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Banking Union in the roadmap for the Euro: taking stock on the eve of the European Council

Abstract :

To find a decisive response to the euro crisis the European Council is putting forward a four part programme for union: budgetary, banking, economic and political union. This roadmap, which will be discussed on 13th and 14th December 2012, aims to remedy the constitutive weaknesses of the Economic and Monetary Union. It concerns, on the one hand, the lack of adequate budgetary and economic coordination, together with solidarity mechanisms, and on the other, the upkeep of national supervision in the face of a trend towards financial integration that has been fostered by the introduction of the euro.

Overall the project for banking union aims to centralise supervision under the guidance of the European Central Bank (ECB), a necessary condition for the recapitalisation of struggling banks via the European Solidarity Mechanism (ESM). This should break the national vicious circles that exist between banks and States and thereby stabilise the euro zone. Although integrated supervision by the ECB is a necessary first step to strengthening the euro it raises questions about the distribution of tasks within the new mechanism, just as much as it does about the future organisation of the institutions themselves.

It was in the context of the global financial reform, undertaken by the G20 in 2008 and coordinated by the Financial Stability Council (FSC) that the European Union set out its own regulation. Since then, financial shocks led to an economic and then to a sovereign crisis in Europe. The financial consolidation and budgetary programme that was started four years ago has proved insufficient in response to the threats that weigh over the euro zone.

In June 2012 European heads of State and government therefore laid out the principles of an overall reform of the Economic and Monetary Union (EMU) at the European Council, the structure of which supports the euro to provide a decisive response. The European Council on 13th and 14th December 2012 should lead to details and the implementation of these guidelines [1].

After a brief diagnosis of the causes of the turbulence that is sweeping over the euro zone, we shall look into the project for banking union that is part of the euro reform programme – whose strategic interest we shall then assess, likewise the issues that it raises.

1 – KEY FEATURES OF THE EURO ZONE CRISIS

The existence of a vicious circle between the banks and the sovereign debts is frequently highlighted in explanation of the deep crisis that the euro zone is now experiencing. However two other factors are to be taken into account – the lacuna that are intrinsic to the Economic and Monetary Union (EMU) and the inefficacy of supervision.

A- The Constitutive Weaknesses of the Economic and Monetary Union

Two major shortcomings in the euro's structure have emerged during the present turbulence.

On the one hand no real budgetary and economic union runs together with solidarity mechanisms. The minimal discipline introduced in 1997 with the Stability and Growth Pact has remained fairly weak and many States were exonerated at the first opportunity[2]. The worsening of budgetary situations, in the wake of the recession and the national banking crises, were,

1. http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf

2. Introduced by the Amsterdam Treaty (1997), the Stability and Growth Pact notably aims to prevent and correct excessive deficits. Not extremely binding from the start this pact has been the focus of several consolidation measures.

in the opinion of the market players, a serious factor of uncertainty. Since there was a lack of solidarity the default of a State thereby became a possibility. This phenomenon emerged in the considerable differences in levels of public debt in the euro zone states as of 2009 which increased the burden of the debt of the weakest states. We should also recall the lax attitude and lack of vigilance that led the European Council to integrate countries into the euro zone, which really did not have the required criteria, and which now form the eye of the storm.

On the other hand bank supervision and guarantee mechanisms have largely remained within the national domain. In view of increasing financial integration, pushed forward by the single currency, which has led to a stronger, faster spread of financial shocks, this kind of decentralisation has not helped in overcoming cross border banking failures effectively.

