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Policy Change: An Eclectic Analysis Of The Establishment Of The European Banking Union

by

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List of abbreviations

ACF	Advocacy Coalition Framework
BAC	Banking Advisory Committee
BCBS	Basel Committee Banking Supervision
BIS	Bank for International Settlements
CBRSP	Committee on Banking Regulations and Supervisory Practices
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CRD	Capital Requirement Directive
DGS	Deposit Guarantee Schemes
EBA	European Banking Authority
EBU	European Banking Union
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECSC	European Coal and Steel Community
EEC	European Economic Community
EIOPA	European Insurance and Occupational Pensions Authority
ELA	Emergency Liquidity Assistance
EMU	Economic and Monetary Union
EP	European Parliament
ESA	European Supervisory Authorities
ESC	European Securities Committee
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Agency
ESRC	European Systemic Risk Council
EU	European Union
FED	Federal Reserve System
FSAP	Financial Services Action Plan

FSB	Financial Stability Board
FSF	Financial Stability Forum
G7	Group of Seven
G10	Group of Ten
G20	Group of Twenty
G-SIB	Global Systemically Important Bank
HI	Historical Institutionalism
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
NF	Neofunctionalism
NSFR	Net Stable Funding Ratio
LCR	Liquidity Coverage Ratio
LOLR	Lender of Last Resort
OECD	Organisation for Economic Cooperation and Development
SI	Sociological Institutionalism
SMP	Single Market Programme
SSM	Single Supervisory Mechanism
SRM	Single Resolution Mechanism
RI	Rational Choice Institutionalism
TBTF	Too Big To Fail
TLAC	Total Loss-Absorbing Capacity

Abstract

The European Banking Union, currently consisting of the Single Supervisory Mechanism and the Single Resolution Mechanism, was one of the most important policy changes after the outbreak of the financial crisis in 2007 and the European sovereign debt crisis in 2009. The objective of this thesis is to analyze whether a framework consisting of three theories (Neofunctionalism, Historical Institutionalism, and Advocacy Coalition Framework) is able to explain this policy change. Its findings suggest that the role of the European institutions is rather limited in the decision-making process, that decisions taken in the past can restrict policymakers in developing new policies in the field of European banking regulation and supervision, and lastly, intermediate levels of conflict between coalitions lead to policy change, when the levels of conflict are high, then policy change becomes difficult.

Die europäische Bankenunion, zurzeit bestehend aus den einheitlichen Aufsichts- und Bankenabwicklungsmechanismen, war eine der wichtigsten Richtlinienänderungen nach dem Ausbruch der Finanzkrise 2007 und der europäischen Staatsschuldenkrise 2009. Das Ziel dieser Masterarbeit ist es zu analysieren, ob ein Gerüst bestehend aus drei verschiedenen Theorien (Neofunktionalismus, historischer Institutionalismus, Advocacy-Koalitionsansatz) es ermöglicht diese Richtlinienänderungen zu erklären. Die Ergebnisse zeigen, dass die Rolle der europäischen Institutionen im Entscheidungsprozess begrenzt ist, dass die Entscheidungen, die in der Vergangenheit getroffen wurden, die Entscheidungsträger in der Entwicklung neuer europäischer Bankenrichtlinien und ihrer Beaufsichtigung einschränken und drittens, dass intermediäre Konflikte zwischen den Koalitionen zu einer Richtlinienänderung führen. Wenn eben dieses Konfliktpotenzial hoch ist, wird die Richtlinienänderung erheblich erschwert.

"*A system will be put in place to ensure that banks can never again blackmail states and government.*" Statement of the German government in 2009 after the G20 Pittsburgh meeting (Federal Chancellor, 2009)

1. Introduction

To what extent can neofunctionalism (NF), historical institutionalism (HI), and advocacy coalition framework (ACF) explain the policy change that led to the establishment of the European Banking Union (EBU)? This thesis examines this research question by using the most relevant factors of each beforementioned theory namely: cultivated spillovers (NF), path dependency (HI), and policy learning (ACF). These factors give three possible explanations for the policy change that led to the establishment of the EBU, what the relevant actors wanted (their ideas) and how they pursued it.

The financial crisis of 2007 and the European sovereign debt crisis, which started at the end of 2009, amplified pressures on the stability of European financial institutions as there was a strong link between sovereigns and banks (including Global Systemically Important Banks (G-SIBs)), in particular, the euro area. The sovereign-bank nexus, or the mutual dependence between sovereigns and banks, was created due to a combination of national bailout measures and banks that hold considerable amounts of government debt securities. Bailing out banks led to a decline in a government's creditworthiness, which led to an instant negative impact on the value of banks' assets (Angeloni et al., 2012), consequently, both became insolvent and unable to support each other in cases of crises (Donnelly, 2018a). The crises showed that financial problems in one Member State could easily transmit to another Member State and create financial distress. Furthermore, there were no adequate European resolution mechanisms for failing banks.

Policymakers had to address two issues simultaneously: (1) rescue distressed and failed banks, via bailouts, and (2), create a new global framework of post-crisis banking regulation and supervision to prevent future banking crises. The EU's regulatory response to this external major shock was, inter alia, the establishment of the EBU (Quaglia, 2019). The EBU itself consists of the single rulebook (regulations for capital requirements for banks, deposit guarantee schemes and rules for managing failing banks and applies to all financial institutions in the European Union), the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), and when the Member States have agreed, a European Deposit Insurance Scheme (EDIS) and a common fiscal backstop for the Single Resolution Fund (SRF).

The theoretical analysis of the establishment of the EBU is the main topic of this thesis. However, the thesis aims to give a broader overview of banking regulation and supervision in general and in particular in the European Union. Because of this, in this thesis there are sections on the rationale of banking supervision, how and by whom international banking supervision and regulation policies are made, how banking regulation and supervision has developed since the creation of the European Union until the outbreak of the financial crisis.

Three main clarifications are presented here. The first caveat is that the theories will not be used for purely theory testing, parts of the theories will be used to understand the decision-making process that led to the EBU. The second caveat is that it is not the aim of this thesis to evaluate whether the EBU is successful in its tasks, this thesis aims to analyze the policy-making process that led to the EBU. The third caveat is that because of space constraints, not all Member States and their positions on the EBU are analyzed, the main actors (in particular Germany and France) are analyzed.

The rest of this thesis is organized as follows. The second section presents the used methodology. The third section gives the conceptual framework consisting of NF, HI, and ACF. The fourth section explains the rationale of banking regulation and supervision, and includes concepts like contagion, systemic risk, and moral hazard. The global standards for banking regulation and supervision policy are made at Global Standard-Setting Bodies like the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). The BCBS and FSB and their international regulatory frameworks for banks are described in section five. After the international regulatory frameworks for banks are agreed on, they have to be transposed into EU legislation. The EU legislation on banking regulation and supervision since its creation until recently is analyzed in section six. The seventh section is the theoretical analysis of the policy change that led to the creation of the European Banking Union. The final section draws conclusions.

2. Methodology

This section presents an outline of the methodological framework to answer the research question. It consists of analyzing policy change and the research method.

First, institutions and policy will be defined. Dovers and Hezri (2010, p. 221) define these as: “institutions are the means by which human societies mediate their affairs and policy is how they allocate resources and opportunities—both are thus value-laden as abstract ideas, general prescriptions, and practical mechanisms.” Wolin (2006) adds that institutions have the authority to make decisions for the community at large. Institutions (formal and informal) can be studied from different academic disciplines. The academic approach used in this thesis is European studies. As explained by Rosamond (2007), European studies, originating from a range of social scientific fields, is the analysis of institutional, policy-making and governance dimensions of the European Union and European integration. The nature of the analyzed object is the evolution of European banking regulation and supervision of banks, with an emphasis on political negotiation that led to the EBU.

Policies change in various ways, one of the core questions in the literature is to investigate why policy changes. One of the ways that policies change is via policy learning, there seems to be a consensus within the academic community that individuals and institutions have the potential for learning (Farrell, 2009; Moyson, 2017). Policy learning is defined by Zito and Schout (2009, pp. 1103-1104) as:

> “a process of exercising a judgement based on experience or some other kind of input that leads actors to select a different view of how things happen (“learning that”) and what course of action should be taken (“learning how”), what is learned depends on the theoretical lens as there are various learning theories.”

Policy learning is used "to explain changes in political agendas, the choices of policies and instruments, as well as the dynamics of organizational processes and strategies" (Rietig & Perkins, 2018, p. 487). Policy learning does not necessarily lead to change as actors can also decide, based on new knowledge not to change policy. The concept of policy learning has been described by various authors, theoretically e.g., Bennett and Howlett (1992); Hall (1993); May (1992); Moyson and Scholten (2018); Moyson et al. (2017); Zito and Schout (2009) and is used empirically e.g., Bomberg (2007); Dunlop and Radaelli (2016, 2018); Kamkhaji and Radaelli (2017).

A policy can be changed in various ways. Two conditions should apply before new ideas can affect policy change: first, policymakers promote new ideas and get support for these new ideas by building coalitions, and second, via the process of social learning, ideas need to become embedded in institutions (Hall, 1993). Hall (1993) argues that there are three types of policy change: adjustment of policy instruments (first-order change), changing policy instruments (second-order change) and change in policy goals (third-order change). The first two are considered by him as normal policymaking, while the third one leads to a change of goals, instruments, and setting of policy instruments. Jabłecka and Lepori (2009) argue that the third order is difficult to achieve and is usually related to external shocks and leads to major changes in the power of different coalitions. The above-mentioned policy change process is the process that occurs normally, but during the decision-making process on the EBU, there was the sovereign debt crisis. Lefkofridi and Schmitter (2015) and Kamkhaji and Radaelli (2017) have investigated the impact of crises on policy learning, they concluded that crises fasten policy learning and have led to an expansion of EU institutions. Within European integration theories, each theory has its own ideas about policy learning and policy change. Various scholars (Cairney, 2012; Kamkhaji & Radaelli, 2017) have used the combination of policy change and European integration theories to explain the European decision-making process.

This master thesis can be characterized as a descriptive qualitative congruence analysis. Congruence analysis is defined by Blatter and Haverland (2012, p. 144) as: "a small-N research design in which the researcher uses case studies to provide empirical evidence for the explanatory relevance or relative strength of one theoretical approach in comparison to other theoretical approaches." The small-N research consists of the EBU, and the case studies are the policy processes that led to the establishment of the SSM and the SRM. A potential downside of using case studies is that they can be more limited for causal inference and generalization (Gerring, 2004). The theoretical approaches are NF, HI, and the ACF. This thesis follows a deductive approach, in which the theories (NF, HI, and the ACF) and the hypotheses are presented in the theoretical framework. After that, empirical observations regarding European banking regulation and supervision are analyzed and followed by testing of the hypotheses in section 8, theoretical explanations of the establishment of the European Banking Union. It concludes with an explanation of the causal relationship between independent variables, the predictions of the theories (NF, HI, and the ACF) and the dependent variable, the establishment of the SSM and the SRM.

The data that is used for the analysis consists of policy documents of the Global Standard-Setting Bodies like the BCBS and FSB, and, of the European institutions like the European Central Bank, the European Council, the Economic and Financial Affairs Council of the EU. Furthermore, articles from academic journals and newspapers will be used for the analysis. The research for this thesis was carried out until August 2019. The research aims to gain knowledge and understanding of the establishment of the European Banking Union. To the knowledge of the author, no research has been carried out yet using a framework consisting of three theories (NF, HI, and the ACF) to explain the decision that led to the European Banking Union. The thesis hopes to contribute to the existing scientific literature on European banking regulation and supervision. In the following section, the theoretical framework will be presented.

3. Theoretical framework

This objective of this section is to give an overview of possible theoretical explanations on the mechanisms of decision-making, policy change and learning process behind the establishment of the European Banking Union (EBU). The aforementioned can be studied from various theories. As in European studies, it is becoming increasingly difficult for one theory to analyze a decision-making process in full, the decision was made to use an eclectic approach in which the contributions of each theory in explaining the establishment of the EBU is used.

The theoretical framework exists of three different schools of thought neofunctionalism (NF), historical institutionalism (HI), and Advocacy Coalition Framework (ACF). Each theory has been used for the analysis of the European financial integration since the outbreak of the financial crisis; NF (e.g., Hooghe & Marks, 2019; Niemann & Ioannou, 2015; Schimmelfennig, 2018), HI (e.g., Newman & Posner, 2016; Verdun, 2015) and ACF (e.g., Donnelly, 2018a; Quaglia, 2010). This shows that the selected theories can be used to analyze European financial integration. Other reasons for selecting these theories are that they seem to be complementary, each theory has its ideas about what and which policy actor drive policy change. Combining the three theories, one might give a better understanding of the process. The last reason is that although the traditional European integration theories are liberal intergovernmentalism and neofunctionalism, Pollack (2009, p. 141) argues that the new institutionalisms, which includes historical institutionalism, have become “the dominant approaches to the study of European integration”, Aspinwall and Schneider (2000) use similar words. Of each theory, the foundations are described and explained which concepts of the theory will be used for the analysis. Lastly, hypotheses are presented.

3.1 Neofunctionalism

Key thinkers in Neofunctionalism (NF) are Ernst B. Haas, Leon N. Lindberg, and Philippe C. Schmitter. NF was presented for the first time by Haas (1958) in his book *The Uniting of Europe: Political, Social and Economic Forces* and five years later, by Lindberg (1963) presented his book *The Political Dynamics of European Economic Integration*. They, as explained by Niemann and Schmitter (2009), presented in their publications a response to the establishment of the European Coal and Steel Community (ECSC) and the European Economic Community (EEC), Haas argued that cooperation on ECSC led, via spillovers, to the EEC. NF is not a static theory, it has been criticized and amended by various scholars, for example, Schmitter (1970).

NF is based on five assumptions: (1) actors (emphasis on non-state actors, like organizations and institutions) are rational and self-interested and are capable to change their preferences as they learn from previous experiences, (2) creators of institutions cannot control fully the institutions they created, employees of these institutions become supporters of further integration, (3) as most actors are incapable to engage in long-term purposive behavior, they prefer incremental decision-making in which the consequences of this decision-making is often insufficient, (4) decision-making in itself is not a zero-sum game, (5) functional interdependencies between the economies of states led to further integration (Niemann & Schmitter, 2009, pp. 48-49). Integration in NF is considered to be a process, integration is in the words of Haas (as cited in Niemann & Schmitter, 2009, p. 47):

> "the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the pre-existing national states. The end result of a process of political integration is a new political community, superimposed over the pre-existing ones."

Hooghe and Marks (2019) add that crises may hinder further integration for a short time, but on the longer term, policy spillover and supranational activism, lead to more integration.

Policy change and neofunctionalism

Neofunctionalists believe that policy change is pushed by endogenous factors, in other words, conflicts among Member States are produced by the integration process itself because of unexpected outcomes of previously taken collective decisions, these conflicts can best be solved at the European level (Schmitter & Lefkofridi, 2016). Yet as noticed by Rosamond (2000) Member States are not completely independent in finding solutions to common problems, European Union institutions can constrain and shape the preferences of Member States. Within policy change, two concepts are relevant: path dependency and spillovers. Path dependency means that policymakers are restricted in policymaking because of decisions taken in the past, and that because of sunk costs it is almost impossible to change the path (Hooghe & Marks, 2019). Spillovers are defined by Haas (as cited in Niemann & Schmitter, 2009, p. 49) as an "expansive logic of sector integration whereby the integration of one sector leads to "technical" pressures pushing states to integrate other sectors". As sectors are interconnected, the integration of one sector leads almost automatically to the integration of another sector as this integration supposedly solves problems and increases efficiency.

There are 3 different kinds of spillovers: functional spillovers, political spillovers, and cultivated spillovers. Functional spillovers, Bergmann and Niemann (2013) explain that individual policy sectors and issue areas tend to be interdependent, this interdependence is the source of further integrative pressures to arise and penetrates into other policy areas. They explain further that through functional pressures, policymakers are required to take integrative steps to achieve their original policy objectives. Political spillovers occur as national economic and political elites learn that their problems cannot be solved at the national level, these elites increasingly realize that their problems can only be addressed at the supranational/ European level (European institutions) and consequently they become supporters of further integration. Cultivated spillover is explained by Tranholm-Mikkelsen (1991), employees of supranational institutions, like the European Commission, the European Parliament or the European Central Bank, play an important role in fostering integration as they profit themselves from the progression of further integration. Niemann and Schmitter (2009) describe how supranational institutions achieve further integration, by acting as a policy entrepreneur[1], for example, the European Commission can shape the agenda and have the ability to build consensus while upgrading common interests. Thus, employees of European Union institutions are considered to be very important actors in the integration process. The concept of cultivated spillover was selected for the first hypothesis. The following hypothesis was made:

- European Union institutions had a clear preference for further integration and were the main drivers for the establishment of the SSM and SRM.

Operationalization

Neofunctionalists predict that employees of EU institutions, in this case of the European Commission and the ECB, became agents of integration and actively pushed for the

[1] A policy entrepreneur is an actor who has knowledge, power, determination and good fortune to exploit windows of opportunity and solutions to other actors (Cairney, 2012).

establishment of the EBU. In order to test the hypothesis, the policy preferences regarding the EBU of the European Commission and the ECB on the one hand, and on the other hand those of the German and French government will be analyzed and compared. Also, the outcome of the negotiations on the EBU will be analyzed. Sources for the analysis are academic articles, publications of European institutions and think tanks, and news articles.

The conditions to confirm the hypothesis are the following: (1) both EU institutions needed to actively push for more integration during the negotiations on the EBU and (2) without this push of the EU institutions, the establishment of the EBU can not be explained. If these conditions are not met, then the hypothesis will be rejected. If both the European Commission and the ECB and the French and German government were in favor of establishing the EBU, then the hypothesis will be rejected as then it is not possible to argue that the EU institutions were the main drivers.

3.2 Historical institutionalism

Historical institutionalism (HI) originates as described by Hall and Taylor (1996) in response to group theories of politics and structural-functionalism which were prominent in the 1960s and 1970s and has, according to Ikenberry (1994, pp. 7-11) the following assumptions: (1) "institutions shape and constrain the goals and capacities of individuals and groups who operate within them", (2) "policy change is episodic and "sticky" rather than continuous and incremental", (3) causal complexity, and (4) "political outcomes are not simply the result of instrumental behavior by groups and individuals nor are they explicable in terms of functional or efficient social processes", HI is more focused: "on the pre-existing structures of social relations and their often unintended consequences as it is the past that determines what is desirable at specific moments." Pollack (2009) adds that HI rejects functionalist explanations for establishing institutions; they believe that institutional choices taken in the past can restrict the actors later in time.

Historical institutionalists have a wider definition of institutions than the usual definition of an institution, yet within HI it seems to be an essentially contested concept. For example Hall and Taylor (1996, p. 938) define institutions as:

> "the formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy. They can range from the rules of a constitutional order or the standard operating procedures of a bureaucracy to the conventions governing trade union behaviour or bank-firm relations. In general, historical institutionalists associate institutions with organizations and the rules or conventions promulgated by formal organization".

Another relevant definition is given by March and Olsen (1989, p. 160), they define institutions as:

> "collections of interrelated rules and routines that define appropriate actions in terms of relations between roles and situations. The process involves determining what the situation is, what role is being fulfilled, and what the obligation of that role in that situation is".

Thelen and Steinmo (1992) explain the relationship between political actors and institutions, on the one hand, political actors are restrained by institutions, but on the other hand, these actors also create and change institutions as they shape the preferences, interests, and goals of actors. Vijge (2013) elaborates further on the behavior of actors by using the so-called "calculus approach" (actors behave instrumentally and strategically to maximize the acquirement of their interests) and "cultural approach" (behavior of actors is not completely strategic and influenced by the worldviews of actors). Actors might be strategic, but as argued by Thelen and Steinmo (1992), a historically based analysis is needed to explain what the actors are trying to maximize and why they have a certain preference for goals over other goals. Historical institutionalists believe that "moral and cognitive templates for interpretation and action" institutions can influence the perception of what actors think are their goals and interests (Vijge, 2013, p. 157). This also influences preference formation, Jackson (2010) argues that the preferences of actors are not fixed, and ideas play a role in how groups think about their interests.

Historical institutionalists also believe that institutions influence the interactions between actors, as actors meet at the fora organized by institutions where debates take place, with the help of the “cultural approach” Vijge (2013) explains that not all actors are treated equally by the institutions, some actors get more access to information about the decision-making process. As having information gives an actor power, Vijge (2013) believes that the behavior of the institution leads to power inequalities and this has an influence on the trajectories of institutional developments.

Within HI there are two important concepts: path dependency and policy learning. Path dependence is defined by Bridges (2000, p. 110) as “events, decisions, and arrangements put in place at one moment constrain the choices available later”. In other words, the outcome of a political process is decided as well by the actions taken in the past, as explained by Peters (2011) that governments are tied in their policymaking to institutionalized commitments made by previous governments. Historical institutionalists use path dependency, according to Vijge (2013) also for explaining the persistence of institutional structures to change or not to change, incremental change and the inefficiencies that might arise due to institutional change. After all, she concludes that historical institutionalists believe that not all institutional change leads to efficient institutions and at the same time path dependency can explain why an inefficient institution does not change into an efficient organization. Hansen (2002, p. 271) adds to this that: “path dependence is established only when it can be shown that policy change was considered and rejected for reasons that cannot be explained without reference to the structure of costs and incentives created by the original policy choice.”

Policy learning is about: “how policy actors make a deliberate attempt to adjust the goals or techniques of policy in response to past experience or new information” (Jabłecka & Lepori, 2009, p. 699). In the literature, there are three different orders of policy learning (Hall, 1993; Jabłecka & Lepori, 2009). The first order occurs when solely changes in the settings of policy instruments occurred, the overall goals and instruments of policy did not change. The second-order takes place when instruments used to achieve policy goals are modified, the goals have not changed. And the third order happens when there is a change in the instrument settings, the instrument themselves, and the goals. Jabłecka and Lepori (2009) argue that the third order is difficult to achieve and is usually related to external shocks and leads to major changes in the power of different coalitions (comparable with ACF).

