Regional Integration and Financial Regulation*

Sahoko Kaji

Professor of economics, PCP Co-ordinator and PEARL Academic Director, Keio University.

Ryuichiro Izumi

Ph.D. candidate, department of economics, Rutgers University

Abstract

In the aftermath of the global financial and economic crisis, Europe and the United States are taking the lead in revamping the financial regulatory and supervisory framework. In this paper, we focus on the recent changes in the financial regulatory and supervisory framework in the European Union (EU) where regional integration is most advanced, to draw implications for the rest of the world. The EU established the European Banking Union (EBU) with a single regulatory and supervisory system, necessary from the point of view of macro-prudence. At the same time, the EU is embarking on structural reform of the banking sector, as well as the Capital Markets Union, in order to improve the workings of the EBU and the Single Market. These reforms are making progress through conflict and compromise between member states and the European Institutions. Reform within the framework of regional integration has three advantages. First, when the interests of financial institutions and tax payers collide, democracy can be made to function better if supra-national institutions and national institutions represent the interests of the opposing entities. Second, the existence of many supra-national institutions can maintain the momentum and balance of reform. Third, transfer of sovereign power to a supra-national institution can help the implementation of desirable policy.

Keywords: Banking Union, structural reform of the banking sector, integration, democracy
JEL Classification: F45, F55, G28

I. Introduction

The Lemann crisis and the subsequent euro crisis brought about significant changes in Europe. Since the crises, European integration entered a new stage.

Institutional change in European integration is created through an increased transfer of sovereignty to the EU as a supra-national entity. Due to the post-crisis governance reforms, member states can no longer draft their budgets or plan public debt issuance without consulting the EU institutions. Macroeconomic imbalances, not just fiscal imbalances, are under

* We would like to thank the editorial committee and essay evaluation meeting of the Financial Review for the opportunity to write the Japanese version of this paper and for their useful comments.

scrutiny of the European Commission. On the financial side, new systems such as the European Banking Union (EBU) were introduced, and more are in the making.

Behind the series of institutional changes is a qualitative change in European integration. This constitutes a change in perception about institutional change shared among policy authorities and advisors, with increased intervention and transfer of sovereignty being deemed necessary.[1]

Europe's financial regulatory reform also has institutional and qualitative aspects. And as far as the changes in financial regulation are concerned, there are many similarities with the rest of the world. The first major point of similarity is the shift in focus from individual institutions to macro-prudence (or systemic risk). At the same time, there is now more intervention in the financial sector, such as the Tobin tax and regulation on bank bonuses.

The emphasis on macro-prudence comes from the fact that badly run financial institutions are a risk to macroeconomic stability and fiscal stability. The private cost of bankruptcy to individual financial institutions is lower than the cost to society as a whole. In economics, such a state is called "external diseconomy" or "negative externality." From the point of view of micro-prudence, it may be reasonable for individual financial institutions to sell assets to reduce risk. But if all financial institutions behaved in this same manner, the value of their assets would fall dramatically, with catastrophic consequences on the balance sheets of all financial institutions. This stops financial intermediation, and as a consequence economic activity is hindered, tax revenue goes down, and capital injection becomes necessary, worsening government budgets. Macro-prudence aims at "internalising" this kind of "negative externality."[2]

According to Okina (2014, pp. 150–152), macro-prudence is not new if we recall that some policies conducted before the Lehman crisis were adopted for macro-prudential reasons. These include capital injections, bad debt resolution, supply of funds by central banks, and increased public financial intermediation. The difference since the crisis is the heavier emphasis on the relationship between shadow banking, the real economy including fiscal balances and the social cost of decisions taken by financial institutions. Okina (2014, p. 154) lists "variable capital requirements and allowance for doubtful accounts to avoid pro-cyclicality," "upper limit on Loan to Value (LTV)" and "encouraging transactions through central

