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The European Commission's Proposals for a Single Supervisory Mechanism: Racing Towards Banking Union in the EU?

The European Commission has published draft legislation and a blueprint for transferring significant European banking supervisory powers to the European Central Bank (ECB).[1] The proposed Single Supervisory Mechanism (SSM) is due to take effect and shall be directly applicable in all Eurozone Member States from 1 January 2013, subject to a partial one year phasing-in period. By 1 January 2014, it is supposed to cover all credit institutions in the Eurozone.

The SSM is part of the package of measures comprising the establishment of a Banking Union in the EU. The Commission is also calling on the European Parliament and the Council to reach agreement by the end of 2012 on the capital and liquidity standards to be introduced by the new Capital Requirements Directive and accompanying Regulation (known as the CRD 4 package), the proposal for a Directive on Recovery and Resolution of Credit Institutions and Investment Firms and the proposal for a (recast) Directive on Deposit Guarantee Schemes.

The Commission's proposals are, however, controversial and it is difficult to predict when, and in what form, they will be implemented.

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Introduction

The Commission's new proposals on a Banking Union and, in particular, the SSM, include:

- a Communication setting out the Commission's "Roadmap towards a Banking Union";
- a draft Regulation conferring significant powers on the ECB for the supervision of all credit institutions in the Eurozone; and
- a draft Regulation amending the existing Regulation which established and governs the operation of the European Banking Authority (EBA).

This client note provides an overview of the Commission's new proposals.

The concept of a Banking Union

The concept of a Banking Union emerged in the political debate surrounding the sovereign debt crisis and weakness of the banking sector in certain EU countries. A Banking Union is expected to strengthen the Economic and Monetary Union for the Eurozone countries and to deepen market integration in the banking sector in the entire EU. Some of the Banking Union measures will apply only to Eurozone members while other measures will have EU-wide application.

[1] Available at http://ec.europa.eu/commission_2010-2014/barnier/headlines/news/2012/09/20120912_en.htm.

Political agreement was reached at the Euro Area Summit of 29 June 2012 that the establishment of the SSM, in particular, would be a precondition for a possible direct recapitalisation of banks by the European Stability Mechanism. The Commission's proposals on the SSM create a legislative framework for the introduction of an integrated system for the supervision of banks in the Eurozone, with the ECB at its centre. The hope is that an SSM could mitigate the risk of bank failures and associated spillover effects across participating Member States.

The SSM is the most recent in a series of proposals relating to a Banking Union. The Banking Union will encompass a variety of legal instruments designed, in the Commission's words, to break the "vicious link" between sovereign states and their banks. Other elements of the proposed Banking Union include progress towards a 'single rulebook', in particular the CRD 4 package, an integrated crisis management framework (click here for our client alert on this proposal) and a common system for deposit guarantees.

Increased powers for the ECB

As regards the Eurozone, the Commission proposes moving a number of supervisory responsibilities to the European level with a view to promoting the safety and soundness of banks and the stability of the financial system.

The new supervisory responsibilities of the ECB shall be limited to credit institutions, i.e. institutions that receive deposits or other repayable funds from the public and grant credits for their own account. Institutions which do not qualify as credit institutions will continue to be supervised by national authorities. Furthermore, the ECB's supervisory role will be limited to credit institutions established in the Eurozone Member States, although a non-Eurozone Member State may elect to participate in the SSM.

The ECB's responsibilities will include, for example, the authorisation and withdrawal of authorisation of all credit institutions, the assessment of acquisitions and disposals of holdings in banks, ensuring compliance with prudential regulatory requirements, and supervising financial conglomerates. The ECB will also be able to deploy early intervention tools when a bank breaches or risks breaching the applicable prudential requirements. For the purpose of carrying out its tasks, the ECB will be granted meaningful investigatory and sanctioning powers.

The ECB will be accountable to the European Parliament and the Council/the Eurogroup in respect of its new responsibilities. Monetary policy and bank supervision will be operationally separated at the ECB. The ECB will be able to levy fees on credit institutions subject to its supervision in order to finance its activities.

Role of the EBA

The Commission's legislative proposals do not fundamentally change the role of the EBA. Broadly speaking, it will remain responsible for developing the 'single rulebook' and for promoting supervisory consistency in relation to the banking sector across all 27 EU Member States.

However, the procedures of the EBA will be adapted to the SSM framework. For the purposes of the EBA's tasks, the ECB will normally be treated like other competent authorities, subject to modifications for actions by the EBA to settle disagreements or to address emergency situations. In addition, the voting modalities of the EBA's Board of Supervisors will be adjusted for matters (in particular, legal breach and settlement of disagreements) which are currently subject to simple majority voting. Finally, at least two members on the EBA's Management Board will come from Member States not participating in the SSM.

Role of national competent authorities in participating Member States

Competencies not expressly transferred to the ECB will remain with the competent authorities of Member States participating in the SSM. Interestingly, they will continue, for example, to be responsible for the supervision of banks from third countries establishing a branch or providing cross-border services in the EU. They can also impose pecuniary sanctions for breaches of EU law except, presumably, where an ECB act is concerned.

In any case, the relevant national competent authorities will assist the ECB by preparing and implementing measures on its behalf. In practice, their expertise and resources will be essential for effective day-to-day banking supervision.

Timeline and scope of the SSM

The Commission is proposing to phase in the SSM gradually. According to the proposed transitional arrangements, from 1 January 2013, the ECB will have discretion to decide to assume full supervisory responsibility over credit institutions, particularly those which have received or requested public financial assistance. From 1 July 2013, the ECB will also supervise the most significant credit institutions of European systemic importance at the highest level of consolidation. The list of the institutions concerned will be published by the ECB before 1 March 2013. The Commission envisages that, by 1 January 2014, the SSM will extend to all (approximately 6,000) credit institutions in the Euro area.

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Member States outside the Euro area and the SSM

The application of the proposals to non-Eurozone Member States has perhaps been the most controversial political aspect of the proposals. Competent authorities in Member States outside the Eurozone will cooperate with the ECB through colleges of supervisors and existing home/host state procedures. Beyond that, non-Eurozone Member States will have the option of establishing close cooperation between their competent authorities and the ECB. This requires such Member States to undertake, *inter alia*, that their national competent authorities will abide by ECB acts. The ECB will set out the conditions under which representatives of the competent authorities of such Member States will take part in the activities of its Supervisory Board. The modalities are not clear from the Commission's proposals as yet.

Open questions

The Commission's proposals are ambitious and the timeline (with phase-in to begin on 1 January 2013) and scope (ultimately extending to all credit institutions of Eurozone Member States) seem rather unrealistic. Member States outside the Eurozone wishing to enter into a close cooperation with the ECB on supervisory matters will be concerned about their remaining influence over the ECB. For non-Eurozone Member States that want to remain outside the SSM, the interaction between the EBA and the ECB and decision making processes and representation at the EBA will be sensitive issues.

Several practical questions are also likely to be raised by the latest proposals. These relate, in the first instance, to building up the ECB's human and organisational resources for supervision. Beyond this, the division of labour between the ECB and competent authorities may raise questions about arrangements, for example, for passporting and, potentially, enforcement action.

Lastly, it will be interesting to see the ultimate scope of the SSM, i.e. whether it will apply to all institutions regardless of their size and legal form, and whether or not this is sufficient to ensure convergence of supervisory practices across the EU or will instead result in new possibilities for regulatory arbitrage.