Policy change and historical institutionalism

Policy change is characterized, according to Peters et al. (2005), by extended times of considerable stability and is interrupted by what they call formative moments. Peters et al. (2005, p. 1276) explain further that the results of these formative moments are revolutions; new objectives, new political and administrative coalitions are formed to support new policies. However, like in in NF, also historical institutionalists believe that European Union institutions can restrict policymakers in policymaking. So-called critical junctures create a window of opportunity for institutional change. Verdun (2015, p. 222) defines critical junctures as: "a period in which there is a transition and there are various alternative options from which to choose." Another definition of critical junctures is given by Acemoglu and Robinson (2012, p. 106), they define critical juncture as: "a major event or confluence of factors disrupts the existing balance of political and economic balance in a nation," they add to this definition that normally critical junctures do not affect one state, but the majority of states.

Within HI there are six kinds of policy change. Mahoney and Thelen (2010) argue that there seem to be four ideal types of policy change; displacement, layering, drift, and conversion. They consider that rules play a role in institutional change and define these 4 concepts; displacement as: "the removal of existing rules and the introduction of new ones", layering as: "the introduction of new rules on top of or alongside existing ones", drift as: "the changed impact of existing rules due to shifts in the environment", and conversion as: "the changed enactment of existing rules due to their strategic deployment" (2010, pp. 15-16). Streeck and Thelen (2005) add to the list the ideal type of "exhaustion" for institutions in decline, they define this concept as: "gradual breakdown (withering away) of institutions over time" (2005, p. 31) while Verdun (2015) adds the ideal type of "copying" for institutions that are emerging, the institutional design used for one institution is used for another one. Regarding the EBU, the SRM and SSM, could be argued to be layering as new rules were added to existing rules for banking regulation and supervision and copying as the legal foundation is based on Article 114 (1) TFEU. More about the institutional design of the EBU follows in section 7.

Streeck and Thelen (2005) criticize the foundations of HI, in particular, they argue that HI-scholars understate the extent of change, these scholars are too focused on dramatic disruptions when it comes to policy change. Streeck and Thelen (2005) consider that policy change occurs incrementally and is driven by endogenous factors, and not by exogenous factors. They prefer to use the concepts "processes of change" for incremental or abrupt institutional change, and "results of change" for continuity or discontinuity. They also have a different definition of institutions; they are two different institutions informal institutions (normative regulation of social action, as an example they mention shaking hands, not shaking hands potentially has consequences) and formal institutions (actors are expected to conform to the norm, included in this definition of Streeck and Thelen (2005, p. 12) are policies:

> "to the extent that they constitute rules for actors other than for the policymakers themselves- rules that can and need to be implemented and that are legitimate in that way that they will if necessary be enforced by agents acting on behalf of the society as a whole."

Another way of seeing institutions is in the words of Streeck and Thelen (2005) to see "institutions as regimes", in which rule makers and rule takers interact with each other to enact the rules. However, Streeck and Thelen (2005) argue at the same time that this does not mean that the rules are perfectly enacted, as there is a gap between the ideal and real pattern of a rule. Consequently as stated by Streeck and Thelen (2005) full control over an institution is impossible, as there are no standardized outcomes and results are often unpredictable. Like in HI they use model of change, even if this change is gradual, and they use the ideal types of policy change, they do add the concept exhaustion, which they Streeck and Thelen (2005, p. 31) define as: "gradual breakdown (withering away) of institutions over time" and explain that gradual and incremental shifts led to transformative change of an institution.

Pierson (2000) explains why HI should be used, he claims that the sequencing in political processes matters, most social scientists take a "snapshot" of an event and do not look at the bigger picture, if they would add time and path dependence to their analysis, they would get a better understanding of complex social dynamics. The concept of path dependency was selected for the hypothesis. The following hypothesis was made:

- Policymakers chose rationally as if they could design the European Banking Union from scratch

Operationalization

Historical institutionalists predict that policymakers are restricted in making the EBU policy because of decisions taken in the past. In order to test this hypothesis, previous EU banking supervision regulation, the policy preferences of the policymakers regarding the EBU, and the outcome of the regulations will be analyzed. Furthermore, relevant European Union law, and jurisdiction of the Court of Justice of the European Union regarding establishing European Union institutions will be analyzed to check where there were legal limitations in designing the EBU. If the past did not hinder policymakers in designing the EBU, then the hypothesis is confirmed. If EU law directed policymakers in a certain direction that couldn't be changed, then the hypothesis is rejected.

3.3 Advocacy coalition framework

The Advocacy Coalition Framework (ACF) is founded by Sabatier and Jenkins-Smith (Sabatier, 1988; Sabatier & Jenkins-Smith, 1993) and is based on the idea of Heclo (1974) that in policy change next to changing political, social and economic causal factors, the interaction of specialists within a specific policy area is relevant for analyzing advocacy coalitions, policy learning and policy change. Specialists are needed because Sabatier and Weible (2007) describe that ACF assumes that policymaking is currently so complicated that participants need knowledge if they want to be influential in policymaking.

An ACF is of composed of 1-4 advocacy coalitions. An advocacy coalition was originally defined as: "consisting of policy actors who share policy core beliefs and coordinate their behavior in nontrivial ways over extended periods of time toward some sort of shared outcome in a policy subsystem" (Weible et al., 2019, p. 7). They explain further that an advocacy coalition has 5 attributes: (1) policy actors, (2) belief system, (3) coordination of political activities, (4) resources and (5) stability. Policy actors are (1) individuals or groups of individuals and (2) can or not be part of government and (3) are influential in the decision-making process, and (4) regularly try to exert that influence. Other characteristics of actors are that they are boundedly rational with complex normative and empirical believe systems (Luxon, 2019). The driving force of individual actors in ACF is not based on material interests, but on beliefs (Cairney, 2013). The second attribute, belief system, is characterized according to Sabatier (1998, p. 103) as a “hierarchical, tripartite structure”, each belief system exists of 3 layers, the first layer is called the “deep core” and consists of basic ontological and normative beliefs, in other words the actor’s “underlying personal philosophy” and examples are being left or right on the political spectrum (Sabatier & Jenkins-Smith, 1993, p. 30). The second layer is the “policy core” existing of the perceptions of a coalition towards the cause of a policy problem and the solution to solve the problem including the use of the basic policy instruments, the third layer is called the “secondary aspects”, the belief system of a coalition compromises a large set of narrower beliefs about policy preferences, for example regarding desirable regulations and the design of specific institutions. The third attribute, coordination of political activities is the idea that all policy actors engage in political activities like strategic use of information, lobbying, and participating in debates (Weible et al., 2019). The fourth attribute resources is about the accessible capacity of policy actors within a coalition to influence policy processes, by using scientific and technical information, access to officials and leadership (Weible et al., 2019). The fifth and last attribute is stability, all subsystems, policy actors and coalitions experience stability and change over time (Weible et al., 2019).

Policy change and advocacy coalition framework

The majority of policymaking occurs in policy subsystems, policy change happens in policy subsystems when the values of the members of one of the advocacy coalitions change (Bennett & Howlett, 1992; Weible & Sabatier, 2007). The values can be changed by exogenous factors or by policy learning. Exogenous factors are divided by Sabatier and Weible (2007) into stable exogenous factors (attributes of the problem, distribution of resources, fundamental sociocultural values and structure and constitutional structure, these factors hardly change within 10 years and are therefore called stable) and dynamic exogenous factors (socioeconomic conditions, changing of governing coalition, and policy decisions made in other subsystems). Compared to the dynamic exogenous factors, the stable exogenous factors are hardly ever used in the strategy game of the involved actors, yet they might be used in the processes in the subsystem. Policy learning is defined by Sabatier and Jenkins-Smith (1999, p. 123) as:

“relatively enduring alterations of thought or behavioural intentions that result from experience and/or new information and that are concerned with the attainment or revision of policy-objectives”. Sabatier and Jenkins-Smith (1999) continue and explain that policy learning is instrumental; coalition members seek ways to understand the world better to further their policy objectives. They state that this gained knowledge leads to increased knowledge of problem parameters, however, it will not change their deep core or policy core briefs but can lead to policy change. Luxon (2019) adds that advocacy-coalition participants must correctly interpret and skillfully respond to opportunities if they want to enable or prevent policy change. Strategic choice is instrumentally rational, Sabatier and Jenkins-Smith (1999, p. 142) argue that advocacy-coalition participants ‘seek to utilize their resources efficiently.’

It is important to add that the degree of conflict is also relevant for policy learning, the lower the level of conflict within a subsystem, the higher the potential for cross-coalition learning, the best however for learning across coalitions is an intermediate level of conflicts as high or low levels of conflict inhibit policy learning (Olofsson & Weible, 2018; Weible & Jenkins-Smith, 2016). Brooks (2018, p. 13) explains this further: “The greater the degree of conflict between coalitions, translating to the “depth” of the disputed beliefs, the more information is produced and publicized, but the less receptive opposing actors become.” Sabatier and Jenkins-Smith (1999) explain further that within policy learning two other factors that can lead to policy change, namely changes in the real world (external system events) or personnel changes (a new member of a coalition might have different ideas). The concept of policy learning was selected for the hypothesis and the two coalitions selected, consist of like-minded Member States which share the same beliefs and ideas on policy identification and policy solutions. By using the input of the hypotheses of Sabatier and Jenkins-Smith (1999), the following hypothesis was made:

- There were only intermediate conflicts between the two coalitions and because of this the SSM and SRM could be established

Operationalization

During the negotiations on the EBU, there were conflicts between the Member States. In order to test this hypothesis the conflicts will be analyzed for high, intermediate and low level conflicts, because of the hypothesis there is a focus on the intermediate level conflicts. Sabatier (1998, p. 106) defined such a conflict as: 'the conflict be between secondary aspects of one belief system and core elements of the other or, alternatively, between important secondary aspects of the two belief systems.' The condition to confirm the hypothesis is the level of conflict. If there was a high- or low-level conflict, then the hypothesis is rejected. In other words, only when there were intermediate levels of conflicts then the hypothesis is confirmed. Sources for the analysis are academic articles, publications of think tanks, and news articles.

Figure 1 below shows a summary of the analytical framework and the hypotheses that will be tested in the theoretical explanations of the establishment of the EBU (chapter 8). Each theory explains a different part of the decision-making process: NF at the role of European institutions like the European Commission and European Central Bank, HI looks whether decisionmakers were restricted based on decisions made in the past, while the last theory ACF examines the conflicts between 2 coalitions.

Theories	**Hypotheses**	**Empirical testing**	**Expectations of theory**	**Key concept of theory that is tested**	**Policy change is triggered by:**	**Relevant actors**
NF	EU institutions had a clear preference for further integration and were the main driver of EBU	What was the position of EU institutions regarding the establishment of the EBU?	Employees of EU institutions became agents of integration and actively pushed for the establishment of the EBU	Cultivated spillover	Endogenous factors	EU institutions
HI	European Union Member States chose rationally as if they could design the EBU from scratch	Were policymakers legally or politically restricted when designing the EBU?	Policymakers are restricted in making new policy because of decisions taken in the past	Path dependency	Endogenous factors	EU Member States
ACF	There were only intermediate conflicts between the two involved coalitions and because of this the SSM and SRM could be established	At what level (low, intermediate or high) were the conflicts regarding the EBU?	Intermediate levels of conflict is a prerequisite for learning, high or low levels of conflict hinder learning	Policy learning	Exogenous factors	EU Member States

Figure 1. Analytical framework and hypotheses

3.4 Summary and conclusion

Above the various theories were presented and explained how they see policy change and its drivers. In this research design, NF focuses on the role of European institutions in this process, while ACF explains the preferences/ ideas of Member States and how these preferences/ ideas compete with each other. HI gives a theoretical lens to explain why policymakers selected a certain path, as historical institutionalists believe that the past matters in decision-making and constraints policymakers in future decision-making. Combined these 3 lenses should give a fuller idea about the policy change and its drivers that led to the establishment of the EBU. By testing 3 hypotheses the theoretic assumptions on the EBU will be tested in section 8. The next section will elaborate on the reasons why banks need to be regulated and supervised.

4. Literature review: the rationale behind banking regulation and supervision

The purpose of this chapter is to describe the rationale behind banking regulation and supervision policy and explains further why banks are vulnerable to crises, and includes concepts as moral hazard, contagion, and systemic risk. Financial crises, as the global financial crisis of 2007-2008, may have destructive effects on the global economy. Scholars differentiate financial crises, as explained by Jing et al. (2015), there seem to be three different kinds of financial crises: currency crises, debt crises, and banking crises. The latter seems to have a more serious impact on the economy, according to them, and that is why they claim that it is important to prevent banking crises and reduce the costs of banking crises when they occur. Laeven and Valencia (2008, p. 5) identify a banking crisis as:

> "a country's corporate and financial sectors experience a large number of defaults and financial institutions and corporations face great difficulties repaying contracts on time. As a result, non-performing loans increase sharply and all or most of the aggregate banking system capital is exhausted. This situation may be accompanied by depressed asset prices (such as equity and real estate prices) on the heels of run-ups before the crisis, sharp increases in real interest rates, and a slowdown or reversal in capital flows. In some cases, the crisis is triggered by depositor runs on banks, though in most cases

> it is a general realization that systemically important financial institutions are in distress.”

A banking crisis occurs more often than one might expect, Laeven and Valencia (2013) have calculated that in the period 1970-2011 there were 147 systemic banking crises. Laeven and Valencia (2013, p. 4) argue that a banking crisis becomes systemic when two conditions are met: “(1) significant signs of financial distress in the banking system (as indicated by significant bank runs, losses in the banking system, and/or bank liquidations), and (2) significant banking policy intervention measures in response to significant losses in the banking system.” Policymakers try to prevent these kinds of systemic banking crises by regulation and supervision of financial institutions and intervene, as explained by Rochet (2007), via two different ways in the banking sector, (1) via financial safety nets (existing of deposit insurance systems and emergency liquidity assistance) and (2) prudential regulation systems (existing of capital adequacy and liquidity requirements, exit rules and policies for closing a commercial bank). Countries also regulate the banking sector by setting up organizations like the Basel Committee of Banking Supervision (BCBS) and have harmonized regulations via the Basel Accords I, II, 2.5 and III.

4.1 The vulnerability of banks to crises

To understand what makes banks so vulnerable to crises, the objective of this section is to explain this, and which international institutions design the regulation for banks. In academic literature, there seems to be a consensus by, for example, Benston and Kaufman (1996) and international organizations like the OECD (2009) that banks needed to be regulated and supervised because of bank runs, moral hazard and excessive risk, contagion and deposit guarantee insurance. According to Boot (2006), due to further integration of financial markets and increasing cross-border operations of banks, the need for sound regulation and supervision of banks becomes only more important. The concepts mentioned before will be explained below.

4.1.1 Bank runs

As explained by Diamond and Dybvig (1983) bank runs are a common feature of crises and have played an important role in monetary history, they explain that a bank run occurs when depositors run to their bank because they expect that their bank will fall because of possible insolvency, consequently the sudden withdrawals have a destructive effect on the stability of the bank as it can force the bank to liquidate its assets at a loss and eventually to fail. Freixas et al. (2000) add that information asymmetry plays a role in this, which means that not all depositors have access to the same information.

To prevent bank runs the lender of last resort (LOLR) function is used. LOLR is defined by Freixas et al. (1999, p. 152) as: "the discretionary provision of liquidity to a financial institution (or the market as a whole) by the central bank in reaction to an adverse shock which causes an abnormal increase in demand for liquidity which cannot be met from an alternative source" and was designed after the bankruptcy of the English Overend & Guerney due to losses on its small loans in 1866. The bankruptcy of Overend & Guerney also led to the bankruptcy of banks that depended on Overend & Guerney. The English economist Bagehot came up with the idea that the Central Bank should coordinate the role of LOLR and provide liquidity. As explained by Rochet (2007, p. 25), Bagehot, based on the ideas of Henry Thornton, proposed three requirements for providing liquidity:

> "(1), the central bank should only lend money against good collateral, so that only solvent banks might borrow, and that the central bank would be protected against losses, (2), lend at a "very high" interest rate so that only "illiquid" banks are tempted to borrow and that ordinary liquidity provision would be performed by the market, not by the central bank: and (3), announce in advance its readiness to lend without limits to establish its credibility to stop the contagion process in the bud."

The LOLR doctrine was introduced in other European countries, while in the United States commercial banks introduced their own system before the establishment of the Federal Reserve System in 1913. The LOLR doctrine led to a more stable financial system however scholars also agree that LOLR increases moral hazard. During the financial crisis, Central Banks in both the Euro area as the United States provided liquidity, to be more specific emergency liquidity assistance (ELA) to banks. Domanski et al. (2014) explain that the providing of ELA was something that many Central Banks had not done for a long time, the level of ELA was in the period mid-2007 till the beginning of 2009 $4 trillion.[2]

4.1.2 Moral hazard and excessive risk

In the section above the concept of moral hazard is used. Moral hazard is explained by Krugman (2009, p. 63) as: "to any situation in which one person makes the decision about how much risk to take, while someone else bears the cost if things go badly." Bankers believed for a long time that their bank would be bailed out by the government when the bank failed, this is known as moral hazard. Kostovetsky (2015) notices with respect to bailing out a bank by a government, that the decision of a government to bail out a bank can be influenced by political connections and considerations, like any governmental decision, and he shows as well that there is a positive relationship between political connections and risk-taking behavior (measured in stock volatility or leverage ratios), yet banks that had close relationships with politicians had higher stock returns and were less likely to go bankrupt or insolvent during the financial crisis of 2008-2009.

One of the objectives of the FSB (2010b) during the financial crisis was to reduce the moral hazard and excessive risk that is associated with G-SIBs, the instrument to achieve this objective was that global G-SIBs should have a higher loss-absorbency capacity than as agreed in Basel III and G-SIBs should also be under stricter supervision and resolution planning to reduce the probability and impact of their failure. In the section on the European Union, it will be described how the European Union implemented the framework of the FSB.

4.1.3 Contagion

As explained by Kaufman (1994, p. 123) contagion is: "a term used to describe the spillover of the effects of shocks from one or more firms to others," and he argues that contagion occurs to be more likely and to be more serious in the banking sector than in any other sector of the

[2] ELA was not only provided to banks, but also for example to American International Group, an American insurance company.

economy. Often when scholars discuss contagion, they use the concept “domino effect”, as the failure of bank A might lead to the failure of bank B, and eventually, it may lead to the failure of companies outside the banking sector. Policymakers use the concept of contagion as a reason to regulate and supervise the banking sector, for example, the former president of the Federal Reserve System (FED), Bernanke (2008), stated that the takeover of Bear Sterns by JPMorgan Chase in 2008, prevented contagion. During the financial crisis, all large banks that were in crisis, but Lehman Brothers were rescued, as policymakers were afraid that the failure of one big bank would lead to the failure of other big banks.

4.1.4 Deposit guarantee schemes

To protect the financial interests of depositors when a bank fails, policymakers have designed deposit guarantee schemes (DGS). Via DGS the deposits are protected till a certain amount. DGSs should prevent bank runs. According to Demirgüç-Kunt and Detragiache (2002) DGS were introduced in the United States in 1934 to prevent bank runs that contributed to the Great Depression (1929-1939), and after the Second World War other countries followed. However, there are downsides to the DGS as well, depositors have no incentive to watch what their bank is doing with their money, in other words, as argued by scholars that DGS can lead that bankers take excessive risks (Demirgüç-Kunt & Detragiache, 2002; Rochet, 2007). Rochet (2007) also shows that in countries where there are DGS there are also more often banking crises. During the financial crisis of 2008-2009, the maximum amount of money on someone’s personal bank account that was protected was set to 100.00 euro in every Member State of the European Union, the harmonization of EU deposit guarantee schemes will be further explained in the section on the European Union policy.

4.2 Summary and conclusion

This section aimed to show that banking regulation and supervision policies have to take into consideration the vulnerability of banks to crises, bank runs, moral hazard, contagion, and deposit guarantee schemes. As the standards for banking regulation and supervision are decided by Global Standard-Setting Bodies, the next section will present these organizations and their standards.

5. Global prudential policies of regulation and supervision

The BCBS (2012b) stated that the objective of banking supervision is the promotion of the safety and soundness of banks and the banking system. The banking regulation and supervision can be separated into a microprudential and macroprudential approach, the first focuses on the safety and soundness of individual banks, the second focuses more on the "health" of the banking system as a whole. First, a description will be given about the macroprudential approach in relationship with the financial crisis of 2008-2009 and after that, the Global Standard-Setting Bodies (the Basel Committee on Banking Supervision and the Financial Stability Board) and their policies will be outlined.

5.1 Macroprudential policy of regulation and supervision

The macroprudential approach is not a new concept, it was already used in the 1970s by BCBS when the participating authorities discussed policy options regarding the implications for the macroeconomic and financial stability of lending funds to developing countries (Clement, 2010). Later on, Clement (2010) explains that the macroprudential approach was used for the banking system, for example in a report published in 1986 about how financial innovation could raise risks for the financial system as a whole. As explained by Borio (2011) it was then acknowledged that financial stability is more than just the financial strength of individual banks.

Crockett (2000), the former General Manager of the BIS and Chairman of the FSF, mentions that the objective of macroprudential policy is to:

> "limiting the costs to the economy from financial distress, including those that arise from any moral hazard induced by the policies pursued. One could think of this objective as limiting the likelihood of the failure, and corresponding costs, of significant portions of the financial system. This is often loosely referred to as limiting "systemic risk "."