B – The ineffective nature of supervision in the management of bank crises

Just a little time after the introduction of the euro in 1999 the ECB and European Parliament requested the centralisation, within the euro zone, of banking supervision which had remained in the national sphere.[3] These requests were curtly rejected by the Ministers of the Economic and Finances Council (ECOFIN), to the great satisfaction of the national Central Banks which had just lost monetary policy, but succeeded in maintaining supervision. European supervisors' committees were however created as a result in the financial sector between 2002 and 2004 to coordinate financial activity supervision according to sector (bank, insurance, financial markets)[4]. These organisations were the focus of several strengthening measures, the latest of which was their transformation into Authorities when supervision was revised in 2010, but implemented at the beginning of 2011 - for example the European Banking Authority (EBA), which has some binding powers. However since the EBA has to adhere to disproportionate specifications, lacks any real decision making power, and also has to function according to a collegial system with ill adapted supervisory tools, it cannot effectively face the crises that affect cross border banks[5].

C – The Vicious Circle between banks and sovereign debts

It is now over two years since the euro zone crisis began in the spring of 2010 with the public debt problems experienced by Greece. Since then it has spread to other countries (Ireland, Portugal, Spain). The crisis is still not under control. It is now agreed that public finance imbalances and severe banking problems are a "vicious circle" [6]. Indeed notably in the euro zone banks and sovereign borrowers are indissolubly linked for two reasons.

However given the lack of any supranational banking resolution the States retain the responsibility of saving their banking system. Given the size of the latter these operations have major budgetary consequences. Hence the difficulties experienced by the banking systems affect the States.

Furthermore a major share of the banks' financial assets lies in sovereign bonds. Indeed in December 2010 the public bonds held by the banks totalled 41.5% of the weighted risks in the heavily case of Germany, and 20% or more in France, Greece and Italy. These public bond portfolios focused on the domestic public debt of the banks in question. Hence in December 2011 the share of domestic sovereign bonds totalled more than 70% in Germany and over 80% in Spain, Ireland and Portugal [7]. And so, all uncertainty about the States' solvency implied immediate consequences for the banks because of the depreciation of their sovereign debt portfolio. Banking and sovereign debt crises lead to a decrease in financial integration, which emerges as a fragmentation of the financial markets and of the lending conditions for the economies.

2 – BANKING UNION IN THE EURO ZONE'S CONSOLIDATION PROJECT

Banking union is one of the four parts in the European Council's plan. We should briefly outline the structure of this before looking into the measures put forward for financial integration in greater detail.

A – A four part "construction kit"

During the European Council in June 2012 President Herman van Rompuy presented a report entitled "Towards a genuine Economic and Monetary Union"[8].

3. This point is reiterated in the draft regulation of September 2012, by the European Commission : Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM 2012 (511) from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0511:FIN:EN:PDF>

4. The introduction and development of these organisations are reviewed in a paper by the author. See Perrut D., "Financial Regulation after the Subprime Crisis: what lessons have been learnt and what reforms undertaken?" Robert Schuman Foundation, Policy paper, July 2012

5. These inadequacies are noted in two reports which inspired the reform of supervision in 2010 : Centre for European Policy Studies, 2008, Concrete Steps towards More Integrated Financial Oversight, The EU's Policy Response to the Crisis; The High-level Group on Financial Supervision in the EU, Feb. 2009, Report, Chaired by J. de Larosière.

6. On these points see: IMF, Global Financial Stability Report, April 2012 ; Bank for International Settlements, 82nd Annual report, July 2012; Merler S. & Pisani-Ferry J., « Une relation risquée : l'interdépendance entre dette bancaire et dette souveraine et la stabilité de la zone euro », Revue de Stabilité financière, Banque de France, April 2012 ;

7. Cf. Merler S. & Pisani-Ferry J., op.cit.

8. European Council (2012), Towards a genuine Economic and Monetary Union, Report by President of the European Council, 26th June 2012, EUCO 120/12 from http://ec.europa.eu/economy_finance/focuson/crisis/documents/131201_en.pdf

Set up by the heads of the main institutions at work within the euro zone (ECB, Eurogroup, European Commission) this document suggests the euro's consolidation over the next ten years according to a four part "construction kit":

