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Banking union:state of play and proposals for the way forward

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BANKING UNION:
STATE OF PLAY AND PROPOSALS FOR THE WAY FORWARD

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Abstract

This paper examines the current state of play of the Banking Union project aiming at unveiling the weaknesses and gaps of this still incomplete framework. In this context, the implementation so far of the Banking Union legislation sheds light on the vulnerabilities concerning supervisory change, transparency, trust and a proper allocation of bank failure costs since all these criteria are deemed as essential contributing factors to promoting financial stability at European level. Taking into consideration the latest steps towards completing the Banking Union framework until June 2022, this paper aims at depicting the proposed leeway potentially capable to align resilience and flexibility with the view of mitigating any persisting shock-amplifying factor against financial stability**.**

Keywords: Banking Union, Single Supervisory Mechanism, Single Resolution Mechanism, European Deposit Insurance Scheme.

JEL-classification: G21, G28, O52, E42, F33, F42

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1. Introduction

The financial crisis that initiated in 2007 revealed the inadequacy of the European Union (hereinafter EU) regulatory framework to address the significant threats to financial stability across the Economic and Monetary Union (hereinafter EMU) and the imperative need for further steps in order to tackle the specific risks within the euro area, where pooled monetary responsibilities have spurred close economic and financial integration and increased the possibility of cross-border spillover effects in the event of bank crises.

The European Banking Union (hereinafter EBU) project emerged as a building block with centralized supervision and resolution establishing a policy tool for further integration, but also as a shock absorber to the European financial crisis that was spurred on by the US property market downturn in 2007 and spread along with the subsequent loss of trust in banks after the collapse of Lehman Brothers in September 2008. In confirmation of the establishment of the EBU as a proper response to the fragile financial landscape, a recent assessment of sovereign debt restructuring and debt mutualisation in the euro area (Rossi 2019, p. 30) confirmed that monetary policy alone has been proved ineffective and the existing backstop, i.e. the European Stability Mechanism (hereinafter ESM), may be insufficient to provide the liquidity required in case of systemic crises that could trigger an existential crisis of the euro.

A wide range of literature revealed the causes of the European banking crisis, including macroeconomic imbalances, adverse fiscal policies, inadequate structural reforms, and low productivity. Such negative factors were mainly associated with the periphery countries of southern Europe. However, the persisting link between banks and sovereigns, and the chain reaction of the existing divergences within the euro area in the aftermath of the crisis, highlighted the leading role of the single currency's weaknesses, which progressively widened the gap between the core and the periphery countries and favoured speculation at the expense of the latter. The distortion of competition in the internal market is associated with: i) northern countries' capital surplus, which stemmed from stronger national currencies and was followed by the abolition of national currency devaluation as a calibrating tool of debt-ridden countries; ii) northern countries' trade surpluses; and iii) lending capacity at historically low interest rates. These market distortions paved the way for a euro-induced disequilibrium that rendered southern Europe's deficits the fault of both southern European borrowers as well as northern European lenders (Moravcsik 2012, p. 4). This frailty was accompanied with loss of control over interest rates and inflation, thus rendering the reduction of public spending the only way to bridge the competitiveness gap between surplus and deficit countries, and accordingly to mitigate the rising debt associated with the latter (Vikelidou 2021, pp. 1-2).

On 29 June 2012, the Heads of State and Government, taking into consideration the failings in the financial sector before the crisis, adopted a reform agenda to address them. In this context, they agreed to create a Banking Union, completing the Economic and Monetary Union and allowing for centralized application of EU-wide rules for banks based on single (i.e. federal-type) mechanisms.

In this paper, we review the current state of play of the Banking Union as regards its three pillars, the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the common system of deposit guarantees. Next, we present the various proposals put forward in order to address existing weaknesses and complete the Banking Union.

2. The EBU project

The EBU project, interrupting twenty years of deregulation and lack of common supervision in the European banking sector, was the outcome of the regulatory agenda designed to reform the European financial rulebook, with the view to: a) de-link banks from sovereigns; b) prevent the next banking crisis, which would simultaneously lead to another crisis of the EMU; c) prevent and punish market abuse; and d) increase financial stability. In this respect, the Banking Union was acknowledged as the means to curb the regulatory weaknesses, supervisory failures, and excessive risk-taking in the European banking sector by establishing a common set of banking rules at European level (Vikelidou

2021, p.21). Against this backdrop, the Banking Union project emerged as a response to the worrying gaps in risk management and the supervisory failures that favoured the global financial crisis, with a dual mandate to preserve the safety and soundness of the banking system and to avert further fragmentation by promoting further financial integration among participating member states and correcting the misalignment between the reality of banks' businesses and the institutional supervisory architecture (ECB 2019a). This fragmentation stemmed from the accelerating feedback loop between sovereign credit and bank funding conditions due to the combination of member states' guarantees on domestic banks and those banks' outsized holdings of home-country sovereign debt in periphery countries (Véron 2011). Based respectively on articles 127.6 and 114 of the Treaty on the Functioning of the EU (hereinafter TFEU) for the establishment of a common framework on supervision and recovery, the (EBU) project was introduced as an essential complement to the EMU and the Internal Market. This legal basis aligns responsibility for supervision, resolution and funding at EU level, and forces banks across the euro area to abide by the same rules. Specifically, these rules were introduced to ensure that banks take measured risks and that, should a bank adopt a mistaken policy, it will pay for its losses and will face the possibility of closure, while minimising the cost to the taxpayer. In this context, following the financial crisis, the creation of the Banking Union was a move towards building an integrated EU-level framework to allow a coordinated response to risks originating in the banking sector, with the view to further limiting the risk of individual banks and the failing EU member state economic policies (Vikelidou 2021, pp.24-25).

2.1. The three pillars of the Banking Union

Against this background, the Banking Union was designed to consist of three pillars:

First, the Single Supervisory Mechanism[1] (hereinafter SSM), stipulated in Council

[1] Based on article 127.6 TFEU, which reads as follows: 'The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the ECB, confer specific tasks upon the ECB concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.' "Until the establishment of the SSM, Art. 127.6

Regulation (EU) No 1024/2013[2] (SSMR) concerning policies relating to the prudential supervision of credit institutions, which as of 4 November 2014 entitled the ECB to be the supervisor of all 6000 systemic banks in the euro area, whereas non-euro area member states may opt in if they choose to participate. According to the ECB's counting, at that time there were 120 significant banking groups in the euro area, including all those with more than €30 billion in total assets, and which represented almost 85 percent of the euro area's total banking assets (ECB 2014). On 1 November 2020, 115[3] significant institutions in the euro area were directly supervised by the ECB, while national supervisors continued to supervise all other banks under the ultimate responsibility of the ECB. The criteria for determining whether banks are considered significant, and therefore fall under the ECB's direct supervision, are set out in the SSM Regulation and the SSM Framework Regulation. They relate to a bank's size, economic importance, cross-border activities, and need for direct public support. Thus, the actual number of banks directly supervised by the ECB can vary over time, according to the fulfillment of the previously mentioned criteria as well as the ECB's decision at any time to classify a bank as significant so as to ensure that high supervisory standards are consistently applied. The number of less significant institutions (hereinafter LSIs) amounted in 2020 to 2.951, while the bulk of the LSIs' sector remained concentrated in Germany, Austria and Italy (Regulatory News 2020, and ECB 2017b, p. 6).

Second, the Single Resolution Mechanism (hereinafter SRM), based on Regulation EU 806/2014[4](SRMR), which provided for bank resolution to be managed more effectively

TFEU had only been used once to entrust the ECB with the task to support the functioning of the European Systemic Risk Board. Council Regulation (EU) No. 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board [2010] OJ L 331/162. The use of article 127.6 implied that the ECB could only perform banking supervision tasks within its central banking jurisdiction, i.e. within the euro area. This defined the jurisdiction of the Banking Union, particularly since the jurisdiction of the Single Resolution Mechanism followed that of the SSM" (Teixeira 2017, p. 547).

[2] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1024&from=EN.

[3] ECB supervisory practices (https://www.bankingsupervision.europa.eu/banking/list/html/index.en.html).

[4] European Parliament and Council of the European Union, Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution

through a Single Resolution Board (hereinafter SRB) and a Single Resolution Fund (hereinafter SRF). Specifically, the SRB in Brussels has adopted since 1 January 2015 a central role in the management of crises involving significant banks directly supervised by the SSM. On 1 January 2016, the SRB acquired its resolution authority and the key bail-in provision of the Bank Recovery Resolution Directive (hereinafter BRRD[5]), i.e., the ability of resolution authorities to impose losses on senior creditors and uninsured depositors of non-viable banks ("bail in" mechanism) entered into force. The SRM Regulation thus provided an institutional framework to apply the BRRD rules in the Banking Union remit (Teixeira 2017, p. 553). The SRM Regulation also entrusts the SRB with a SRF, the modalities of which are specified in a separate Intergovernmental Agreement (hereinafter IGA)[6] that was signed in May 2014 by 26 EU member states (all except Sweden and the UK).

Third, a common system for deposit guarantees based on the existing regulatory landscape, that will pave the way for a single European Deposit Insurance Scheme (hereinafter EDIS). This third building block is still under discussion; it is proposed with the view of ensuring that all EU savers will be guaranteed that their deposits up to €100.000 (per depositor/per bank) are protected at all times and everywhere in the same terms across the EU.

Fund and amending Regulation (EU) No 1093/201, Official Journal of the European Union, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:124:FULL&from=EN (accessed 1 May 2015).

[5] European Parliament and the Council Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 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, of the European Parliament and of the Council Directive 2014/59/EU, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059&from=EL.

[6] Council of the European Union, Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, 8457/14 EF 121 ECOFIN 342, http://data.consilium.europa.eu/doc/document/ST-8457-2014-COR-1/en/pdf.

3. State of play of the three pillars of the Banking Union

3.1. The Single Supervisory Mechanism (SSM)

3.1.1. Introduction

The Banking Union introduced a new era of centralised banking supervision at European level, where the banking industry becomes the first to absorb losses, instead of governments supporting banks with taxpayers' money. This entered into force, in the first place, with the SSM framework, which sets European rules that weaken the link between the eurozone's self-inflicted financial calamities and banking policy errors at national level, mainly stemming from anaemic regulation and national resistance to prioritise financial stability at European level. In order to assess whether the supervisory framework of the SSM has been effective, it is essential that a clear and robust legislation exists, as well as the establishment of mechanisms that ensure to a considerable level transparency and predictability. The SSM framework seems to have taken into consideration the contingent interests involved in banking supervision, since it was initially introduced to separate banking policy from political control by elevating banking supervision at European level, thus rendering imperative to establish a new legal framework clearly transmitted to participating member states, along with wide communication channels such as guidelines, annual reports, Interinstitutional Agreements, and Memoranda of Understanding. Against this background, and with the aim of contributing to financial stability, the SSM introduced clear benefits by establishing a level playing field based on a legislative framework and trust stemming from the resulting integrated supervision of credit institutions.