Crockett believed that strengthening of the macroprudential supervision by supervisors and other authorities was needed to achieve financial stability. As described by Hanson et al. (2011) before the financial crisis of 2008-2009 the supervision of regulation was deficient as it was focused on a microprudential approach. During the financial crisis this changed, policymakers saw macroprudential supervision as a tool to mitigate systemic risk. In particular, the policymakers were focused on the identifying and measuring of systemic risk as according to the FSB et al. (2011) authorities had difficulties to identify these risks. One of the risks, as written down by the FSB et al. (2011), is procyclicality. Procyclicality refers according to the FSB (2009, p. 1) to: “the mutually reinforcing (“*positive feedback”)* mechanisms through which the financial system can *amplify* business fluctuations and possibly cause or exacerbate financial instability.” In other words, the problem is that during good times banks don’t build up sufficient buffers for bad times, and as a consequence these banks have, as explained by Athanasoglou and Daniilidis (2011), during bad times difficulties to have sufficient buffers and change into mechanisms that exacerbate cyclical fluctuations; they have a negative impact on credit growth and financial stability. A clear example of the consequences of procyclicality is the financial crisis, the problems of Lehman Brothers led eventually to a global financial crisis.

As explained above macroprudential supervision is focused on the supervision of the individual bank. As explained by Rochet (2007) the rationale behind macroprudential policy is twofold, to protect the interests of depositors as they cannot control the banks themselves and to reduce the frequency and costs of individual bank failures. To check the “health” of the individual bank the supervisor controls the buffers (solvency) and liquidity of the individual bank. Most policymakers aim to combine micro- and macroprudential policy of regulation and supervision of banks, as both the “health” of the individual bank but also the collective “health” of banks, is relevant.

5.2 Global Standard-Setting Bodies

So-called standard-setting bodies decide the standards on banking regulation and supervision. Relevant examples of stand-setting bodies in this context are the BCBS and FSB. Below the background and relevant policies of these bodies will be described.

5.2.1 Basel Committee on Banking Supervision

The Bank for International Settlements (BIS) was established in 1930 in Basel, as a mediator for the handling of the administration of the reparations that Germany had to pay, as part of the Treaty of Versailles (1919). The Great Depression of the 1930s led to the Lausanne Agreement of July 1932 in which Germany no longer had to pay reparations and thus the main function of the BIS disappeared. The BIS got a new role; it provided a forum for regular meetings for representatives of Central Banks to discuss technical cooperation. The mission of the BIS (2015) is: “to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.” The BIS (2015) has 60 member central banks, which represents according to the BIS about 95% of world GDP. Via the so-called Basel Process, the BIS hosts 6 international committees, among the BCBS, which are engaged in standard-setting and the pursuit of financial stability.

The BCBS itself was established in 1974 by the G10.[3] There were according to the BCBS (2014b) four reasons to establish this institution: (1) increased international financial markets and of cross-border money flows, (2) the failure of the Bretton Woods System in 1973, which had as a consequence that many banks had large foreign currency losses, (3) the liquidation of German Bankhaus Herstatt in 1974 had negative consequences not only for other German banks, but also for banks outside Germany and, (4) the failure of Franklin National Bank of New York, also in 1974, which also had negative consequences for banks outside the United States. Summarized, states needed to cooperate to prevent banking crises and systemic risk, these problems could no longer be exclusively solved at the national level. In 1989 the Committee on Banking Regulations and Supervisory Practices was changed into Basel Committee on Banking Supervision (BCBS), the BCBS meets at the BIS. The objective of the BCBS (2013b, p. 1) is: “to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.” Before these tasks were exclusively arranged at the national level, as explained by Kerwer (2005) but globalization reduced the effect, as banks can relocate their headquarters to a country where the regulation and supervision on banks are less strict and create a race to the bottom in regulatory standards. Ho (2002) adds that as a consequence of the liberalization of capital flows and the rise of multinational banking, it is increasingly becoming more difficult for national regulators to

[3] The member states of the G10 were Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. The G10 existed of 10 IMF member states and Switzerland.

protect against systemic risk, at the same time national regulators want to create a level playing field with uniform capital regulation.

The BCBS has no founding treaty and as mentioned in Article 5 of the Charter (2013b) the agreements of BCBS are in itself not legally binding, via peer pressure and moral suasion, member states, currently 27 and the European Union,[4] are pushed to implement the agreements into national legislation. Every member state is, as explained in Article 4, represented by its central banker and the banking supervisory authority. The BCBS exists of a Committee, various (working) groups, a chairman (since March 2019 Pablo Hernández de Cos, Governor of the Bank of Spain) and a secretariat. The Committee of the BCBS is according to Article 8 of the Charter the decision-making body, meets in general four times per year, and decisions are taken by consensus (Article 8.4). To achieve this goal, the BCBS sets setting minimum standards for the regulation and supervision of banks, however, member states do have the possibility to have stricter regulation than as agreed in the Basel Agreement (Article 12).

The first agreement of the CBRSP was the so-called Concordat, in which the CBRSP (1975) explained that the objective of international cooperation is to guarantee that no foreign bank establishment (branches, subsidiaries or joint ventures) escapes supervision, because of this the member countries agreed that each country supervises foreign bank's establishments and agreed that contacts between the host and parent supervisory authorities were important. The banking supervision of CBRSP (1975) exists of three pillars: liquidity, solvency and foreign exchange operations and positions. On each of these pillars, the CBRSP has suggestions. The CBRSP (1975) acknowledges that in the first two pillars there is a shared responsibility of the host and parent supervisory authorities, for example in the first pillar, the supervision of the liquidity requirements of foreign bank's establishments are decided by the host country, yet the parent authority has responsibilities as well in for example controlling the liquidity of the parent bank. The third pillar, foreign exchange operations and positions, the CBRSP (1975) believes that again there are shared responsibilities between the host and parent supervisory authorities,

[4] The BCBS consists of members from Argentina, Australia, Belgium, Brazil, Canada, China, European Union, France, Germany, Hong Kong Special Administrative Region (SAR), India, Indonesia, Italy, Japan, Korea, Luxemburg, Mexico, Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

the parent supervisory authority has because of prudential reasons the main responsibility, while the host supervisory authority has because of balance-of-payments and to maintain orderly market conditions the main responsibility when it comes to bank's foreign exchange positions.

To promote the cooperation between the supervisory authorities, the CBRSP (1975) recommends the member states to direct transfers of information between supervisory authorities, direct inspections by parent authorities of their domestic bank's foreign establishments and indirect inspections of foreign banking establishments by parent authorities through the agency of host authorities. The supervisory criteria from the Concordat are mentioned in the First Banking Directive (77/780/EEC). The concept of a consolidated supervisor, a concept in the revised Basel Concordat, was introduced in the First Consolidated Supervision Directive (Directive 83/ 350/ EEC).

Since then this document was revised, for example the BCBS (1992, 1996, 1997) published various documents, in 1992 it presented a document with four minimum standards for the supervision of international banks and another document, in 1996, after there were problems with the implementation of the previously mentioned document, the document presented 29 recommendations to improve the supervision of multinational banking groups. One year later, in 1997, the BCBS presented 25 core principles for effective banking supervision, these principles are also known as the Basel Core Principles. Next, to the Basel Core Principles there are the so-called Basel Capital Accords: Basel I, Basel II, Basel II enhanced and Basel III, these agreements will be explained below. Furthermore, as the Basel Agreements are in itself not part of European law, the implementation of Basel Agreements into European legislation is described. Basel I, II, enhanced and III were incorporated into Capital Requirements Directives (CRDs), these CRDs had no direct effect and thus had to be transposed to the national legislation of the Member States, this is different from Basel III, which was transposed into an EU regulation and a directive.

5.2.1.1 Basel I

As described by the BCBS (2014b) the BCBS was concerned, in the beginning of the 1980s, about the deteriorating capital ratios of the main international banks, this concern was increased by the Latin American debt crisis. Increased convergence in the measurement of capital adequacy and a weighted approach to the measurement of risk was seen as the solution to this problem. Basel I (1988) was created with the objective of regulatory convergence by strengthening the soundness and stability of the international banking system and diminishing the differences to competitive inequality among international banks. Basel 1 sets minimum levels of capital for internationally active banks.

Basel I (1988) is divided into four pillars, the first pillar is called "The Constituents of Capital", and explains that equity capital and disclosed reserves are the key element of capital, as equity capital and disclosed reserves are common to all the banking systems of the G10. Capital should be defined, for supervisory reasons, in two tiers, tier 1 consists of equity capital and published reserves from post-tax retained earnings while tier 2 consists of supplementary capital. It also defines what types of capital are calculated as reserves. The second pillar is called "Risk Weights", and explains that bank assets are weighted, from 0% till 100%, in relation to their credit risk levels. The third pillar is called "A Target Standard Ratio" and explains that the target standard ratio of capital to weighted risk assets should be set at 8%. The fourth pillar is called "Transitional and Implementing Agreements" and states that there will be no formal standard or minimum level set, the BCBS believes that every member should encourage banks to build up their capital and comply with the above explained 8%-rule and should be achieved by the end of 1992.

Basel I was designed for internationally active banks in G10 members, however, not only member states of BCBS implemented Basel I, non-member states also implemented the agreement as large banks considered the implementation of Basel 1 as a sign of regulatory strength and a global standard for other states (Balin, 2008). Moreover international organizations, like the IMF and the World Bank look, according to Barr and Miller (2006), increasingly demand that states have implemented the Basel Agreements as they consider the implementation as a sign of sound national policy.

The implementation of Basel I into European legislation occurred via the Directive on the capital adequacy of investments firms and credit institutions (93/6/EEC), also known as CAD 1 (there were already common standards for a minimum of solvency ratios in Directive

89/647/EEC, but the Directive 93/6/EEC sets common standards for market risks incurred by banks). The Directive sets in Article 4 the capital requirements for banks and the risks associated with their banking activities and Article 8 requires banks to give all information needed for national authorities to assess whether the banks have complied with the rules in the Directive. As explained by Konoe (2010) the Directive targeted all financial institutions, including investment firms and securities activities of banks and as these institutions offered the same types of investment services, they all had to comply with the Directive (a functional approach of regulation and not an institutional approach of regulation). The Directive was amended in 1998 by the Directive amending Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions (98/31/EEC), also known as CAD 2. The market risks associated with commodities trading and commodity derivatives are mentioned in Directive 89/647/EEC, but the market risks are not, the amended Directive changed this.

Balin (2008) does notice that Basel I was criticized because of its limited scope, the possible broad interpretation of the rules as the rules were not specific, and Basel I allowed banks to take improper risks and hold too low capital reserves. In 1999 almost every state had implemented Basel I. However, due to the banking crises of the 1990s and the critique on Basel I, the BCBS (1999) decided that Basel I needed to be reformed, a new capital adequacy framework, supervisory review and market discipline should be included in Basel II.

5.2.1.2 Basel II and Basel II enhanced

The new accord is called "International Convergence of Capital Measurement and Capital Standards. A revised framework" and is also known as Basel II. The designing of Basel II took longer than expected, as explained by Kane (2007a), because the European Union and the United States, had different ideas about Basel II, the United States aimed at enhancing financial stability and improve risk management, while the European Union was focused on regulatory integration.

The first version of Basel II was presented in 2004, and the updated version in 2006. Basel II (2006) exists of a three-pillar structure existing of minimal capital requirements, a supervisory review process, and market discipline. The first pillar, minimal capital requirements, and sets the minimal capital requirements for credit, operational and market risk and explains how they are calculated. To measure the capital requirement for credit risk, Basel II, introduces two different approaches, the standardized approach, and the internal ratings-based approach. Under the standardized approach, to measure the risk weights in the 8[5] different business lines of a bank, banks are allowed to use assessments of external credit assessment institutions (also known as credit rating agencies, Moody's, Standard and Poor's and Fitch are examples). It could be argued that the standardized approach is an improved version of Basel I. Under the internal ratings-based approach (this approach has two different methods: the foundation internal ratings-based approach (FIRB), and the advanced internal ratings-based approach (AIRB)), banks don't use the assessments of external credit assessment institutions, but use their own internal estimates; a bank can only use the internal ratings-based approach as long it has the approval of the supervisor. The BCBS (2001) argued that this approach secures two key objectives, additional risk sensitivity and incentive compatibility.

The objective of the second pillar is to be sure that a bank has adequate capital to support all risks and to push a bank to use well-developed risk management techniques to monitor and manage its risks. In Basel II operational risk is introduced, which is defined by the BCBS (2004, p. 137) as: "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events." The objective of the third pillar, market discipline, is in the words of the former Chairman of the BCBS Caruana (2004, p. 3) to: "strengthen external incentives for prudent management, as is strengthens the ability of marketplace participants to reward well banks and to penalize poorly managed ones by enhancing transparency in banks' financial reporting." The G10 members agreed to implement Basel II by 2008. The implementation process seemed, compared to Basel I, to be more complicated. Scholars, like Herring (2007), argue that especially the implementation of Basel II in the United States was difficult, he explains that the explanation for this threefold, the first reason is the fragmented nature of banking regulation in the United States, the second reason is the numerous checks and balances built into the legislative oversight process which makes the U.S. regulatory process inefficient, the third reason and according the most important reason is the argumentation of Kane (2007b) who argues that the regulatory system in the United States is different than in

[5] The 8 business lines are corporate finance, trading and sales, retail banking, commercial banking, payment and settlement, agency services and custody, asset management, and retail brokerage.

other member states of the BCBS, Kane (2007b) explains that the difference between American regulators and non-American regulators is that regulators in the United States are required to demand that banks nearing insolvency either recapitalize their bank or cede control of the bank to regulatory officials. Kane (2007b, p. 407) states that regulators are: "accountable for resolving the capital shortage of firms over which they take control at minimum cost to the deposit-insurance fund. Absent a voluntary recapitalization, resolution usually entails – not the closure of the bank – but its transfer to new owners". In for example the European Union, as explained by Herring (2007), the regulators are not responsible for the costs inflicted on other banks and/or taxpayers if the Basel II capital standards appear not to be adequate. Because of this, the FDIC (accountable for the costs of capital forbearance), asked for additional prudential safeguards. Getter (2012) adds that another problem was the discussion in the United States whether Basel II should apply to all banks or only to the 19 biggest banks, as initially was the idea. Ferguson (2003), the former Vice Chairman of the Federal Reserve Board and Chairman of the FSF, argued that Basel II would not apply in the United States to all banks as the benefits would not outweigh the costs for smaller banks.

In the European Union, Basel II was incorporated in European legislation via Directives relating to the taking up and pursuit of the business of credit institutions (recast) 2006/48/EC and Directive on the capital adequacy of investment firms and credit institutions (recast) 2006/49/EC, also known as Capital Requirement Directive 1 (CRD 1). CRD 1 applied to all 8000 banks and 2000 investment funds in the European Union. The CRD appeared to be of high importance, Christopoulos and Quaglia (2009) called the CRD crucial for both prudential regulation of banks as for the stability of the financial system. CRD 1 was amended in 2009 by Directive 2009/111/EC (also known as CRD II); it was the first response to the outbreak of the financial crisis. CRD II should improve, according to the European Commission (2008a): "the management of large exposures, the quality of banks' capital, the liquidity risk management and the risk management for securitized products' and introduced the "colleges of supervisors" for banking groups that operate in various Member States.

The compliance with Basel II was getting into problems with the outbreak of the financial crisis. In November 2008 the G20 met in Washington DC and discussed the financial crisis that started in 2007. The leaders of the G20 (2008) agreed that the regulatory regimes, prudential oversight, and risk management needed to be strengthened and that all financial markets, products, and participants are regulated. Based on this agreement the BCBS decided to reform the Basel Capital Accords and presented in 2009 the amended version of Basel II, called Basel II enhanced or Basel 2.5. The rules of Basel II in itself were criticized for relying too much on bank-internal models and evaluations conducted by credit rating agencies (Konoe, 2010).

Summarized by the BCBS (2010a, pp. 4-5), Basel 2.5: "introduces higher risk weights for resecuritization exposures to better reflect the risk inherent in these products and is also requiring that banks conduct more rigorous credit analyses of externally rated securitization exposures". The deadline to implement Basel 2.5 was December 2011, however, in the United States, it took till June 2012. Another change in 2009 was the membership policy of the BCBS, which was criticized by Barr and Miller (2006), they acknowledge that the BCBS as the most important example of a transgovernmental regulatory network, yet they criticize the BCBS for the lack of democratic accountability and legitimacy as it only has 28 member states, but many more states implement the Basel Agreements without having any influence in the decision-making. In June 2009 the BCBS (2009) announced that Argentina, Hong Kong SAR, Indonesia, Saudi Arabia, Singapore, South Africa, Turkey, and Singapore were invited to become a member of BCBS, there were according to the BCBS (2009) two reasons to widen the membership policy; it enhances the Committee's ability to carry out its core mission to strengthen global supervisory practices and standards and the BCBS also believes that having more members will make it more effectively to implement the reforms of the international financial system.[6]

Before the implementation of Basel 2.5 was finalized, the BCBS (2010c) presented in March 2010 the "Report and Recommendations of the Cross-border Bank Resolution Group", in this document the BCBS gives 10 recommendations about an effective cross-border crisis management., and includes recommendations about effective national resolution powers,

[6] Next to 28 members, there are also three states (Chile, Malaysia, and the United Arab Emirates) that are observers. The following organizations are also observers: Bank for International Settlements, Basel Consultative Group, European Banking Authority, European Commission and the International Monetary Fund.

frameworks for a coordinated resolution of financial groups, reduction of complexity and interconnectedness of group structures and operations.

5.2.1.3 Basel III

In September 2010, the Group of Governors and Heads of Supervision agreed on higher global minimum capital standards for commercial banks, the overall design of the capital and liquidity reform package. Together these reforms are now known as Basel III. The G20 (2010) endorsed the reform package in November 2010 and agreed that implementation should start in 2013 and should be finished by 2019. On G-SIBs, the G20 (2010) stated that no company should be too big to fail and that in cases of bank failures a resolution of banks should not be paid by taxpayers, Basel III should reduce the moral hazard risks that are posed by G-SIBs by implementing the policy framework that is behind Basel III. In December 2010 the BCBS (2010b) presented the Basel III agreement. The General Manager of BIS, Caruana (2010), summarized the key features of the policy framework behind Basel III: (1) a stricter definition of common equity, also known as core capital, the new definition makes that minimum of 2% as agreed in Basel II goes now to 4,5% in Basel III, excluding the recommended 2,5% conservation buffer, in other words, the common equity goes from 2% to 7%), (2) Tier 1 capital increase, from 4% in Basel II to 6% excluding 2,5 % conservation buffer, (3) introduces macroprudential policy within the Basel Agreements to deal with systemic risk, this means in practice according to Caruana that procyclicality should be reduced, by the conservation buffers, and supervisors should take into account the interlinkages and common exposures among financial institutions, in particular of G-SIBs. Caruana explains that this means that in Basel III there are additional requirements for G-SIBs, namely G-SIBS need to have loss-absorbing capacity beyond the common standards.

Basel III also introduces new global minimum liquidity standards existing of liquidity coverage ratio (LCR), which aims in the words of Caruana (2010): “to promote banks’ short-term resilience to potential liquidity disruptions” and the net stable funding ratio (NSFR), which addresses: “funding mismatches and provide incentives for banks to use stable sources to fund their activities.” It was the intention to implement 100% of the LCR on the first of January 2015, but the BCBS (2013a) changed this, full implementation date is now January 2019 (the implementation will be in 2015 60% of LCR, and every year 10% more until it is 100% in 2019). The NSFR (2014a) should be implemented by 2018. The other parts of Basel III are implemented in phases and should be completely implemented by 2019. Although the Institute of International Finance (2011), a global association of the financial industry, argued that it was in favor of Basel III, it warned about the economic consequences of implementation Basel III, as 7.5 million fewer jobs would be created by 2015. Academics also criticized Basel III, in particular, there is criticism on the equity levels in banking (Admati, 2014, 2015; Admati & Hellwig, 2013). Admati and Hellwig (2013) argued that there are three problems with Basel III: (1) the transition period is too long, claiming that healthy banks don't need a long period to increase their equity levels and when banks are unable to raise their equity levels it should be the supervisor to step in, (2) the equity requirements itself are too low, the equity level should be 20-30% of the total assets as this would make the financial system safer and healthier, (3) the required assets is based on risk-weighted assets, it should be the total assets of a bank as risk-weighted assets are a fraction of total assets, the health of a bank could be better determined if the required assets requirements are based on all assets. Admati (2014) explained that when the equity level of a bank is less than 30% banks shouldn't be allowed to make payouts to shareholders, and when it is below 20% banks have to recapitalize with new equity, however she does claim that the 20-40% requirement shouldn't be taken as absolute, she wanted the equity levels to be significantly higher. Véron (2013) disagrees with this criticism, he stated that the critics have not presented better alternatives, and he believes that Basel III goes far for a consensus driven Committee. As concluded by Admati (2015) her recommendations have not been followed.

CRD II was amended by the Directive on capital requirements for the trading book and for re-securitisations and the supervisory review of remuneration policies (2010/76/EU) (also known as CRD III), amended were, according to the European Commission (2009a): capital requirements for re-securitisations, disclosure of securitization exposures, capital requirements for the trading book, and remuneration policies and practices within banks. CRD III itself was also amended into CRD IV and exists of Directive access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (2013/36/EU/ CRD IV)) and EU regulation on prudential requirements for credit institutions and investment firms

(575/2013) (CRR). As stated by the European Commission (2013a) Basel III was not simply "copied" to design CRD IV, the European Commission argued that this was not possible for two reasons: first, Basel III is not a law in itself and therefore it needs to go to a process of democratic control and Basel III needs to fit within European and national legislation, the second reason is that the capital adequacy agreements of Basel agreement are focused on internationally active banks, while in the European Union it would apply to all banks (more than 8,300) as well as investment firms as in the European Union banks are more likely than anywhere else to provide their services in other Member States and if the regulation had only applied to a selected group of banks then this would have led to competitive distortions and potential for regulatory arbitrage. The Tier 1 requirement followed Basel III, in other words it went from 2% to 4,5% (Article 92 1 a of Regulation of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012) (575/2013), a Tier 1 capital ratio of 6 % (Article 92 1 b Regulation 575/2013) and a total capital ratio of 8% (Article 92 1 c Regulation 575/2013), the LCR should be implemented in 2018, in other words one year earlier than in Basel III.

