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THE INSTITUTIONAL CONSOLIDATION OF THE ECONOMIC AND MONETARY UNION WITHIN THE EUROPEAN UNION: PROPOSALS AND ACTIONS*

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Abstract

The economic and financial crisis that erupted a decade ago, with all its negative consequences, has led to the adoption of a regulatory framework that, despite its heterogonous and complex nature, has worked to strengthen the Economic and Monetary Union (EMU). At the present time, without the pressure to provide immediate solutions, the institutions of the European Union (EU) and its Member States are considering how to simplify and streamline the actions adopted while at the same time proposing measures for further developing the EMU. In this work, we examine the proposals and measures we consider of most relevance in strengthening the economic governance of the EU and completing efforts to achieve the banking union.

Key words: European Union; Economic and Monetary Union; Banking Union.

LA CONSOLIDACIÓ INSTITUCIONAL DE LA UNIÓ ECONÒMICA I MONETÀRIA AL SI DE LA UNIÓ EUROPEA: PROPOSTES I REALITZACIONS

Resum

La crisi econòmica i financera que es va iniciar fa una dècada, amb totes les seves conseqüències adverses, ha comportat l'adopció d'un conjunt normatiu que, tot i ser heterogeni i complex, ha propiciat un enfortiment de la Unió Econòmica i Monetària (UEM). En l'actualitat, sense la pressió per donar respostes immediates, les institucions de la Unió Europea (UE) i els seus països membres reflexionen sobre com simplificar i racionalitzar les accions adoptades i, simultàniament, proposen actuacions per avançar en l'aprofundiment de la UEM. En aquest treball examinem les propostes i les mesures que considerem més significatives dirigides a reforçar la governança econòmica de la UE i a completar la consecució de la Unió Bancària.

Paraules clau: Unió Europea; Unió Econòmica i Monetària; Unió Bancària.

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Economic and Monetary Union (EMU) started on 1 January 1999, taking the form of a monetary union in which the participating Member States transferred their exclusive competence of monetary policy. However, the economic union was still merely nominal, held together by a coordination of its Member States' economic policies. Harmonising economic policies prior to monetary union was never a solid option on which to base the union.

The provisions laid out in the Treaty on European Union required States participating in the euro area to fulfil certain nominal convergence criteria, a requirement that remains unchanged in the current Treaty on the Functioning of the European Union (TFEU). In the beginning, the sustainability of the euro depended on the coordination of national economic policies. It was underpinned by an intergovernmental process, led by the Council, which sets out guidelines and recommendations.

The economic and financial crisis, and especially its intensity and persistence, has sparked a reaction among European and national institutions, which have seen themselves forced to adopt a series of measures to alleviate the repercussions. The measures were aimed, in the first instance, at avoiding the financial collapse that threatened to destroy the economic functioning of the European Union (EU), and, secondly, to equip EU institutions with instruments and preventive mechanisms to reduce the chances of such crises recurring in the future.

As a result of these measures, we have witnessed a remarkable change in the way that the EMU operates in recent years. The crisis laid bare its vulnerabilities, imbalances and operational problems and led to the adoption of a complex network of diverse mechanisms, based on EU law and public international law governing issues of a similar nature. The aim of these different mechanisms was to achieve similar goals, and, ultimately, what we now see is a heterogeneous regulatory conglomerate lacking in transparency.[1]

However, regardless of other considerations, this action has strengthened and deepened economic governance within the EU. The solutions provided were a response to the need to take swift action to address the problems that triggered the grave situation in the first place. Recent – and often urgent – measures taken in recent years have prompted the EU institutions to present proposals for completing and improving the functioning of the EMU.

Indeed, now that the situation has become more consolidated and the need to provide an immediate response to the root causes of the economic and financial crisis has subsided, the EU institutions are taking time to reflect on what exactly will form the pillars of greater EMU integration. At the heart of this new strategy is the Five Presidents' Report, presented on 22 June 2015 by the president of the Commission, Jean-Claude Junker, who delivered a roadmap for the completion of the EMU.[2] The report was followed by a series of communications, legislative proposals and measures presented by the Commission in December 2017, offering a blueprint for deepening the EMU. The debate over its implementation is ongoing, and a good part of the proposed actions will probably not see the light, given how hard it is proving to achieve the necessary consensus among the member countries.

Other important contributions have been the meetings conducted by the Heads of State or Government of the euro countries, the last of which took place on 21 June this year, and the meetings between the ministers of Economy and Finance of the euro countries (the so-called Eurogroup), the last of which took place on 13 June this year.

The following is a description of some of the main points dominating discussions on the status of actions to strengthen and deepen the EMU.

1 (De Gregorio Merino, 2015: 75).