3.1.2. Developments in banking supervision and the way forward.

In the context of SSM, supervisors conduct a regular review and assessment to monitor compliance with EU regulation, relevant guidelines and supervisory expectations. This is the so-called Supervisory Review and Evaluation Process (SREP) aimed at providing an overall evaluation of the institution's viability. This evaluation leads to the SREP decision adopted by the Governing Council and indicatively involves: own funds requirements, institution-specific quantitative liquidity requirements and other qualitative supervisory measures. In this vein, the SREP is pivotal to European banking supervision since it includes the required qualitative measures that correspond to the institution's endogenous risk profile, its vulnerability to exogenous factors along with possible mitigants. These measures are triggered by the SREP assessment cycle of the previous year and reflect the SREP decisions to be implemented in the oncoming year. The SREP methodology is applied to significant institutions under direct supervision by the ECB and the SSM. It is based on a case-by case approach, which, however, involves the use of a single methodology and harmonised tools regarding business models, internal governance, risk management, risks to capital along with risks to liquidity and funding (ECB 2022c).

According to the latest report of the Commission on the SSM (European Commission 2017d, p. 13), the ECB managed to apply a specific SREP to all significant institutions (hereinafter SIs), in accordance with a common methodology that incorporates best practices. Although the SSM was only established in November 2014, the ECB has managed, in a timely manner, to increase capital levels throughout the 2015 and 2016 SREP exercises, thus strengthening the stability and resilience of the euro area banking industry. Additionally, the ECB has proven to be swiftly adaptable to regulatory developments and to the consistency requirements in SREP results for similar institutions.

Specifically, the SSM has made a further leap forward by shedding light on information regarding each bank's supervisory capital requirements based on the SREP that annually reveals the adequacy of capital requirements of each bank under the SSM remit and what banks should do to address the respective risk. The new element in this process was the publication for the first time of the Pillar 2 requirements, entailing that banks, as of January 2020, have the capacity to compare their position with the Pillar 2 requirements of their peers, as well as receive tailor- made guidance by the ECB, which is based on more granular data. Thus, the SREP has the potential to equip banks and investors with a deeper insight into the supervisory assessment of European banks, thus rendering investors better informed when making decisions and banks capable of deploying more effective strategies In this light, banks can receive more suited guidance to the sustainability of their business model, and thus orientate their focus on a better strategic steer based on more radical improvements on their risk profile and cost efficiency, which could in the long run bring down the cost-to-income ratio and contribute significantly to strengthening bank profitability. Accordingly, the cost of regulatory reform (namely the cost of reporting requirements and ad hoc data requests) induced by the 2007 financial crisis, which is deemed as a major concern for low bank profitability, could be mitigated by this improved communication channel provided by the SREP (ECB 2020a).

In 2020 the SREP methodology was tailored to meet the repercussions of the coronavirus crisis that triggered an unprecedented economic environment. This entailed that Pillar 2 requirements and guidance remained unchanged at 2019 levels. However, in 2021 the ECB banking supervision readopted its regular SREP methodology. In fact, the ECB banking supervision as of 2021 took further steps and adopted a two-step bucketing approach to decide the Pillar 2 Guidance (hereinafter P2G) levels of each bank. The P2G is a supervisory recommendation that tells banks the Common Equity Tier 1[7] ratio they must preserve to be able to withstand stressed situations. This new P2G methodology was introduced in 2021 and aims at ensuring a level playing field while reflecting banks' resilience at individual level. The criterion regarding banks' P2G level is banks' capital ratios performance under economic shock during the EU-wide stress tests. Although P2G is not legally binding (in contrast with the Pillar 2 requirements), it is a driving factor of the SREP (ECB 2022b). The 2021 supervisory cycle revealed the overall resilience of banks as reflected by robust capital and liquidity reserves (ECB 2022d, ECB 2022i).

Despite the encountered impediments, significant progress has been achieved up to now as regards restoring confidence in the European banking sector. Specifically, for the period from 2014 to mid-2018, bank capital was raised through capital increases without resorting to adjustments in risk-weighted assets or deleveraging, which resulted in an average capital increase of three percentage points (from 11.1% to 14.1%). In turn, the

[7] "The Common Equity Tier 1 ratio indicates the relationship between a bank's capital and its risk-weighted assets. The risk-weighted assets are a measure of the risks hat a bank has on its books, showing how risky its assets are (ECB 2022i, p.1).

SREP for 2021, which assessed banks' capital, banks' overall scores on risk profiles and main elements as well as the issuance of formal decisions and recommendations, reflected a return to normality by revealing solid capital and liquidity positions throughout the pandemic and the resilience of EU banking sector regarding present and upcoming challenges. The unveiled vulnerabilities concern credit risk control, internal governance and risk control frameworks that can have a negative impact on compliance issues and IT functions linked with data aggregation. Against this background, profitability slightly recovered in 2021 entailing that overall capital requirements and guidance have increased by 0.2% for 2022 namely from 14,9% in the 2020 SREP assessment to around 15,1 % of risk-weighted assets. It is to be noted that supervisors attribute low profitability to pre-existing and stagnant issues such as the inexistence of efficient strategic plans. However, following an increase from 2.1 % to 2.3 % in total capital stemming by Pillar 2 capital requirements, the average amount of overall capital requirements and guidance in CET1 increased from 10.5% to around 10.6% of risk-weighted assets. In parallel, the Pillar 2 guidance increased from 1.4% to 1,6% following the results of stress tests while the ECB expects banks to conduct their operations above their Pillar 2 guidance by 1 January 2023 (ECB 2022a).

Furthermore, the stock of non-performing loans (NPLs) was reduced from 7.6% at the end of 2014 to 4.4% in the second quarter of 2018 on a weighted average basis, following an ECB's guidance on NPLs (ECB 2017a), an addendum on supervisory expectations on new NPLs (ECB 2018c), and bank-specific supervisory expectations for the stock of NPLs (ECB 2018b). The total shortfall in provisions for non-performing exposures decreased by over 75% in 2021 entailing limited add-ons in the 2021 SREP decisions (ECB 2022d). Loans with expired Covid-19 measures stood at €738 billion in the fourth quarter of 2021, of which €38 billion are non-performing and €172 billion are performing stage 2 (ECB 2022f, p.115). According to the SREP for 2021, the implementation of plans to eliminate and allocate NPLs along with exceptional public support contributed to the ongoing reduction of NPLs while the deterioration of credit quality shed light on the economic sectors that need to be examined more closely in order to mitigate negative repercussions (ECB 2022a). In this light, despite the overall banking resilience, as regards 2022 onwards, the ECB banking supervision intends to continue focusing on banks' governance and credit risk management policies related to non-financial corporate sectors, leveraged finance and risks posed by an excessive search for yield. This ECB's supervisory spectre aims at including the emerging risk concerning banks' digitalization strategies, IT and cyber resilience policies along with climate change, non-bank financial institutions and bank activities (ECB 2022d).

3.1.3. The SSM accountability arrangements

The effectiveness of the safeguards embedded in the SSM is enhanced by: i) the balance between the tasks and responsibilities conferred to the several parties in the SSM; ii) the range of the tools and powers available to the ECB to perform its tasks; iii) several provisions for accountability, such as the Annual Report on supervisory activities stipulated in article 20(1) SSMR, as analysed below; and iv) the density of judicial review by the CJEU since the legality of the ECB decisions is often questioned in front of the CJEU (ECB 2020b).

Article 20(1) SSMR stipulates that the ECB is accountable to the European Parliament and to the Council. The ECB submits an annual report to the European Parliament, to the Council, to the Commission and to the Eurogroup (article 20(2) SSMR) and presents it in public to the European Parliament and to the Eurogroup in the presence of representatives from any participating member states whose currency is not the euro (article 20(3) SSMR). This annual report shall be simultaneously forwarded to the national parliament of the respective participating member state (article 21(1) SSMR). The competent authorities of the European Parliament can invite the Chair of the Supervisory Board of the ECB to a hearing in the execution of its supervisory tasks (article 20(5) SSMR). The Chair of the Supervisory Board of the ECB can be asked to take part in confidential oral discussions behind closed doors with the Chair and Vice-Chairs of the competent Committee on Economic and Monetary Affairs (ECON) of the European

Parliament (article 20(8) SSMR), while the ECB has to cooperate with any investigations by the European Parliament (article 20(9) SSMR). The national parliament of a participating member state may invite the Chair or a member of the Supervisory Board to participate in an exchange of views in relation to the supervision of credit institutions in that member state, together with a representative of the national competent authority (article 21(3) SSMR). These accountability provisions are accompanied with an Interinstitutional Agreement between the European Parliament and the ECB on the practical modalities of the exercise of democratic accountability and oversight over the supervisory tasks of the ECB under the SSM remit (ECB 2013), a Memorandum of Understanding between the Council and the ECB (Council of the EU 2013a), as well as a Memorandum of Understanding between the ECB and the European Court of Auditors (hereinafter ECA) (ECA 2019).

These accountability arrangements have been proven to be frequently used and effective (EC 2017d, p. 4) and equip the SSM with a far broader range of communication channels and transparency safeguards than those provided by the participating states alone. These accountability provisions dispel any shadow of doubt regarding the democratic accountability over the exercise of the supervisory tasks of the ECB. However, regarding administrative accountability, the ECA, in its latest report on crisis management (ECA 2018), emphasised the fact that the ECB did not provide them with all the required information, thus rendering incomplete the assessment of the ECB's operational efficiency. The ECA based this argument not only on insufficient information, but also on its survey conducted in March and April 2017 involving all the existing, by that time, one hundred twenty-five SIs. The banks' response to this survey concerned their need for "further clarity and guidance towards addressing remaining ambiguities in early warning signals, recovery plan indicators, the calibration of indicators, and the appropriate threshold levels, the alignment of indicators with banks' business models, and the methodology adopted for reverse stress testing on the full range of scenarios" (ECA 2018, p. 32).