The implementation of Basel III into CRD IV was more complicated than the earlier version of the Basel Agreements, Atik (2014) explained that this was due to the bancassurance (a financial conglomerate existing of a bank and assurance company) issue, the United Kingdom wanted that CRD IV would apply to bancassurances as well, but Germany and other Member States disagreed**.** Other differences, in the Directive, are according to the European Commission (2013a) remuneration policies (the implementation of the FSF Principles for Sound Compensation Practices and Implementing Standards (2009b) Article 75 and 92 of Directive 2013/36/EU, the implementation of the G20 concerning the identification criteria of G-SIBs and a mandatory systemic risk buffer for G-SIBs of 1-3,5% (Article 131 Directive 2013/36/EU) and a possibility to introduce a systemic risk buffer (Article 133 Directive 2013/36/EU). Other difference in the Regulation, which is not mentioned in Basel III, is the Single Rule Book to have a uniform application of Basel III in all Member States.

In December 2017 the BCBS presented revisions of Basel III by introducing a new framework for the calculation of capital requirements for banks, this included a leverage ratio buffer to further limit the leverage of G-SIBs. In the words of the BCBS (2018, p. 9):

> "The leverage ratio G-SIB buffer must be met with Tier 1 capital and is set at 50% of a G-SIB's risk- weighted higher-loss absorbency requirements. For example, a G-SIB subject to a 2% risk-weighted higher-loss absorbency requirement would be subject to a 1% leverage ratio buffer requirement."

In April 2019 the European Commission (2019a) proposed to include the revision of the Basel 3 requirements into CRR and the CRD.

5.2.1.4 Identification of G-SIBs

In 2011 the BCBS (2011) presented a consultative document in which it argues that there is no single solution to the externalities posed by G-SIBs, the policy of the BCBS is therefore focused on two goals: reduce the probability of failure of G-SIBs (which should be achieved by increasing their going-concern loss absorbency) and reduce the extent or impact of failure of G-SIBs which should be achieved by improving global recovery and resolution frameworks). However, the BCBS first needed to decide which banks are of systemic importance, and thus determine when a bank becomes a G-SIB. Claessens et al. (2010) explain that due to consolidation and globalization, G-SIBs are produced that are crucial to the functioning of the international financial system, yet their failure causes systemic risk.

The BCBS uses an indicator-based measurement approach, the BCBS (2011, p. 3) explains why it chose for this approach: "it encompasses many dimensions of systemic importance, is relatively simple, and is more robust than currently available model-based measurement approaches and methodologies that only rely on a small set of indicators or market variables."

The indicator-based measurement approach exists of a model that contains 5 categories: cross-jurisdictional activity, size, interconnectedness, substitutability/financial institution infrastructure, and complexity. Each of the indicators applies for a maximum of 20 percent, in total there are 12 indicators. Figure 2 gives an overview of the indicators.

Indicator-based measurement approach		
Category (and weighting)	**Individual indicator**	**Category (and weighting)**
Cross-jurisdictional activity (20%)	Cross-jurisdictional claims	10%
	Cross-jurisdictional liabilities	10%
Size (20%)	Total exposures as defined for use in the Basel III leverage ratio	20%
Interconnectedness (20%)	Intra-financial system assets	6,67%
	Intra-financial system liabilities	6,67%
	Wholesale funding ratio	6,67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6,67%
	Payments cleared and settled through payment systems	6,67%
	Values of underwritten transactions in debt and equity markets	6,67%
Complexity (20%)	OTC derivatives notional value	6,67%
	Level 3 assets	6,67%
	Held for trading and available for sale value	6,67%

Figure 2. Source: BCBS (2011, p. 5)

Cross-jurisdictional activity measures the global footprint of a bank. The idea of the BCBS (2011) is that the greater the global footprint of a bank, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure. The individual indicators within cross-jurisdictional activity are cross-jurisdictional claims and cross-jurisdictional liabilities outside the home jurisdiction of the bank.

Size measures the number of activities of a bank; the indicator is the Total exposures as defined for use in the Basel III leverage ratio. The idea of the BCBS (2011) is that the bigger the bank is, the more difficult it is for the activities of bank A to be replaced by bank B or C and therefore the failure of bank A could cause disruption to the financial system and has a negative impact on the trust in the financial system as a whole. Size is for the BCBS (2011) a key measure of systemic importance.

Interconnectedness is about the legal obligations banks have with each other, the idea of the BCBS (2011) is that the systemic impact of a failed bank is likely to be positively related to its interconnectedness towards other financial institutions. The indicators are intra-financial system assets and liabilities and the wholesale funding ratio.

Substitutability/financial institution infrastructure gives information about the bank's footprint in a particular business line. The thought of the BCBS (2011) is that the substitutability gives more information about the costs and impact of a failed bank. Indicators are assets under custody, payments cleared and settled through payment systems and the values of underwritten transactions in debt and equity markets.

Complexity, the BCBS (2011) explains that there are three kinds of complexity: business, structural and operational complexity. The opinion of the BCBS (2011)is that the higher the complexity of bank, the greater the costs and time are needed to replace a bank. The individual indicators are the OTC derivatives notional value, level 3 assets, and held for trading and available for sale value.

The score of one bank is compared to a sample. The sample consists of collected data of end-2009 which included the indicators of the indicator-based measurement approach of 73 banks, who accounts broadly 65% of global banks assets, from 17 jurisdictions.[7] Based on the outcome of the methodology, the BCBS (2011) expects that there will be 29 G-SIBs, the BCBS expects that the number of G-SIBs changes per year as G-SIBs change their behavior due to regulations. The BCBS has not specified which score is needed for a bank to become a G-SIB, the BCBS only publishes annually which banks are according to them G-SIBs.

[7] The 17 countries are according to BCBS (2011, p. 10): Australia, Belgium, Brazil, Canada, China, France, Germany, India, Italy, Japan, Korea, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

Bucketing approach		
Bucket	**Score range**	**Minimum additional loss absorbency (common equity as a percentage of risk-weighted assets)**
5 (empty)	D	3,5
4	C-D	2,5
3	B-C	2
2	A-B	1,5
1	Cut-off point A	1

Figure 3. Source: BCBS (2011, p. 15)

The BCBS has published in cooperation with the FSB, every year since November 2011, an updated list of the G-SIBs. In November 2018 the BCBS and FSB presented the most recent list and can be seen in figure 4.0.

G-SIBs as of November 2018 allocated to buckets corresponding to required level of additional loss absorbency	
Bucket	**G-SIBs in alphabetical order within each bucket**
5 **(3,5%)**	(Empty)
4 **(2,5%)**	JP Morgan Chase
3 **(2,0%)**	Citigroup Deutsche Bank HSBC
2 **(1,5%)**	Bank of America Bank of China Barclays BNP Paribas Goldman Sachs Industrial and Commercial Bank of China Limited Mitsubishi UFJ FG Wells Fargo
1 **(1,0%)**	Agricultural Bank of China Bank of New York Mellon China Construction Bank Credit Suisse Groupe BPCE Groupe Crédit Agricole ING Bank Mizuho FG Morgan Stanley Royal Bank of Canada Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG UBS Unicredit Group

Figure 4. Source: Financial Stability Board (2018, p. 3)

To monitor whether members of BCBS have implemented Basel II, Basel 2.5 and Basel III, the

BCBS (2012a) has established in 2012 the so-called regulatory consistency assessment programme. This programme includes the risk-based capital requirements, the requirements for G-SIBs and D-SIBs, and the liquidity coverage ratio and the leverage ratio. Regularly the BCBS presents progress report on the adaptation of the Basel regulatory framework. In the last version, which was presented in May 2019, the BCBS (2019) concludes that the requirements for G-SIBs and D-SIBs are implemented and in force. Currently, a framework for the leverage ratio buffer is being considered, the deadline for the implementation is 2022. The following organization that will be described is the Financial Stability Board.

5.2.2 Financial Stability Board

The Group of Seven (1998), also known as the G7,[8] decided that after the outbreak of the financial crisis in Asia (1997-1999) there was a need to intensify the cooperation of the G7 members in reforming the international financial system. The G7 (1998) asked the former President of the Deutsche Bundesbank Tietmeyer to consult with the relevant regulatory and supervisory bodies and discuss the arrangements for cooperation and coordination between the beforementioned bodies and the international financial institutions, and to give recommendations to the G7 about possible new structures and arrangements to foster stability, reduce systemic risk and exchange information about risks in the international financial system.

Tietmeyer (1999) presented three recommendations: (1) there was a need to identify the vulnerabilities in financial systems for a better understanding of the sources of systemic risk and to design effective financial, regulatory and supervisory policies to deal with systemic risk, (2) there should be more guarantees that international rules and standards of best practice are developed and implemented, and (3) better rules are needed that apply to all financial institutions and authorities responsible for financial stability should share information.

To coordinate the reforms, the FSF was established in 1999. As mentioned by Liberi (2003) the increasing use of technology and communications led to an increasingly interconnected economy in which national economies are exposed to the risks of financial systemic instability, examples are besides the Asian Crisis, the failure of the Bank of Credit and Commerce

[8] The G7 consists of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

International (1991), the Mexican Peso Crisis (1994) and the Barings Crisis (1995) also played a role in the establishment of the FSF, as reformers of the international financial architecture argued that there were two main problems: (1) lack of a single set of rules or standards, and (2) lack of a central body to oversee and enforce standards.

Not only the G7 member states were members of the FSF but, as mentioned by FSF (2009a) also Australia, Hong Kong, Netherlands, Singapore and Switzerland, and international organizations like international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank, and international financial institutions. The most important document presented by the FSF is the so-called Compendium of Standards. The FSF (1999) regarded the Compendium of Standards as a reference document that included examples of guidelines, principles and good practice for sound, stable and well-functioning financial systems and the adaptation of this compendium could lead to better policymaking, sound financial markets, and an international financial system. The FSF also designed 12 key standards which should be implemented to strengthen financial systems, these key standards fell within three main categories: macroeconomic policy and data transparency, institutional and market infrastructure, and financial regulation and supervision. However, the FSF did not have a legal status and thus did not have the power to enforce member states to implement recommendations.

In October 2007 the G7 (2007) asked the FSF to investigate the causes of the financial crisis. Six months later the FSF (2008, p. 5) published a report in which it explains that the direct cause of the financial crisis was an "exceptional boom in credit growth and leverage in the financial system", the indirect causes were accumulated weaknesses in risk management and underwriting standards (including weaknesses in regulatory frameworks and other policies). Besides analyzing the causes of the financial crisis it also gives recommendations in five areas among: strengthened prudential oversight of capital (for example to increase the capital requirements for complex structured credit products Basel III), and strengthening the authorities' responsiveness to risks (the FSF mentions that the pace of innovation in financial markets sometimes went faster than the regulatory and supervisory responses of member states, nor have member states checked whether companies implemented regulations, this is why the

FSF recommends member states that supervisors need to have the resources and expertise to understand the risks of new innovations in the financial markets).

The FSF itself was criticized for its membership policy, as argued by Liberi (2003) who believes it is counterintuitive to expect from non-members to implement regulations without giving them the possibility to express their opinion. Although at first, the FSF did not change its membership policy, in March 2009 the FSF (2009a) announced that Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, Spain, South Africa, Turkey, and the European Commission joined the FSF, in other words, membership was now open to G20 and other countries, but still not to all countries. In April 2009 the G20 announced that the FSF would change its name and become the Financial Stability Board (FSB). The reason for this change was a broadened mandate, the objective of the FSB is enshrined in the Charter of the FSB (2012a, p. 2) and is:

> "to coordinate at the international level the work of national financial authorities and international standard setting bodies (SSBs) in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. In collaboration with the international financial institutions, the FSB will address vulnerabilities affecting financial systems in the interest of global financial stability."

The FSB got more responsibilities; the mandate and tasks of the FSB are mentioned in Article 2 of the Charter (2012a, p. 2):

> "(a) assess vulnerabilities affecting the global financial system and identify and review on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address them, and their outcomes; (b) promote coordination and information exchange among authorities responsible for financial stability; (c) monitor and advise on market developments and their implications for regulatory policy; (d) advise on and monitor best practice in meeting regulatory standards; (e) undertake joint strategic reviews of and coordinate the policy development work of the international standard-setting bodies to ensure their work is timely, coordinated, focused on priorities and addressing gaps; (f) set guidelines for and support the establishment of

> supervisory colleges; (g) support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; (h) collaborate with the International Monetary Fund (IMF) to conduct Early Warning Exercises; (i) promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations through monitoring of implementation, peer review and disclosure; and (j) undertake any other tasks agreed by its Members in the course of its activities and within the framework of this Charter."

As mentioned in Article 23 of the Charter (2012a) the FSB it is not intended that the Charter creates any legal rights or obligations, in other words like the FSF the FSB has no legal power to enforce member states to implement the recommendations. The members of the FSB are the same ones as were in the last year of the FSF.

In 2010 the FSB (2010b) presented a report about reducing the systemic and moral hazard risks that are posed by G-SIBs. The FSB (2010b) recommended member states to have a policy framework for G-SIBs which included:

> "(a) a resolution framework and other measures to ensure that all financial institutions can be resolved safely, quickly and without destabilising the financial system and exposing the taxpayer to the risk of loss; (b) a requirement that G-SIBs and initially in particular global G-SIBs (G-G-SIBs) have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system; (c) more intensive supervisory oversight for financial institutions which may pose systemic risk; (d) robust core financial market infrastructures to reduce contagion risk from the failure of individual institutions and (e) other supplementary prudential and other requirements as determined by the national authorities."

The FSB requested its member states to implement the policy framework for G-SIBs before the end of 2011. Two weeks later the FSB (2010a) published another report on G-SIBs, this time the topic was the supervision of G-SIBs. Summarized the FSB (2010a, p. 1) noted that the supervisory work was often focused on processes and not on outcomes, it also noted that in particular, the supervisory expectations on G-SIBs needed to increase, in the words of the FSB the supervision of G-SIBs should be "more intense, effective and reliable". The FSB (2010a) explains in the report that an appropriate risk assessment/capital requirement balance is needed, the financial crisis showed that even highly capitalized and highly liquid can fail, because determining capital sufficiency is not only a quantitative exercise but also a judgmental exercise. The FSB (2010a) explains further that the risks in the financial system should be well controlled, however this does not mean that there can nor should be no risks at all, as banks exist precisely for the purpose of making a reasonable return for their risk taking activities, supervisors, on the other hand, exist to decide whether there is a balance between the risky activities of a bank and an appropriate level of capital in cases problems arise, whenever there is an imbalance the supervisor should act, in particular when a G-SIB is involved as the failure of a G-SIB potentially has great consequences for the entire economy. Excessive capital requirements are also potentially problematic according to the FSB (2010a) could lead to a drive to less regulated entities which can create new risks to the system. To achieve an improved supervision of G-SIBs, the FSB (2010a) gives 32 recommendations in 10 areas: mandate, independence, resources, supervisory powers, improved techniques, group-wide and consolidated supervision, continuous and comprehensive supervision, supervisory colleges, home/ host sharing, macroprudential surveillance/ multidisciplinary approach and use of third parties. The recommendations are in line with the Basel Core Principles.

One year later the FSB (2011b) presented a progress report on the above-mentioned recommendations. The FSB (2011b) notes that supervisors are making progress with implementing the recommendations, yet there seem to be 2 challenges that need attention: (1) G-SIBs have problems with IT and because of this they don't produce reports on time or that are not accurate (to solve this problem the FSB, together with standard setters, will inform the G-SIBs about a set of supervisory expectations so that G-SIBs produce reports, and G-SIBs have to do this before the beginning of 2016, in which the risks are accurately reported), and (2) problems related to supervisory authorities who don't have sufficient resources (The FSB asks member states to respect the agreements that were made in November 2010 to be sure that supervisors have adequate resources). The following year, the FSB (2012b) concludes that in some financial institutions the risk controls are still weak and that according to the IMF and the World Bank Financial Sector Assessment Program (FSAP) there remain problems when it comes to supervisors meeting the requirements for effective supervision, examples are the core principles for official mandates, resources, and independence. The FSB (2012b) makes 4 recommendations in particular in the supervision of G-SIBs: (1) more intense G-SIBs supervision (supervisors should be more proactive in assessing succession planning and set performance expectations for key positions within G-SIBs, supervisors should have more interactions with Boards and senior management, supervisors should be sure that stress testing undertaken for G-SIBs is comprehensive, (2) assessment of effective supervision (member states must implement the fundamental requirements for effective supervision), (3) operational risk (the BCBS should review its approach to approach toward capital for operational risk and update its capital requirements for operational risk by the end of 2014, and (4) supervisory colleges (the FSB and other standard-setting organizations like BCBS and the International Organization of Securities Commissions (IOSCO) should intensify efforts to increase the effectiveness of supervisory colleges, particularly for G-SIBs. In 2013 the FSB did not publish a report, the following year the FSB did publish a report. In this report the FSB (2014b) notes again that more effective and intense supervision remains very important in the supervision and regulation agenda, there are 8 recommendations presented by the FSB on what kind of work should be improved (examples of these 8 recommendations are again about the implementation of enhancements, strengthen risk management and measurement by implementing and enhance stress testing).

5.2.2.1 The resolution of G-SIBs

The FSB has also published annual reports about the resolution of G-SIBs. As explained by Carstensen (2013), before the outbreak of the financial crisis the idea was that a fundamentally stable international financial system is based on national regulations which are then harmonized through international regulation, this applies in particular to G-SIBs, but the financial crisis showed that G-SIBs might enjoy the possibilities of the global marketplace, but when they are in the process of failing they will come home to the national regulator to die. In other words as expressed by the former Chairman of the former Financial Services Authority Turner (2009) who quoted the former Governor of the Bank of England King: “global banks are global in life but national in death”. Since the meetings of the G20 in Pittsburgh (2009), Toronto (2010) and Seoul (2010) the topic of resolution of G-SIBs was discussed, the outcome was that the G20 asked the FSB to come up with proposals for more effective arrangements for the resolution of G-SIBs, which is also known as ending TBTF.

In October 2011 the FSB (2011c) presented the final version of the Key Attributes of Effective Resolution Regimes, these measures are called by the G20 (2011) “a new international standard for resolution regimes”. When member states of the FSB implement twelve[9] elements for an effective resolution regime then it should be, according to the FSB (2011c) possible for member states to resolve financial institutions in such a way that taxpayers don’t pay (solvency support) and the economic motor is not stopped. The elements can be divided into three clusters; responsibilities, instruments and powers. Summarized the plans of the FSB (2011a) fit into four points; (1) every member state should have a resolution authority with powers to intervene and resolve failing financial institutions, (2) cross-border cooperation is very important, resolution authorities should have the power to share information, (3) there should be a recovery and resolution plan for every G-SIBS, (4) and there should be a so-called Crisis Management Group for every G-SIBS existing of home and key-host authorities. The FSB (2011c) mentions that the date of implementation for members states in which there are G-SIBs is before the end of 2012.

The Key Attributes of Effective Resolution Regimes were updated in 2014, the FSB (2014a) notes that the key attributes itself are not changed, but the FSB adopted additional guidance for insurers, financial market infrastructures and the protection of client assets in resolution. In November 2015 the FSB (2015a) announced the so-called Total Loss-Absorbing Capacity (TLAC) standard for G-SIBs. The objective of TLAC is according to the FSB (2015b, p. 9) : “to ensure that G-SIBs have the loss-absorbing and recapitalization capacity necessary to help ensure that, in and immediately following a resolution, critical functions can be continued without taxpayers” funds (public funds) or financial stability being put at risk’. G-SIBs are

[9] The twelve elements are: (1) scope, (2) resolution authority, (3) resolution powers, (4) set-off, netting, collateralisation, segregation of client assets, (5) safeguards, (6) funding of firms in resolution, (7) legal framework conditions for cross-border cooperation, (8) Crisis Management Groups, (9) Institution-specific cross-border cooperation agreements, (10) resolvability assessments, (11) recovery and resolution planning, (12) access to information and information sharing.

required to meet the so-called Minimum External Total Loss-absorbing Capacity should be at least 16% of the resolution group's risk-weighted assets in January 2019 and 18% in January 2022. This is next to the requirements for G-SIBs that are described in Basel III.

5.3 Summary and conclusion

This section gave an overview of the most important international standard-setting organizations for the regulation and supervision of banks. Especially since the 1970s, the BCBS has set standards via the various Basel regulatory frameworks. After the Asian financial crisis (1997-1999) the Financial Stability Board was established, policymakers were convinced that in an interconnected economy, all states are exposed to the treats of a global financial crisis. Both organizations have focused on the financial crisis of 2007-2008 and G-SIBs, how to identify them, how high capital ratios of banks should be and how the resolution of distressed G-SIBs should be organized. The standards of the international standard-setting organizations are however not legally enforceable and thus the European Union needs to transpose the standards into European legislation. The following section will explain how the regulation and supervision of European banks have developed from the creation of the European Union via the Treaty of Rome in 1958 till the present.

6. The evolution of EU regulatory and supervisory policy and architecture

This section aims to give an overview of the European banking regulation and supervision since the creation of the European Union. Furthermore, the High-level Expert Group reports of Lamfalussy (2001), De Larossière (2009) and Liikanen (2012) and the outcome of these reports on European banking regulation and supervision are analyzed as they had an important influence on the policymaking in the European banking regulation and supervision.

6.1 Historical overview of European regulation and supervision of banks

With the signing of the Treaty of Rome in 1957, it was intended to create a single common market by harmonizing rules and regulations. The integration of the European financial sector started, as explained by Dermine (2002), with the adaptation by the European Council of the Directive *The Abolition of Restrictions on Freedom of Establishment and Freedom to Provide Services for self-employed Activities of Banks and other Financial Institutions* (73/183/EEC) in

1973[10]. The objective of this Directive was to abolish legal restrictions on the freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions, Dermine explains further that the directive had the objective to ensure the equal regulatory and supervisory treatment of all financial firms operating in the same Member State, as there was no coordination on the supervision of banks, which led to different rules for banks in the various Member States, to prevent this the Directive mentions that the supervision of a bank which has branches in other Member States would eventually be carried out by the home country of the bank, and no longer by the host. He also notices that international competition through the supply of cross-border services was not favored by the Member States, capital flows were severely restricted by regulations. Via minimal harmonization of banking regulation, and in particular via the First Banking Directive on The Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of Credit Institutions (77/780/EEC) in 1977 the European Commission wanted to address these problems.