2 The report is titled *Completing Europe's Economic and Monetary Union* and can be found at website. The document was prepared by Jean-Claude Junker, "in close cooperation" with the European Council president, Donald Tusk, (in his role as president of the Euro Summit, the meeting of heads of state or government of the countries participating in the EMU), the president of the Eurogroup (the meeting of ministers of Economy and Finance of the euro area countries), Jeroen Dijsselbloem, the president of the European Central Bank (ECB), Mario Draghi, and the president of the European Parliament, Martin Schultz.

1 The progressive strengthening of economic governance in the EU

1.1 From the European Stability Mechanism to the European Monetary Fund

In 2010, following tensions in government bond markets and the extremely serious situation triggered by a profound lack of confidence in the markets' ability to finance certain countries, the EU decided to adopt a set of urgent measures to try to reverse the situation.

One of these measures consisted in the members of the euro area incorporating a Luxembourg-based limited liability company, which was named the European Financial Stability Facility (EFSF), the purpose of which was to grant financial assistance to States in difficulty. This entity was financed by the international capital market with the support of guarantee commitments from the EFSF shareholders – the euro area members. In consideration for this assistance, the beneficiaries accepted a programme of economic and budgetary adjustments to reduce their public deficit and ensure debt sustainability.[3] The entity was incorporated on a temporary basis and was expected to be wound up on 30 June 2013.

The EFSF was later replaced by the European Stability Mechanism (ESM). The ESM was established by a treaty signed on 2 February 2012 by the States participating in the EMU.[4] Since 1 July 2013, it has become the only instrument to grant financial assistance to euro area countries experiencing difficulties in meeting their financing requirements unassisted.[5]

The ESM is an international organisation, headquartered in Luxembourg, the main objective of which is to "mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States" (Article 3). To accomplish its purpose, the Treaty establishes the provision of a set of tools, including the ability to provide loans for the specific purpose of recapitalising the financial institutions of a Member State experiencing financial difficulties and the acquisition of debt securities issued by a member of the ESM.

In December 2017 the Commission presented its proposal on the establishment of a European Monetary Fund (EMF) to replace the ESM.[6] The EMF would be the successor to the ESM and would assume all its rights and obligations, and would form part of the institutional framework of the EU and be bound by its rules of operation. The mutation of the organisation would have to be implemented through an agreement by the Member States participating in the EMU, whereby the capital of the ESM would be transferred to the new EMF.

The future EMF would assume the functions entrusted to the ESM and, moreover, would be assigned new tasks. Thus, the EMF would act as a common protective mechanism for the Single Resolution Fund (SRF), within the Banking Union (BU), which would be activated when the funds placed at the disposal of the SRF were insufficient to meet the restructuring needs of a financial institution. This resource would have to be tax neutral to the extent that any payment made to a financial institution would, in theory, be recovered in the medium term.

Regarding decision making, it is expected that major decisions, that is, those with financial implications, will be adopted unanimously; however, a reinforced qualified majority system has been proposed, requiring approval by 85% of the members for certain specific decisions. Furthermore, the SRF would be accountable for its activities to the national parliaments of the Member States and the EU institutions (Parliament, Council and Commission).[7]

3 (Pastor Palomar, 2014: 297-298).

4 The text of the ESM Treaty is available in the Official Gazette of the Government of Spain (BOE), no. 239 of 4 October 2012.

5 The complexity of the legal nature of the ESM has been the subject of many debates surrounding the doctrine in this area; see, for example, Martínez Mata (2013: 75-89).

6 Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM (2017) 827 final of 6 October 2017.

7 Statutes of the European Monetary Fund, annex to the Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM (2017) 827 final of 6 October 2017.

The proposed regulation for an EMF, for which unanimity is required in the Council, has not achieved a general consensus among the Member States. In fact, no advance has been made in the negotiations. Instead, at the Euro Summit of December 2018 it was decided, following a request from a group of finance ministers called the New Hanseatic League (comprising the finance ministers of Czechia, Denmark, Estonia, Finland, Ireland, Latvia, Lithuania the Netherlands, Sweden and Slovakia), that the ESM would conserve its intergovernmental nature, thereby precluding the possibility of it becoming an EU authority. However, the possibility remained to include a protective function in its articles to deal with any hypothetical shortcomings in the SRF.[8] In this regard, it should be stressed that the Eurogroup meeting on 13 June 2019 reached political agreement on a proposal for the revision of the ESM Treaty, which included the provision of a common budgetary protection mechanism for future bank resolutions and the establishment of mechanisms for cooperation between the Commission and the ESM.[9]

1.2 Depth of coordination of the economic and budgetary policies of the Member States

Before the crisis, the coordination of economic policies was essentially based on consensual measures between the Member States. The only area in which a mechanism was established involving legal obligations for the receiving parties was budgetary policy, the purpose of which was to ensure that the public deficit of the participants did not exceed 3%. Indeed, when the EMU was introduced, a Stability and Growth Pact (SGP), with two core elements was adopted: Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (the preventive arm) and Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (the dissuasive arm).[10]