- *An integrated financial framework* ("banking union", notably comprising centralised supervision),
- *An integrated budgetary device*; in this area proposals firstly aim to consolidate recent budgetary achievements (the Treaty on Stability, Coordination and Governance (TSCG) comprising the "golden rule" on the balance of public finances, adopted in June; a framework of budgetary and economic discipline comprising six measures, the "six pack" under discussion). Then they target mid-term goals to pool sovereign debts and to achieve a European Treasury for the euro zone that can take the shocks in certain countries and raise funds centrally.
- *A common economic policy framework*; this anticipates the strengthening of the macro-economic supervisory framework (comprising the European Semester, the Euro Pact+ and procedures against macro-economic imbalances); to implement as a matter of urgency, the Pact for Growth and Employment, adopted in June, which comprises a wide range of national and community measures; to plan types of support for national structural reform.
- *A strengthening of "democratic legitimacy"* and the obligation to give account; this aspect aims to involve both European Parliament and the national parliaments regarding the exercise of democratic control "during the decision making process". The drive to enhance governance of the euro zone, by notably implementing measures in the TSCG has been confirmed.

The conclusions of the June European Council planned for the work undertaken by the "Group of Four" to continue (heads of the euro zone institutions, as mentioned earlier) in view of drafting a roadmap and a timetable to submit to the European Council on 13th and 14th December 2012. To this end the Commission published proposals on 12th September for centralised supervision including a draft regulation[9], then on 28th November, a communication "for deep, genuine EMU"[10]. In an interim report on EMU printed on 12th October the European Council gave its position.[11]

B – What kind of banking union?

In this area the European Council's proposals are based on two closely linked ideas. On the one hand it is vital to end the negative national spirals between banks and the States, thereby enabling the newly established ESM to intervene directly with the banks in difficulty[12]. On the other, this type of action requires the prior integration of banking supervision. Centralised supervision indeed enables the guarantee of uniform action in view of preventing banking risks, and then to reduce recapitalisation requirements. On the eve of the European Council in December the chapter putting forward the integrated financial mechanism (or Banking Union) might be summarised according to the four following points.

A single supervisory mechanism. The re-shaping of the supervisory system, undertaken in 2010, did not centralise decision making powers, which mostly remained in national hands. The October interim report by the European Council recommends a single supervisory mechanism under the management of the ECB and refers to the draft regulation put forward by the Commission in September in the context of article 127-6 included in the Treaty [13]. This article stipulates that by means of a regulation, prudential supervisory tasks can be undertaken by the ECB. The centralisation of supervision would be restricted to the prudential dimension, which monitors financial stability and would concern all countries in the euro zone, which other countries would be able to join. Prudential supervision would notably cover the following: bank licences and major acquisitions, the supervision of the implementation of prudential rules (particularly the famous Basel III ratios bearing on own funds, leverage and liquidity), early intervention regarding struggling banks. Other supervisory activities (consumer protection, anti-laundering, preparation of the ECB's prudential decisions) would remain in the hands of the national supervisory bodies.

The Commission's draft regulation anticipates a strict separation between monetary policy and supervisory missions (art. 18 & 19). To this end a Supervisory Committee would be set up to prepare decisions regarding this. However the final power of decision would certainly remain within the Council of Governors' realm,

9. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0511:FIN:EN:PDF>

10. European Commission (2012), *A blueprint for a deep and genuine economic and monetary union Launching a European Debate*, COM(2012) 777 final, from http://ec.europa.eu/commission_2010-2014/president/news/archives/2012/11/pdf/blueprint_en.pdf

11. European Council (2012), *Towards a genuine Economic and Monetary Union, Interim report by President of the European Council*, 12th October 2012 from http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/132809.pdf

12. *The treaty on the European Stability Mechanism was signed on 2nd February 2012 by the euro zone States. ESM was introduced on 8th October 2012.*

13. Art 127-6 TFEU: "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confers specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

responsible for the euro zone's monetary policy. The latter might however delegate certain decisions to the Supervisory Committee.