Furthermore, ten supervised banks, replying to the ECA's survey, stressed the ambiguity stemming from duplication of information requests, which reveals the need for a clearer distinction between the recovery plans and resolution plans when such a feedback is transmitted to banks by the ECB. The ambiguity in this distinction was alleged to concern the identification of legal entities, and to critical functions and business lines, which are mostly related to the SRM framework rather than recovery planning (ECA 2018). Although the ECB denied this point, the ECA suggested that the ECB should enhance its operation guidance on the early intervention stage (for instance, on how to integrate subsidiaries into group recovery plans) and on the assessment of a bank as Failing or Likely to Fail (hereinafter FOLTF) (ECA 2018, pp. 12, 32). Since there are specific criteria to assess whether a bank is FOLTF (stipulated in article 18(4) SRMR), the outcome of this assessment may be misplaced due to other intervening assessments, such as the one made on State Aid rules. Accordingly, it is crucial that the ECB focuses the improvement of the crisis management framework on the early intervention stage, when there is still not enough leeway for interventions resulting in deviations from the initial target, which is safeguarding financial stability at European level rather than saving a supervised bank with public money. To this end, the harmonisation of the criteria and triggers for determining failing banks would be an essential leap forward (Kraemer and Strupezewski 2022).

3.1.4. Obstacles regarding optimal banking supervision

Despite the opportune and timely assessment of a bank as FOLTF, it is to be noted that the developments in the aftermath of this ECB’s assessment reveal that it is often the case that supervised banks contest the opening of insolvency proceedings or the onset of resolution action in the national courts. Individual bank cases in the litigation procedure disclose that the quality of the ongoing supervision of the ECB is included in the main points of banks’ criticism against the legality of the final outcome of the ECB’s FOLTF assessment, or of the extent of the SRB’s decision-making power, for instance, regarding a liquidation under national law. This was the case for the Latvian ABLV Bank and its subsidiary in Luxembourg, the Italian Bank Monte dei Paschi di Siena, the Latvian AS PNB Banka, and the German NordLB (Deslandes et al. 2019, pp. 2-3).

This policy starkly unveils that despite the admitted by the National Competent Authorities (NCAs) improvement in banking supervision, as well as in the interaction with the supervisory colleges and the functioning performance measurement system (which are capable of tracking the progress achieved in different supervisory processes due to the effective leadership of the ECB since the establishment of the SSM), the trust of the relevant stakeholders is quite often overturned as a result of the final outcome of judicial review due to accountability of the ECB's decisions to judicial bodies. Trust is limited to the operational guidance of the ECB and seems to wither when the final decision is taken at European level, either by the ECB or the SRB. It may be the case that this constitutes the first reaction to a complete system of banking supervision at European level; but it can also be the case that the SSM has yet to reach, either its full potential and effectiveness in the existing Banking Union, or the required acceptance by the participating member states.

The SSM seems to be hindered from reaching its full potential because of the fragmentation that still exists in the national banking supervision regimes. This fragmentation emerged from a persisting and considerable level of national regimes differentiating implementation of rules at EU level. This paved the way for mistrust, ring-fencing and protectionism. From the onset of the 2008 crisis, the financial stress of subsidiaries and integrated funding were deemed as a source of vulnerability. This triggered host authorities to take ring-fencing decisions against foreign branches or subsidiaries with the view of protecting those banks' local assets or mitigating the repercussions of the parent failure on the local stakeholders (EBA 2018c). This short-sighted ring-fencing policy at national level remained stagnant despite the progress in the EBU project because the national interest still fragments, namely outweighs a truly integrated banking sector at European level where risk sharing and risk reduction are interdependent factors towards mitigating financial distress. This in turn maintains uncertainty regarding the outcome of the still emerging EBU framework, which entails that the SSM is based on the cooperation between the ECB and the NCAs (article 6, article 4(3) first subparagraph, and recital 34 SSMR). In this context, banking regulation, or banking policy at national level, or even the interpretation and implementation of European banking rules by the NCAs, sometimes hinder the SSM from intervening, thus creating inconsistency among banks by weakening the necessary consolidation. Thus, the existing fragmentation could be rather attributed to legal loopholes that leave ample leeway for the implementation of either national regimes or European legislation in a way that deviates from the initial subject matter aim of the SSM, namely financial stability at European level (stipulated in article 1(1) SSMR). These legal loopholes clearly need to be addressed. In this context, the ECB took the initiative in 2016 to reduce options and discretions (hereinafter O&Ds) by harmonizing rules applied to significant banks under its remit (Kudrna and Puntscher Riekmann 2018). However, the differentiated use of national O&Ds by EU member states urged the ECB to provide further transparency on how it will exercise O&Ds when supervising banks in order to establish a level playing field and further banking integration (ECB 2022k).

3.1.5. Low bank profitability and other obstacles related to SSM

Another core element in the banking sector has been considered to be low bank profitability. Prudential standards enhancing financial stability do not always go hand in hand with a riskier banking policy that is associated with greater profits. It is to be noted that low profitability proved to be also the outcome of excessive costs, inefficient processes, weak business strategies, cybercrime and IT deficiencies, as well as overbanking, thus rendering imperative on the part of the banks the adoption of new strategies focused on new technologies, as well as the adaptation, on the part of the banking industry, to prudential standards in consistency with those imposed at supervisory level and with the outcome of the ongoing stress tests (Angeloni 2018, pp. 1-2).

It is to be noted that low profitability is also linked with a bigger threat posed by FinTech and BigTech firms[8] since banks lose their competitive advantage because of heavy

[8] "FinTech is defined by the Financial Stability Board as technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services. FinTech is also defined as financial innovation based on the use of digital technologies and big data. The use of digital technologies makes it possible to provide many existing financial services more efficiently and to enhance these services. BigTech firms are technology companies with established presence in the market for digital services. They are firms that have successful digital platforms such as Amazon,

bank regulation and capital requirements which restrain rapid growth and render bank products more expensive than those offered by FinTech and BigTech firms. Against this backdrop, banking regulation aimed at protecting banks backfires against the banking sector by rendering FinTech and BigTech innovative products more easily accessible (Stulz 2019, pp. 2-3).

The issue of low bank profitability drew further attention to the causes and response to this problem, since insufficient bank profitability could have negative repercussions on financial stability by weakening bank lending to the real economy, misallocating lending to the remaining banks with higher profitability, as well as by triggering the ECB's further intervention that could end up giving rise to the risk of regulatory capture[9] by favouring the violation of the ECB's mandate and serving the supervisee's interest. Such conditions could potentially favour advancing the interests of the banking industry rather than financial stability. To this end, the responses proposed include bank restructuring that will reduce the banks' size, the limitation of bank supervision on micro and macroeconomic profitability drivers, the remodeling of bank management practices so that bank supervision does not overlap with decisions on bank business models, as well as the strengthening of risk management systems and the facilitation of cross-border mergers and acquisition opportunities (Bertay and Huizinga 2019, Farina et al. 2019, Bruno and Carletti 2019, Dias et al. 2019, p. 3).

In reaction to the Covid 19 pandemic, the ECB permitted banks in March 2020 to operate below the capital requirements defined by the Pillar 2 Guidance and the capital conservation buffer with the view of providing temporary capital and operational relief that would allow additional resources to be available to banks to provide lending and absorb losses. In order to withstand the lasting shock posed by the pandemic, the ECB declared in July 2020 the maintenance of this capital flexibility until at least the end of 2022. In

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Facebook Google and Alibaba. While a typical FinTech firm is a a specialized firm that challenges a specific product line of banks, the BigTech firms can challenge banks across a large number of product lines (Stulz 2019, p.1).

[9] "Regulatory capture" is an economic theory that says that regulatory agencies may come to be dominated by the industries or agencies they are charged with regulating rather than driven by the public interest they are entitled to promote (Kenton and Boyle 2021).

September 2020, the ECB consented to let banks exclude specific central bank exposures from the leverage ratio[10] to let them face the exceptional macroeconomic circumstances (the leverage ratio requirement became binding on 28 June 2021). This measure was extended until the end of March 2022 and the ECB advised banks to preserve adequate capital to serve the real economy by the time this exceptional step would expire. This regulatory discretion due to the exceptional conditions of the coronavirus pandemic let banks meet their capital requirements. Specifically, the aggregate Common Equity Tier 1 ratio of banks under direct ECB supervision stood at 15,47% while the aggregate leverage ratio stood at 5,88% (ECB 2022i). In this light, the uncertainty associated with abrupt changes in the economic conditions was mitigated while reflecting the readiness and effectiveness of the ECB regime to cushion the impact of the pandemic.

Despite the progress achieved in banking supervision at European level that has promoted a European supervisory culture based on common standards, along with transparency and accountability provisions, the vicious circle between banks and sovereigns is still in motion, but this this is not the blame of the SSM alone. The still existing mutually reinforcing feedback loop stresses the importance of the still incomplete Banking Union, due to the lack of a single deposit protection scheme. This lack renders banking supervision more burdensome, and potentially favours riskier banking activities in some participating member states, since a euro area safety net offering the same level of reassurance is missing (Angeloni 2018, p. 2). Higher risk-taking is often linked with higher profitability linked with potentially illegal activity such as money laundering, tax fraud, unethical selling practices or market misconduct (e.g. benchmark rate-rigging – EURIBOR). In turn, this sheds light on the fragilities of supervision as regards keeping profitability in a legal framework (ECB 2022j)

In addition to the abovementioned factors, the regulatory gap regarding liquidity in resolution, the national policies towards bailing-out banks with public money and the lack

[10] The leverage ratio shows the relationship between a bank's capital and its assets irrespective of how risky those assets are. Since the leverage ratio does not depend on risk, it serves as a backstop to risk-weighted capital requirements. The leverage ratio indicates the maximum loss that can be absorbed by equity, while the risk-based requirement refers to a bank's capacity to absorb potential losses (ECB 2022i).

of a harmonised insolvency rules regime have a negative impact on ECB banking supervision. Against this background, the incorporation of group requirements and intragroup financial support agreements into banks' recovery plans, as well as the establishment of an administrative liquidation tool at European level, could contribute significantly to a more harmonised system, and thus to a more level playing field for banks under the SSM remit. This would entail providing adequate safeguards or motives to countries with the view of "making them feel comfortable about lowering national barriers via credible arrangements of the ECB", such as entitling national supervisors with some discretion regarding intragroup exemptions to large exposure requirements. Such arrangements would not only lower the perceived costs of pulling down national ring-fencing policies but would also map out the leeway for a more effective application of the Banking Union framework in a way that is more supportive of group-wide asset and liability management within the EBU, along with the reassurance of a potential group support in a crisis situation (ECB 2020a, pp. 5-6).

