti 2015, p 10-11.

[15] Decision of the Board of Appeal of the European Supervisory Authorities given under Article 60 Regulation (EU) No. 1093/2010 and the Board of Appeal's Rules of Procedure (BoA 2012 002), Appeal by SV Capital OÜ against European Banking Authority.

specific set of guidelines[16]. On the other hand, it would be interesting to investigate also the extent to which these guidelines and recommendations can play a role in the interpretation of Union law, in those cases where the competent authorities have declared that they do not intend to comply with their content. An issue which probably cannot be addressed in general terms by the legal interpreter, but rather has to be analyzed against the specific elements of each different case, to verify whether the specific decision not to comply hinges on legitimate grounds notwithstanding the legal duty that competent authorities have "*to make every effort to comply*" with the guidelines, as provided for by Article 16 of the EBA founding Regulation. In fact, the latter legal provision suggests that – given that the decision not to comply cannot be based on arbitrary elements – it is misleading to qualify the legal status of the GL as simple "comply or explain" rules, at least in the meaning the expression is used in the field of private self-regulation.

2.4 The EBA Q&As tool

A specific remark is also worth doing for the Q&A tool, *i.e.* the answers provided by the EBA on the interpretation of L1 and L2 provisions. The process as such is consistent with Article 29(2) of Regulation 1093/2010, which asks the EBA to "*develop new practical instruments and convergence tools to promote common supervisory approaches and practices*". The Q&A contribute to and supplement the Single Rulebook, and somehow ensure that the latter embodies a 'living' and evolving regulatory framework. They have no binding force in law nor are they subject to "comply or explain", even though one cannot exclude that a specific weight could be given to them by jurisdictional authorities, given the highly technical source they stem from. Also, it seems reasonable to expect that the Q&A will be scrutinized and challenged by the EBA and national supervisory authorities, given their undoubted practical significance to achieve a level-playing field. Peer pressure and market discipline are also expected to play a driving force in ensuring adherence to and compliance with the answers provided in the Q&A process. Finally, depending on the observation of regulatory implementation across the EU, evolution of banking operations or supervisory practices, the Q&A might inform the review of the Level 1 text, of related technical standards or of EBA guidelines, and if necessary lead to the extension or issuance of GL by the EBA on an own initiative basis.

2.5 The EBA rule-making toolkit…

To conclude, the creation of the ESAs has led to a new regulatory environment which opens up challenging questions to the interpreter, from both the public law and the private law angles. The overall picture include a panoply of tools, which range from proper European rules (the TS) to the guidelines and the recommendations, and reaches out to more "soft law" instruments, such as the Q&A, and the opinions and the advices granted by the Authority to the European institutions in support of legislative initiatives. Altogether the instruments so far considered comprise a comprehensive toolkit made of heterogeneous components, whose effective perimeter and reciprocal interaction still needs to be fully explored by the legal interpreters, and whose legal effects will probably become clearer and more predictable in the coming years, with the buildup of a critical mass of practical experience and possible jurisdictional decisions.

2.5.1 …and the instruments used to foster consistency and convergence of practices

Furthermore, one should not overlook that the rule-making activity and the SR are complemented by a number of instruments which the EBA dispose of in order to foster the convergent application of these

[16] § 56 of the Decision states that «even on the basis that the EBA Guidelines are not legally binding, they address the matter from a practical perspective, and assist in the interpretation of the scope of the provisions of Directive 2006/48/EC».

rules by the supervisory and resolution authorities across the Single market. The SR is a necessary condition to create the SM, but it is not sufficient if it is not complemented by convergent and consistent practices in the application of the rules. As it has been incisively remarked "setting rules without ensuring their implementation is akin to building a lighthouse without ever switching the light on"[17].

Here again, the EBA's toolkit covers a wide range of hard and soft tools. Just to mention the main ones: the coordination role played by the EBA in the stress test to ensure comparability and transparency; the EBA's participation to supervisory and resolution colleges to foster their effectiveness; the peer reviews tool ; the benchmarking exercises, the single supervisory handbook provided by Article 29(2) of the EBA founding Regulation; the binding and non-binding mediation pursuant to Articles 19 and 31(c) of the EBA Founding regulation. While distinct from the proper rule-making activity of the EBA, these instruments have an evident impact on the way the SR is interpreted and applied on the ground, and can probably have a bearing on the way Courts would be inclined to interpret the SR.