Following the economic and financial crisis, the SGP underwent a major reform with the adoption of a set of regulations known as the *Six-Pack*. This is composed of six legislative acts, five regulations and one directive, which were adopted on 16 November 2011. Strictly speaking, only two of these alter the regulations comprising the SGP: Regulation (EU) No 1175/2011 of the European Parliament and of the Council, amending the preventive arm, and Council Regulation (EU) No 1177/2011, amending the dissuasive arm.[11] In addition, Regulation (EU) No 1173/2011 was adopted on the effective enforcement of budgetary surveillance, aimed at encouraging compliance with the preventive and dissuasive arms of the SGP. This regulation is exclusively addressed at countries in the euro area, and includes a series of sanctions and fines (including interest-free deposits lodged at the European Central Bank) designed to ensure the utmost diligence in their compliance with the SGP.[12] The regulation may be considered a "special" SGP for members of the euro area, regulating the consequences of any failure to comply with fiscal adjustment rule when significant deviations are detected, even when the deficit is below 3%.

The legislation also includes Regulation (EU) No 1176/2011 for the correction of excessive imbalances among members of the EMU. This act leads to a monitoring of economic policy that extends beyond budgetary surveillance and opens the door to monitoring indicators other than public deficit and public debt.[13] In order to ensure effective compliance, this act has its corresponding instrument, Regulation (EU) No 1174/2011, which establishes sanctions if countries do not correct their imbalances effectively.[14]

8 Euro Summit Statement of 14 December 2018, EURO 503/18.

9 The text of the proposed revision of the ESM Treaty is available at this website.

10 Both regulations were adopted on 7 June 1997 and were published in the OJ L 209 of 2 August 1997.

11 Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011, amending Council Regulation (EU) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, and Council Regulation (EU) No 1177/2011 of 8 November 2011, amending Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure. Both regulations were published in the OJ L 306 of 23 November 2011.

12 Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, OJ L 306 of 23 November 2011.

13 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306 of 23 November 2011.

14 Regulation (EU) No 1174/2011 of the European Parliament and of the Council on enforcement measures to correct excessive macroeconomic imbalances in the euro area, OJ L 306 of 23 November 2011.

Finally, the Council adopted Directive 2011/85/EU, which defines the precise characteristics that budgets must comply with for the purpose of ensuring compliance with the obligations imposed by the TFEU to avoid deficits.[15]

In this regard, mention must be made of the European Semester, introduced in 2010 and first applied in 2011. The Semester was formalised by Regulation (EU) No 1175/2011 and included in the preventive arm. The aim of the Semester is to ensure closer coordination of the economic policies of the Member States and sustained convergence. In essence, it establishes a common procedure for synchronising and harmonising timelines for presenting and evaluating budgets. The European Semester provides a framework for coordinating an integrated economic policy while simultaneously maintaining the autonomy of previously existing coordination and monitoring procedures, a situation which generates a remarkably complex overlapping of jurisdictions.[16] It is essentially an instrument that allows the EU institutions to intervene in and influence a priori the formulation of economic policies of Member States, introducing limits on the discretion of national governments when drawing up draft budgets.[17]

Later, in 2013, two regulations were adopted aimed at strengthening economic governance in the euro area (known as *Two-Pack*).[18] The first of these, Regulation (EU) No 473/2013, established a common budgetary timeline for all EMU countries, as well as rules for the monitoring and assessing of budgetary plans by the Commission. In the event of serious breaches of SGP rules, the Commission may request the budgetary plan be revised. It also stipulates that members of the euro area that are subject to an excessive deficit procedure should present an economic partnership programme, detailing the policy measures and structural reforms required to achieve an effective and lasting correction of the excessive deficit. At the proposal of the Commission, the Council shall issue a ruling on the aforementioned programme.

The second act is Regulation (EU) No 472/2013, which affects the Member States that are experiencing or threatened with serious difficulties with respect to their financial stability. It aims to establish rules to strengthen the economic and budgetary supervision of EMU countries experiencing serious problems in the sustainability of public finances or who have received or applied for financial assistance from the ESM or any other international financial institution.

Alongside these instruments of secondary legislation is the pact that was proposed at the peak of the crisis to assume greater budgetary rigour and strengthen the rules provided in the SGP. This pact was given legal form in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSGC), signed on 2 March 2012 by 25 EU Member States and entered into force on 1 January 2013, following ratification by 12 participants of the EMU. This Treaty, known colloquially as the *Fiscal Compact,* is considered to be a "provisional, transitional emergency care measure", aimed at endowing the EMU with more economic strength.[19] It was an emergency solution adopted in a period of deep crisis. The act, which has attracted much diverse criticism, contains a so-called rule of budgetary stability, requiring public administrations to balance their budgets, so that the structural deficit does not exceed 0.5 % of GDP (the possibility of a temporary deviation is admitted in exceptional circumstances), but allowing the structural deficit to be increased to 1% if the difference between public debt and GDP is below 60% and "the risks to the long-term sustainability of public finances are low". These limitations restricting the budgetary discipline of the participating countries were laid down, though formulated differently, in the SGP, resulting in an increased degree of complexity because of the introduction of similar legal systems in instruments of a different nature and scope.[20]

15 Council Directive 2011/85/EU of 8 November 2011 on requirements applicable to the budgetary frameworks of the Member States, OJ L 306 of 23 November 2011.