3.1.6. Asset Quality Review (hereinafter AQR) and the impact of the COVID-19 pandemic

Towards a more operational crisis management framework, a systematic and consistent AQR with advanced practices and effective tools at practical level was considered to be meaningful as regards signaling the lead-up to a bank potentially being later considered as FOLTF. According to the ECA (ECA 2018, p. 34), "operationally efficient" entails that the ECB applies its powers in the way highlighted by the EBA's guidelines and in the context defined by the SSM objectives, which comprise the prudential supervision of credit institutions with the aim at contributing to their safety and soundness as well as to the stability of the financial system within the EU and each member state, based on the principles of equal treatment and proportionality as well as on a consistent regulatory landscape that mitigates the existing or emerging loopholes (article 1(1) SSMR). The ECA also highlighted that this operational efficiency should entail a clear understanding on the part of recipient banks that will be reflected on ECB's practical guidance, and the opportune implementation of recovery plans.

To this end, in June 2018, the ECB updated its manual for AQR of banks by incorporating: i) the new accounting standard IFRS 9[11]; and ii) an enhanced significance of business models focused on investment services, which entails broadening the scope of the fair value exposures review, as well as involving complex and illiquid level 2 assets under the AQR remit, along with the introduction of some new methodologies. In this upgraded context, the SSM framework could ensure further supervisory consistency in the euro area, as well as enhanced transparency for both supervisors and investors (ECB 2018a). In parallel, this updated manual for AQR could facilitate meaningful guidance to the supervised entities, namely practical guidance targeted at mitigating the factors leading to a bank's later consideration as FOLTF.

The improvement of asset quality has also been linked with the reduction in the NPLs ratio (European Commission 202b, p.6). This entails that the higher the credit risk stemming from loans not being paid back, the lower the quality of the loan, namely the asset quality. In this light, when identification of low asset quality is lagging behind, banks' balance sheets are potentially exposed to more NPLs (ECB 2022h). Against this background, the flexibility available in the new IFRS 9 standard strengthens operational efficiency by taking into consideration not only a sudden increase in the probability of default caused by financial distress, but also the remaining lifetime of a loan thus embedding adequate weight to cases based on long-term stable macroeconomic outlooks (European Commission 2020b).

The impact of the COVID-19 pandemic shed further light on the significance of the quality of banks' assets and the potentially resulting solvency risk against a background where the repercussions of the pandemic may emerge in full by the time that any

[11] Since January 2018, the international IFRS 9 accounting standard replaced the IAS 39 standard for financial instruments The new IFRS 9 standard introduces a new approach on impairments of bank assets and the classification of financial instruments, which is based on the "significant increase in credit risk since initial recognition" and the "related newly introduced forward-looking approach to provisioning". With this new banks' approach to credit loss, the expected credit loss is the core driver instead of the incurred loss model. This entails that banks shall allocate financial instruments subject to expected credit loss requirements allocated in three different stages based on the significance of credit risk (EBA 2019).

extraordinary support will cease. The rising search for yields initially triggered by historically low interest rates and worsened by the uncertain economic outlook due to the pandemic, have redirected ECB's strategic priorities for 2022-2024 in order to lessen abrupt corrections in financial markets valuations and interdependent fragilities. The core driver for setting out the oncoming three-year supervision strategy has been the risk-identification and priority-setting process with the view of guiding the Joint Supervisory Teams, the national supervisors and pave the way for a level playing field. Specifically, the supervisory priorities for 2022-2024 aim at ensuring that banks under the SSM remit: 1) emerge from the pandemic healthy addressing exposures to credit risk management, COVID-19 vulnerable sectors and leveraged finance, 2) address structural weaknesses via effective digitalisation and enhanced governance, and 3) tackle emerging risks including exposures to climate and environmental risks, counterparty credit risk (especially towards non-bank financial institutions) and shortfall in IT outsourcing and cyber resilience. All these priorities involve targeted reexamination by Joint Supervisory Teams aimed at ensuring adherence to ECB's supervisory expectations along with on-site inspections wherever relevant deficiencies are identified (ECB 2022g).

As Europe recovers from the pandemic and pursuits carbon neutrality, the European Commission published in October 2021 its latest banking package comprising revisions to the Capital Requirements Directive (CRD VI) (European Commission 2021d), the Capital Requirements Regulation (CRR III) (European Commission 2021e) and the "daisy chain" proposal to amend CRR regarding resolution. The implementation date is set to be January 2025. The ECB is of the view that the Commission's proposal to include in the CRD environmental, social and governance risks in banking regulation successful manages the risks from the green transition by mandating supervisors to monitor relevant plans for mitigating such risks and requiring banks to implement measures should insufficient banks' strategies do not comply with the respective EU policy targets. If the latter scenario takes place, the respective bank shall meet the risks posed in its balance sheet by such financing. Furthermore, the CRD proposed amendments include: i) provisions for a more robust bank governance by rendering banks' board members under the same standards of conduct, experience and reputation in all EU countries; and ii) common rules for third-country branches with the view of creating a level playing field. On the other hand, regarding the CRR proposals, the ECB points to the potential risk posed by underestimating in the proposed provisions some significant asset classes such as real estate exposures and unrated corporate exposures. Such deviation from the original Basel III standards is considered by the ECB as a factor paving the way for potential exposures stemming from inadequate capital safeguarding (ECB 2022 e).

3.1.7. Policy steps towards a common European culture of Banking Supervision

Against this background, the ECB has taken considerable steps to establish a fruitful cooperation with the NCAs in order to ensure a consistent and coherent implementation of prudential rules in banking supervision. Except for the ad hoc cooperative efforts in case that the NCAs need further guidance on specific issues on Less significant Institutions (hereinafter LSIs) supervision, between 2016 and 2018 the ECB's planned cooperation initiatives towards NCAs increased by 48%, involving multilateral fora, bilateral visits, and workshops concerning management and technical issues of the LSI banking sector. The ECB also organises bilateral initiatives with the aim of promoting country-specific issues through the cooperation with national managers and experts. These initiatives are set up through country visits, meetings at the ECB, and teleconferences. In 2018, sixteen country visits to NCAs and one meeting at the ECB took place, along with thirteen teleconferences, on-site inspections, the secondments of national experts to the ECB for a few months, training events on the new LSI SREP methodology, and the implementation of the new IFRS 9 standard both on fintech and stress-testing methodology (ECB 2019b).

Given this framework, the Commission has proposed that the ECB implements legal concepts such as harmonisation, flexibility and proportionality in a way so that the diverse LSI sector cannot be deliberately misused against a consistent application of high supervisory standards. This would entail the establishment of common approaches for LSI supervision on major competences of by the NCAs based: i) on harmonisation, which is defined by the European Commission as "ensuring a sufficient level of convergence with regard to the supervisory approach applied to LSIs across participating member states and between LSIs and SIs within participating member states"; and ii) on flexibility and proportionality, meaning that NCAs would be "able to adapt their supervisory activities to the size, complexity and riskiness of the respective institutions" (European Commission 2017d, pp. 14-15).

To this end, the ECB has introduced since 2018 the SSM LSI SREP as an ongoing process based on the SSM methodology applicable to SIs, with the view to promoting convergence in the way NCAs conduct the SREP, as well as to supporting a minimum level of harmonisation and continuity in the evaluation of SIs and LSIs. In this context, the LSI specificities (such as accounting standards and regulation) are evaluated against the existing risk assessment criteria for SIs (indicatively, these involve: a combination of quantitative and qualitative elements, an holistic assessment of institutions' viability, including their specificities, and a forward-looking perspective), along with the SSM methodology (article 39 SSMFR), EBA Guidelines (EBA 2018a), and supervisory best practices, as reflected on the annual SSM priorities, thus allowing for national regimes to be taken into account based on the principles of proportionality and flexibility (ECB 2019b, pp. 4-5). Under this framework, the LSIs can adapt more easily to the targeted by the ECB balance between financial stability and divergent regulatory and supervisory frameworks (ECB 2019b, pp. 4-5, 19).

Against the background of all the challenges posed by the coronavirus pandemic, the ECB has prompted banks to adopt digitalisation strategies tailored to meet the level, nature and challenges of the new services required by the digitalized economy and its respective clients. This transformation shall go along with updated risk-management policies that will take into account the nature of riskier assets and less steady funding structures in light of prudential supervision (ECB 2022i). To this end, a perfect example is set by the MiCA Regulation[12] introduced by the European Commission in 2020 as a part of the EU Digital

[12] https://www.europarl.europa.eu/doceo/document/A-9-2022-0081_EN.html#title2

Finance Strategy with the view of providing at European level a sound legal framework for crypto-assets that are not covered by existing financial services legislation. This is a major step towards mitigating market manipulation, flows of illicit money, money laundering, terrorist financing and financial crime that threatens financial stability and confidence in the EU financial system. Furthermore, this draft Proposed Regulation includes crypto-assets mining within EU Taxonomy[13] for sustainable activities by 1 January 2025 in accordance with EU environmental legislation. Both the developments in the regulatory landscape concerning bank supervision and economic crime could favour bank consolidation, weaken the bank sovereign nexus and limit national interventions to appropriate cases.

The guiding driver of banking supervision within the SSM framework consists in safeguarding financial stability while banks serve their ultimate purpose, which is to transform liquid savings into sound credit to the economy. The latter links financial stability with the safety of deposits, while at the same time entails delinking taxpayers from being obliged to pay for bank failures. This task can be better achieved at European level, since this EU regulation can better ensure: i) supervision that is cut off from the origins of threatening conditions to financial stability; and ii) a more objective evaluation of bank risk levels in a context of a wider background comprising European legislation, global fora, treasuries, central banks, and supervisors (Angeloni 2019, pp. 3-4). However, none of these tasks could be effective in their full potential without a single deposit insurance scheme at European level that would ensure at all times the two sine qua non elements of financial stability, namely protection of depositors and investors, along with economic efficiency. Given the fact that EDIS is still pending, no matter how much progress is achieved at supervisory or resolution level, fear is looming over the potential incapacity of banks to cover asset outflows in crisis situations, should a future economic downturn materialise. This inherent risk could hardly mitigate banking disturbances related to imposed ring-

[13] The EU Taxonomy is a classification system establishing a list of environmentally sustainable economic activities with the view of creating security for investors, protecting private investors form greenwashing, helping companies to become more climate-friendly, mitigating market fragmentation and driving investments where they are most needed (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en)

fencing national measures and allow for a steady state Banking Union that could foster integration and inspire further convergence and trust to the supervised entities. That said, in the absence of EDIS, it may be considerably fruitless to ascertain to what extent the ECB is meeting its supervisory objective of achieving financial stability (Vikelidou 2021, pp. 112-125).