Lannoo (2002) mentions that, as the European Commission chose for minimal harmonization, additional rules should be agreed under mutual recognition. This possibly led, according to him, to the issue of regulatory competition between Member States. The directive introduced the principle of Home Country Control (banks may set up branches in other Member States, the branches are consequently supervised by the authorities in which the bank has its legal headquarters), and defined credit institution and branch, and based on Article 11 of the Directive the so-called Advisory Committee of the Competent Authorities of the Member States of the European Economic Community (also known as the Banking Advisory Committee (BAC) was established. The members of BAC are representatives of Member States and the European Commission. The objective of BAC is mentioned as well in Article 11, BAC assists the European Commission in ensuring the proper implementation of the Directive and of Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks

[10] Council Directive 73/183/EEC, 77/780/EEC, 89/299/EEC, 89/646/EEC, 89/647/EEC, 92/30/EEC, and 92/121/EEC were codified and put in one single Directive 2000/12/EC.

and other financial institutions, another task was to prepare proposals, in cooperation with the European Commission, about further coordination in the area of banks. Built upon Directive 77/780/EEC, in 1983 the Directive on the supervision of credit institutions on a consolidated basis (83/350 EEC) was presented, it aimed to set the conditions for the form and extent of consolidation (Article 4), consolidation was required for participation of 25% or more of the capital of another credit or financial institution (Article 1).

The Single Market Programme (SMP) of the European Union, which was presented in a whitepaper by the European Commission in 1985, aimed to complete the internal market by removing physical, technological and fiscal barriers. The European Commission (1985) focused on the financial services, as part of the common market for services, on the liberalization of financial services as this would lead to integration and widening of the internal market. Financial products, like home-ownership contracts and consumer credits, should be exchanged at the European Union level, using a minimal coordination of rules (in particular for the supervision of banks) and the European Commission repeated its ideas about the Home Country Principle and announced it will work towards the mutual recognition of rules concerning the supervision of financial institutions and the single banking license (as long as laws in a Member State meet certain minimum standards, banks from other Member States may open branches in this Member State, without asking permission from the host state). These principles were incorporated in the Single European Act (1986)[11] and the Second Council Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (89/646/EEC) in 1989.

6.2 The establishment of the Economic and Monetary Union

Another step towards further integration was the Economic and Monetary Union (EMU). In 1991 the European Council (1991) reached an agreement about the establishment of the EMU, which included the introduction of a single currency (the European Currency Unit (ECU) which was replaced in 1999 by the euro), a European System of Central Banks (ESCB) and a European

[11] The Single European Act introduced qualified majority voting and the principle of mutual recognition replaced the goal of harmonization.

Central Bank (ECB). Although this explanation for creating the EMU has an economic perspective, Baun (1995) argues that an important reason to establish the EMU was the German unification and the end of the communist system in Eastern Europe, France and Germany secured their national interests with agreeing on the EMU, as Germany signed the EMU to show its commitment towards the European Union and France signed because via the EMU the European institutions had some control over Germany. Fratianni and Pattison (2015) added that EMU would lead for Germany and France to trade deepening and financial integration, while smaller Member States could benefit from lower interest rates from higher collective credit ratings and the currency risk that investors had would be eliminated.

In February 1992 the Treaty on European Union (TEU) was signed, and EMU is part of the TEU (Article 3A TEU mentions the Economic and Monetary Union). EMU separated the supervision of banks from monetary authority; the supervision of banks remained a task of national authorities (with a role for the ESCB, Article 105 (5) TEU stipulates: "The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to prudential supervision of credit institutions and the stability of the financial system". The Eurosystem, which exists of the ECB and the Central Banks in the euro area, is the monetary authority. Due to German pressure during the negotiations on the EMU the institutional design of the ECB resembles the German Bundesbank and not like for example in the United Kingdom where these two functions were combined in 1997 (the establishment of the UK Financial Services Authority) (Buiter, 1999; Smits, 1996; Vives, 2001; Wyplosz, 1997). The ECB is independent of national governments (Article 107 TEU), price stability is the main task of the ECB (Article 105 TEU), and as mentioned before the ECB did not supervise banks and had no LOLR-function. The decision to separate the supervision of banks and the monetary authority led to a debate between scholars; the question is whether the combination of tasks led to conflicts of interests. Goodhart and Schoenmaker (1995) conducted a research of 104 major bank failures in 24 countries (11 combined, 13 separated system), and tried to find out whether the combined or separated functions of bank supervision and monetary policy has an effect on the resolution of bank failures and avoid systemic consequences. They concluded that a bank failure occurs less often in a combined regime, problematic for those who support the separation of the tasks is that the Central Bank in a country usually is the only source of immediate funding, which makes it that even when the functions are separated the agencies have to work together in operation and decision-making.

In 1998 the European Council (1998, p. 9) concluded that "historic steps" were taken on the EMU, and recognized that more had to be done and invited the European Commission to table: "a framework for action by the time of the Vienna European Council to improve the single market in financial services, in particular examining the effectiveness of implementation of current legislation and identifying weaknesses which may require amending legislation". The European Commission (1998, p. 1) acknowledged that the introduction of the euro removed a barrier and further completion of the Single Market could be realized, however in an increasingly global financial market, the European financial market had to be accompanied by: "more effective prudential regulation and supervision at both European and global level". To achieve this, the European Commission (1998, p. 2) added that there was no need for a radical change, cooperation between supervisors should be strengthened as financial institutions are based increasingly on a cross-border basis. To achieve this the European Commission (1998) decided to contribute to the so-called supervisors co-operation charter, the EU bank capital requirements had to be updated in line with supervisory practices and in parallel with the BCBS, and research the prudential problems that banks may pose.

Built upon this the European Commission presented in 1999 the Communication Financial Services Action Plan (FSAP), a collection of policy objectives and 42 measures for the next five years. In the FSAP the European Commission (1999) stated that internationalization, disintermediation, and globalization of financial services challenged the current cooperation between supervisory authorities, therefore the European Commission for closer cooperation, besides that the European Commission noticed that there is criticism on the current bilateral Memorandum of Understanding between national supervisors when it came to cross-border effects of failure of big banks, although the European Commission did not share this criticism it encouraged to a high-political assessment of the current arrangements for banking supervision. In the so-called strategic objective 3, the European Commission presented its policy objectives and measures concerning the prudential rules and supervision of banks, examples of policy objectives are the elimination of any hiatus in the EU prudential framework, the EU should be able to play a key role in setting high global standards for regulation and supervision. To achieve these policy objectives various Directives should be adopted, the European Commission set an optimal timeframe for the adoption of these Directives. During a meeting of the European Council (2000) in Lisbon in 2000, the heads of state or government considered the FSAP as part of a plan to reform the EU into "the most competitive and dynamic knowledge-based economy in the world" and an efficient and transparent financial market was part of this plan. In 2009 there was an assessment of the FSAP and currently, most actions are completed.

6.3 Reports on reforming the regulation and supervision of banks.

Since the beginning of the twenty-first century, various reports have been published about the regulation and supervision of banks. As these reports have had a great influence on the supervision and regulation of banks they are summarized in this section.

6.3.1 The Lamfalussy report

The Economic and Financial Affairs Council (ECOFIN) (2000) concludes during a meeting in 2000 that the euro and the resulting structural changes have fastened the integration of financial markets in the European Union, the ministers of finance and economic affairs wondered whether the regulation needed to be updated. ECOFIN (2000) set up the so-called Committee of Wise Men under the leadership of Lamfalussy who was asked to find ways to more effectively regulate: the conduct of cross-border financial operations, the day-to-day operation of the regulated markets, the protection of consumers, the integrity of the market and other areas of regulation. The mandate of the Committee (Lamfalussy et al., 2000, p. 30) was threefold:

> "to assess the current conditions for implementation of the regulation of the securities markets in the European Union; to assess how the mechanism for regulating the securities markets in the European Union can best respond to developments underway on securities markets, and to propose as a result scenarios for adapting current practices to ensure greater convergence and cooperation in day to day implementation, taking into account new developments in the market."

The Committee would not deal with prudential supervision.

In 2001 Lamfalussy et al. (2001) presented the final version of his report, the main conclusion was that the EU legislative process on regulation was too slow, the average co-decision procedure took over two years. It took for example 4 years to implement Basel I. The Expert Group on Banking (2004) warned that the 10 new Member States that were going to join the European Union in May 2004 would make the legislative process not going faster and warned for potential diverging and conflicting application of the regulation. The Committee considers this to be a problem as the pace of market change is accelerating due to globalization, deregulation and information technology.

The solution would be a regulatory decision-making reform, the Committee proposes a four-level approach, level 1 the European Commission sets the framework principles for new regulations and directives, level 2 two new Committees (EU Securities Committee and EU Securities Regulators Committee), help the European Commission with technical advice on how to implement the framework principles and the European Parliament gives its position about the proposal to the European Commission, level 3 national securities regulators vote about the proposal, and level 4 is about strengthening the enforcement of regulation by all parties but in particular by the European Commission as guardian of the European treaties.

The Committee (2001) noticed that when this new four-level approach would not work, which is reflected in the Monitoring Group's half-yearly reports, then the Committee would propose a Treaty change to establish a single EU regulatory authority for financial services. Quickly after the publication of the report, the proposal to create a four-level approach was approved by ECOFIN (2001b), and they made a resolution on the functioning of a new legislative process for EU securities markets. In June 2001 the European Commission established the Committee of European Securities Regulators (CESR) and the European Securities Committee (ESC) by adopting Decision Decisions 2001/ 527/EC and 2001/528/EC. CESR was, according to Article 3, composed of high-level national representatives of public authorities and a high-level representative of the European Commission. The ESC was, according to Article 3, composed as well of both high-level representatives, the chairmen of CESR participated at the meetings as an observer.

Although the report of Lamfalussy was focused on securities markets in the European Union, in December 2002 ECOFIN (2002) decided to apply the Lamfalussy process to all financial sectors (banking, insurance, and occupational pensions) in the European Union and asked the European Commission to establish similar institutions for the banking and pension sector. The European Commission established in November 2003 so-called Level 3 Committees existing of the Committee of European Banking Supervisors (CEBS) (Decision 2004/5/EC), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) (Decision 2004/6/EC), and the before-mentioned CESR. The tasks of the CEBS are mentioned in recital 4, 5 and 6, it should advise the European Commission, contribute to the consistent and timely application of Community legislation, and should promote cooperation in the banking field and work together with Banking Supervision Committee of the European System of Central Banks and with the Groupe de Contact of European banking supervisors.

After the aforementioned reforms, the European Commission wanted a break. During a speech by McCreevy (2005), the former European Commissioner for Internal Market and Services, to the Economic and Monetary Affairs Committee of the European Parliament in February 2005 about the Governance and Accountability in Financial Services, McCreevy recognized that there was "real regulatory fatigue". McCreevy announced that he wouldn't introduce new legislative proposals but rather implement the FSAP. This position was a bit surprising as Alford (2006) claimed that possibly the political climate was not supportive of major changes, the financial industry supported generally consolidating existing financial services legislation and coordinating supervisory practice between the Member States of the European Union. Meanwhile, Schüler (2003) claimed that the systemic risk potential in the European banking market has increased and believes that this threat can't be dealt with at the national level. The following important report was the De Larossière report.

6.3.2 The De Larossière report

The former President of the European Commission, Barroso (2008b), stated about the purpose of the High-Level Expert Group on EU financial supervision under leadership of De Larossière, a former Governor of the Banque de France, (hereafter: De Larossière group):

> “There is an obvious mismatch between European and global financial markets and supervision which remains largely national. There is wide agreement that we need to bridge that gap but different ideas on how to go about it. So, the Group’s role is to bring forward concrete proposals which will contribute to greater financial stability and help maximize protection for depositors, policy holders and investors.”

The European Commission (2008b) described the mandate of the De Larossière group:

> “how the supervision of European financial institutions and markets should best be organized to ensure the prudential soundness of institutions, the orderly functioning of markets and thereby the protection of depositors, policy-holders and investors; how to strengthen European cooperation on financial stability oversight, early warning mechanisms and crisis management, including the management of cross border and cross sectoral risks; and how supervisors in the EU”s competent authorities should cooperate with other major jurisdictions to help safeguard financial stability at the global level.”

The view of the European Commission was not in line with the position of ECOFIN. After a meeting of ECOFIN(2008), it was concluded that the improvement of EU wide supervision of banks was, for a large part, completed.

The report of De Larosière et al. (2009) on financial regulation and supervision was presented in 2009. The report is divided into 4 chapters: causes of the financial crisis, policy and regulatory repair, EU supervisory repair, and global repair. There were multiple reasons why there was a financial crisis, the Group (2009, p. 13) stated: “the complex interaction of market failures, global financial and monetary imbalances, inappropriate regulation, weak supervision and poor macro-prudential oversight”. Another reason for the outbreak of the crisis was according to the De Larossière group (2009) the lack of a consistent set of rules. To deal with these problems, the De Larossière group gave recommendations in each chapter. Summarized in the field of supervision and regulation the De Larossière group stated first that the main problem is that the regulatory framework was not cohesive due to options provided for Member

States in the directives when it came to enforcement of these directives. The De Larossière group also gave advice in the crisis management and resolution, crisis management of national banks in distress should remain at the national level, but the crisis management of distressed cross-border banks should go to the European level. About DGS, the De Larossière group recommended to harmonize the DGS and pre-fund them by the private sector. Supervision of national banks that are distressed should be kept at the national level, but in the case of cross-border banks, supervision should be at the European level.

However, the most important recommendation of the De Larossière group (2009) was to establish two new institutions, the European Systemic Risk Council (ESRC) (macroprudential) and the European System of Financial Supervision (ESFS) (microprudential). The ESRC would replace the BSC and be composed of the ECB General Council (the General Council exists of the ECB President, the vice-president of the ECB and the Governors of the 27 central banks), the chairs of CEBS, CEIOPS, CESR, and a representative of the European Commission. The task would be to analyze information that is relevant for financial stability. The reason to establish the ESRC is, according to De Larossière group (2009), that there is a need to upgrade macroprudential supervision in the European Union and the De Larossière group believes that central banks play a key role in a sound macroprudential system. The task of the ESRC would be assessing high-level macro-financial risks to the system and warn the Financial and Economic Committee in cases of threats to the financial system. The other new institution, the ESFS, should exist of European financial supervisors and the Committees. The reason to establish the ESFS is, according to the De Larossière group, that the structure and role of the existing Committees are not sufficient to ensure financial stability in the European Union. The ESFS should be according to the De Larossière group a decentralized network in which national supervisors carry out supervision, while the replacers of CEBS, CEIOPS, and CESR, would coordinate the application of supervisory standards and cooperation between the national supervisors. The De Larossière group also set a timeframe for setting up the new institutions, in 2012 the new system should have been set up.

The response of the European Commission to report of the De Larossière group followed in May 2009, when the European Commission (2009b) adopted a Communication on Financial Supervision in Europe in which the establishment of two institutions was presented, the

European Systemic Risk Council (ESRC) and the European System of Financial Supervisors (ESFS), as was proposed by the De Larossière group. The rationale of the ESRC is, according to the European Commission, to address the fundamental weaknesses of the financial system in particular to interconnected, complex, sectoral and cross-sectoral systemic risks. The task of the ESRC would be to monitor and assess potential risks to the financial stability. The task of the ESFS would be to build up a network consisting of national financial supervisors, in cooperation with the European Supervisory Authorities (ESA) consisting of the European Banking Authority (EBA) to replace the CEBS, European Securities and Markets Agency (ESMA) to replace CESR and European Insurance and Occupational Pensions Authority (EIOPA) to replace CEIOPS. The European Council (2009, p. 9) agreed with establishing the ESRB and ESFS and noted that the ESFS should upgrade: "the quality and consistency of national supervision, strengthening oversight of cross-border groups through the setting up of supervisory colleges and establishing a European single rule book applicable to all financial institutions in the Single Market." The European Council also noted that the ESFS should have binding and proportionate decision-making powers so that the ESFS can assess whether the national supervisors are respecting the Single Rule Book and in cases of disagreement between the host and home state supervisors, this should also apply to credit rating agencies. The last thing the European Council noted was that a request to the European Commission to come up with a cross-border framework for the prevention and management of financial crises, in which the ESFS should play a coordinating role.

In January 2011 EBA (EBA Regulation 1093/2010), EIOPA (EIOPA Regulation 1094/2010) and ESMA (ESMA Regulation 1095/2010) were established. The legal foundation for the establishment of these institutions was Article 114 Treaty on the Functioning of the European Union (TFEU) (the article aims to further the internal market by harmonizing laws). The objective of EBA is mentioned in Article 1 (5) of EBA Regulation 1093/2010 and entails to: "protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses", to achieve this objective the EBA contributes to, among other things, Article 1 (5) (a): "improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision", the specific tasks of EBA are mentioned in Article 8 and

9 and include contributing: “to the establishment of high-quality common regulatory and supervisory standards and practices” and promote “transparency, simplicity and fairness in the market for consumer financial products or services”. EBA has, according to Article 5, a legal personality, and is composed of a Board of Supervisors (Article 40, the Board of Supervisors exists of the head of the national public authority competent for the supervision of credit institutions in each Member State, a representative from the European Commission, the ECB, the ESRB, ESMA and EIOPA), a Management Board (Article 47), a Chairperson (Article 48), an Executive Director (Article 53) and a Board of Appeal (Article 60). Article 6 mentions that the seat of EBA is in London.[12]

The decision-making in EBA is described in Article 44; each head of the national public authority has 1 vote and for most decisions, a simple majority system is used, the representatives of the European institutions have no voting rights. Compared to the CEBS, EBA has a greater role in the regulation and supervision of banks in the European Union, as EBA can draft technical standards that become regulation once approved by the European Commission, CEBS could only issue guidelines and recommendations that were non-binding, another difference is that EBA has the right to participate in all supervisory colleges, while CEBS participated only in a few supervisory colleges, EBA also has a mediation role in cases of conflicts between NSAs, the last difference is that EBA got a specific consumer protection role, CEBS did not have this. The daily supervision of banks remains in the hands of NSAs, in other words EBA does not carry out direct supervision of banks in the European Union. The budget of EBA is in 2019 47.8 million euro.

Based on Articles 21 (2) (b) and 32, EBA, in cooperation with the ECB and the European Commission, coordinates so-called stress tests to assess the resilience of financial institutions; it is the national authority that carries out the actual stress test and consequently EBA collects all data. A stress test assesses whether a bank passes a hypothetical scenario, when a bank

[12] ESMA is located in Paris and EIOPA is located in Frankfurt. Because of the withdrawal of the United Kingdom from the European Union, the office of EBA in London was closed at the end of May 2019 and the office of the EBA is in Paris, France.

passes the test, it shows that it can bear losses arising from the scenario. The criterion to pass the test is the impact on banks' core tier 1 ratio.

The predecessor of the EBA, the CEBS, carried out the first stress test in 2009. The CEBS (2009a) tested whether 22 major European cross-border banking groups were sufficiently capitalized, in order words their core tier 1 ratio was examined. All banking groups passed as their core tier 1 ratio remained above 8%, however, the results per banking group were confidential (CEBS, 2009b). The objective of this stress test was not to test the individual needs of the banking groups, but to provide policymakers with more information. In 2010, the European Council (2010) announced that the outcome of the next stress test would be published. CEBS (2010) carried out in 2010 a similar stress test, this time 91 European banks were tested, 7 banks did not pass the test ((5 banks from Spain, 1 from Germany and 1 from Greece), as they did not have 6% Tier 1 capital ratio, however the regulatory minimum, at that time, was 4% Tier 1 capital. The capital shortfall of these banks was 3,5 billion euro (CEBS, 2010).

In 2011 EBA (2011a) did another stress test, this time 91 banks,[13] from 21 Member States, were tested and 20 banks did not pass the 5% core tier 1 ratio, although the EBA did not publish the names of the banks that participated in the test, they did announce that the banks that did not pass were from Austria (1 bank), Cyprus (1 bank), Denmark (1 bank), Spain (7 banks), Greece (2 banks), Ireland (3 banks), Italy (1 bank), Portugal (1 bank) and Slovenia (1 bank). According to the EBA (2011a) the capital shortfall of these 20 banks was 26.8 billion euro. However at the presentation of the report EBA (2011c) announced that banks recapitalized and therefore 8 banks would not pass the capital benchmark by end December 2012, the capital shortfall was 2.5 billion euro. The stress test was, according to Berrospide (2015), criticized as EBA did not take into account sovereign debt exposures and some large banks that passed the stress test of 2011 needed a few months later recapitalization or failed (e.g., Dexia). Not only scholars criticized the 2011 stress test, but also the European Court of Auditors (2014, pp. 29-30), which noted that EBA had a limited mandate and legal scope as it was not EBA who set the scenarios but ECB, and did not have direct access to banks and had a limited staff (10 seconded national staff and 5 EBA staff), as a consequence this affected the reliability of the stress test, examples

[13] There were 91 banks tested, but one bank refused EBA to publish the data.

of banks that faced problems were Dexia, Bankia, SNS Bank and Slovenian banks Nova Ljubljanska banka and Nova Kreditna Banka Maribor which all passed the stress test but later were recapitalized or nationalized by their national government.