16 (López Escudero, 2015: 371).

17 (Carrera Hernández, 2018: 55).

18 Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area and Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability. Both regulations were published in the OJ L 140 of 27 May 2013.

19 (Martín & Pérez de Nanclares, 2012: 426).

20 (Carrera Hernández, 2012: 20).

This process has led to a two-pronged gradual centralisation of economic governance measures: one imposed by EU law and another that is self-imposed by the Member States through the adoption of an international treaty.[21] However, in practice, the relevance of the TSGC is not significant, and it has been argued that, although it is an international treaty that entered into force following agreement by the Member States, its impact does not differ from that of statements of intent, such as the conclusions of the Council, making it an essentially symbolic and less than optimal political instrument.[22]

In any case, the Commission has suggested the integration of what it considers to be the essential elements of the TSGC into EU law, with the aim of giving substance to Article 16 of the TSGC, stating the expectation that the necessary measures will be adopted to incorporate the content of the TSGC into the legal framework of the EU. In this regard, on 6 December 2017, the Commission presented a proposal for a Council Directive laying down provisions to strengthen fiscal responsibility and medium-term budgetary orientation in the Member States.[23] Despite this display of intent by the Commission, the reality is that the idea has not been warmly received by some of the actors involved in the legislative process of the EU. Thus, the opinion on the proposal issued by the European Central Bank (ECB) states that its content deviates from the provisions in the TSGC, and that the latter shall remain in force and that the approval of this act would weaken budgetary discipline.[24] Consequently, the TSGC will remain in place even though many of its provisions are irrelevant, and they have not been adequately included or integrated into the EU legal framework.[25]

1.3 The creation of a minister of Economy and Finance

The Commission considers that the creation of a European Ministry of Economy and Finance would be a major step towards consolidating the EMU. So, in December 2017, it adopted a Communication that proposed the establishment of this ministry, whose minister, if the proposal comes to fruition, would hold the position of vice president of the Commission and president of the Eurogroup. The Commission states that this authority would not represent a further stage in the bureaucratisation of the EU, but would assume duties already carried out by other agencies and would facilitate the creation of synergies.[26]

The Commission considers that, similarly to the EU High Representative for Foreign Affairs and Security Policy, the new office must combine the function of Commission vice president with that of the president of the Eurogroup – the meeting of finance ministers of the Member States that make up the EMU. This situation would lead to the formulation of another “hybrid” authority, halfway between an intergovernmental and an EU body. The minister would preside over the Board of Governors of the future EMF, to the extent that the president of the Eurogroup carries out this task in the ESM. Also, as a member of the College of Commissioners, the minister should be accountable to the European Parliament and be subject to its prior approval.

The justification of the proposal is based on the desirability of advancing the coherence and effectiveness of European governance, promoting the accountability and transparency of decision-making processes carried out by EU policymakers. In principle, the new position would be assigned various functions, notably assuming the responsibility of promoting the general interest of the euro area and being its international representative. Its existence could have a positive impact on the foreign relations of the EMU, as it would simplify the external representation of the EU and give it greater political weight.[27] It would be the spokesperson for the euro in international relations, representing it in international bodies. However, we must not forget that the external representation of the EMU is very fragmented, and there are various types of obstacle in the way.

21 (Fabbrini, 2016: 24).

22 (Laffan & Schlosser, 2016: 243).

23 COM (2017) 824 final of 6 December 2017.

24 Opinion of the European Central Bank of 11 May 2018 on a proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States (CON/2018/25), doc. 8948/18, 16 May 2018.

25 (Carrera Hernández, 2019: 228-229).

26 Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank *A European Minister of Economy and Finance* COM (2017) 823 final of 6 December 2017.

27 (Álvarez Verdugo, 2019: 146).

In addition, the Commission considers that the minister would strengthen the coordination of economic policies in the EU and give greater consistency to the various political activities. One of the responsibilities would be to monitor the budgetary policies of the Member States and oversee implementation of the SGP. Its functions would also include monitoring the budgetary instruments of the EU, including the EU budget and other financial mechanisms such as structural and European investment funds. However, the ability to assume these responsibilities is not without its difficulties. Indeed, the question has been posed that if the idea of creating such a representative is to improve economic governance, why is the person responsible for ensuring compliance with fiscal prudence the same person who will chair the group that determines the general economic direction of the EU, while also being responsible for the disbursement of funds to countries in difficulty?[28] In effect, this figure would work simultaneously on monitoring the performance of Member States and managing activities that come into contradiction with this task.