3.2. The Single Resolution Mechanism (SRM)

3.2.1. Fragilities of the current resolution framework

The legal framework comprising: the bank crisis regime (BRRD), bank resolution (SRMR) and bank supervision (SSMR), provided a strong legal background for failing or likely to fail banks in the Eurozone. However, several loopholes or legal arrangements, either individually or cumulatively, undermine the EU resolution regime. It may be considerably incompatible to require, as a main precondition for the initiation of resolution, the inadequacy of the normal insolvency procedure to generate financial stability, since the objectives of resolution and normal insolvency proceedings do not overlap. Resolution aims at securing overall financial stability, whereas normal insolvency proceedings aim at maximizing the value of the insolvency estate with the view of fulfilling the creditors' interest, and the latter may not be the case when, for instance, the bail-in tool has to be implemented for the sake of financial stability. Additionally, the further prerequisite of ensuring that no creditor will be worse off in resolution than insolvency (the NCWO principle) inevitably leads to assessing the creditor's destiny (as a potentially adversely affected stakeholder) under criteria of divergent objectives, not to mention that it brings into play non-harmonised insolvency proceedings at national level. This interference of diverging national insolvency regimes (often implying less stringent preconditions under state aid rules than in the SRM), the lack of harmonisation in significant criteria such as the public interest assessment or the hierarchy of creditor claims (rendering the NCWO test heterogeneous), as well as the key role of the Commission in solvency tests and state aid assessment (potentially contradicting the SRB's approach), leave ample leeway for substantially different outcomes and for legal interpretations that weaken the level playing field by promoting national solutions that overrule the resolution regime, and especially the bail-in tool (Vikelidou 2021, p.221, SRB 2021d). Furthermore, the impact of loopholes on the progress of the EBU project has been recently revived because of attempts to alleviate the severity of bail-in rules. This took place in April 2022 during a Eurogroup meeting aimed at reviving the efforts towards establishing the EDIS along with enhancing the role of the SRB by rendering smaller banks and national deposit guarantee schemes under its remit (Comfort et al. 2022).

The current set-up of the EU resolution regime should encapsulate financing arrangements for resolution, since liquidity support is crucial to discourage bank runs, and should apply the first best resolution tool or power, while ensuring to the greatest extent that the following day after the resolution weekend will be for the sake of financial stability a business-as-usual scenario for the entity under resolution. Liquidity requirements were considered to be insufficiently addressed by the potential liquidity sources, including ELA, national Deposit Insurance Schemes (hereinafter DISs), and compensation of shareholders and creditors based on the NCWO principle (IMF 2018 pp. 17-18), since they were the key factor that triggered the FOLTF assessment as a precondition before an entity enters resolution.

Notable resolution cases of banks such as the Banco Popular Español (BPE) and the ABLV bank, revealed the limited time space for their declaration as FOLTF due to their significant deterioration in their liquidity situation, thus limiting the SRB's timeframe to react to such a quickly evolving situation of liquidity inadequacy. This, in turn, may have led to partially inaccurate assessments or valuations. Specifically, concerning the BPE Valuation Report 2 (pursuant to article 36 SRMR or article 20 BRRD), the independent expert (i.e. Deloitte) explicitly declared that the required report aiming to inform on the applicable resolution tool was completed in just twelve days, instead of the six weeks that would normally be required, entailing that the respective conclusions shall be deemed as "highly uncertain and provisional for the purposes of article 36 BRRD" (Magnus 2018, p. 5). Despite the fact that the General Court of the EU declared on 1 June 2022 as lawful the SRB decision to resolve Banco Popular Español as well as the European Commission's endorsement of this resolution scheme (SRB 2022b), it is still questionable to what extent stakeholders' trust in the public interest of the resolution regime has been restored. As long as national solutions have ample space to interplay with different legal arrangements within the EBU framework but without adequate and politically acceptable EU safeguards in this multi-level legal construction, it will be hardly possible to tailor, what Asimakopoulos (2018) defined as "nationalized European integration" (led by the strongest economies in the Eurozone), to the acceptable level entailing acceptance of decisions at EU level by all member states.

Liquidity scarcity could potentially have negative repercussions on triggering resolution, as well as on the choice of the suitable resolution tool or power. As Lehmann (2018) has rightly pointed out, the new international rules on banks' liquidity[14] that came into effect in 2015 provide limited protection against a failure of a large cross-border bank, let alone a systemic crisis. This is due to the fact that in the lead-up to bank crises, inadequate liquidity has been proved to be strongly interrelated with the other root causes of bank failures, namely lack of profitability, solvency, reputational or integrity problems entailing loss of market confidence, as well as vulnerability to contagion from sovereign markets. In this vein, Lehmann proposed the following steps towards the completion of the Banking Union: i) strengthening of cooperation and information exchange between the ECB and the SRB, entailing the assessment of macro-prudential risks in resolution plans; ii) harmonizing the use of payments moratoria across the euro area, and extending their use throughout the resolution process and across all asset classes; and iii) establishing a credible and transparent liquidity backstop by the ECB to fund the resolution process that will be guaranteed by the SRF and national budgets (Lehman 2018, p. 4). The importance of potential access to liquidity provided by collective financing channels at national or EU

[14] "Two liquidity standards were introduced as additional safeguards in the Basel III regime and were transposed into EU law through the CRRII (Regulation (EU) 2019/876) (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R0876) and CRDV 2019/878 (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019L0878): i) the liquidity coverage ratio (LCR), firstly introduced on 1 January 2015, which is designed to secure short-term resilience by ensuring that each bank has sufficient high-quality liquid resources to withstand a stress scenario lasting one month; and ii) the net stable funding ratio (NSFR), firstly applicable on 1 January 2018, which seeks to ensure long-term stability up to one year" (Lehmann 2018, p. 7).

level has also emerged by the fact that the current regime ends up favouring national liquidation or state bail-outs. The existing bail-in requirements and the provision in the BRRD of too high MREL standards for many retail banks along with the lack of automatically available resolution funds, undermine considerably the applicability of the EU bank resolution regime. In this context, a considerable number of EU banks cannot assume the share of the losses before bail-in and in turn, resolution is averted while rendering national solutions the one-way impasse (Asimakopoulos and Howarth 2022).

Demertzis et. al. (2018) focus on the importance of providing liquidity to banks after resolution but before full market confidence is restored, namely on the required liquidity needs that evolve after the resolution weekend and are essential to be met in order to pave the way for a successful resolution, which might demand that liquidity requirements are met without the contribution of regular monetary policy or ELA, while solvency is restored through bail-in and recapitalisation, if needed. To this end, they suggest that the ESM, the SRF, and the national treasury of the bank under resolution provide public guarantees along with the cooperation of the respective finance ministers and the consideration of state aid rules. When the Banking Union is completed, the guarantee should be given by the euro area fiscal body (the ESM or a euro area treasury), with recourse to the SRF.

It is to be noted, at this point, that ELA in its current form could not be regarded as a source for resolution funding, as it is first of all hardly possible that before or after resolution the entity under resolution would meet the ELA conditions. Such a funding solution is deemed even more remote if we take into consideration that ELA depends on a decision of the national central bank, whereas banking supervision is at European level regarding significant banks, thus signaling for potential wrong or delayed ELA decisions. As Lehman has highlighted, it is unlikely that the decentralised implementation of ELA by individual central banks, as well as intervention in creditor rights through national payments moratoria, could be in consistency with the considerably integrated banking market (Deslandes and Magnus 2019, p. 3, and Lehman 2018, p. 4).

The European procedure of resolution planning is so complicated and demanding, since it takes place in a very short period of time, that it is largely dependent on the quality of the information provided by the banks to IRTs and to what extent this information is complete and accurate regarding the short-to-medium-term liquidity and funding position. This entails that the SRB may be led to a wrong decision or conclusion based on the inaccurate or inadequate information provided. To this end, improvement of bank Management Information Systems could be very meaningful (SRB 2022a).

The ECA, in its 2017 report (ECA 2017, p. 45), indicated that the substantive impediments to resolution were not determined because of insufficient resources from the banks under the SRB's remit, mainly stemming from their inadequate guidance. It is noteworthy that the relevant articles of BRRD and SRMR do not include any provisions for a practical implementation of the resolution procedure along with better communication strategies. However, the SRB published numerous guidelines in 2019 and onwards on the interpretation of crucial resolution criteria such as the public interest assessment, the critical functions, and the MREL policy after the adoption of the Banking Package, with the view of addressing the complexity of the SRM framework, pointing stakeholders to the right direction, while paving the way for monitoring of compliance, which requires the engagement of the involved banks.

The SRM, as the second pillar of the Banking Union framework, was designed to make resolution and the whole regime work. Therefore, the complex overall regime concerning bank resolution and crisis management is meaningful when it is "fit for purpose", entailing at least that the relative practices do not contradict the envisioned targets in a way that annihilates the purpose of existence of the respective legislation and of the statutory tasks. The first target of the EBU was to elevate the responsibility for banking policy from the national to the European level in order to weaken the doom loop between banks and sovereigns. Although there has been remarkable progress in banking policy at European level, accompanied with substantial regulation in previously unregulated areas of financial services and with a lengthy revision of the existing one, the vicious circle is still alive and kicking.

This has been painfully revealed in the Bank Monte dei Paschi di Sienna (BMPS) case as well as in recent cases, which render at stark contrast the state aid rules to the targets of resolution in the context of the Banking Union framework. In December 2019, the Italian government allocated €900 million to rescue the cooperative bank Popolare di Bari, explicitly declaring that this public financing aimed at protecting savers. Two weeks earlier, the EU Commission approved under the state aid rules the €3.6 billion public financing of a German bank, i.e. Bank NordLB, which resulted in this bank not being considered as failing, and accordingly not falling under the SRB's remit. Many experts have questioned whether the Commission's interpretation of state aid rules regarding the BMPS in 2017, as well as the most recent case of NordLB[15], are in consistency with the SRB's treatment of failing banks. The handling of such cases by the Commission culminated in being considered as "perceived inequality" by the Chair of the SRB Ms Elke Koenig, who asked for more clarity on the timing and conditions that allow national regulators to use national deposit-guarantee schemes to save banks, as was the case with the bank Popolare di Bari and the NordLB bank (Noonan 2020).