[1] On the other hand, some voters have not accepted this as necessary. The politicians who listen to such voters are gaining support and advocating anti-EU, anti-immigration and anti-foreigner policies. These parties include: Syriza (acronym of a phrase indicating a far left coalition), which won the Greek elections in January 2015; Spain's Podemos (meaning "we can"); France's Front National (FN); Germany's Alternative für Deutschland; Italy's Five Star Movement (MoVimento 5 Stelle) and Northern League (Lega Nord; LN); the UK's United Kingdom Independence Party (UKIP); the Netherlands' Freedom Party (Partij voor de Vrijheid; PVV); and, Finland's Finns Party (which used to be called True Finns, Perussuomalaiset). The anti-EU movement is spreading on an EU-wide basis. But since such movements include parties on the left and right, at least at this stage it is unlikely that they will form a grand coalition. Some scholars, such as Professor José Ignacio Torreblanca at the National University of Distance Education (UNED) in Madrid and the European Council on Foreign Relations, as well as Professor Mariely Lopez-Santana at the George Mason University see this as proof that the conflict is no longer "left vs. right" but "insiders (with jobs) vs. outsiders (without jobs)."

[2] Micro-prudence and macro-prudence can sometimes contradict each other, and sometimes supplement each other. Basel II's capital requirement can be pro-cyclical, but if governance is improved at each financial institution, that would contribute to macro-prudential stability.

counterparties" as regulations with macro-prudential viewpoints.

Behind these institutional changes in financial regulation is a qualitative change. This represents a change in perception about the financial sector. Both the public and the private non-financial sector began to regard this sector with less confidence. Many in the USA and Europe began to criticise this sector, which was at the centre of the Lehman and euro crises.[3]

The denunciation comes from a variety of sources, ranging from demonstrations such as the "we are the 99%" to commentators of major financial journals and well-known economists. The dissatisfaction comes from the fact that taxpayers found themselves rescuing the financial institutions where very few managers seem to have taken responsibility and the wages remain high. Measures to avoid a repeat of similar crises are seen as being diluted under heavy lobbying by the financial sector. These negative opinions keep the momentum for financial regulatory reforms. In the UK general election on 6th May 2010, the Conservatives pledged to internationally adopt the Volker Rule. The new Chancellor of the Exchequer Mr Osborne did not adopt his predecessor's bonus tax, but budgeted a balance sheet levy (applicable to debt of over 20 billion pounds) to raise the 2.5 to 3 billion pounds expected from the bonus tax. And the new coalition government reflected the Liberal Democratic Party's election pledge for ring-fencing (separation of retail and investment banking) by asking the Independent Commission on Banking to analyse this issue. The result was the Vickers Report of 2011, recommending this ring-fencing and other reforms.[4]

On the European continent, in January of 2012 the then French presidential candidate Mr Hollande called the financial sector his "enemy" for "governing without being elected." In the USA, former Fed Chairman Paul Volcker established in 2013 the Volcker Alliance,[5] and called for a change in financial regulation to suit the 21st century. In Mr Volcker's view "the system for regulating financial institutions in the United States is highly fragmented, outdated, and ineffective." The Bank for International Settlements (BIS) also released a working paper by Cecchetti, Stephen G and Enisse Kharroubi (2012, 2015), which argued that total factor productivity declines when factors of production are concentrated in the financial sector.

The scholarly world is also raising its voice. In the President's address for the January 2015 American Financial Association, Professor Zingales of Harvard University said the following:

> While there is no doubt that a developed economy needs a sophisticated financial sector, at the current state of knowledge there is no theoretical reason or empirical evidence to support the notion that all the growth of the financial sector in the last forty years has been beneficial to society. In fact, we have both theoretical reasons and empirical evi-

[3] In Japan, similar criticism started with the capital injection into Jusen (housing loan companies) in the run-up to the Japanese bubble in the mid-1980s. It reached its peak after the burst of the bubble, leading to downward adjustments in bankers' pay.

[4] The Vickers report sets the capital requirement at 10% instead of 7%, and the leverage ratio at 4% instead of 3%, for ring-fenced retail banks. As would be expected, the series of stronger regulation and taxes were opposed by the city on the grounds of hurting competitiveness, and by June 2015 Chancellor Osbourne declared an "end to banker bashing."