2 Plans to complete the BU

The opportunity to introduce the BU arose as a result of the economic and financial crisis. One of the causes that is often cited is the reluctance of some national supervisors to recognise the severity of their domestic problems, that is, a tendency to downplay the internal financial losses and risks that some lenders had assumed. This laxity, which may be related to a certain lack of diligence on the part of the national supervisors, is clearly manifested in certain organisations classified as key elements in the national economy and, in many cases, which maintain very close links with the national political class.

This situation opened up the possibility of the EU adopting the necessary measures to directly assist entities in crisis without the State having to assume the cost of financing. However, to make this feasible, the European institutions had to be able to oversee the entire process from start to finish, including assessing the suitability of each case for intermediation and checking whether it meets the conditions for a prudent exercise of its activities, verifying compliance and establishing consequences for non-compliance.

In this context, the BU is based on the *Single Rule Book* (SRB), which provides a set of rules for the capital requirements and prudential supervision conditions that have to be met by credit institutions and investment firms. SRB is composed of Directive 2013/36/EU, which regulates access to the activity (and its supervision)[29] and Regulation (EU) No 575/2013 on prudential requirements that must be fulfilled,[30] which, together, constitute the legal framework regulating access to activities, supervisory functions and prudential provisions for credit institutions and investment firms. In this regard, Regulation (EU) No 575/2013 established prudential capital, liquidity and credit risk criteria. In short, the requirements laid down require credit institutions to maintain capital (own funds) that is sufficient to cover unexpected losses and maintain solvency in a crisis. Directive 2013/36/EU sets the rules on capital buffers, remuneration and bankers' incentives, prudential supervision and corporate governance.

But implementing legislation is not enough. EU institutions recognise that the European financial system continues to maintain a high exposure to certain risks that may unbalance the financial stability of the EU and, consequently, greater robustness is needed to protect it against future financial shocks. Among the dangers identified, the one considered top priority is to reduce the number of so-called doubtful loans, given the high ratio of these loans among the financial institutions of certain member countries. In this regard, on 23 November 2016, the Commission presented legislative proposals to amend Directive 2013/36/EU and

28 (Enderlein & Haas, 2015: 13).

29 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 relating to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176 of 27 June 2013.

30 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No 648/2012, OJ L 176 of 27 June 2013.

Regulation (EU) No 575/2013,[31] some of which have already been issued, such as Directive (EU) 2019/878 of 20 May this year.[32]

2.1 Prudential supervision, bail-out and resolution of credit institutions

The Single Supervisory Mechanism (SSM), established on 15 October 2013 by Council Regulation (EU) No 1024/2013, is another instrument underpinning the BU.[33] The SSM is a body composed of the ECB and national supervisory authorities, tasked with inspecting credit institutions in the euro area.[34] The ECB cannot be considered a federation of national supervisory bodies or a college of supervisors, because it has overall responsibility for the functioning of the BU, and, consequently, is granted a set of faculties to exercise its functions effectively.[35] Nor is it a single supervisory authority, as responsibility for banking supervision in the participating Member States has not been fully denationalised. Indeed, the daily exercise of banking supervisory powers is distributed between the ECB and national authorities, although the ECB is in charge overall.[36] The latter deal with overseeing less significant credit institutions (under the authority, coordination and control of the ECB). The guidance and monitoring of the so-called significant entities, on the other hand, falls on the ECB.[37]

Council Regulation (EU) No 1024/2013 assigns specific powers and functions to the ECB for the prudential supervision of the credit institutions of the States participating in the EMU. The SSM does not cover the entire financial system and treats each credit institution individually. It also extends to the supervision of financial holding companies and the oversight of mixed financial companies; insurance companies are explicitly excluded. It is an instrument oriented mainly to euro area countries, but is flexible and can be extended to any Member of the EU, regardless of its currency, if a “close cooperation” is maintained between the competent authorities of the State in question and the ECB.

From another perspective, the SSM should be more readily recognised as a regulatory framework, that is, a body governing the implementation of a specific piece of EU legislation. It must identify all relevant administrations and regulate the exercise of their powers and their interactions and relationships with private stakeholders. The framework ensures that financial supervisory tasks are distributed between numerous national, EU and mixed bodies. The supervisory process is therefore undertaken by a variable and heterogeneous organisation that is functionally governed by an EU institution, the ECB.[38]

The rules and procedures for the recovery and resolution of financial entities were adopted in May 2014, through Directive 2014/59/EU.[39] The underlying issue is that banks have enjoyed a special resolution

31 Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, COM (2016) 854 final of 23 November 2016, and Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 COM (2016) 850 final of 23 November 2016.

32 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, OJ L 150 of 7 June 2019.

33 Council Regulation (EU) No 1024/2013 of 15 October 2013, which entrusts the European Central Bank with specific tasks with respect to policies related to the prudential supervision of credit institutions, OJ L 287 of 29 October 2013.