The handling of the abovementioned cases attaches more significance to the fact that when the time comes for bail-in to be implemented, national solutions come into play, thus revitalising the bank-sovereign nexus as well as shedding light on potential double standards in the Eurozone that undermine the progress of the completion of the Banking Union. This is the case not only for high-debt countries, but also for core Eurozone countries, taking into consideration that seven out of the fifteen banks most exposed to sovereign debt are German and only three are Italian, according to the economist Eric Dor (Sandbu 2020). Such a policy confirms that the doom loop has not yet been disabled. The more national solutions are used, the more leeway is created to increase government support and to strengthen the vicious circle. Against this background, it may be regarded as a burdensome task to ask for a severe reduction in Italian NPLs or to stop agitating against the ESM Treaty (for fear of aggravating Italians who put their savings in government bonds), while the respective decisions in the context of the SRM framework

[15] Karel Lannoo, CEO of the Centre of European Policy Studies in Brussels, declared that "it's up to the Commission to interpret the rules in a strict way […] if we want to achieve our overall objective to have a competitive banking market, then we have to apply the rules as they are" (Euronews 2019).

are deemed as a reflection of political protectiveness under the application of state aid rules regarding a German bank. Such a regime may concern legal rescues, but it is not fair enough to restore trust and ensure comprehensive application of rules that could deliver the aims of the Banking Union. That said, in combination with the legal loopholes that leave ample space for national solutions in case of bank failures, further cooperation is needed at political level in order to fulfill the Banking Union mandate to its full extent (Beck 2021, Vikelidou 2021). Against this background, Berrigan (2021) states that the wider establishment of branches instead of subsidiaries along with group support agreements and digitalization of bank services at cross-border level could mitigate the ongoing impasse at the political level.

It is also essential that the SRB acquires more independence, consistent with its statutory tasks in decision-making process, concerning the way of dealing with unviable banks, the FOLTF, and the public interest assessment, as well as the choice of the suitable resolution tool. This entails the use of expertise knowledge on the banking industry that will enable the cooperation of the banks under resolution with the best bidder in a limited timeframe. To this end, better communication channels with the NRAs and the Commission could contribute significantly, without their involvement in the SRB's decision-making process (Véron 2019a, pp. 17-19). It is to be noted, however, that despite potential steps towards a more independent SRB in the future, these steps could stumble at the first hurdle, since the SRB is an EU agency whose decisions can be rejected by the Commission or the Council, whereas the ECB is a fully independent institution, and the NRAs as well, as the national banks may have been granted with more independence (Lannoo 2019, p. 17).

As regards the coronavirus pandemic, tt should be stressed that the SRB reacted properly catering for any emerging cause of crisis. Specifically, the 2021 resolution planning cycle was successfully implemented by the International Resolution Teams (IRTs), no relief measures were necessary, and banks were able to keep up with all resolution planning activities in accordance with the adjusted work environment and resolution work programmes (SRB 2022d, p.19). The same readiness of the SRB to address crises related to extreme events was revealed at the Sberbank case. The failure of the

Sberbank Austria stemmed from a liquidity crisis because of loss of trust to a bank connected to the still ongoing Russian aggregation against Ukraine. In this case, the SRB regarded resolution as necessary for the two subsidiaries in Croatia and Slovenia, whereas it assessed winding up the Austrian parent under national insolvency proceedings would safeguard financial stability in a better way. As a result, the two subsidiaries returned timely to business as usual. The Austrian parent was wound up under national insolvency procedures while protecting eligible deposits with Austrian deposit guarantee system. In this context, financial stability was achieved by protecting both the taxpayer money along with the depositors (SRB 2022e).

3.2.2. Policy steps towards an optimal resolution regime at EU level

Taking stock of the legal framework of the SRM, the International Monetary Fund (IMF 2018) conducted an assessment, with the view of making proposals in accordance with the aims of the Banking Union, which comprise: a) establishing a level playing field for all the participating banks; b) mitigating moral hazard; c) enfeebling the vicious circle between banks and sovereigns by reducing government support; d) minimising the cost of bank failure; and e) aligning predictability with the required flexibility to deal with exigencies without resorting to national regimes that favour fragmentation (IMF 2018, p. 10). Within this context, the IMF suggested a financial stability exemption dependent on strict conditions and governance arrangements that would allow for departure from: i) the 8% bail-in requirement as a precondition to receive financial help from the SRF (as stipulated in article 18(7a) SRMR); ii) the 5% cap on SRF funding; and iii) the proposed stricter state aid burden-sharing rules. Such an exemption would thus be significant in mitigating critical constraints in case of a crisis in the euro area or in a wide national crisis.

In more specific terms, a more targeted correlation is essential in the list of exclusions from bail-in, the treatment of deposits based on the ranking of deposits in insolvency hierarchy (article 108 of the BRRD) and national insolvency regimes. This would calibrate the repercussions of potential legal claims under the NCWO regime in case of bail-in of creditors taking into consideration that under current national legislation, similar creditors of a bank may be treated differently across jurisdictions (IMF 2018, p. 25). Furthermore, in the context of harmonizing the hierarchy of creditor claims in bank insolvency and bail-in provisions, member states were required by the end of 2018 to establish a new asset class of "non-preferred" senior debt instruments issued by credit institutions that would be bailed-in during resolution after capital instruments but before other senior liabilities. These "non-preferred" senior debt instruments must meet the following criteria: i) the original contractual maturity is of at least one year; ii) they have no embedded derivatives and are not derivatives; and iii) the relevant contractual documentation and the prospectus concerning the issuance explicitly refers to the lower ranking. This "non-preferred" senior class of debt instruments would rank lower among senior claims but would acquire a higher priority ranking than capital instruments or any other subordinated liabilities (IMF 2018, p. 26).

In the same vein, a recent Bank of Greece report (Bank of Greece, 2021) highlighted essential points of improvement regarding the crisis management framework that indicatively included: i) the unsecured and ineligible deposits being excluded from being considered as bail-inable liabilities that could be used to absorb losses in the resolution of credit institutions, since this has already arisen considerable national concerns. Provided that the use of national resources is dependent on strict conditions that mitigate moral hazard concerns and contributes to financial stability, such a step would mitigate the invention and implementation of national solutions that potentially undermine the EU crisis management framework in the name of national financial stability, as this case has been starkly reflected in notable cases of bank failure; ii) further flexibility regarding the state aid rules in case of: a) precautionary recapitalisation; b) the establishment of asset management companies in the context of the resolution framework; c) the use of deposits under a liquidation regime if the financial stability of the member state is under stress; and d) a systemic crisis, provided that strict conditions are in place iii) the adjustment in the methodology concerning the calculation of MREL as regards its build-up for small and medium sized deposit-taking institutions, since potentially low profitability conditions and reliance mostly on depositor funding could render more burdensome for the latter the fulfillment of the same MREL requirements as those related to larger institutions. This is essential for the feasibility of the bail-in tool and an effective implementation of the respective resolution strategy (Bank of Greece 2021, pp. 239-240, Garicano 2020, p. 4).

Flexibility, providing for an explicit exemption from the EU's subsidiarity principle[16], would be functional, under the condition of effective cooperation among involved agencies entitled to find time-consistent and feasible solutions on a case-by case basis, thus rendering the EU resolution framework more meaningful in case of systemic risk of contagion. Further fragmentation could be mitigated by lessening the role of the NRAs in the application of resolution plans, and accordingly entitling the SRB with more directly applicable resolution powers concerning the strengthening of a level playing field. Broadening the powers of the SRB would also mitigate in the long run this nationally driven European integration", which was considerably revealed at the creation of the SRF with an Intergovernmental Agreement, by elevating member states' negotiating capacity to a level playing field of European standards that could effectively better calibrate the contracting role of both weak and stronger financially member states.

With the aim of offsetting fragmentation with more unification of the resolution regime, a significant step in that endeavour would be to harmonise the concepts of financial stability, solvency, critical functions, and public interest, so that important criteria such as the solvency test for FOLTF, precautionary recapitalisation, and the geographic scope for financial stability mean the same thing at national as well as at Banking Union level. To this effect, the aligning of the SRM with the state aid regime would not only reduce uncertainty but could also have the potential to equalise risk sharing at European level by deploying European funds provided to this end by the sector on a least-cost basis that would

[16] The principle of subsidiarity is defined in article 5 of the Treaty on EU. It is the principle whereby the EU does not take action (except in cases that overlap with its exclusive competence), unless it is more effective than action taken at national, regional or local level. The IMF suggests a nationally tailored implementation of the bail-in rule, the SRF funding and the state aid burden-sharing rules with the view of making the specific regime more easily applicable and effective in crises situations by proposing deviations that are deemed necessary to achieve the objectives of the crisis management framework. This is in accordance with the proportionality principle, with which the subsidiarity principle is closely bound up (https://eur-lex.europa.eu/summary/glossary/subsidiarity.html).

mitigate the risk of competitive distortions by enfeebling the cost incentives to resort to national solutions (IMF 2018, pp. 6, 20-21).

In order to promote a more unified, transparent, and predictable resolution framework that would avert the misuse of legal inconsistencies to the detriment of the EU resolution regime, the IMF suggested aligning loss sharing requirements under state aid rules with the more severe SRM prerequisites. Against this background, the IMF considered the establishment of an administrative bank liquidation tool for all banks within the SRB's remit and for banks regarded as systemic at the time of failure to be a meaningful alternative in the resolution toolkit. Specifically, this supranational liquidation tool would entail the appointment of a liquidator and the initiation of proceedings, either individually or along with: i) another resolution tool; ii) provisions for the continuity of critical functions; iii) harmonised creditor hierarchy rules; iv) access to funding; and v) deposit insurance for the transfer of covered deposits. In turn, this consistency would favour a level playing field for creditors at euro area level and a disincentive to override the EU resolution framework (IMF 2018, pp. 6, 22-23).