In line with the demand for democratic control and the obligation to give account, re-iterated in the European Council's interim report, the ECB would deliver an annual report on new prudential tasks to the European Parliament, the Council, the Commission and Euro-group (art. 21).

The division of tasks between the ECB and the European Banking Authority (EBA) is planned for in the regulation. This recalls that the EBA's role [14] is on the one hand, to establish a single rulebook in view of a convergence of supervisory practices to guarantee the conditions for healthy competition on the single European market and on the other, to undertake the role of ombudsman between the supervisory authorities, notably in their supervisory work with cross border groups.

The running of the EBA, which involves the national supervisory authorities, will be affected by the new measure if the regulation is adopted. Firstly regarding issues that come under the ECB's competence, the national authorities in the euro zone Member States will have to coordinate to formulate a joint position.

Then, in order to avoid the marginalisation of the non-euro countries, voting methods within the EBA will be revised. Moreover for cross-border banking groups established in the euro zone the ECB will assume all of the supervisory functions undertaken by the EBA. [15] Concerning the Union's banking groups that are established both in the euro zone and exterior to it, the tasks would be shared between the ECB (for the euro zone) and the national authorities (for the other Union countries).

Harmonised deposit guarantee mechanisms. Deposit guarantee systems aim to prevent saver panic which can cause massive withdrawal of capital and has frequently been observed in times of bank crises. In Europe the harmonisation of these systems is necessary in order to prevent savings being transferred to more protective countries. One of the first measures taken by the Union in response to the financial earthquake of autumn 2008 was to raise the guarantee ceiling for European savers. This rose from 20,000 to

100,000 € in 2011. A legislative proposal on the part of the Commission in 2010 aims to harmonise national guarantee systems, notably ensuring that the latter have enough funds that mainly come from the financial sector.[16] The proposal anticipates the beginnings of solidarity between national systems. The idea of a centralisation of the deposit guarantee systems, as set out in the European Council's June report, has now been deferred to a later stage.

Towards a European mechanism for the resolution of bank crises. The financial crisis has mainly been managed by public authorities and as a matter of urgency, which has led to a massive transfer of bank losses over to the taxpayer. This situation has created an unhealthy precedent because the banks' leaders may now believe that they are protected by their State if they are in difficulty, notably if their establishment grows to a size implying that it is "too big to fail". By this we mean that their collapse would be disastrous for the economy and that public support is guaranteed in all circumstances. A climate of impunity such as this is qualified as a moral hazard. It is precisely to restore normal market conditions and to reduce moral hazard and the risks run by the taxpayer that resolution mechanisms for banks in difficulty have been established. The introduction of this tool, now deemed vital to consolidate the financial system has been the focus of guidelines on the part of the Financial Stability Council[17]. According to these principles the European Commission published a draft bill for the recovery and resolution of bank crises[18]. The text anticipates the establishment of a national independent authority for the implementation of the following principles on struggling or failing banks: costs must be borne by the shareholders and the creditors, then by guarantee mechanisms funded by the banks in order to avoid using public money. Once adopted, this directive and that covering deposit insurance, the Commission is planning to put forward a single resolution mechanism in the euro zone.[19] This clearly defers the centralisation of this kind of measure until a later phase. In the future the Single Resolution Authority would probably include a centralised deposit guarantee fund and would enjoy financial support, possibly supplemented by funding from the ESM.

14. European Commission (2012), Draft regulation of September 2012 mentioned above, Explanatory Memorandum point 4.1 and 4.2

15. European Commission (2012), Draft regulation of September 2012 mentioned above, Explanatory Memorandum point 4.3

16. European Commission (2012), Deposit Guarantee Schemes, COM(2010) 368 from http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2010/com_2010_0368_en.pdf

17. Financial Stability Board (2011a), Key Attributes of Effective Resolution Regimes for Financial Institutions, October.