In December 2011 EBA (2011b) announced that 37 banks, out a sample of 71 banks (included G-SIBs) in various countries had a lack of capital, the capital shortfall was 114,7 billion euro, this was a capital exercise. The eight banks that had failed the stress test in 2011 were not part of the 71 banks (Mésonnier and Monks (2015)). To solve this problem, EBA (2011a) recommended national supervisors to require banks to have a Core Tier 1 capital ratio of 9% by the end of June 2012, and banks should have an exceptional and temporary capital buffer against sovereign debt exposures. In October 2012, EBA (2012) published the capital position of 61 banks, it showed that out of 61 banks there were 4 banks (Banca Monte Dei Paschi Di Siena S.p.A (Italy), Cyprus Popular Bank Public Co Ltd (Cyprus), Bank of Cyprus Public Co Ltd.(Cyprus) and Nova Kreditna Banka Maribor d.d.(Slovenia)) that did not meet the requirement to have Core Tier 1 capital ratio of 9% at the end of June 2012. In 2012 there was no stress test. Mésonnier and Monks (2015) argue that also this exercise was criticized, as in 2011 the euro area was considered to be extremely weak and recapitalization of banks might have led to weak credit supply, aggregated the recession in several Member States and contributed to a credit crunch in the euro area. In 2013 there was also no stress test, but EBA (2013) carried out a transparency exercise, which showed that out of the 64 European banks from 21 countries from the European Economic Area (EEA), the average Core Tier 1 capital ratio had grown from 10% in December in 2011 to 11.7% in June 2013.

In October 2014 the EBA (2014) conducted a stress test, this time 123 banks from 22 countries (including Norway) were part of the test, there was a minimum of 8% CET1 ratio for the baseline scenario and 5.5% CET1 ratio for the adverse scenario based on the CRR/CRD IV requirements. 24 banks failed the stress test and the capital shortfall was 24.2 billion euro. In March 2015 the EBA (2015a) announced that there would be no stress test in 2015 as there was time needed to prepare for a stress test, with new elements such a conduct risk, in 2016. In November 2015 the EBA (2015b) published the outcome of a transparency test, in the sample there were 105 banks from 21 countries, EBA concluded that the capital position of banks keeps on improving but was worried about so-called non-performing loans. In July 2016 EBA (2016) published the results of the stress test, 51 banks from 15 European countries were analyzed, there was no pass/fail threshold, but under the scenario used by the EBA only Italian bank Banca Monte dei Paschi di Siena S.p.A. did not "pass" the test. In November 2018 EBA carried out another stress test. In this test, EBA (2018a) tested 48 banks from 15 EU and EEA countries, the banks with the lowest scores were Barclays Plc (6,37%), Banco BPM S.p.A (6,67%) and Lloyds Banking Group Plc (6,80%). When the beforementioned percentage is less than 5.5% regulators can force banks to raise more capital, curb their dividends or sell risky assets. Like in the previous tests there was no pass/fail threshold. The next stress test will be carried out by EBA (2018b) in 2020. The last report that will be summarized is the Liikanen report.

6.3.3 The Liikanen report

In October 2012 there was another report on the EU banking sector, this time it was chaired by Liikanen, the Governor of Suomen Pankki (the Bank of Finland), and called the High-level Expert Group on reforming the structure of the EU banking sector (2012). The objective of the committee was (2012, p. 99):

> "to consider in depth whether there is a need for structural reforms of the EU banking sector or not and to make any relevant proposals as appropriate, with the objective of establishing a safe, stable and efficient banking system serving the needs of citizens, the EU economy and the internal market."

The Liikanen report (2012) first summarized the four developments in the banking sector in the European Union that have led up to the crisis, the first development is the growth and size of the banking sector in the European Union between 2001 and 2008 (double-digit growth of bank assets in Spain and Ireland) and concluded that the size of the banking sector in the European Union with the banking sectors in Japan and the United States is much bigger, for example the banking sectors assets are in the European Union in 2010 349% of GDP, while it is 78% in the United States and 174% in Japan. Another development according to the Liikanen report (2012) were changes in the balance sheets of banks in the European Union, due to Basel II risk weighting and internal models were introduced, the increased leverage led to a lower degree of resilience and the ability of banks to absorb shocks and losses was reduced. The third development was the increased activities of banks in other Member States of the European

Union and the world, the Liikanen Report explained that in particular financial integration happened at a very rapid pace, creating capital flows between states, this development was accelerated by the Single Market and the euro.

The last development was the consolidation of the banking sector in the European Union and the emergence of what the Liikanen Report calls very large institutions. The number of MFIs has decreased in particular in the euro area, since October 1999, while very large institutions started to emerge, for example as noted by the Liikanen Report from the 30 largest banks by total assets in the world in 2011, 15 are headquartered in the European Union, the very large institutions also became strongly interconnected. The Liikanen report also noticed that supervision remained at the national level, policymakers have to make a decision between upgrading the institutional architecture or downgrade market integration, when they opt for the first, they fully support economic and monetary integration, the Liikanen report is therefore in favor of the proposal to create a banking union. The Liikanen report reviewed in particular the regulatory reform on capital and liquidity requirements and recovery and resolution schemes, it concluded that the on-going reforms are positive yet proposes two plans. The first proposal is a banking separation of activities when the banking's trading assets exceed 100 billion euro or 15-25% of the bank's total assets. When this condition is fulfilled then the banking group should create a legal entity for the financially risky activities. The second proposal of the Liikanen report was the bail-in proposal, the reports supports using so-called "designated bail-in instruments", banks should have a larger layer of bail-inable debt this "would increase overall loss absorptive capacity, decrease risk-taking incentives, and improve transparency and pricing of risk"(2012, p. iii). The third proposal is that capital requirements should be reviewed. The fourth proposal is that governance and control of banks should be strengthened by: "1) strengthen boards and management; 2) promote the risk management function; 3) rein in compensation for bank management and staff; 4) improve risk disclosure and 5) strengthen sanctioning powers" (2012, p. 106). The fifth proposal of the Liikanen report is that banks have effective and realistic recovery and resolution plans.

Based on the Liikanen report the European Commission presented the proposal Banking Structural Reform in 2014. The aim of the regulation was in the words of the European Commission (2014b): "to stop the largest and most complex banks from engaging in proprietary trading, which means trading using the bank's own money as opposed to on behalf of customers”, and “supervisors could also require banks to separate certain risky trading activities from their deposit-taking business if these activities compromise financial stability”. In 2015 ECOFIN agreed on the proposal after modifications on the original proposal, but the European Parliament was divided and failed to agree a common position on the proposal. In October 2017 the European Commission (2017b) announced it would withdraw the proposal as the purpose of the proposal had been achieved by other measures, referring to the EBU. European Parliaments rapporteur on BSR, Hökmark (2017), agreed with the withdrawal of the proposal and believed the proposal would have weakened the European banking sector.

6.4 Summary and conclusion

The harmonization of a common European banking regulation and supervision started with the signing of the Treaty of Rome in 1957 which aimed to create a single market by harmonizing rules and regulations and was followed by the first directive to establish this in 1973. At that time there was no coordination in the regulation and supervision of banks, and as a consequence each Member State had its own rules for banks. This changed slowly at the end of the 1970s as the Banking Advisory Committee was established in 1979, one of its tasks was to ensure the correct implementation of the 1973 and 1977 directive.

The creation of the EMU in the 1990s speeded integration as the ECB, a common currency and the European System of Central Banks were established. Also, the FSAP was a step forwards as globalization challenged the cooperation between supervisory authorities in the European Union. The Lamfalussy report advised in 2001 to reform the regulatory decision-making process (4-level regulatory approach) as the EU legislative process on regulation was too slow and not effective. The De Larossière report on financial regulation and supervision was issued in 2009. It focused on the causes of the financial crisis, policy and regulatory repair, EU supervisory repair, and global repair. It concluded that inappropriate regulation and weak supervision were reasons for the outbreak of the financial crisis. To improve this, the report recommended to establish new institutions, the ESRC to investigate potential risks to the financial stability and the ESFS to ensure consistent and coherent financial supervision in the European Union. Also, the EBA was established, this organization carries out stress tests and monitors. The last report is the report of Liikanen, this report recommended a banking separation of activities when the trading assets exceed 100 billion euro, a review of capital requirements and a bail-in proposal. Initially the European Commission was in favor of the recommendations, but the European Parliament did not manage to create a common position. Consequently, the European Commission withdrew the proposal in 2017. The next section is about the European Banking Union and the EU Bank Recovery and Resolution Directive.

7. The European Banking Union and the EU Bank Recovery and Resolution Directive

The aim of this section is to describe the institutional and legal framework of the SSM, SRM and EDIS. Although the EU Bank Recovery and Resolution Directive is officially not a part of the EBU, it is related and because of that also the institutional and legal framework of this directive is analyzed.

In June 2012, as explained by Alexander (2015), EU-policymakers and investors were afraid that the Spanish banking system would collapse as it was in crisis, and that this collapse would cause contagion throughout the euro area and would threaten the euro as well. Alexander (2015) elaborates further, that to prevent these problems, the Spanish government was negotiating with the European Commission about a euro area bailout of its banking system. Again, this fear for contagion showed that there should be a European Union solution. About this and other topics, the President of the European Council, Van Rompuy et al. (2012), presented the report "Towards a Genuine Economic and Monetary Union". In collaboration with the President of the European Commission, the President of the Eurogroup and the President of the European Central Bank, Van Rompuy presented a vision for the EMU to ensure stability and sustained prosperity. To achieve this goal, the Presidents (2012) present a plan which contains four building blocks: (1) an integrated financial framework (existing of single European banking supervision and a common deposit insurance and resolution framework), (2) an integrated budgetary framework (which is about fiscal policy at both the European and national level and includes coordination and joint decision-making), (3) an integrated economic policy framework (existing of a framework to be sure that European and national policies are promoting sustainable growth, employment and competitiveness, and is compatible with EMU-legislation) and (4) strengthened democratic legitimacy and accountability (as there is a tendency towards integrated fiscal and economic decision-making between the Member States of the European Union, mechanisms for legitimate and accountable joint decision- making are essential).

Three days later, at a meeting of the euro area leaders (2012), it was concluded that “is imperative to break the vicious circle between banks and sovereigns,” to achieve this objective the leaders of state or government in the euro area asked the European Commission to come up with proposals to create a Single Supervisory Mechanism (SSM) based on Article 127(6) TFEU. This Article gives the European Council the power to confer specific tasks, relating to the prudential supervision of credit institutions and other financial institutions, to the European Central Bank. With the SSM, the euro area leaders (2012) argued there would be a mechanism: “in place for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly”. On the same day, during a meeting of the European Council (2012), the heads of state or government agreed with the plan of Van Rompuy and asked him to make, in cooperation with the Member States, a time plan for the implementation of the four building blocks. Below in figure 5 the pillar structure of the EBU is presented, followed by a description of the Single Supervisory Mechanism, the Single Resolution Mechanism, and the European Deposit Insurance Scheme.

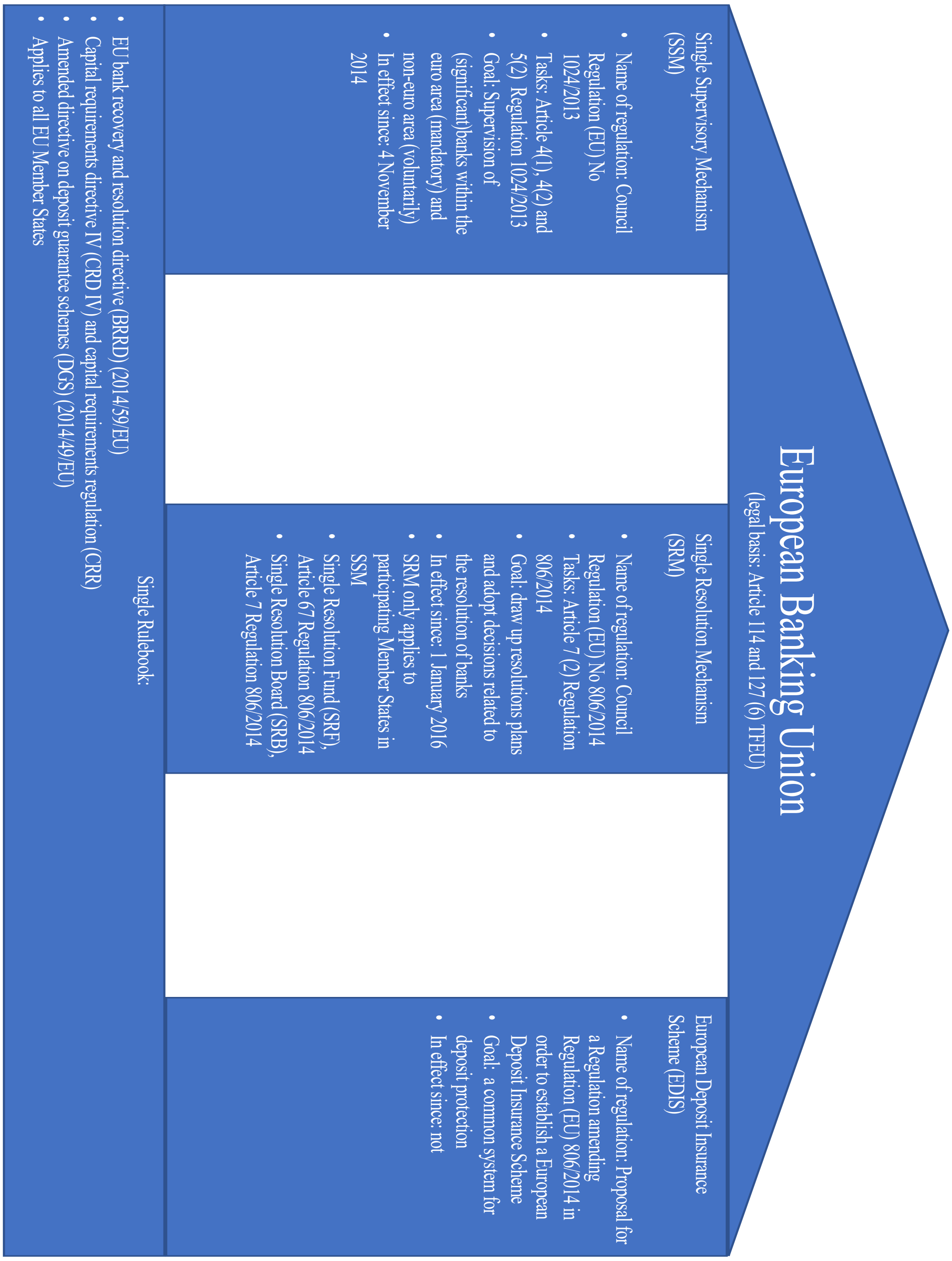

Figure 5. The pillar structure of the European Banking Union. Sources: Regulation 1024/2013, Regulation 806/2014, Proposal for Regulation to establish EDIS, and European Council (2018).

7.1 The Single Supervisory Mechanism

In September 2012 the European Commission (2012a) presented a proposal to establish the SSM, which is the first pillar of the European Banking Union. The European Commission (2012a) believed that supervision of banks should be carried out at the EU-level as only European supervision can guarantee “appropriate oversight of an integrated banking sector and a high level of financial stability in the EU and the euro area in particular”. As stated in the memorandum of the proposed Regulation, the European Commission (2012a) wanted the ECB, eventually, to carry out the supervision of all credit institutions in the participating Member States, the ECB would cooperate with the 3 European supervisory Authorities and the ECB would not take over any task of EBA. The ECB would carry out the task of supervision with the NCAs. In October, during another meeting of the European Council (2012) the heads of state or government decided two things: (1) that the SSM should be open to all Member States, thus not only the euro area, and, (2) that the two functions of the ECB, monetary policy and supervision, should be clearly separated.

The European Commission (2012b) presented on the same day another proposal to amend Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority), among the reforms are a procedure when the ECB does not comply with a decision of the EBA in cases of settling disagreements or emergency situations (Article 18 and Article 19). The Regulation also changes the composition of the independent panel of EBA, Article 41 guarantees that at least one Member State that is not participating in SSM is a member of this independent panel. Also, the composition of the Management Board of EBA is changed, Article 45 sets that at least two Member States that are not participating in SSM are members of the Management Board. In October 2013 Regulation 1022/2013 replaced Regulation 1093/2010.

The European Council approved Regulation 1024/2013, better known as the SSM Regulation, in October 2013. Although the Regulation is called the Single Supervisory Mechanism, in reality as mentioned in Article 6 Regulation 1024/2013 the ECB and the NCAs together became the supervisors of banks, including G-SIBs, in the euro area and in non- euro Member States which chose to participate in the SSM. Banks are grouped in 4 different entities according to Article 6 (4) Regulation 1024/2013: credit institutions, financial holding companies, mixed financial holding companies, and branches of credit institutions established in non-participating Member States.

Regulation 1024/2013 mentions in Article 1 the objective of the Regulation; it should contribute to:

> " the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage."

Members States in the euro zone are automatically participating in the SSM, based on Article 7 Regulation 1024/2013 non-euro Member States can participate in the SSM by so-called "close cooperation" between the NCA of that Member State and the ECB. Articles 4, 5 and 6 describe the tasks of the ECB in the SSM, and include authorize/withdraw banking licenses, decide the degree of significance of a bank, setting capital requirements, and has supervisory and investigatory powers (Article 9) and eventually may impose administrative penalties (Article 18). The ECB supervises directly the significant banks. The criteria for a bank to become significant are mentioned in Article 6 (4) (i-iii) Regulation 1024/2013: size (total value of the assets of a bank are more than 30 billion euro), relevance for the economy of a MS/ EU, the significance of cross-border activities (there are two conditions: (1) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20 %, and (2) the total value of its assets is more than 5 billion euro.) and whether the bank has received or requested financial assistance from the EFSF or ESM. Indirectly the ECB supervises the less significant banks as well based on Article 4 (1) Regulation 1024/2013, directly these banks are supervised by NCAs.

The supervision in itself is arranged in Articles 9-17 Regulation 1024/2013, and also in Regulation 468/2014. In Articles 3 and 4 Regulation 468/2014 it is explained that there are so-called Joint Supervisory Teams (JST) for every significant bank that is directly supervised by the ECB, each JST is composed of staff members of the ECB and NCAs, and are coordinated by a JST coordinator (an ECB staff member). The tasks of the JST are described in Article 3

Regulation 468/2014: performing the supervisory review and evaluation process (SREP), this is further described in Article 97 Directive 2013/36/EU and includes the implementation of arrangements, strategies, processes and mechanisms by the bank, and evaluate risks which might threat the bank, evaluate the risks of a bank to the financial system, and evaluate risks revealed by stress tests. Another task of the JST is the participation in the preparation of a supervisory examination programme, which is further described in Article 99 Directive 2013/36/EU. In the supervisory examination programme supervisors explain how they are going to supervise the bank, explain whether the bank needs extra supervision and contain a plan for inspections of the bank and its branches and subsidiaries in other Member States. The last task is to implement the supervisory examination programme.

The ECB started in November 2013 a yearlong comprehensive assessment, consisting of a stress test and an asset quality review (AQR), of the 130 largest euro area banks. The ECB (2014) announced that the results of the comprehensive assessment showed that 13 banks did not pass the stress test and that the AQR showed that the value of the assets of banks needed to be adjusted by 48 billion euro. Since November 2014 the ECB is responsible for the supervision of banks in the euro area. The ECB (2015b) stated that since the beginning of the Banking Union in November 2014 the ECB supervises directly 123 banking groups and that the NCAs supervise directly around 3500 institutions. All banks that are declared G-SIBs in the euro area by the FSB are directly supervised by the ECB, G-SIBS from other European Union Member States are not supervised by the ECB, only their offices in the euro area are directly supervised by the ECB (for example G-SIBS from the United Kingdom like HSBC, Barclays, and Royal Bank of Scotland have offices in various euro area countries (2015a)).

Based on Article 26 Regulation 1024/2013, it is the Supervisory Board that plans and executes the supervisory tasks of the ECB. The Supervisory Board is composed of a Chair (currently Enria, former Chair of EBA 2011-2018), a Vice Chair (most likely Mersch, the European Parliament needs to approve his appointment, Mersch is a Member of the Executive Board, ECB and was Governor of the Banque centrale du Luxembourg, 4 representatives of the ECB, and 1 representative from each NCA. The selection of the Chair and the Vice Chair has to be approved by both the European Parliament and the European Council (Article 26 (3) Regulation 1024/2013 and both are selected for 5 years, it is not possible to serve more than one term

(Article 26 (3) Regulation 1024/2013). The Supervisory Board issues based on Article 6 (5) (a) Regulation 1024/2013 regulations, guidelines or general instructions to NCAs and may, based on Article 6 (5) (b) Regulation 1024/2013, decide to take over the supervision on a bank from an NCA. Article 25 Regulation 1024/2013 stipulates that the functions of monetary policy and supervision of banks should be separated, Alexander (2015) argues that the German government insisted that these two functions were separated as they wanted to protect the ECB monetary policy from being influenced by the banking supervision task. The ECB has to inform the European Parliament and the European Council how it has respected the separation of tasks.

It is the Supervisory Board that sends draft decisions/ reports to the ECB Governing Council (exists of 6 members of the Executive Board and the Governors of the Central Banks in the euro area). When the ECB Governing Council does not object the draft decision of the Supervisory Board, the decision is adopted (Article 26 (8) Regulation 1024/2013). When the Supervisory Board takes a draft decision about a non-euro area Member State, then the procedure is slightly different, via Article 7(7) Regulation 1024/2013 it is possible for this Member State to inform the ECB Governing Board that it will not be bound to the potential decision. Consequently, the ECB Governing Council will then suspend or terminate the close cooperation with that Member State. When a non-euro area Member State disagrees with a draft decision of the Supervisory Board, then it informs the ECB Governing Council, and the Member State may decide to end the close cooperation, as a consequence the Member State may not become member of the SSM for three years (Articles 7 (8) (9) Regulation 1024/2013). The next section is about the second pillar of the European Banking Union, the Single Resolution Mechanism.