[5] https://www.volckeralliance.org/

> dence to claim that a component has been pure rent seeking. By defending all forms of finance, by being unwilling to separate the wheat from the chaff, we have lost credibility in defending the real contribution of finance.[6]

He also stated that the financial sector should be "competitive, democratic, and inclusive."[7] Furthermore, Professor Admati of Stanford Business School, co-author of *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It*[8] continues to ring alarms about the inadequacy of post-crisis financial regulatory reform.

There is reason to ring warning bells. Some of the regulatory changes have been weakened, and those that were introduced have not eliminated the possibility of another crisis. One reason is the political power of the financial industry. For example, in the USA, between 1998 and 2008, a total of 5 billion dollars was spent on lobbying by investment banks, commercial banks, hedge funds, real estate companies and insurance conglomerates. For the single year of 2007, the number of lobbyists officially registered as working for the financial sector amounted to 3,000.[9] In the UK, the amount spent by the financial industry on lobbying during 2011 was reported to be 92 million pounds.[10]

As the Financial Stability Board,[11] in step with the Basle committee, strengthened financial supervision and regulation, the lobbyists also integrated across national borders. In November 2009, the London Investment Banking Association (LIBA) and the European section of the US Securities Industries and Financial Markets Association (SIFMA) merged to create a 197 member Association for Financial Markets in Europe (AFME). The European Covered Bond Dealers Association (ECBDA), European High Yield Association (EHYA), European Primary Dealers Association (EPDA), European Primary Markets Division (EPMD), European Securitisation Forum (ESF) and the European Securities Services Forum (ESSF) all came under its umbrella.[12] Furthermore, this AFME is forming the Global Financial Markets Association (GFMA) together with the Hong Kong based Asia Securities Industry & Financial Markets Association (ASIFMA) and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington, D.C.[13]

One reason why the financial sector has such political influence is the fact that the economy would stagnate without financial intermediation. This is the other side of the coin of the aforementioned "negative externality." Financial intermediation for an economy is like the

---

[6] Zingales (2015), p. 3.

[7] Zingales (2015), p. 6. Professor Robert Schiller of Yale University is also calling for "democratisation" of financial innovation in his publications and on homepage http://newfinancialorder.com/

[8] Admati and Hellwig (2014). The authors point out that banks' capital ratios are too low compared to other firms and should be raised to 20% or 30%. If bankers counter that lending will have to be reduced when capital requirements are raised, the authors say the banks should lend instead of pay dividends.

[9] http://www.wallstreetwatch.org/soldoutreport.htm

[10] http://www.thebureauinvestigates.com/2012/07/09/revealed-the-93m-city-lobby-machine/

[11] According to Kitami (2014, p. 14), the FSB has stronger regulatory powers than its predecessor the Financial Stability Forum (FSF, set up by the G7 after the Asian financial crisis), with the emerging market countries as additional members. It also incorporates national authorities, international standard setting bodies and international financial institutions.

[12] http://www.afme.eu/About/History.aspx

[13] http://www.gfma.org/about/#sthash.dG5m2oDW.dpuf

heartbeat for the human body, and the fact that it is indispensable cannot be changed by policy. Policy authorities know this well. For instance, in July of 2014, Finance Minister Sapin, anxious about lower economic growth in France,[14] called the financial sector "the government's friend" and even used the expression "bonne finance" in his Aix en Provence speech.

Economists also recognise the particular characteristics of finance. Financial intermediation is indispensable, and there is information asymmetry and moral hazard (the "too big to fail" problem) in financial transactions. In addition, prices in the financial markets change very rapidly. These economic principles cannot be changed by policy either. Most economists and policy authorities acknowledge that the possibility of crises cannot be brought down to zero. But this is not to say that crises are like natural disasters and nothing can be done about them. Everything must be done to minimise the frequency and magnitude of crises.

As we have seen above, the need for and the limits of financial sector reform are universal. The uniqueness of Europe lies in the supranational nature of these reforms. As private sector transactions cross borders more and more, so should regulation and supervision. Europe is the first in the world to provide examples and lessons in attempts at reform of financial regulation and supervision across national boundaries. Furthermore, Europe can suggest a model different from that of the Anglo-American one, in terms of faith in the market mechanism.