3. The pillars of the SR, and their interplay with the SSM's and SRM's tasks

Almost five years have passed by since the EBA's first engagement on the SR project, a time sufficiently long to take stock of the work carried out, at least in quantitative terms, and indentify what have been the main areas, priorities and directions followed, and how these may affect the tasks of the SSM and the SRM.

3.1 Facilitating access to the different layers of the SR

Overall, the Authority issued so far more than 100 TS, around 30 GL, 25 opinions and advices, 50 reports. 50 more TS, 20 GL, and 50 opinions and reports, are expected by the end of 2015. Around 670 answers are currently provided in the QandA tool. As already remarked, the GL and the Q&A tool are a necessary complement of the L1 and L2 provisions for the making of the SR. In light of this articulation of sources, the EBA is committed to facilitate access to all the different layers which comprise the SR through "the Interactive Rulebook", an on-line tool that provides a comprehensive compendium of the CRR, CRD IV, and the BRRD, and the corresponding TS, GLs and related Q&As, coupled by the possibility to have a "surgical" access to the relevant provisions within these sources, pooled together through enquiries by topic and/or article.

3.2 The two main pillars of the SR: prudential rules and resolution

While the figures above include also EBA's activity covering further areas such as consumer protection and anti-money laundering, the main bulk of the SR in its current status is represented by prudential rules and the rules comprising the new resolution regime for banks. These two pillars have evolved over these years following different pace, with the second one being developed in more recent times, in parallel with the evolution of the international framework on crisis management.

3.2.1 The priorities in the prudential area

In the area of prudential regulation, the priorities in the build up of the SR have mirrored the flaws which were identified in the wake of the crisis, as they have been recalled above in the first paragraph. Hence, in its first years the rule-making activity of the EBA focused mainly on: (a) the harmonization of the definitions which affect the determination of the own funds (*i.e.* the numerator of the capital

[17] Ingves S 2011

ratio), covering the whole spectrum of rules which impact on them, from the regime on deductions to the terms which define the loss-absorbing capacity of the instruments, and the application of the "floors"; (b) the implementation of the new Basel III framework on liquidity requirements, e.g. through the identification of a common European definition of "highly liquid assets"; (c) the creation of a single reporting system for all banks on prudential and accounting aggregates (COREP and FINREP) accompanied by truly single definitions for this purpose, such as those concerning non-performing loans, asset encumbrance, fore-bearance. It is clear that these achievements not only have addressed some of the main shortcomings revealed by the crisis, but they also proved to be important underpinnings for the "comprehensive assessment" and the setting in motion of the SSM, which could start its activity on the basis of common definitions and comparable aggregates within its area of competence.

In the later years the action of the EBA has progressively expanded "from the numerator to the denominator" of the capital ratio, with an extended number of GL, TS and technical reports aiming to provide – in line with the international framework – a consistent implementation across the EU of the provisions related to topics such as credit and market risk adjustments, definition of default, permission to use Standardised/IRB approach, appropriateness of risk weights, credit risk mitigation techniques.

It is however worth warning that the areas of prudential regulation covered by the SR still present a worrying range of national options and discretions, allowed for by the CRR and the CRD IV. This is a source of concern for the level playing field across the Single market, even within the SSM in those cases where the national options are exercised by national legislations. For these reasons, the EBA is closely monitoring the way in which each Member State exercises the options and national discretions available in the CRR and CRD, through an *ad hoc* reporting tool, whose results are disclosed on the EBA web-site. Also in this instance, depending on the observation of the regulatory implementation across the EU, this reporting tool could inform the review of the Level 1 texts, of related TS or of EBA GL, and if necessary lead to the extension or issuance of GL by the EBA on an own initiative basis.

3.2.2 The new resolution regime: introducing the "paradigm shift"

Finally, the second pillar of the SR, *i.e.* the new regime on banking resolution, rests on the BRRD and the DGSD which entered into force on 3 July 2014, and mandates the EBA to draft more than 40 TS and GL, which have already been published as consultation papers and are expected to be finalized, for its greatest majority, by 3 July 2015. Overall, these TS and GL cover all the key stages of crisis management and resolution (from recovery and resolution planning and the criteria for the definition of the MREL, to the application of bail-in and the other resolution tools)[18]. Together with the Commission's delegated acts on a number of limited but important aspects (also issued on the basis of technical advices provided by EBA), these GL and TS represent a necessary complementary component of the BRRD in order to make cross-border resolution in the Single market a credible and feasible scenario[19].