7.2 The Single Resolution Mechanism

In May 2013 the French and German governments (2013) released a press statement, in this statement they announced their plans for a stronger Europe of stability and growth, concerning the Single Resolution Mechanism they agreed on the following: a single resolution board, involved national resolution authorities, should be allowed to make decisions at the central level in a quick, effective and coherent way, the single resolution mechanism should be funded by the financial sector itself, the ESM could play a bigger role in lending facilities or recapitalization, investigate if the Single Resolution Mechanism and the ESM should be combined. A few months later, in July, the European Commission (2013b) presented its plans for the establishment of the Single Resolution Mechanism and a Single Bank Resolution Fund. In March 2014, The European Parliament, the European Commission and the European Council agreed about the text of Regulation 806/2014, as explained by Alexander (2015) they agreed that: (1) the ECB identities when a bank, supervised by the SSM, is in financial distress and needs to be resolved, (2) A Single Resolution Board would be established, with representatives of the European Commission, the ECB and national resolution authorities, (3) the European Commission would get the power to decide whether the recommendation (including the resolution plan) of the Single Resolution Board should be approved and send its approval to the European Council for final review, (4) national resolution authorities implement the approved resolution plan, the Single Resolution Board supervises the national resolution authorities in implementing this plan, and (5) outside the EU-treaty, via an intergovernmental agreement, there would be a Single Resolution Fund with 55 billion euro in 2024, it is the supervised banks that have to pay the fund.

Via Regulation 806/2014 the Single Resolution Mechanism (SRM) was established. Based on Article 98 Regulation 806/2014, the Single Resolution Board is operational since January 2015. The Regulation itself is applicable in phases; Article 99 Regulation 806/2014 sets that the Single Resolution Mechanism will be fully operational in January 2016.

Article 1 Regulation 806/2014 explains the objective of the SRM, which is to establish uniform rules and a uniform procedure for the resolution of banks. To achieve the objective, the Single Resolution Board has based on Article 7 (1) Regulation 806/2014 the responsibility for an effective and consistent functioning of the SRM. As stated in Article 7 (2) Regulation 806/2014 the Single Resolution Board has the responsibility to draw up resolutions plans and adopt decisions related to the resolution of banks. National resolution authorities help the Single Resolution Board and are responsible for adaptation of resolution plans, adaptation of measures related to intervention. The ECB or a NCA informs the Single Resolution Board when a bank is about to fail (Article 13 Regulation 806/2014), subsequently the Single Resolution Board informs the European Commission and adopts a resolution scheme which respects the principles of Article 15 Regulation 806/2014 which includes that the shareholders bear the first losses, senior management has to be replaced, natural and legal persons are made liable for their responsibility for the failure of the bank, and covered deposits are fully protected.

The Single Resolution Board is also responsible for and the owner of the Single Resolution Fund (Article 67 Regulation 806/2014). The Single Resolution Fund, Article 76 Regulation 806/2014 explains that the Single Resolution Board may be used for: (a) to guarantee the assets or the liabilities of the institution under resolution, (b) to make loans to the institution under resolution, (c) to purchase assets of the institution under resolution, (d) to make contributions to a bridge institution and an asset management vehicle, (e) to pay compensation to shareholders or creditors, (f) to make a contribution to the institution under resolution in lieu of the write-down or conversion of liabilities of certain creditors, when the bail-in tool is applied and the decision is made to exclude certain creditors from the scope of bail-in, and (g) any combination of the above mentioned. As explained by De Witte (2015) it was on the request of the German government that the original regulation for a EU-wide banking resolution mechanism was spilt in a regulation for the SRM and an international agreement, officially the intergovernmental Agreement (IGA) on the transfer and mutualization of contributions to the Single Resolution Fund (2014a), which establishes the Single Resolution Fund (SRF). The reason why Germany wanted to spilt these two is according to De Witte (2015) the opinion of the German government that financing contributions by banks is a fiscal provision, which does not fall under the scope of Article 114 (1) TFEU. The Council of the European Union (2014b) argued that an international agreement would provide "maximum legal certainty" as there were "legal and constitutional concerns" in some Member States. Fabbrini (2014) nonetheless disagrees with the opinion of the German government; he argues that there is no rule in European Union law that says that the European Union cannot impose financial duties on Member States through European Union regulations. Another possibility that De Witte (2015) mentions for the IGA are political reasons, he argues that via the IGA Germany could better protect its interests regarding the bail-in provision in the SRM regulation. In May 2014 all Member States but Sweden and the United Kingdom signed the IGA. Sweden and the United Kingdom are also not participating in the SRM. In Declaration Number 2, which is part of IGA, the Member States agreed that they should ratify the IGA on time so that the SRM can be fully operational in January 2016. As announced by the Council of the European Union (2015) at the end of

November 2015 enough Member States had ratified the IGA and therefore the SRM can indeed be fully operational in January 2016.

The Single Resolution Board itself is according to Article 43 Regulation 806/2014 composed of a Chair (currently König, former President of Bundesanstalt für Finanzdienst-leistungsaufsicht – BaFin), a Vice Chair (Löyttyniemi, former Managing Director of the Finnish government's State Pension Fund), 4 full-time members (Laviola (Director of Strategy and Policy Coordination), Carrascosa (Director of Resolution Planning and Decisions), Jazbec (Director of Resolution Planning and Decisions) and Laboureix (Director of Resolution Planning and Decisions)[14] and 1 member per Member States representing the national resolution authority (2015).

In reply to the report of Liikanen the European Commission (2014a) presented in January 2014 a proposal for a regulation on banking structural reform, as it believed that the largest European Union banks by assets remain "too-big-to-fail, too-big-to-save and too-complex-to-resolve." The European Commission wants to prevent that there is no European Union-wide approach in reforming banking systems in the European Union as some Member States have adopted structural reform measures for their national banking systems, the European Commission believes that this approach would increase fragmentation and complexity of the banking sector in the European Union and has a negative effect on the effectiveness of the SSM and SRM.

The legal foundation is again Article 114(1) TFEU. The aim of the proposed regulation is described in Article 1 Proposal on structural measures improving the resilience of EU credit institutions, and is summarized to prevent systemic risk and the failure of credit institutions, by as mentioned in Article 2 prohibiting proprietary trading (further explained in Article 6(1); G-SIBs are not allowed to engage in proprietary trading in financial instruments and commodities[15] and should become effective in January 2017) and separating certain trading

[14] Each Director of Resolution Planning and Decisions coordinates different Member States and different banks.
[15] Proprietary trading is defined by the European Commission in Article 5 (4) Proposal on structural measures improving the resilience of EU credit institutions: "using own capital or borrowed money to take positions in any type of transaction to purchase, sell or otherwise acquire or dispose of any financial instrument or commodities for the sole purpose of making a profit for own account, and without any connection to actual or anticipated client activity or for the purpose of hedging the entity's risk as result of actual or anticipated client activity, through the

activities (becoming effective in July 2018). Article 3 sets the scope of the regulation and includes all European G-SIBs. Article 9 decides which bank's activities should be reviewed by the competent authority, namely market making, investments in and acting as a sponsor for securitization, and trading in derivatives. Article 10 (1) and (2), when the competent authority decided that the activities of a bank are "a threat to the financial stability of the core credit institution or to the Union financial system as a whole", then these activities need to be, according to Article 13 (1) "legally, economically and operationally" separated from the core credit institution. The competent authority has to consult EBA before taking the decision to separate the activities of the bank (Article 10 (3)).

7.3 European Deposit Insurance Scheme

The third pillar of the Banking Union is the European Deposit Insurance Scheme (EDIS). Before the plans for EDIS are described, first there will be a historical overview of the attempts of the European Commission to establish national deposit guarantee schemes (DGS) in line with International Association of Deposit Insurers (IADI) standards in all Member States and eventually one uniform EDIS.

Since 1987 the European Commission has been trying to harmonize DGSs, this started with Recommendation 87/63/EEC (1987). As six Member State (Denmark, Greece, Ireland, Italy, Luxembourg and Portugal) did not have a national DGS, they were recommended to establish one before January 1990. Seven years later, Directive 94/19/EC (1994) was presented. The European Parliament and Council were not satisfied with the DGS at that time, which according to recital 5 of the Directive: "may prove prejudicial to the proper functioning of the internal market". Article 3 and 14 of the Directive set that every Member State needed to have a national DGS before July 1995 and banks were obliged to join a national DGS. Based on Article 7 (1) each depositor had to be covered up to 20.000 ECU, but as the Directive is based on the principle of minimum harmonization, Member States were allowed to cover more than 20.000 ECU. Directive 94/19/EC states, in recital 23 that national DGS should be financed by banks,

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use of desks, units, divisions or individual traders specifically dedicated to such position taking and profit making, including through dedicated web-based proprietary trading platforms."

in proportion to their liabilities, and should not jeopardize the banking system of the Member State. In other words, this Directive does not harmonize but gives guidelines how to finance the national DGSs. Article 4 (2) of the Directive states that a bank operating in another Member State, thus a branch, may voluntarily join the national DGS of that other Member State. The home-country rule was, with this Directive, extended to national DGS.

During the break out of the financial crisis in autumn 2008, after the collapse of Lehman Brothers in September 2008, there was at first no uniform approach to the maximum level of DGSs in the European Union, this led to different levels of deposit protection in the European Union. Schich (2009, p. 90) created an overview of the reformed DGS as they were at the end of 2008, it shows that 5 Member States guaranteed unlimited coverage of deposits, while 7 Member States covered 100.000 euro, and 7 Member States guaranteed less than 100.00 euro (from 61.000 United States dollar in Sweden till 90.000 United States dollar in France). Allen et al. (2011, p. 473) call the actions of the Irish government to protect the banking sector in 2008 "the most extreme example", the Irish government intervention in the banking sector to help the 6 largest Irish banks, but not the foreign banks operating in Ireland, with an estimated cost of 50 billion euro, led eventually to a deterioration of Irish public finances, and ultimately the EU and the IMF created a bailout plan worth 85 billion euro in November 2010.

Directive 94/19/EC was amended by Directive 2009/14/EC in 2009. The new Directive was designed, according to recital 1 of the Directive, because the Council and the European Parliament aimed to promote the convergence of DGS in the European Union. Another reason was mentioned in recital 3 that 20.0000 euro was considered not to be sufficient and this was raised in two steps from 20.000 to 50.000 euro and from 50.000 euro to 100.000 euro at the end of December 2010. Article 2 of the Directive mentions that Member States had to implement the Directive before the end of December 2010.

In July 2010 the European Commission (2010, pp. 2-3) proposed to further harmonize the DGS in the European Union, the main points of the proposal were: simplification and harmonization, a further reduction of time of paying out depositors, sufficiently financed DGSs and mutual borrowing between DGSs. The last point, the mutual borrowing between DGSs, was not acceptable for the German and Austrian government, and because of this and legal issues (a possible need for treaty change), the European Commission decided to shelve the plan (Donnelly, 2014; Howarth & Quaglia, 2018). In 2012 the European Commission wanted to create, according to Barker (2012), the European Deposit Insurance and Resolution Authority (EDIRA). EDIRA would become the only resolution authority, yet as the German government was not in favor of EDIRA, the proposal to establish EDIRA was removed (Howarth & Quaglia, 2018). It was also in this period that scholars published articles about pan-European DGS, scholars like Abascal et al. (2015); Ayadi and Lastra (2010); Gros and Schoenmaker (2014) had been writing about creating a pan-European DGS and were in favor. Ayadi and Lastra (2010) support the establishment of a pan-European DGS in particular for large cross-border banks with cross-border exposure, the system was according to them fragmented as there were in some Member States more than one DGS, and a pan-European DGS would, among other things, remove competitive distortions and preserve the internal market for banking.

In April 2014, Directive 2009/14/EC was amended by Directive 2014/49/EU. Recital 4 mentions that it should be possible to merge the DGSs of different Member States, as there is a growing integration of the internal market. Article 14 (5) mentions that for an effective cooperation of DGSs between the Member States, they need to have written cooperation agreements and inform the EBA about these agreements. Article 8 shortens the repayable amount from 20 working days to 7 working days in 2024. Article 10 sets the rules of financing DGSs, and article 12 allows Member States their DGS to lend to other DGSs in other Member States. This lending facility was according to Quaglia (2013) controversial and some Member States tried to take out this during the decision-making process. Member States had to implement, according to Article 20, most parts of the Directive before the 3rd of July 2015.

In October 2015 the European Commission (2015a) presented a Communication in which they, based on the report of the five Presidents (Juncker et al., 2015), propose several measures to strengthen the EMU. The proposals include the establishment of an advisory European Fiscal Board, national Competitiveness Boards, Capital Markets Union, and the European Deposit Insurance Scheme (EDIS). In November the European Commission (2015b) presented their proposal for EDIS. The European Commission (2015b, p. 3) wants to create:

> “a more European system, disconnected from the sovereign, so that financial stability is enhanced, citizens can be certain that the safety of their deposits does not depend on their geographical location, and sound banks are not penalised by their place of establishment”.

The European Commission (2015b) believes that EDIS complements SSM and SRM, as the responsibilities for the last ones are shared at the European level and thus should the responsibility for DGSs also be shared at the European level. The legal basis of EDIS is Article 114 TFEU. Article 4 (1) states that the membership policy of EDIS is that all euro area Member States and Member States that have a so-called “close cooperation” with ECB to participate in SSM are member of EDIS. The European Commission proposes that the board that is responsible for SRM, also becomes responsible for EDIS, the new name of the board would be the Single Resolution and Deposit Insurance Board (hereafter the Board).

When a DGS is informed that a bank is failing, it has the legal duty (Article 41l) to inform the Board. The Board has, according to Article 41m (1), 24 hours to decide whether the DGS has fulfilled the requirements and if the DGS gets access to the funds in the Deposit Insurance Fund (DIF). The Board will monitor the pay out procedure (Article 41p) and the insolvency procedure (Article 41q) of the involved bank, the DGS has to pay back the funds to DIF on a pro rata basis (Article 41o). The DIF is part of EDIS and administrated by the Board. As mentioned in Article 74a (1), the DIF is funded in the same way as DGS are, by banks. The contribution of a bank is risk-weighted. Decisions of the Board are taken by simple majority (Article 52 (1), besides the exceptions that are mentioned in Articles 50 (a), (b) and 71, 74 (f), (g), and 78.

EDIS itself will be introduced gradually, in 3 stages. In the first phase from 2017-2020, the so-called reinsurance, in which the participating DGS covers deposits up to 100.000 euro, but can get according to Articles 41a, 41b and 41c of the Directive financial support from the DIF after the DGS has exhausted its own funds, it thus functions as a back-up for DGS. The second stage from 2020-2024 is called the coinsurance. During this period there is no requirement that the DGS has exhausted its own funds. EDIS contributes, as stated in Article 41e of the Directive, to the share of coverage in the first year with 20%, this means that 20% of the costs are paid by EDIS and 80% by the national DGS. The second year with 40% for EDIs and 60% for DGS, the third year with 60% for EDIS and 40% for the DGS, and the fourth and final year with 80% for EDIS and 20% for the national DGS. The third stage from 2024 is called the full insurance period in which EDIS covers 100% of the costs (Article 41h). The European Commission aims to limit moral hazard; a DGS has only access to EDIS, in all 3 stages, when the DGS has met its requirements as are mentioned in Article 41i.

Not all Member States supported the plans of the European Commission to establish EDIS. As explained by Donnelly (2014) Member States that have sufficient funds to support national banks, like Germany and Benelux, are in general not in favor of pan-European DGS, while countries like France, Italy and Spain are not in this position and therefore support the establishment of pan-European DGS. According to Spiegel and Wagstyl (2015) the German government rejected the plans of the European Commission, because the German government believes that the plan redistributes the risk that Germany has to cover losses for weaker banks in other Member States instead of reducing it and said that ideas of the European Commission sets the "wrong priorities and guidelines". Brunsden (2015) adds that the German minister of finance, at that time Schäuble, announced that on the day of the ECOFIN meeting on the 8th of December 2015, Germany is prepared to go to the EU Court of Justice to overturn the plans of the European Commission as he believes that EU treaties should be reformed and more measures should be taken to restrict excessive risk-taking in the financial system. In the words of Schäuble: "There is a moral hazard problem," he told ministers. "As soon as you share risk, the decisiveness to reduce risk is lessened. That is what happened over the past few years." (Brunsden, 2015). Christie et al. (2015) claim that the Dutch minister of finance, then Dijsselbloem, agreed with the German minister of finance about reducing risks, Dijsselbloem stated that sovereign debt should play a smaller role in banks' balance sheets to get support from other Member States for EDIS. Donnelly (2018a) added that Schäuble only wanted to discuss the plans after a number of preconditions had been reached. Countries like France and Italy were in favor of the plans as they consider EDIS as the final pillar of the BU. Other relevant actors, like the EBF (2015) were also critical, it wanted to be sure that banks do not have to pay more for the DGS and asked the European Commission to make sure that all Member States have implemented the Directive 2014/49/EU to have the same tools and funding resources for EDIS in all Member States.

On the same day, ECOFIN discussed for the first time the Communication of the European Commission about their plans to strengthen EMU and the proposal to establish EDIS. ECOFIN (2015) decided to establish an ad hoc Council working group to consider the Communication of the European Commission to strengthen EMU and the proposal to establish EDIS. In June 2016, the European Council (2016) did not agree on the plans regarding EDIS and agreed to wait till the Basel Committee had published recommendations on the field of regulatory treatment of sovereign exposures, meanwhile discussions at technical level within the Council Working Party continued. On 11 October 2017 the European Commission (2017a) announced to introduce into two phases (a more restricted reinsurance phase followed by coinsurance).

In December 2018, ECOFIN (2018) mentioned a hybrid model based on the plans of the European Commission of October 2017 and a mandatory lending scheme. The technical details behind this hybrid model were discussed by the Austrian Presidency of the European Union. Also, the "transitional aspects in the context of the introduction of EDIS, the impact of EDIS on non-banking union member states, alternative measures and the calculation of risk-based contributions" (Economic and Financial Affairs Council, 2018, p. 6) were discussed by the working party. The Eurogroup (2018) suggested to the European Council to set up a High Level Working Group to work on "next steps", the High Level Working Group should report in June 2019. On the 14th of December 2018, the Euro Summit (2018) approved the suggestion of the Eurogroup. After the meeting of the Eurogroup in June 2019, Centeno, the president of this group, declared that Member States were not ready yet to take a decision on the next steps, the High Level Working Group has to report in December 2019 about a possible roadmap regarding the political negotiations on EDIS (Eurogroup, 2019).

7.4 EU Bank Recovery and Resolution Directive

In April 2014 Directive a framework for the recovery and resolution of credit institutions and investment firms (2014/59/EU) was presented, this Directive amends several Directives and

Regulations[16]. The Directive aims to establish one single procedure for the recovery and resolution of G-SIBs, Member States are required to have one resolution authority which has resolution tools and powers (Article 3 (1) Directive 2014/59/EU). Based on Article 4 (10) Directive 2014/59/EU, banks that are supervised by the ECB have to set up their own recovery plan. It is the Member States, Article 5 (1) (2) (3) Directive 2014/59/EU ensure that every bank has a recovery plan that is annually updated or updated after a change in the legal or organizational structure of the bank and a bank should not assume that it will receive public financial support. The recovery plans are reviewed by the Member States.

The Directive also explains the early intervention measures which include the removal of the management body (Article 28 2014/59/EU), the appointment of a temporal administrator (Article 29 2014/59/EU). The following section of the Directive describes the objectives of resolution (for example ensuring the continuation of critical functions, Article 31 (2) (a) 2014/59/EU, the conditions for resolution Article 32 and 33 2014/59/EU, the General principles governing resolution (for example, the shareholders bear the first losses Article 34 (1) (a) 2014/59/EU). The following section gives more information about the different resolution tools that might be used, Article 37 2014/59/EU informs there are four resolution tools: the sale of business tool; the bridge institution tool; the asset separation tool; the bail-in tool.

When banks are failing, Member States need not only to have resolution plans which are in line with the Directive 2014/59/EU but also with EU state aid legislation. In November 2015 the European Commission (2015c) announced that the resolution plans for four small Italian banks (Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara and Cassa di Risparmio della Provincia di Chieti) were in line with Directive 2014/59/EU and EU state aid legislation. Based on Article 130 BRRD, the bail-in provisions, were not entered into force before the 1st of January 2016, and thus were not used for these 4 banks.

[16] 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012.

On the 7th of June 2017, Spanish bank Banco Popular Español was declared "failing or likely to fail" by the ECB because of the liquidity situation of the bank, the ECB (2017b) informed the SRB about this and the SRB decided to make a resolution scheme so that Banco Popular Español could be sold to Banco Santander. The resolution of the Banco Popular Español was the first one since all provisions of the Single Resolution Mechanism Regulation are into force (European Commission, 2019b). Two weeks later, on the 23rd of June 2017, two Italian banks Veneto Banca and Banca Popolare di Vicenza, were declared "failing or likely to fail" by the ECB, because they breached supervisory capital requirements and were unable to present capital plans. The ECB (2017a) informed the SRB about this, the SRB however decided that the conditions for resolution actions had not been met and the banks had to be wound up in line with Italian insolvency procedures. As explained by Micossi (2019) Italian bank Banca Carige was vulnerable because of non-performing and bad loans, and as it remained below the supervisory capital requirements the ECB required a capital increase. After the shareholders did not approve the capital increase, a majority of the Board members resigned. On the 2nd of January 2019, the ECB (2019a) announced it had appointed three temporary administrators, their task is to stabilize the governance and find an effective solution, furthermore three members were appointed for the surveillance committee. The Latvian bank AS PNB Banka was declared "failing or likely to fail" on the 15th of August 2019 by the ECB (2019b), the SRB stated that resolution action was not in the interest of the general public.

7.5 Summary and Conclusion

This section aimed to describe the EBU and the EU Bank Recovery and Resolution Directive. At the end of June 2012, the leaders of the state or government in the euro area asked the European Commission, based on the recommendations of the report of Van Rompuy et al. (2012), to come up with proposals to create a SSM. The SSM, the first pillar of the EBU and operates since November 2014, gives the task to the ECB to supervise directly significant banks and to NCAs to supervise less significant banks. In July 2013, the European Commission presented the plans to establish the SRM, the second pillar of the EBU. The SRM includes the SRF and SRB and sets a legal framework for the resolution of failing banks. In November 2015 the European Commission presented its proposal to set up an EDIS. EDIS, the future third pillar of the EBU, and is not supported by all Member States as for example Germany believes EDIS would increase risks that Germany has to cover losses for weaker banks in other Member States instead of reducing. Consequently, European policymakers have not been able yet to agree on the proposal. The EU Bank Recovery and Resolution Directive is officially not a part of the EBU, sets a single procedure for the recovery and resolution of banks. The next section analyzes the establishment of the EBU theoretically by testing three hypotheses that were formulated in the second section, the theoretical framework.