In 2021 the SRB took the following steps: i) defined a resolvability heatmap as a tool to monitor, benchmark and communicate on banks' progress towards full resolvability; ii) provided further operational guidance on the solvent wind-down of trading books as well as separability for partial transfer tools[17]. The latter aims at helping banks provide more detail on how to concretely deliver the relevant information and analysis through the separability analysis report along with an operational document namely the transfer playbook (SRB 2021c). This guidance on separability was published in the context of the immediate SRB priorities aiming at estimating banks' performance and ensuring continuity

[17] Separability is a broad concept relevant to all resolution strategies. It is particularly relevant for banks for which the resolution strategy envisages a transfer tool, such as sale of business, asset separation tool and the bridge institution tool. Specifically, "Separability is defined as the bank's ability to implement a transfer of i) legal entities, ii) business lines, or iii) portfolios of assets and liabilities at short notice to a third party. Separability allows the SRB to execute, together with the national resolution authorities (NRAs), a market transaction within a reasonable amount of time, in order to ensure the resolution objectives through the bank's transfer, in due course, to a private owner or through an orderly wind-down". With the view of safeguarding financial stability, the concept of separability allows the SRB to access the necessary information and analysis from banks to make full use of resolution tools in case of bank distress, which could entail that different arms of a banking group could be separated based on appropriate solutions (SRB 2021c, p.3).

in SRB's assessment. The SRB's 2022 priorities in terms of banks' resolvability include: a) liquidity and funding in resolution regarding banks' capacities to identify, mobilise and monetise assets as collateral in resolution, b) separability and reorganization plans, and c) management information system capabilities related to the execution of bail-in and valuation (SRB 2021d, SRB 2021e), iii) on 18 May 2021 the SRB published a blueprint for the CMDI framework primarily focusing on the completion of the Banking Union as an indispensable part of breaking the sovereign-bank vicious circle and long-term financial stability. To this end, the SRB proposed: i) a legislative time-bound transition period of the hybrid model of EDIS in order to provide legal certainty that could mitigate the possibility of a continuous transitional period with negative repercussions on deposit insurance as well as on the Single Resolution Mechanism due to divergent national solutions, and ii) a central role for the SRB empowered to manage all bank failures in the Banking Union along with managing the SRF and EDIS. Meanwhile, during the completion of the steady state of EDIS, the SRB could make a combined use of the SRF and EDIS in order to explore potential acquirers while maintaining the franchise value of failing banks under the SRB's remit as well as coordinate the implementation of the national DGSs alternative measures; iv) in May 2021 the SRB published a revised approach to the Public Interest Assessment test (SRB 2021g) with the view of considering the potential impact of bank failure under system-wide financial instability. Besides in May 2022 the SRB published an addendum to the Public Interest Assessment (SRB 2022c) clarifying the role of the latter concerning DGSs. This publication aimed at strengthening the choice of the best resolution strategy as related to the resolution objectives; and v) the SRB conducted dry-run exercises to ensure resolution preparedness (SRB 2022a).

Despite the vulnerabilities of the SRM framework, which are quite justified given the size and complexity of the respective legislation, the number of the involved stakeholders, and the required standard of cooperation, it could not be disregarded that what has already been achieved in elevating banking resolution policy at European level is remarkable. Taking also into consideration the set-up of the SRB in a limited timeframe along with the IRTs, the MREL standards, reports on resolution valuation, and the drafting of resolution plans for most of the banks under its remit, it is conspicuous that the SRB has achieved not only to make this complex resolution framework work, but also to carve open promising avenues for further improvement. In cooperation with the EBA, the ECB, and NRAs, the SRB has provided guidance on best practices to mitigate obstacles and address the implementation challenges, thus rendering the completion of the Banking Union a more tangible venture.

3.3. The European Deposit Insurance scheme (EDIS).

The net effect of the establishment of a truly EDIS should be assessed against the background of the Banking Union – that has already been established to a considerable level high-quality supervision and resolution, which by definition tend to reduce potential negative effects on financial stability. EDIS was introduced as a fundamental change to the existing architecture of the national safety nets. The initially proposed design of EDIS (European Commission 2015c) aimed to balance to a considerable level moral hazard issues due to its coverage, financing, and structure that correspond to an integrated financial market and depend on a broader institutional context aimed at mitigating bank failures.

In particular, the initial Commission's Proposal (European Commission 2015c) stipulated a EDIS that paved the way for a single safety net, where all the national deposit guarantee schemes would be replaced by European components. In more specific terms: a) there was the DIF as the lender of last resort for insolvent institutions, b) resolution and deposit insurance were administered by the SRB and had the same geographic reach to address incentive effects, and c) the ESM was proposed to be the fiscal backstop. This structure of EDIS augmented its credibility, as it better aligned liability and control in a single market with banking activities of cross-border nature.

At this critical juncture, the EDIS requires a step-by-step reassessment, accompanied by the political determination to safeguard financial stability at European level. Addressing certain technical points should give member states the required time to update their national legislation in line with the proposed EDIS and inspire the required commitment by addressing moral hazard issues along with financial stability concerns. Against this background, the gradual establishment of EDIS should aim at correcting the main initial design flaws of the EMU by reducing the vulnerability of national DGSs, ensuring more consistent depositor confidence, and enfeebling the link between banks and their national sovereigns. This can be achieved by the political willingness to interpret and implement the EBU rules without the threat of an oncoming crisis so that the fragilities of the incomplete union and the untested tools could gradually be eliminated (Mayes 2018, p.140).

In this context, the EDIS should be assessed as a trust-building mechanism, given that deposits are an important source for financing bank lending and hence economic growth. The deposit insurance serves the purpose of increasing trust, even if no disbursement may be needed. Deposit guarantee schemes provide therefore an important psychological element: in safe times, they increase savers' willingness to deposit money at a bank, and in uncertain times (bank run), their existence reflects the assurance that dissuades any depositor from trying to achieve a "first mover advantage" by being the first to withdraw deposits while the bank is still liquid.

Consequently, a credible deposit protection scheme could contribute immensely to financial stability by keeping the banking system immune against potential adverse conditions such as sudden and massive withdrawals of liquidity (bank run). Furthermore, a EDIS capable of providing a further risk pool could provide better risk spreading, higher efficiency, and more robustness, compared to the existing national deposit guarantee schemes (Roosebeke 2015, p. 2).

In order to break the political deadlock regarding the progress on EDIS, it is essential to highlight the limits of the existing DGSs, taking into consideration: i) the difference between a common DGS, in which the national schemes of the member states are insurer takers, and a single deposit insurance scheme, where the insurance takers are all Eurozone banks (Roosebeke 2015, p. 9), and ii) that the existing DGSs could not possibly prevent a large systemic crisis with the current targeted financial endowment of 0.8% of deposits by 2024 (article 10(2) DGSD). These limits echo the requirements that should be met for a beneficial EDIS. These requirements should outweigh the fragilities of a Eurozone DGS and should include: i) mitigating member state bias that, in the existing case of DGSs, has the potential to distort competition among national deposit guarantee schemes by favouring deposits in banks based in the stronger member states; ii) better risk pooling amongst the insurer takers that lower the cost of insurance, while increasing the resilience and credibility of the deposit insurance scheme. To this end, two options have been suggested: a) regarding a single DGS (entailing the abolishment of national DGSs), an institution-based risk analysis aiming to estimate each bank's contribution to the fund, and b) regarding a common DGS, some national DGSs would need a higher target level than the existing common financial target of 0.8% of covered deposits (article 10(2) DGSD) due to different risk exposure of each national DGS, as well as due to different sovereign risk exposure in bank balance sheets (Roosebeke 2015, pp. 8, 9). Otherwise, DGSs could "choose to take out commercial excess of loss insurance". The latter would "cover losses that exceed a certain threshold (liability floor) up to another specified threshold (liability cap). Thus, where the incurred damage is below the liability floor, the insured DGS is solely responsible for compensating a depositor. Where the incurred damage is between the liability floor and the cap, the DGS has to indemnify up to the amount of the floor, and the insurance will pay compensation for all losses in excess of the floor amount. Where the losses exceed the liability cap, the insurer pays for all damage between the floor and the cap" (Roosebeke 2015, p. 9); iii) addressing the sovereign exposure issues by inducing the coverage of the banks' sovereign exposure by their own funds instead of being covered by a national DGS that would end up strengthening the vicious circle between banks and the respective member states (Roosebeke 2015, p. 10); iv) mitigating moral hazard issues by imposing significant national financial contributions before any use of a single DGS, should a default take place. Such a policy would avert member states from arrogating the benefits of a risky, and thus potentially more profitable, national banking sector, as well as from transmitting the costs of the latter to the single DGS in the Eurozone under consideration; v) alleviating the moral hazard problem and addressing financial stability and competition concerns by limiting the mutual use of financial means of national compartments participating in a forthcoming common Eurozone DGS instead of a single one. The gradual mutualisation of financial means progressing until 2024 that is stipulated in the DGSD, in the form of a financial endowment of 0.8% of covered deposits in each national DGS by 2024, constitutes a contributing factor to this end (article 10(2) DGSD) (Roosebeke 2015, pp. 8-11).

Additionally, it has been suggested that the EDIS Regulation should provide for the mandatory contribution of every bank to the DIF as of the initial re-insurance phase and be based on their risk profile in order to avert the possibility of low-risk banks subsidizing high-risk bank activities. The lack of such variations would trigger high risk taking that in the long run would distort competition and be detrimental to financial stability. In this vein, it is suggested that banks back their investments in sovereign bonds with own funds, so that weak DGSs and member states are triggered to ameliorate their credit rating above the level of the existing DGSD and banks with a low own-funds ratio are disincentivized to invest considerably in government bonds (Roosebeke et al. 2016, pp. 3-4). Such safeguards would set clear legal and operational frameworks that would minimize moral hazard in favour of sound competition and robust financial stability. On the other hand, however, such a financial support of banks towards sovereigns would not build on lessening the likelihood of taxpayers having to rescue banks.

Regular assessment of the effectiveness of EDIS, taking into consideration best practices, is crucial so that any remaining gaps are settled in this respect. These gaps could indicatively be covered with information regarding: i) which bank is on the edge of a bank run; ii) which stakeholder owns the debt, so that the potential impact of a bail-in on the financial system can be evaluated more accurately; or iii) the amount related to funding costs for banks, in order to estimate the possibility of a bank writing down the specific debt rather than be rescued by the respective sovereign (Jones 2020b).

The EDIS introduces a unified European scheme for deposit insurance that is structured based to a great extent on the US approach for deposit protection, thus redefining the role of DGSs as part of the changing architecture of the financial safety net in a European territory mostly looking like a federal union, where financial stability is pursued at European level. To this end, a regular review of EDIS, in close cooperation with global stakeholders, regarding the treatment of bank exposure to sovereigns, and a permanent Ad Hoc Working Party within the Council that will comprise experts from all the member states, could contribute to minimizing the shortcomings of the incomplete framework of the EU, which from the outset lacked a common political structure that could ensure more effective cooperation during a crisis.

The EDIS should be evaluated according to its capacity to provide meaningful and in due time coverage in case of financial distress at European level. Its main aim is to protect depositors against risk, not to avoid it. Banking nationalism, European skepticism, misplaced criticism, and provocative inattention, hinder a more profound recognition that even in its still incomplete form, EDIS could be considered as a first best step towards a trust-enhancing mechanism indispensable to financial stability. Brilliant and efficient solutions may be proposed for Europe’s many crises, but if member states are not willing to reach agreements that promote primarily the European interest and in the long run the national interest, the EU is presented as lacking teeth, especially if this process is not accompanied by political reform that would give full democratic legitimacy to European institutions to prove that they are trustworthy and have the ability to address crucial financial issues in a way acceptable to all member states. Short-sighted political disincentives regarding resoluteness of European policy and national perverse incentives may lead to failure to assess EDIS as a single financial tool that could protect European deposits from a false illusion of financial safety, which in turn perpetuates vulnerabilities and undermines the European integration project.