18. European Commission (2012), Proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012) 280 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0280:FIN:EN:PDF>

19. Press release of the European Commission of November 2012, mentioned above, point 313.

Intervention of the European Stability Mechanism (ESM). Launched on 8th October 2012 the ESM, which succeeds the European Financial Stability Fund created in 2010, is a permanent system within the euro zone whose present lending capacity is 500 billion €. After the introduction of the single supervisory mechanism by the ECB the ESM might be used to recapitalise struggling banks; or be used as a financial support fund to the centralised deposit insurance and resolution mechanisms; or intervene on public debt markets. Its use in struggling banks is deemed to be one of the major issues at stake in the centralisation of supervision. As for the ESM's means of action in this area the European Council's report carefully states that they would be subject to "appropriate conditionality". The euro zone's declaration of June 2012 states that this financing would have to be the focus of agreement protocols.

3 – THE PROJECT FOR BANKING UNION: A FIRST ASSESSMENT

A – About the roadmap to reform Economic and Monetary Union (EMU)

After many partial tests, made over three years on the budget, the economic policy and supervision, which have been inadequate and sometimes ineffective, the roadmap aiming to reform the EMU has powerful ambitions mid-term. The reforms aim to remedy the fundamental weaknesses in the Economic and Monetary Union, thereby to guarantee its continuation, based on economic growth. This major initiative combines short term measures (such as centralised supervision) and long term reform projects (such as the creation of a European Treasury). It also includes simple measures to consolidate previous achievements (budgetary coordination) and new projects (the pooling of Treasury bonds, contracts for structural reforms). The assessment of this vast project allows us to point to some strong areas but also some lacuna.

As for the budgetary chapter it has to be acknowledged that a great amount of legislative work has been achieved over the last three years to provide 27 Member States with a binding budgetary framework, together with possible sanctions for the 17 euro zone countries. However the measure is proving to be extremely com-

plex. How for example do the measures included in the TSCG and the "Six Pack" work together? The various elements in the reform apply to varying perimeters (27 countries as far as the "six pack" is concerned, 25 for the TSCG, 17 for the "two-pack"). Furthermore the voting rules are different depending on the measures in question.[20] Consolidation and simplification work of the budgetary system seems to be vital to guarantee both its effectiveness and its clarity for the citizen.

In the economic chapter the new supervisory framework certainly indicates progress but that it is suffering – according to the very terms used in the European Council's interim report - weaknesses as far as its visibility and its effectiveness are concerned. Moreover it would be improved if it enjoyed "greater authority". As for mid-term measures (the Growth and Employment Pact, declared to be an "absolute priority" and the support of structural reforms), which are being deployed over a wide range, they deserve close assessment.

In contrast with the previous areas, the political dimension, focusing on democratic legitimacy and the obligation to give account seems to be timorous, to the point that the term "political" was withdrawn from the interim report in October. Of course we have to laud the will to involve parliaments (on a European and national level) in the institutional work. But apart from the renewed drive[21] to enhance the governance of the euro zone, in the wake of recent decisions, the report does not offer the slightest idea about how to implement institutional reform. However the extreme complexity of the European machine in terms of its procedures, institutions and the measures adopted make the launch of this work vital. Clarity is a condition *sine qua non* for the exercise of democracy and to win citizen support.

B – On banking union and single supervision

Banking union comprises one key phase: the centralisation of supervision. This now means assessing the legitimacy and interest of this project as well as the issues it raises.