34 Cooperation within the SSM between the ECB and national authorities is regulated by Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014.

35 (López Escudero, 2014: 197).

36 (Ferran, 2015: 61).

37 The features required of entities to be classified as significant are defined in Article 6.4 of Council Regulation (EU) No 1024/2013. Entities can acquire this classification in several ways, the most common of which are: having assets of over 30,000 million euros, or a ratio of total assets in relation to the GDP of the relevant participating Member State in excess of 20%, unless the total value of the entity’s assets is less than 5,000 million euros.

38 (Chiti & Racine, 2018: 103-104).

39 Directive 2014/59/EU of the European Parliament and of the Council of 15 May of 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, amending Sixth 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, OJ L 173 of 12 June 2014.

mechanism that is specific to them and far removed from general liquidation principles. The fundamental difference is that the authorities of the Member States have injected the entities in crisis with taxpayer money, enabling them to safeguard part of their liabilities, but at the expense of jeopardising the stability of the public sector.[40]

Initially, these injections of liquidity were granted as public aid, thereby coming into conflict with rules on free competition within the single market. Originally, the Commission determined that the aid granted by the Member States had to be regulated within a general framework on the basis of common EU principles. To this end, it endorsed a set of communications and guidelines defining and clarifying the principles and criteria used to assess the compatibility of the financial instruments approved by the States under the original law.[41]

Within this context, the EU has adopted a normative framework aimed at ensuring an orderly recovery or resolution of failing banks. The ultimate aim is to move the cost of this process away from the taxpayer's sphere (external rescue funded with public money, a bail-out) and transfer it onto the banks' investors, shareholders and creditors (internal rescue, a bail-in).[42]

Directive 2014/59/EU harmonises State legislation on bank resolutions and establishes cooperation between national authorities. It attributes common powers and procedures to deal with banking resolution processes, but leaves them with a relatively large margin of discretion, in which national authorities can take divergent decisions regarding a single factual situation. In any case, bank recovery and resolution instruments made available by State authorities are coordinated from a material perspective, including the preventive measures and restructuring plans as well as resolution powers when recovery is impossible.

The overall objectives of the directive are to reduce the probability of the financial institutions going bankrupt and minimise losses, should this occur. In the case of non-viability, the resolution authorities can adopt a set of measures that range from the total or partial sale of the business activities (including shares, assets, rights, etc.) to the transfer of part (or the totality) of the activities of the affected entity to another entity (bridge) governed by the public sector, including the segregation of all (or part) of the damaged assets to an asset management company or the recapitalisation of the entity. In the latter case, the main purpose is that the cost of the financial clean-up is paid for by the banks, shareholders and investors. Thus, the authorities should impose losses on the liabilities of the financial institution following a specific ranking, whereby the first to be allocated such losses must be the shareholders, followed by the creditors (although these may be unevenly treated if justified for reasons of public interest and financial stability). In this sense, Directive 2014/59/EU has been amended through Directive (EU) 2017/2399 of 12 December 2017 in an attempt to harmonise State legislation regarding the ranking of unsecured creditors in the event of a financial institution resolution.[43]

This harmonisation framework is insufficient for credit institutions that are supervised by the SSM. In the same way that a specific and unique supervisory instrument was adopted for significant financial institutions, a specific resolution mechanism also needed to be put in place that would allow Directive 2014/59/EU to be applied centrally by a single authority.

Regulation (EU) No 806/2014 creates the Single Resolution Mechanism (SRM), which is a uniform procedure for the resolution of credit institutions subject to the SSM.[44] It is governed by a single authority, thereby avoiding possible divergent interpretations of the provisions contained therein. This authority is the Single Resolution Board (SRB), which, from 1 January 2015, has been constituted in an EU agency with legal personality.

40 (Conlon & Cotter, 2016: 80).

41 (Pérez Rivarés, 2013: 103).

42 (Martínez Mata, 2019: 87).

43 Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 of December 2017, amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, OJ L 345 of 27 December 2017.

44 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 of July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of an SRM and an SRF and amending Regulation (EU) No 1093/2010, OJ 225 of 30 of July of 2014.

The same act also establishes the creation of an SRF, which helps to finance the cost of resolutions when entities in crisis are unable to cover their losses. It is one of the elements considered essential in the constitution of the BU, since it establishes a common protective mechanism that allows State funding to be decoupled from that of banks. However, in principle, the purpose pursued by constituting an SRF is to guarantee the financial stability of the system rather than to absorb the losses or provide capital to the financial institutions in a situation of resolution.[45]

The financing and operating rules of the SRF are excluded from the EU ambit. The member countries (except Sweden and the United Kingdom) have opted for the creation of an international treaty, the Agreement on the transfer and mutualisation of contributions to the SRF, signed on 21 May 2014, and which came into force on 1 January 2016. This intergovernmental option represents a pragmatic approach to ensuring the smooth creation and operation of the SRF. Some States were deeply concerned about the possibility that their constitutional authorities would oppose the Regulation regulating the SRM and SRF, if it included the possibility of mutualising banking risks and facilitating a transfer of interstate funds. The alternative of making an ordinary review of the TFEU was risky and had little chance of success, given the express refusal of two of its members.[46]

The SRF will be endowed with approximately 55,000 million euros, a figure that is equivalent to 1% of the amount of guaranteed deposits of all credit institutions authorised in all participating Member States. This amount shall be collected progressively until 2024 and financed by contributions from financial institutions subject to the SSM. Right from the start, the amount allocated was considered grossly inadequate, especially if the aim was to generate confidence in the system, and it was felt that, somehow, a source of funding needed to be found which the SRF could turn to if necessary.