8. Theoretical explanations of the establishment of the European Banking Union

In the theoretical framework three theories were presented and their ideas on how policy change occurs. Furthermore, various hypotheses were formulated. In this section the hypotheses will be tested on the establishment of the SSM, SRM, and SRF, these are considered to be the European Banking Union in this section. Negotiations on the EDIS have not finished and hypotheses on EDIS can therefore not be tested and are left outside of the scope.

8.1 Neofunctionalism

Neofunctionalists argue that the drivers of integration are spillovers, therefore neofunctionalists could argue as well that the monetary integration (the EMU) had spillovers effects on financial integration, and this created a need for the establishment of the European Banking Union. Neofunctionalists argue further that European institutions would actively support this establishment. In this section, one hypothesis about cultivated spillovers will be tested to see whether neofunctional assumptions can be applied. The first hypothesis that will be tested is:

European Union institutions had a clear preference for further integration and were the drivers for the establishment of the European Banking Union.

Below the role of the European Central Bank and the European Commission, as the most important European Union institutions, in the establishment of the SM and SRM will be analyzed to see to what extent this establishment complies with neofunctional expectations.

European Central Bank

The Single Supervisory Mechanism (SSM)

The ECB was before the outbreak of the financial crisis already a supporter of the idea that this institution would supervise banks, for example in 2001 the ECB (2001) published a publication about the role of Central Bank in prudential supervision in euro countries. After presenting the pros and cons of a combined role of central banking and the supervision of banks, the ECB (2001, p. 7) concluded that:

> "an institutional framework in which the Eurosystem's responsibilities for monetary policy in the euro area are coupled with extensive supervisory responsibilities of NCBs in domestic markets, and with reinforced co-operation at an area-wide level, would seem appropriate to tackle the changes triggered by the introduction of the euro."

However, the *communis opinio* of the Member States was not to agree with the view of the ECB. Former president of the ECB, Duisenberg, was in favor of expanding the mandate of the ECB to the supervision of banks (Sims, 1999), but during a meeting of ECOFIN (2001a) the ministers stated that supervision of banks should remain at the national level. After this the ECB remained silent on this topic until the outbreak of the financial crisis when then member of the Executive Board of the ECB, Bini Smaghi (2008), argued that the ECB needed more information about the solvency of banks in the Eurozone as he wanted to prevent that the ECB would finance banks that were not only illiquid but also insolvent. Bini Smaghi (2008, p. 12) believed that there was thus a "need of timely and exhaustive transmission of supervisory information at the European level". Yet again, European policymakers did not change their minds, the ECB was not going to supervise banks, and thus until the outbreak of the financial crisis, there was no policy change.

In February 2012, Member of the Executive Board of the ECB Praet (2012) actively promoted the idea of further integration. A few months later the report of Van Rompuy et al. (2012) about the future of the EMU, the European Commission issued quickly proposals on the SSM. As argued by De Rynck (2016, p. 129) there were two reasons for the ECB to support the establishment of EBU, next to its long preference for more centralized banking supervision and its changed role from guarantor of price stability to guardian of the sustainability of EMU as such, for the ECB to push for further integration namely a change in governor and board members which brought in new ideas and as the scale of LTRO increased, the chances of moral hazard behavior by national supervisors also increased.

European Commission

Several scholars like Lannoo (2014) argued that the role of the ECB during the first year of the crisis was limited during meetings of ECOFIN. This started to change in 2012 when the Spanish banking system fell into a severe crisis. The Spanish government asked the Eurogroup to borrow 100 billion euro to recapitalize its failing banks. Spain was after Greece, Ireland, and Portugal the fourth country that needed the European Financial Stability Facility (EFSF, established in June 2010). The EFSF changed into the European Stability Mechanism (ESM, October 2012) and it was the ESM that provided loans to Spain. During a meeting of the euro heads of state or government, in June 2012, it was decided that: "it is imperative to break the vicious circle between banks and sovereigns" and the leaders asked the European Commission to set up a plan for a single supervisory mechanism (SSM) supervised by the ECB (2012). In September 2012 the European Commission presented its plans ("Roadmap towards a Banking Union") to establish the European Banking Union. On the same day, the ECB (2012) released a press statement in which the ECB supported the plans of the European Commission. The European Parliament (2012) also welcomed the plans of the European Commission, regarding the proposal of the EC to set up the European Banking Union. The European Parliament only had consultative status, regarding the amendment of the European Banking Authority, the European Parliament had more power, as it had shared decision-making power with the Council.

The Single Resolution Mechanism

In May 2013 the French and German governments presented their plans for a single resolution board. In July 2013 the European Commission presented a draft version concerning the establishment of the SRM. The European institutions (European Parliament (EP), the ECB and the European Commission) supported the idea of the SRM. There was however not an instant agreement between the European institutions and the European Council. As described by Howarth and Quaglia (2014, p. 126) there were four issues during the negotiations on the SRM: the scope and membership of SRM, the centralization of decision-making authority, the sources of funding and the mechanism's legal basis. It was in particular Germany that had the aforementioned doubts about the SRM. European institutions had different opinions, for example, the European Parliament (2014) disagreed with the European Council on which banks should be included and stated: "all banks must be treated equally, irrespective of which country they are established in, and that the system must be credible and efficient." Another issue that is presented by Howarth and Quaglia (2014) is that the German government had the idea that the SRM should start as a network of national authorities, and not as a single and independent organization as the ECB wanted. The solution to the 4 beforementioned issues was to create a hybrid construction in which there is an intergovernmental agreement for the Single Bank Resolution Fund, and the Single Resolution Board is part of the SRM EU regulation.

To summarize, the European institutions had their ideas and some of these ideas were accepted by the Member States, however, the Member States were the main drivers of the policy change that led to the establishment of both the SSM and SRM. Therefore, the first hypothesis has to be rejected as the European institutions were not the sole drivers and in the end, the Member States had the last decision power about establishing the SRM and SSM.

8.2 Historical institutionalism

Historical institutionalists expect that decisions taken in the past, restrict policymakers in decision-making. This restriction is also known as path dependency. In this section, one hypothesis about path dependency will be tested to see whether historical institutionalist assumptions can be applied.

The second hypothesis that will be tested is:

- Member states chose rationally as if they could design the European Banking Union from scratch

When the euro area heads of state and government discussed the plans of Van Rompuy et al. (2012) on the 29th of June 2012, it was decided that an SSM should be established at the ECB. In other words, a new institution the SSM had to be created by the Member States. When Member States want to establish a new EU institution to delegate regulatory powers, they have to take into consideration the Meroni doctrine and Article 127 (6) TFEU. In the Meroni doctrine (derived from *Meroni & Co., Industrie Metallurgiche, società in accomandita semplice v High Authority of the European Coal and Steel Community*), the Court of Justice of the European Union (1958, p. 152) set the conditions to establish an agency that has regulatory powers: (1) institutions can only delegate powers that they have themselves, (2) a delegation is allowed when it: "involves clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority", 3, it is not allowed to delegate powers when: "it involves a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy" because "it replaces the choices of the delegator by the choices of the delegate, brings about an actual transfer of responsibility".[17]

Article 127 (6) TFEU stipulates that:

> "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer special tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertaking."

Taken the SSM into consideration, theoretically, the Member States could have decided to strengthen the powers of the EBA, instead of those of the ECB. There were two reasons why this did not happen: (1), the Meroni doctrine and Article 127 (6) TFEU made it impossible for the EBA to get supervisory powers, legally only the ECB could get these powers and (2), theoretically European legislation could have been amended, but this would be a time-

[17] Relevant in this case is also the principle of institutional balance, which is about the relationship between the European Commission, the Council of the European Union and the European Parliament. An institution may not infringe the powers of another institution. This principle is derived from the Meroni case.

consuming task and as there was a lot of pressure on the European financial institutions, there was no time and 3, not all Member States were in favor of transferring banking supervision competences to the European Union level, in particular, the United Kingdom was against.

Because of the beforementioned, it can be concluded that the second hypothesis has to be rejected, Member states could not design the European Banking Union from scratch because of legal and political reasons. Agreements made policymakers in the past (Article 127 (6) TFEU) and European jurisprudence (the Meroni doctrine) limited the possibilities that European policymakers had when they established the SSM. Politically there was no support from all Member States, and this was needed.

8.3 The advocacy coalition framework

In this section, one hypothesis about policy learning will be tested to see whether ACF assumptions can be applied. The third hypothesis that will be tested in this section is:

- There were only intermediate conflicts between the two coalitions and because of this the SSM and SRM could be established

The negotiations on the SSM

During the Euro Summit of 28-29 June 2012 the Member States asked the European Commission to come with a proposal for the establishment of a single supervisory mechanism in which the ECB is involved, and once this mechanism was established, the ESM could recapitalize banks directly for banks in the euro area (Euro Summit, 2012). According to Glöckler et al. (2017) the establishment of the SSM could be considered as a package deal as through SSM, direct bank recapitalization would be possible. In September 2012 the European Commission presented its proposals for the SSM. This was the starting point of the negotiations as not all Member States agreed with the plans of the European Commission.

During the negotiations on the SSM, there were two coalitions, one coalition led by Germany (the other members were Finland and the Netherlands), the other coalition was led by France (Spain and Italy were the other members). The coalition led by France supported right away the establishment of an SSM because of national solvency, the French government was in favor as French bank's exposure to southern debt became clear (Epstein & Rhodes, 2016). The other coalition was more hesitant.

Although Chancellor Merkel was in favor of the creation of an SSM, there were 3 areas in which the coalitions did not agree initially. The first one was whether all banks should be supervised by the ECB or only the systemically important big banks. The German minister of Finance Schäuble stated: "It would be very difficult to get approval by the German parliament if (the deal) would leave the supervision for all the German banks to European banking supervision" (cited in: Fox, 2012). He believed that *Landesbanken* and *Sparkassen* (regional banks and savings banks) should be excluded from the supervision of the ECB. The French government disagreed with this view and believed that all 6000 banks in the Eurozone should be supervised by the ECB. The French minister of Finance Moscovici stated that: "In the end it must be the ECB that has the responsibility on the whole. Otherwise, there is no real system of banking supervision"(cited in: Fox, 2012).

The second issue was about the minimum value of assets of banks to be supervised directly by the ECB. As explained by Epstein and Rhodes (2016) the Cypriot EU presidency suggested that the minimum should be 30 billion euro. The German government disagreed, as they wanted to exclude *Landesbanken* and *Sparkassen* from direct supervision and suggested a minimum threshold of 50 billion euro. The third issue was the timetable for setting up the SSM. The French president Hollande was in favor of "the earlier the better" and wanted the ECB to supervise all banks in January 2013, while the German Chancellor Merkel was in favor of a more cautious approach as "haste could prove costly" (cited in: Times of Malta, 2012).

In the final agreement it was decided that the ECB would have direct supervision of 120 European systemically important banks (E-SIBs), the starting date of the ECB supervision was November 2014 and the minimum threshold was 30 billion euro.

The negotiations on the SRM and SRF

Another component of the Banking Union is the SRM and SRF. In July 2013 the European Commission proposed a regulation for the establishment of the SRM. Like in the negotiations on the SSM, also during the negotiations on the SRM there were 2 coalitions, and again they were led by Germany and France. The coalitions disagreed about the following issues: the scope of the SRM, the role of the European Commission and Member States on resolving failing banks, the legal basis of the SRM, and the funding of the SRF (Howarth & Quaglia, 2014).

The first issue was like during the negotiations on the SSM, the scope of the SRM. When the European Commission presented its plans for the SRM, they proposed that all banks supervised under SSM would be covered by the SRM. The Germans believed that the scope of the SRM should be limited; *Landesbanken* and *Sparkassen* should be excluded. The second issue was the plan of the European Commission that it would be the European Commission that had the final word to decide whether a bank would be resolved. The German government believed that it should not be the European Commission, they believed it should be the European Council. Initially, most Member States supported this opinion. This changed after it became clear that legally the Single Resolution Board (SRB), a new institution that prepares resolution plans for banks in distress, could not have the last word, Member States as France, Italy and others accepted that the European Commission would have the final say in initiating a resolution or not (Skuodis, 2018).

The third issue was the funding of the SRF. The French coalition, supported by the European Commission and European Central Bank, supported the idea of creating a single European bank rescue fund financed by levies on banks. As explained by Howarth and Quaglia (2014) German politicians were not in favor of this, they supported a network of national funds and believed that there would be a need for a treaty change for establishing a common fund. The latter was the fourth issue. A treaty change as the German government believed that financing contributions by banks is a fiscal provision, which does not fall under the scope of Article 114 (1) TFEU (De Witte, 2015).

It was on the request of the German government that the original regulation for an EU-wide banking resolution mechanism was split in a regulation for the SRM and an international agreement, officially the Intergovernmental Agreement (IGA) on the transfer and mutualisation of contributions to the Single Resolution Fund (2014a), which establishes the Single Resolution Fund (SRF) (De Witte, 2015). The reason why Germany wanted to split these two is according to De Witte (2015), the opinion of the German government that financing contributions by banks is a fiscal provision, which does not fall under the scope of Article 114 (1) TFEU. The Council of the European Union (2014b) argued that an international agreement would provide "maximum legal certainty" as there were "legal and constitutional concerns" in some Member States. Fabbrini (2014) nonetheless disagrees with the opinion of the German government; he argues that there is no rule in European Union law that says that the European Union cannot impose financial duties on Member States through European Union regulations. Another possibility that De Witte (2015) mentions for the IGA are political reasons, he argues that via the IGA Germany could better protect its interests regarding the bail-in provision in the SRM regulation. In May 2014 all Member States but Sweden and the United Kingdom signed the IGA. Sweden and the United Kingdom are also not participating in the SRM.

When comparing the negotiations on the SSM and SRM, it is clear that it was most often Germany that disagreed with the plans of the European Commission. This is at first sight remarkable as the German chancellor had agreed to establish a Banking Union. A closer look into the negotiations shows that the German government had a different view on the problems and solutions offered by the European Commission. The German position was based on ordoliberal ideas (for an overview of ordoliberalism see (Nedergaard, 2019; Wandel, 2019)). According to Schäfer (2016, p. 969) this means that their main concern was to align responsibility and liability, as their opinion was that joint liability without joint responsibility causes moral hazard. The German minister Schäuble stated (as cited in: Schäfer, 2016, p. 972) about the European Banking Union:

> "We made sure that we do not set the wrong incentives in the creation of the banking union and the bailout funds. We said we have to restore the old principle: Who gets the

> opportunity also has to take the risk. This principle is also valid for banking regulation. This, ladies and gentlemen, is ordoliberalism."

The other coalition, led by France, was based on neo-Keynesian ideas (Lequesne, 2013) and "European solidarity". European solidarity meant that they were in favor of introducing Eurobonds, public rescue funds and the possibility for the ESM to directly help distressed banks (Schild, 2018). The debate that the German and French government had on the Banking Union was part of a bigger debate between these countries about the eurozone governance and the sovereign debt crisis. The success of the French government is convincing the German government to support their solutions to solve the crises was limited (Howarth & Quaglia, 2013, p. 111). Summarized, the coalitions had discussions on the intermediate level, as in line with the propositions of ACF regarding policy learning. The third hypothesis is accepted.

8.4 Summary and conclusion

In this section, three hypotheses were tested about the establishment of the EBU. The first hypothesis about the role of European institutions in the establishment of the EBU had to be rejected as they were not the only drivers of establishing this institution and ultimately the Member States had. The second hypothesis also had to be rejected, this hypothesis tested whether policymakers were restricted by decisions taken in the past. It is clear that because of legal and political reasons policymakers were restricted. The third hypothesis is accepted, it tested on which level there were discussions between the coalitions as ACF predicts that only on the intermediate level there is policy learning. The next section is the final section of this thesis and gives a final conclusion.

Conclusion

The thesis aimed to answer the following research question: To what extent can neofunctionalism (NF), historical institutionalism (HI) and advocacy coalition framework (ACF) explain the policy change that led to the establishment of the European Banking Union (EBU)? The objective of the thesis was that a combination of three theories could explain the establishment of the first two pillars of the EBU, the SSM, and SRM, better than a single theory could. In order to test the assumptions of the theories, for each theory one hypothesis was made and tested. Below the outcome of the hypothesis testing is described.

The first hypothesis was about the role of European Union institutions and whether they had a clear preference for further integration and if they were the main drivers for the establishment of the SSM and SRM. The theoretical concept that is tested here is *cultivated spillover* and is part of NF. The theoretical assumption is that employees of European Union institutions become agents of integration and actively push for the establishment of the EBU. The outcome of the analysis is that the European institutions like the ECB and the European Commission were in favor, however for a long time, this did not have any influence on the Member States, and thus the hypothesis is rejected. The window of opportunity was created when Spanish banks were in distress and the Spanish government asked for ESM support to recapitalize its failing banks. It was only then when there was support for the policy change that led to the establishment of the EBU. It is hard to argue that there would be an EBU if there had not been a financial crisis.

The second hypothesis was whether policymakers had the possibility to create the European Banking Union from scratch or if they were constrained by agreements made in the past. The theoretical concept that is tested is *path dependency* and is part of HI. The theoretical assumption is that policymakers are restricted when they make policies because of past agreements. The result of the analysis is that policymakers were restricted in two ways, politically and legally, and thus the hypothesis is rejected. Politically because not all Member States, like the United Kingdom and Sweden, were in favor of creating the EBU. Legally, if the Member States wanted to delegate the supervision tasks to another institution, then a treaty change was required. Because of the urgent situation, there was no time for a treaty change. Path dependency expects that policymakers are restricted in policymaking because of decisions taken in the past, in other words, although the hypothesis is rejected, this does not mean that HI cannot explain the establishment of the EBU.

The third hypothesis was about intermediate conflicts between the two coalitions and because of this the SSM and SRM could be established. The theoretical concept that is tested is *policy* *learning* and is part of ACF. Theoretical assumptions are that policy learning is most likely when the conflicts between the coalitions are of intermediate nature. The review showed that there were two coalitions, one led by Germany and the other one by France. And although during the negotiations on the SSM and SRM the coalitions had different ideas (the German coalition was based on ordo-liberalism, while the French coalition was based on neo-Keynesian ideas), the coalitions agreed after a short time. There were no deep conflicts between the coalitions. The hypothesis is accepted.

Out of the three hypotheses, two were rejected. It would be a simplification to argue that these theories are no longer capable of explaining European policymaking. Of each theory only one concept was tested, other concepts of the same theories may be able to explain the establishment of the EBU. And it is also important to notice that a rejection of a hypothesis does not mean that a theory cannot explain or predict a certain outcome as the hypothesis on path dependency shows.

About the third pillar of the EBU, EDIS, there is no agreement yet between the Member States. From a methodological point of view, the hypotheses were not used to see if theoretical predications can explain why there is no EDIS yet. When a preliminary analysis is made, the following can be concluded. Cultivated spillover, like with the SSM and SRM, cannot explain why there is no EDIS, as the European institutions are in favor of creating an EDIS and are actively pushing for it. The second concept of path dependency, policymakers have to take past decisions into consideration when they present a proposal. Member States have agreed in June 2019 that they were not ready to decide on EDIS and they have decided that the High-Level Working Group has to investigate possibilities for a possible roadmap on EDIS. Other solutions have not been made public and because of this, it is not possible to determine whether path dependency has played a role. Policy learning however can explain better why there is no EDIS. It seems that the German ordo-liberalism ideas (moral hazard) clash with the current proposal to establish an EDIS. In the negotiation process, this leads to deeper conflicts and as predicted by ACF, this prevents policy learning and thus there is no policy change. A healthy state of public finances and healthy banks in the euro area, which is another ordo-liberal idea, possibly changes the position of the German government towards the EDIS proposal. Although banks seem to be healthier because of increased equity levels, it is however questionable that the state of public finances in some Member States changes from poor to healthy on short-term notice. An interesting perspective on a possible policy change that leads to the establishment of EDIS is given by Cassell and Hutcheson (2019), they suggest that German policymakers and voters will only agree with EDIS, as they did with the SSM and SRM, when they see their current (financial) situation as "bad" and see it is getting worse in the future.

Future research could add liberal intergovernmentalism to the theoretical framework as it seems from analyzing European banking regulation and supervision that Member States have a determining influence on policymaking. Another idea is to use the selected theories fuller, and not to be restricted by one concept. The last idea for future research is to keep abreast of the latest developments on EDIS, as policymakers might agree in December on EDIS. EBU success? Two European Unions, consequences?

The current functioning of the EBU is criticized. The fundamental idea of the EBU was to break the strong link between sovereigns and banks. Donnelly (2018b) uses the examples of distressed Italian (as mentioned before) and Portuguese (Banco Espírito Santo, which was split into a healthy bank (Novo Banco) and a bad bank with toxic assets in 2014) banks to show that in these Member States remain fragile and that the link between Member States and banks is still existent. The European Commission and the SRB gave the Italian and Portuguese government permission to relax state aid definitions, and consequently, these banks do not have an incentive to become healthy. Also, Praet (2017) is critical about the functioning of the EBU and stated:

> "While supervisory decisions are taken at European level, the relevant risk-sharing mechanisms such as deposit insurance schemes are still at national level. Supervision is common, but the consequences of potential bank failures are still predominantly national. National considerations therefore continue to affect supervisory decisions."

The above shows that the regulation and supervision of banks is not "finished". Globalization, political and technological developments influence the stability of banks as was shown during the last financial crisis. Policymakers have the responsibility to remain alert to the beforementioned developments, and they should prioritize breaking the links between states and banks and make sure that banks are healthy. After all, sooner or later, there will be another financial crisis.

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