Is the ECB a legitimate body for centralised supervision? In comparison with the present situation the ECB rallies all of the conditions for legitimacy, both

20. Pisani-Ferry J., Sapir A., Wolff G. B., 2012, "The messy rebuilding of Europe", Bruegel.

21. The will to reinforce the Eurozone governance is an addition of the interim report. The latter refers to measures taken during the Euro zone Summit on 26th October 2011, and included in the TSG of June 2012. Those comprise in particular: a stable presidency (different from the Eurogroup one) for 2.5 years and two meetings per year. See on this point : T. Chopin, J-F Jamet, F-X Priollaude, "A Political Union for Europe", European Issue n°252, Robert Schuman Foundation, September 2012.

from a doctrinal and technical point of view, to take responsibility for the single supervisory mechanism. Since supervision is a preventive "line of defence" to avoid the implementation of the "lender of last resort" facility, generally granted to the central bank in times of crisis, it is logical that the latter exercises this supervision.[22] Furthermore because of its refunding operations and the control it has over payment and regulation systems the ECB has acquired in-depth, individual knowledge of the banks. Finally the monetary and prudential policies that target financial stability have never been entirely separable. Indeed the monetary policy is indeed often mobilised in operations to stabilise the financial system.

What will the range of centralised supervision be?

The Commission's draft regulation unambiguously anticipates that the single supervisory mechanism will apply to 6,000 banks in the euro zone in two stages. This measure would first concern the systemic banks (in July 2013), then all of the other banks (at the beginning of 2014). Banks that benefit from public funds might fall under centralised supervision in 2013 (art.27). German leaders, concerned about maintaining the control over their regional banks (Landesbanken), have shown their reticence about this reform highlighting both the weakness of the ECB's means in undertaking supervision like this, as well as the concentration of the banking sector (in which 95% of the assets are held by around 200 banks) which would make centralisation on this scale unnecessary. A universal centralised supervisory system will undoubtedly be set up. However it will concentrate on systemic banks; those that receive public aid and undoubtedly cross-border banks. It is likely, in keeping with the regulation and under the pressure of certain Member States that the supervision of other banks will be the focus of extremely extensive delegations to the national authorities.

Timetable: a sequence is emerging. In the banking union project an order of priorities is clearly emerging in favour of centralised supervision which conditions the implementation of the ESM for the direct recapitalisation of the banks. The initial planned deadline (1st January 2013) for the launch of centralised supervision was deemed unrealistic by the ECB. If the European Council takes a favourable decision on 13th and 14th December next the process will become operational in 2013.

Projects for deposit guarantees and national resolution mechanisms will be implemented according to the pace of legislative process. Once these directives have been adopted a proposal will be made to move on to a cen-

tralised resolution mechanism. As far as deposit guarantees are concerned, apart from the adoption of the directive the European Council sees greater integration in the budgetary, economic and political domains as a prerequisite, which clearly delays final completion.

Advantages and drawbacks of prudential centralisation.

The new international banking standards, the so-called Basel III, are now being transposed in the Union (the CRD IV, 22 Directive)[23]. This reform provides greater scope for the discretionary role of the supervisor which is already included in the present rules. Hence according to the new standards, additional "contra-cyclical" own funds "buffers", might be demanded by the supervisor to slow the distribution of loans in the event of a speculative bubble. A harmonised implementation of these new rules by a single supervisor in the euro zone offers an undeniable advantage in terms of guaranteeing the coherence of supervision and avoiding any regulatory relaxing for competitive ends.

The separation of the monetary policy from prudential functions cannot be total. From this standpoint the legal founding of the Commission's proposal (art. 127-6), undeniably places the future Supervisor Committee under the responsibility of the ECB Council of Governors, the supreme decision-making body for the monetary policy. Hence the system is less attractive for countries outside of the euro zone who possibly want to join the banking union. The Governors of their national central banks would not be part of the decision-making body. This is one of the legal limits of the draft regulation.

Moreover, conflicts of interest (between monetary policy and prudential supervision) could arise as the Central Bank exercises its supervisory missions. The argument is a valid one but must not be overestimated: monetary policy allows for prudential considerations.

The difficult sharing of supervisory tasks between the ECB and the EBA.

The European Banking Authority (EBA), established in 2011, has considerable binding powers unlike the Committee of European Banking Supervisors, the organisation it took over from, which enjoyed none. The new supervisory landscape raises several issues as far as the EBA's future role is concerned.