Accordingly, work has begun to devise a budgetary protection mechanism that would act in case of extreme necessity and when the SRF lacked sufficient liquidity. It would serve as a last resort, and would represent a temporary mutualisation of any possible risk. In principle, Member States agree on the relevance of its existence and suitability, given that it is a neutral budgetary instrument in the medium term, since the beneficiaries would be required to return the borrowed public funds used. Indeed, in October 2017, the Commission stressed that the protection mechanism should satisfy a set of criteria to enable it to be operational in the event of an economic crisis, among which are: being the right size to fulfil its role, the ability to be activated swiftly and budgetary neutrality. There should be no room for national considerations or segmentation in its implementation. Its institutional and financial architecture should ensure total effectiveness in achieving the objectives of the protection mechanism.[47]

The main aim of this protection mechanism, according to the Commission, would be to instil confidence in the banking system, thereby strengthening the credibility of the measures taken by the SRB. As an instrument of last resort, it would only be activated if the SRF had insufficient funds available for the purposes of capital or liquidity.[48] Apart from the other functions mentioned above, the future EMF (or a reformed ESM) would be responsible for providing such funds.

2.2 European Deposit Guarantee Scheme

Financial stability requires the implementation of deposit guarantee schemes (DGS). In a crisis, banks are exposed to the possibility that the distrust of depositors may lead to a withdrawal of funds, which would reduce liquidity in the system and exacerbate the situation. When an entity becomes insolvent, a DGS reimburses depositors up to a certain amount, referred to as the level of coverage. From this perspective, it is considered that a DGS fulfils several functions: besides protecting depositors, it helps reduce the spread and minimises the effects that a bank’s lack of liquidity may have on other financial operators.[49]

45 (Busch, 2015: 298).

46 (De Gregorio Merino, 2015: 7-8).

47 *Reflection paper on the deepening of the Economic and Monetary Union* COM (2017) 291 final of 31 May 2017.

48 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions *Towards the completion of the Banking Union* COM(2015) 587 final of 24 November 2015, p. 15.

49 (Donnelly, 2018: 212).

The intensity of the crisis led to the adoption by the European Parliament and the Council of Directive 2009/14/EC,[50] which raised the basic coverage of all bank account holders in the EU. The amount was increased from 20,000 to 100,000 euros per depositor from 31 December 2010.

This emergency measure does not mean that no further progress needs to be made in harmonising and coordinating DGS. It should be noted that, at present, within the EU, dozens of systems still exist to protect different types of depositors, with varying levels of coverage. This heterogeneity is due to the existence of several different banking models across the different States, as countries where banking is highly concentrated in just a few banks coexist with others where smaller entities are the norm.[51]

The current legislative framework in the field of deposit guarantees is laid out in Directive 2014/49/EU of 16 April 2014.[52] This act is an intermediate step towards a possible future integration of the different DGS and allows the creation of cross-border systems, although stops short of creating a single system. Despite this minimum coordination of deposit guarantees, several bodies have emphasised the importance of creating a European Deposit Guarantee Scheme (EDGS) as a fundamental step to achieving complete BU.

The Five Presidents' Report, already mentioned, pointed out that the current model of national deposit guarantee schemes was vulnerable to localised economic problems. In order to increase the robustness of the BU against future crises, a common guarantee scheme would need to be put in place[53] that would provide a solid and uniform insurance coverage to all depositors, regardless of their geographical location in the BU. Following this philosophy, in November 2015, the Commission presented an EDGS proposal,[54] marking out a clear separation of banks from their State of origin, to reduce the vulnerability of the whole system in the event of local economic crises.

The proposal establishes a regime that evolves progressively in three sequential stages into a fully mutual scheme: first, a reinsurance scheme to cover part of the lack of liquidity and excess losses of the DGS participants, followed by a coinsurance scheme comprising an increasingly larger part of the lack of liquidity and losses of the DGS participants and, over time, resulting in a scheme that guarantees full coverage of all liquidity needs and the losses of DGS participants.

The proposed regime implies that, at the time of completion of the process, national DGS will have transferred the funds and management of disbursements to the EDGS. According to this proposal, the EDGS would be administered by the SRB, in cooperation with national DGS. The SRB would combine the functions of resolution and deposit guarantees, which would, in the opinion of the Commission, manage any potential conflicts of interest between the two roles, making the decision-making process more consistent and efficient.