4. Recent proposals towards completing the European Banking Union

The Governor of the Bank of Greece Stournaras (2020) has proposed the following steps: 1) a more flexible implementation of state aid rules. The creation of Asset Management Companies, under the guarantee of the State should be recognized as a reliable solution for dealing with asset quality problems. In addition, the BRRD Directive does not provide for a clear strategy for handling insolvency of small and medium-sized banks, which are mainly financed by deposits and do not have the ability to issue subordinated securities in sufficient quantity to be used to absorb losses. For these banks, perhaps the only available solution is to be liquidated under the national insolvency framework. However, as these frameworks remain fragmented between countries, banks based in different EU Member States are treated differently and have a different hierarchy of creditors (bondholders, depositors, etc.). Consequently, some harmonization of the various national clearing procedures is therefore required such as regarding the creditor prioritization. Besides all deposits should be excluded from the instruments used to absorb capital losses in order to safeguard financial stability and the relevant provision of the BRRD Directive should be reviewed, 2) further provisions for liquidity in the resolution process should be stipulated. Towards this end, it would be useful to render the Single Resolution Fund financing mechanism operational by putting into use the backstop function of the European Stability Mechanism and accelerating its establishment. However, liquidity needs in resolution may exceed the level currently set. In this case, the ECB could establish a special credit line with appropriate safeguard clauses, and 3) it is crucial to complete the third pillar of the Banking Union, the EDIS, since a single, properly designed and adequately financed deposit insurance scheme at European level could strengthen depositors' trust by mitigating the risk of a bank run and breaking the vicious circle between banks and sovereigns. To this end, stronger political will could play a crucial role. Additionally, Stournaras (2022) highlighted the significance of balancing the impact of EBU measures on smaller institutions along with safeguarding the effectiveness of the regime by reducing the segmentation of the decision-making process. To this end, it is essential that central bankers take the initiative to communicate promptly their guidance despite any political controversy taking into consideration the short time limits to address existing and oncoming challenges by the transforming financial landscape.

The lack of a harmonised framework regarding bank insolvency paves the way for an uneven if not arbitrary regime based on national interpretations that render non-functional the crisis management framework since it favours national specificities to the detriment of financial stability at European level. The potential non-alignment between the objectives of resolution and normal insolvency proceedings (supra p. 17) may induce mutually exclusive outcomes that run counter to the uniform application of the EBU rules and undermine financial stability at European level. This could also be the case when the implementation of the resolution rules at EU level triggers political turmoil at national level.

This regime is worsened by banks that are too big to be handled by the national insolvency framework but nevertheless resolution requirements are not met. To this end, Restoy (2021) proposed to set up harmonised mechanisms to promote transfer transactions between the failing entity and the acquirer as regards the small and medium-sized banks either under resolution or national insolvency. Depending on the bank failure management strategy, this would require the existence of available liquidity to protect the maintenance of critical functions along with banks' net asset value and the interest of the DGS and other creditors under insolvency. Specifically, Restoy suggested the following steps: i) rendering the DGS more operational by replacing the current super-preference of covered deposits by a general depositor preference rule. This would entail lessening the amount of transferred assets to non-covered deposits and therefore the amount of the required MREL for a sale of business under the EU resolution framework, ii) redefining the methodology for calculating MREL requirements based on a resolution plan concerning a sales of business transaction in order to maximise the success of such a strategy. In this vein, regulatory capital, loss-absorbing liabilities and DGS funding would contribute to specifying MREL requirements as regards a credible sales of business resolution strategy, and iii) tailoring the minimum bail-in requirements (currently set up at 8%) for each bank as regards access to the SRF in accordance with the respective MREL requirements for each bank, which in turn should be calibrated based on the preferred resolution strategy. However, limiting the fragilities involved in the nexus between banks and national funding, it is essential to equip the EBU with a centralised decision-making authority within the SRB that will be competent for both significant and non-significant entities. To this end, establishing a single EDIS aimed at funding covered deposits and sales of business transactions with a reasonable financial cap could contribute significantly to bettering the crisis management procedures (Restoy, 2021).

The incompleteness of the resolution framework is also depicted in a recent paper on the impediments of resolvability (Bodellini and De Groen 2021), which assessed publicly available indicators and highlighted that there is hardly any improvement on the resolvability of banks. This weakness of the framework is mainly attributed to inadequacy of publicly disclosed information related to liquidity and funding in resolution, operational continuity, IT systems and data requirements. However, there seems to have been timid progress concerning the resolvability of banks, which is linked with reduction in the complexity of bank structures and illiquid asset portfolios since 2015. To this end, this paper suggests that public disclosure of resolution plans could improve the stakeholders' awareness of the potential repercussions of bank failures. The latter could safeguard financial stability by contributing to an orderly resolution or liquidation of the banks that are under the SRB's remit.

With the view of dispelling the ambiguities on liquidity needs in resolution, the SRB published a technical working paper on a methodology for the evaluation of liquidity needs in resolution. This methodology is based on the concept of Minimum Operating Need for a given time window in order to inform on post-resolution liquidity targets based on a certain level of precision leveraging on granular maturity data that are reported monthly by banks. Taking into account that these technical guidelines aim to prepare for the worst despite any potential bank failure, this methodology provides a useful starting point for providing evaluations of liquidity resolution needs for different purposes (such as resolution planning, crisis management) without relying on stress factors that bring banks to failure. Specifically, this technical guidance identifies liquidity needs in resolution by setting different post-resolution targets: i) a short-term target to fulfil the required minimum operating needs for one month; ii) a middle -term target asset as the liquidity necessary to restore the LCR to 100%; and iii) a safety buffer of 110% LCR to provide the bank with more capacity to manoeuver and avert an early non-compliance with the LCR. In parallel, the equation of estimating liquidity needs takes also into account the size of any needed support and the timing of intervention (SRB 2022f).

Against this background, Beck (2021) reached the following conclusions on completing the EBU: i) establishing a European deposit insurance and backstop for the resolution fund, ii) stipulating stronger resolution powers at the European level that could allow a swifter and more decisive interventions that does not lack teeth as regards implementation, and iii) mitigating political influence on regulatory decisions both at national as well as at European level.

Additionally, the President of the Eurogroup Paschal Donohoe suggested in February 2022 a Work Plan comprising four workstreams: i) establish a common protection of depositors. As a first step, EDIS would offer loans to national deposit schemes in case that the latter risk being depleted. In the second phase three years later, the European fund would gradually take over risks concerning depositor protection and winding up failed institutions. Accordingly, contributions would be tailored to the risk profile of the bank and its exposure to sovereign debt; ii) promote diversification of banks' sovereign exposures by promoting further transparency and monitoring through stress tests or through contributions to EDIS based on the aggregate number of sovereign holdings; iii) ameliorate the management of failing banks; and iv) pave the way for a Single Market of banking services (Donohoe 2022, Valero 2022).

In the context of supporting ongoing discussions on the crisis management framework, the Commission launched from 26 January to 20 April 2021 a targeted consultation along with a public consultation with general questions on the CMDI framework (from 25 February 2021 until 20 May 2021) with the view of mapping out the state of play of this regime as viewed by the stakeholders' experience along with upgrading its objectives with the lessons learnt since the onset of its implementation date. The conclusions concern: i) mitigating potential risks for financial stability stemming from bank failures, ii) limiting public financing, iii) protecting depositors, iv) smoothing over cross-border crises, and v) strengthening a level playing field for banks along with breaking the vicious circle between banks and sovereigns. Specifically, the consultation aimed at gathering experience from the implementation of the CMDI legal framework (comprising the Bank Recovery and Resolution Directive (BRRD-Directive 2014/59/EU), the Single Resolution Mechanism Regulation (SRMR-Regulation EU 806/2014) and the Deposit Guarantee Schemes Directive (DGSD-Directive 2014/49/EU) with the view of improving the CMDI framework and completing the Banking Union with its third pillar, namely the EDIS (European Commission 2021c).

5. Conclusions

This paper provided an overview of the implementation of the EBU framework so far shedding light on the considerable progress along with the legal loopholes and gaps that mitigate the validity, enforceability, political acceptance, and effectiveness of the whole regime. Specifically, the paper highlighted the ECB and the SRB as highly effective institutions leading the SSM and the SRM respectively along with facilitating an orderly cooperation with all other involved agencies comprising the Commission, the Council, the national competent authorities and as of 2022 the ESM under the backstop arrangement (ESM 2022). A vivid example of this fruitful interaction has been the only resolution case for the time being, namely the resolution of Bank Popular Español. On the other hand, the outcome of this very same example as reflected in the relevant court decision (SRB 2022b) along with the scrutiny in this paper concerning the implementation of the EBU regime, indicates the potentially perverse impact of political disagreement on preparedness and effectiveness of this framework.

A meaningful contribution towards mitigating legal uncertainty resulting in creating an unlevel playing field and in turn towards completing the European Banking Union, would be elevating insolvency proceedings, the public interest assessment, the criteria and triggers for determining failing banks, the non-creditor worse off principle and the creditor hierarchy at the European level with the view of establishing centralized resolution and liquidation. This would be in line with the Political Guidelines of the President of the Commission Von der Leyen (Von der Leyen 2021). In parallel, such a centralized regime at EU level would pave the way for the completion of the European Banking Union with a truly European Deposit Insurance Scheme (EDIS) as a shock-absorber calibrating legal interests at European level. Against this background, the completion of the European Banking Union with EDIS would align resilience and flexibility and carve out an effective leeway potentially capable to mitigate any persisting shock-amplifying factor. The existence of a trustworthy safety net would maximize the benefits of EU's diversified banking sector within the remit of the EBU. Under this condition, healthy competition policies along with steady cash flows could be favoured. This may not necessarily leave the same margin of profit to the wide-range banks within the EBU, but it could be a brave step towards a sustainable banking framework equipped with the right orientation for growth.

For the purpose of increasing bank profitability, as a core step towards reducing losses, the EBU framework needs to be adjusted to changing business landscape including digitalisation, control over financial crime and environmental issues so that the newly introduced fragilities by the coronavirus pandemic can be mitigated in a flexible and well-ordered framework. In this context, the cost of non-completing the EBU project could be mitigated along with making the most of its financing potential and resilience.

We should not lose sight of the anchor point shedding light on the importance of a stronger political cooperation as a core factor of building progressively further trust while ensuring optimal effectiveness across all workstreams by generating approval through gradual adjustments on all fronts.

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