In this paper, we concentrate on the European Banking Union (EBU) and the structural reform of the EU banking sector, mentioning other reforms only as necessary.[15] The timeline in the Appendix shows the overall picture of the reform.

The paper has three main themes. The building of the EBU as a post-crisis measure, the new axes of conflict that arose in the process, and their lessons.

II. The building of the EBU and its characteristics

It was the then President of the European Commission Mr Barroso that mentioned EBU for the first time in public. This was on the 23rd of May 2012, during his last informal European Council meeting.[16] Then on 26th June, the then European Council President Van Rompuy released the report on the EMU,[17] which contained proposals similar to EBU.

Europe had already started reform of financial supervision during 2009 and 2010, following the de Larosiere report. There were two pillars, the European System of Financial Supervision (ESFS) for micro-prudence and the European Systemic Risk Board (ESRB) for

[14] In November 2014, the OECD forecast French growth for 2014 at 0.4%, for 2015 at 0.8% and for 2016 at 1.5%.

[15] According to the European Commission (2014a), the Commission has made over 40 proposals aimed at recovering trust in markets, financial stability, the health and efficiency of the financial system in the past five years. Véron (2015) calls EBU the "single biggest structural policy success of the EU since the start of the financial crisis," and states that the EBU was behind the ECB's OMT (Outright Monetary Transaction), which was so crucial to containing the crisis. We will explain the OMT below. The EU is also taking measures to encourage financial intermediation that is less dependent on banks. This is represented in the Capital Markets Union, announced in July 2014 by the new European Commission President Jean-Claude Juncker to promote direct financing.

http://ec.europa.eu/finance/capital-markets-union/index_en.htm

macro-prudence.

There are three institutions within ESFS, together called the European Supervisory Authorities (ESAs). They are the European Banking Authority (EBA) in London, European Securities and Markets Authority (ESMA) in Paris and European Insurance and Occupational Pensions Authority (EIOPA) in Frankfurt.

As for the European Systemic Risk Board (ESRB), it was established under the European Central Bank following Regulation (EU) No 1092/2010.[18] Importantly, decisions by the ESRB had no legal binding force. In contrast, the Single Resolution Board (SRB) of the Single Resolution Mechanism (SRM) as part of EBU has legal power over the bankruptcy process.[19]

As the euro crisis worsened, the extent and complexity of mutual interdependence between financial institutions revealed itself to be a clear threat. At the same time, voters' anger over the conduct by, and protection of, financial institutions mounted. It was within such a context that the Barroso speech and the Van Rompuy report came, and Europe embarked upon EBU. Euro area members are automatically EBU members; other EU members can opt in. This much transfer of power in the economically and politically important financial sector would have been unthinkable before the crisis. At the same time, with hindsight it is clear that in an integrated Europe where funds cross borders with increasing frequency and magnitude was in peril without the EBU.

The European Council of June 2012 stated that the objective of EBU was to "break the vicious circle between banks and sovereigns."[20] Needless to say, this is partly in response to taxpayers' anger against bank rescues. In December of the same year, EBU was an important element in the timetable for achieving the "true EMU" of the Van Rompuy report, jointly prepared by the European Council, the European Commission, ECB and the Eurogroup. Within the following two years, EBU had its first pillar and Europe had a single financial supervisor.

---

[16] European Commission (2012d) and European Commission (2012e). Note that discussion of EBU had already begun before these official documents were released. According to Véron (2015 footnote 6), The European Commission's Mr Maarten Verwey (Deputy Director-General for Economic and Financial Affairs) touched on EBU in 2011. This was reported in Véron (2011) which is the first official documentation of EBU in the context of the European crisis. The legal foundation of EBU is comprised of the Treaty on the Functioning of the European Union (TFEU), articles 114 and 127(6). References are European Commission (2014a) and European Commission (2012b) European Commission (2012c) quoted in that document, as well as European Parliament (2014).

[17] Van Rompuy (2012). This report gave four fundamentals for a stable and prosperous EMU. One of them was "[a]n integrated financial framework to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens. Such a framework elevates responsibility for supervision to the European level, and provides for common mechanisms to resolve banks and guarantee customer deposits."