Indeed, the room for national discretions allowed by the BRRD on significant features of the resolution process is so wide that it may undermine the level of trust necessary to converge *ex ante*, in the planning stage, on coordinated and cooperative solutions between home and host resolution authorities. Resolution is a collective action problem. And as game theory and common sense teach, in a collective action problem the higher is the uncertainty on the room of maneuver of the parties, the less likely it is to make cooperative commitment a credible and convenient option.

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[18] For an extensive analysis of the new rules of the BRRD see Binder J-H (forthcoming).

[19] In particular, on these TS and GL see Gardella A (forthcoming).

Moreover, unconstrained national discretion and options can threaten cross-border resolution *ex post*, once resolution occurs, if different national legal proceedings and rules end up to prevent the inter-operability of resolution proceedings across national borders (an issue which needs to be addressed also within the SRM, where the resolution scheme will be implemented through national arrangements).

The TS and GL of the EBA and more in general the whole SR, in its wider definition, play an important role in reducing these gaps and the related risks. They do so by clarifying and specifying the reach of common European rules, and fostering their common understanding not only among all the resolution authorities involved in cross-border resolution (*i.e.* SRM and non-SRM), but also beyond them. In fact, the outreach of the SR on resolution is much wider, as it contributes to a common understanding of the new framework among the whole community of stakeholders concerned. As already said, resolution is a collective action problem which involves a wide number of institutional parties and stakeholders: supervisors; financial ministries; deposit guarantee schemes; banks' managers, shareholders depositors, and investors; analysts, rating agencies and other gatekeepers.
And the new resolution regime affect them not only at the moment banks fail, but also in the going concern stage of banking: while prudential rules aim at reducing the *probability of default* of banks, the goal of the new resolution regime is to reduce the *social costs of default* (i.e. the negative externalities stemming from a disorderly failure of banks), by forcing banks to internalize *ex ante* these costs through planning for an orderly failure. Which in turn reduces also the probability of default, through stronger market discipline and less moral hazard. Hence, the prudential and the resolution frameworks pursue two distinct but complementary and interlinked institutional goals.

From this standpoint, the new resolution regime brings about a real *paradigm shift* in the way banking is carried out, supervised, and priced. Suffice it to consider the impact that the new regime has on the way the liabilities structure of the banks will be supervised and monitored by the investors and market gatekeepers. As well as the impact that it has on the structure of incentives for shareholders and debtholders, incumbent and potential new ones. This paradigm shift, and most importantly its underlying goals, can be achieved only if one achieves *ex ante* an adequate level of clarity and confidence – among all the stakeholders above mentioned – on the new "rules of the game". The SR aims at delivering also this essential precondition.

4. The way forward

To discuss the way forward on the institutional architecture cannot mean to second guess what the next developments will effectively be, an issue depending from the political debate. It rather aims at: (1) identifying the direction of progress which emerges from the interplay between the EBA and the BU, and (2) to draw from the experience so far carried out to identify some of the areas on which further improvements can be brought in.

4.1 The EBA and BU as mutually reinforcing drivers towards harmonization

On the first aspect, the EBA and the BU seem to be mutually reinforcing drivers which herald a likely increase in the degree of harmonization of the regulatory landscape for financial services in the coming years. On the one hand, the SR provided by the EBA fits the need to overcome the national discretions and discrepancies which might otherwise hinder the smooth functioning of the SSM and SRM. The latter, on the other hand, will likely contribute to strengthen the SR on the implementation side, through a convergent application of the rules provided by the SR.

4.2 On the missing pieces: insolvency and corporate laws…

As regards the missing pieces in the institutional and legal framework, I would first of all note that while harmonization of the areas already covered by the SR will likely strengthen, there still remain relevant aspects of banking activity which are not (yet) part of the SR, even though they have a significant impact on cross-border banking. I refer in particular to corporate and insolvency laws. Key aspects for the resilience of cross-border banking groups, such as their internal governance and the way risk can be managed in an integrated way across the borders, hinge on national legislation on corporate groups. Likewise, the national rules on insolvency proceedings and ranking of creditors in insolvency are a fundamental driver of the operational decisions of cross-border banking groups not only in distressed situations, but even in the earlier stage of banking as usual, by rational "backward induction" (the end stage of the game affects the previous ones). A first important step to address this issue has been taken by the BRRD, with the depositor preference granted to physical persons and small and medium enterprises. The crisis proved that it is necessary to go beyond the dogma of insolvency laws and corporate laws as national matters which can be addressed only with minimum (and minimal) harmonization measures, and proceed further along the path of maximum harmonization also on these areas, at least for cross-border banks.