How will the EBA, which will be run as a college, define "the single rulebook" which it is responsible for? The new standards leave the supervisor with room to manoeuvre. The national supervisory authorities outside the euro zone will probably want to retain control over these increased discretionary powers. Regarding the modification of the voting rules within the EBA, pres-

22. Perrut D. (2012), *op. cit.*

23. European Commission (2011), *Proposal for a directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firm*, COM(2011) 453 from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0453:FIN:EN:PDF>

European Commission (2011), *Proposal for a regulation on prudential requirements for credit institutions and investment firms*, COM(2011) 452 from [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2011:0452\(01\):FIN:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2011:0452(01):FIN:EN:PDF)
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http://www.ecb.int/events/conferences/shared/pdf/reg_fs_session3_topic1_thienpont.pdf?0e45806fedeacab57cd3f8b1e2f6640

sure on the part of the British aims to achieve a right of veto via a dual voting system within this organisation. If the single rulebook is published how will the EBA impose this on non euro zone members? Recent backtracking by the USA regarding the application of new international standards may influence the British position to slow their transposal in Europe, in order not to disadvantage the City's competitive position. We may see the emergence of a two-tiered supervision that will lead to regulatory arbitration.[24] Finally given the chronic discord that will arise between supervisors, how will the EBA assert its authority, particularly regarding the ECB?

The strengthening of the EBA now seems necessary so that it can ensure all of its tasks. Supervision must be as harmonised outside of the euro zone as it is within in. The EBA's rising power seems to be a corollary to the centralisation of supervision in terms of the ECB. After the reform of supervision in 2010 the overall layout of the Union's prudential system became too complicated. The planned reform will make it even more complicated. Parallel to the strengthening of the EBA's powers, the mechanism as a whole must be simplified and clarified. This might provide an opportunity to review the legal bases of centralised supervision (art. 127-6).

A lack of proposals regarding banking structures.

Amongst the banking union's weaknesses we should note the lack of any proposal on the reform of banking structures. Many questions are now being raised in the wake of numerous recent financial failings. Should certain banking activities be banned or at least restricted? The subject is the focus of lively discussion and is leading to reform on either side of the Atlantic, with the Volcker reform over proprietary trading, in application in the USA and the Vickers reform that aims to separate savings banks which under debate in the UK. Debate is vital on this point because the revision of banking structures may help to reduce moral hazard and hence, alongside the new banking standards and

resolution plans, improve the system. Of course this subject is addressed by the Liikanen report delivered to the Commission at the beginning of October[25]. But this only presents vague, timorous conclusions, and this includes its leading proposal that focuses on proprietary trading, which is being scrutinised by all regulators.

CONCLUSION

The plan drawn up by the euro zone's leaders to strengthen the single currency is an ambitious one. It aims to restore conditions for growth in order to guarantee the euro in the long term. There are some lacunas, particular in the political and institutional chapter.

The project for centralised supervision in the banking union seems to be the first decisive phase in the stabilisation of the euro zone because it means that the ESM can counter the negative sequences of events seen in the countries in the south. Legitimate and necessary, the single supervisory mechanism brings new challenges to the fore.

Relations between the ECB and the EBA will obviously be difficult. There is a danger of regulatory competition within the union, which will result from two-tiered supervision. It is vital to set out their respective roles and enhance the EBA's powers. This would provide an opportunity to make an in-depth review of the structure of supervision which must be simplified and clarified. For the time being with the single supervisory mechanism European leaders must show their determination by moving on to a decisive phase in the reform of the euro.

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24. Larosière J. de (2012), "La supervision est encore plus importante que la régulation", *Confrontation Europe, la Revue*; October-December.

25. High-level Group on reforming the structure of the EU banking sector, 2012, *Final Report*, Chaired by E. Liikanen from http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

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