Although the constitution of the EDGS has been considered a priority, the proposal is still subject to discussion, and consensus on the issue has yet to be reached. The debates in the European Parliament and the Council point out the existence of opposing views regarding the design of the system in the final stage, the deadline set for it and the different degrees to which problems from the past, especially the risks acquired, are still present in the national banking systems. In this regard, a need has been expressed to ensure that financial institutions are robust enough before being called upon to share the burden of a potential bankruptcy within the BU.[55]

In October 2017, in an attempt to overcome these obstacles, the Commission proposed a de facto revision of the proposal. In principle, the idea is to maintain its final objectives, but modify the design of the system and the timeline for implementation. Thus, in the first phase of reinsurance, the EDGS would only provide

50 Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, OJ L 68 of 13 March 2009.

51 (Howarth & Quaglia, 2018: 196-202).

52 OJ L 173 of 12 June 2014.

53 *Completing Europe's Economic and Monetary Union*..., *op.cit.*, p. 13.

54 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 in order to establish a European Deposit Insurance Scheme COM (2015) 586 final of 24 November 2015.

55 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on *Completing the Banking Union* COM (2017) 592 final of 11 October 2017.

liquidity cover and not cover for losses. Consequently, in the event of default by a bank, national DGS should deplete their funds before the EDGS intervenes.[56]

3 Final considerations and reflections

Based on the situation described above, we suggest the following considerations and reflections.

With the entry into force of the EU Treaty on 1 November 1993, a process began leading to monetary union – the countries that have joined it have accepted the imposition of both procedural and material restrictions and limitations – in the exercise of States' powers over their economic policies. However, since the outbreak of the crisis in 2008, the EU has worked intensely to equip itself with tools that allow greater control over the economic and budgetary imbalances of Member States in general and the countries of the euro area in particular. Moreover, the crisis is considered to have triggered two (silent) transformations in the economic structure of the EU: the acceptance of public financial assistance to Member States of the euro area through specific tools and the replacement of market discipline of national economies by bureaucratic discipline exerted by the EU institutions, especially the ECB.[57]

From another perspective, this situation has led to a heterogeneous and a not very transparent conglomerate of norms. This reality probably needs more transparency in the management of economic governance, an improvement of democratic accountability mechanisms, a greater concern to ensure the democratic legitimacy of the measures taken by the European institutions, and the improvement of the instruments adopted to protect the rights of individuals in the EMU's sphere of action.

With regard to the BU, it is worth pointing out the progress made in terms of its deepening and strengthening. Indeed, remarkable advance has been made in the development of normative bases that establish capital, liquidity and credit risk requirements, as well as the terms of prudential supervision and good corporate governance to be met by credit institutions. However, the European institutions and some Member States consider that the financial system remains overly exposed to risks that may endanger its stability and that these must be reduced.

There has also been a strengthening of the regulatory framework adopted by the EU to ensure the orderly recovery and/or resolution of credit institutions. The goal is to reduce the likelihood of failing financial institutions and, if this situation is inevitable, ensure that the costs of resolution be absorbed mainly by the entity's shareholders and creditors. Also, an SRF instrument has been devised for the entities subject to the supervision of the SSM, the purpose of which is to help finance the cost of resolving any systemically important financial institutions when recovery is impossible. Given the assumption that in a new financial crisis, the liquidity of this instrument would be insufficient, a protective mechanism has been planned that would act in case of extreme necessity, and would produce a temporary mutualisation of the risk. In principle, there is some consensus, provided that the mechanism is budgetary neutral in that the beneficiaries would be required to repay the public funds used.

However, one of the pending issues is the lack of a true EDGS that helps to break the so-called circle of bank and sovereign debt and instils the public with greater confidence in the financial system. In this respect, a common protective mechanism of last resort is also needed, as mentioned above, to ensure the solvency of the SRF, if this were to have insufficient funds to cover certain bank resolution processes. In any case, setting up these instruments, which are primarily mutual in nature, requires previously implementing a series of measures aimed at reducing excessive risk assumed by certain financial institutions within the EU. Until this risk is reduced, one obstacle remains hard to resolve – the reticence of those in charge of more sound banking systems to assume the cost of potentially having to fund financial losses for commitments entered into by entities from other countries.

It is also clear that the EU currently has more efficient instruments available for governing the economic decisions of its Member States and tackling future crises more effectively. In any case, the proper functioning

56 *Completing the Banking Union...*, *op. cit.*, p. 11-12.

57 (Ioannidis, 2016: 1281).

of the EMU requires a greater degree of economic and political integration. Apparently, after the experience of the economic crisis, the Member States now wish to advance in this area, and the European institutions are keen to continue broadening the scope of the coordination mechanisms to achieve greater economic integration.

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