4.2.1 …EBA's mediation

A second aspect which should be kept on the radar is the impact that the expected integration of banking systems and rules within the BU area will have on the interplay between BU and non-BU supervisory and resolution authorities. I already dwelled in the previous pages on the need to have a common regulatory ground to avoid a polarization of the Single market and keep these two components together. What I would like to emphasize here is the importance of the EBA's action to foster convergence and consistency of practices between home and host authorities with respect to European cross-border groups which operate in and out of the BU. Various tools are assigned to the EBA for this purpose. From the legal standpoint it is relevant here to take note of the lack of clarity on what is the legal scope of the mediation role assigned to the Authority pursuant to Article 19 of EBA Regulation. Mediation represents a powerful tool, not only as a means to sort out controversies in a binding way once they deflagrate, but also to incentivize the various institutional actors to converge on a cooperative solution, regardless the fact that mediation is effectively triggered. However, to achieve this goal, the legal framework on the effective reach of mediation needs to be sufficiently clear. This does not seem to be the case given the doubts expressed on whether and to what extent the decision that the ESAs may adopt in a case of "binding mediation"[20] can get to challenge and replace the use of discretionary powers by the competent authorities[21]. A satisfactory response to this question would require to define the various different hypothetical scenarios which might materialize with this respect, a discussion which would result too extensive for this occasion. I would rather limit myself to note that the L1 legislator expressly provides in specific cases for the ESAs' binding mediation between home and host, and this is *per se* a signal that in those cases enhanced relevance should be given to the general principle that the exercise of discretionary powers by one authority has to factor in the impact that those decisions have on the other Member States. If this is correct, it then follows that the use of discretionary powers cannot be considered legitimate whenever they are used in way that make them *arbitrary powers*, *i.e.* powers used without due consideration to and/or due process for the interests of the Union as a whole, as well as of the other Member States involved. A next review of the ESAs founding regulation should be the occasion to address the issue through fine-tuning of the relevant provisions (in particular the interplay between Article 19 and recital 32), in particular to clarify

[20] The expression "binding mediation" is oxymoron which captures well the two different stages of the procedure of provided by Article 19 of EBA regulation.

[21] The lack of clarity is remarked also in the Report from the Commission to the European Parliament and the Council 2014, p 7

whether the Authority's decision in the instances above can substitute the illegitimate discretionary decision.

4.2.2 …and EBA's governance

Finally, few words with respect to the governance of the EBA. The creation of the BU spurred a overhaul of the EBA's decision making rules, with the introduction of the so called "double majority rule". This change stems from the reasonable concern of a polarization of the Single market between BU and non-BU members and a systematic dominance of the first over the second in the decision making process of the EBA. However the double majority rule raises serious concerns, since it increases the risk of deadlocks imposed by minority blocks, and rests on the implicit assumption that the participation to the governing body of the EBA is driven by national interests, rather than being a technical contribution on how to best accomplish the interests of the Union as a whole[22]. From this standpoint, the rule patently clashes with the founding principle according to which the members of the BoS shall not seat in that body in their capacity as representatives of national authorities and related interests (see Article 42 of the EBA founding regulation). In other terms, the shift to double majority further emphasizes the intrinsic friction – which was in fact already present before the introduction of the double majority rule – between the principle carried out by Article 42 of the EBA founding regulation and the fact that the voting members of the BoS are exclusively heads of national supervisory authorities (not even the Chairman is a voting member). The creation of the BU should then spur a more in depth discussion on how to get to a better balance within the EBA's governance between representation of national viewpoints and more centralized, European representation. Various patterns can be drawn from other institutional experiences as inspiration for this purpose, from the governance of the IFRS Foundation and the IASB, to the recent examples of the SSM and the SRM. The time is ripe for the discussion on which arrangement is more fit to adapt the governance of the EBA to the creation of the BU without jeopardizing the functionality of the first.

[22] The issue is noted also in the Report from the Commission to the European Parliament and the Council 2014, p 9

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