[18] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32010R1092

[19] In relation to the ESRB, the SRB, together with the member states' National Resolution Authorities (NRA), "should take into account the warnings and recommendations of the European Systemic Risk Board" as set out in article 46 of the Regulation (EU) No 806/2014.

[20] According to European Commission (2012a), EU taxpayers provided loans and guarantees amounting to 4.5 trillion euro to banks between 2008 and 2011. According to the European Commission (2014a) reports that national support to avoid a financial meltdown between 2008 and 2012 amounted to 1.5 trillion euro (the European Commission State aid scoreboard 2013), and in addition income, assets and opportunities were lost due to increases in unemployment as the result of the economic downturn.

The three pillars of EBU are the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF)—along with Deposit Guarantee Schemes (DGS). The foundation of these three pillars is the Single Rulebook.[21] The Single Rule Book contains the Capital Requirements Directive CRD IV package,[22] Bank Recovery and Resolution Directive BRRD)[23] and regulations regarding depositor protection. Approximately 8,300 EU financial institutions are obligated to follow these rules.

The European Banking Authority (EBA), one of the ESA of the ESFS mentioned above is to produce Binding Technical Standards (BTS) to implement CRD IV and BRRD.[24]

The SSM started on the 4th of November 2014. Since then, the ECB has been supervising the 123 "significant banks" of the euro area, holding 82% of the area's banking assets.[25] The ECB is also in charge of licensing banks. Before October 2014, the Asset Quality Review (AQR, to test the "quality" of the euro area banks' 3.7 trillion euro of assets) and the Stress Tests were conducted, to give the ECB "a clearer idea of the banks' financial health."[26]

It was in December of 2012 that the member states came to an agreement on the range of banks to come under ECB supervision. The single supervisory authority will supervise banks with assets of more than 30 billion euro, or balance sheets worth more than 20% of GDP. Following the political agreement between the European Parliament and the European Council in March of 2013.[27] 123 euro area banks came under direct supervision of the SSM within the ECB. The other banks, called the "Less significant banks," remain under the supervision of national supervisory authorities. Banks outside the euro area can join SSM. In general, when the supervisory authority is placed inside the central bank, conflict of interest

[21] The expression "Single Rule Book" was used first during the European Council of 2009. It was used in the context of unifying financial regulations within the EU, in order to complete the single market for financial services.
http://ec.europa.eu/finance/general-policy/banking-union/index_en.htm
The Rule Book contains rules on bankers' bonuses and disclosure by banks. It states that EU banks must report to the European Commission from 2014 and disclose publicly from 2015, profits made, taxes paid and subsidies received country by country, as well as turnover and number of employees.
http://www.europarl.europa.eu/news/en/news-room/content/20130416IPR07333/html/Parliament-votes-reform-package-to-strengthen-EU-banks

[22] Kitami (2014, footnote 93) states that CRD IV comprises the Capital Requirement Regulation and the 4th version of the Capital Requirement Directive, and is a European version of Basle III. European Parliament (2014) provides explanations of CRD IV and BRRD in plain language.

[23] As of the 1st of January 2015, EU member states must apply the Single Rule Book in resolution of large investment firms and banks, following the Bank Recovery and Resolution Directive (BRRD). BRRD includes the obligation of bail-in, and explicitly states that the cost of resolving a bankrupt institution must not be borne by taxpayers.
http://ec.europa.eu/finance/bank/crisis_management/index_en.htm

[24] To quote from http://www.eba.europa.eu/regulation-and-policy/single-rulebook, "[t]he EBA is mandated to produce a number of Binding Technical Standards (BTS) for the implementation of the CRD IV package and the BRRD. BTS are legal acts which specify particular aspects of an EU legislative text (Directive or Regulation) and aim at ensuring consistent harmonisation in specific areas. BTS are always finally adopted by the European Commission by means of regulations or decisions. At that point they become legally binding and directly applicable in all member states. This means that, on the date of their entry into force, they become part of the national law of the member states and their implementation into national law is not only unnecessary but also prohibited." This homepage of the EBA has a link to the "Single Rulebook Q&A process," and the EBA is "in charge of answering questions from stakeholders."

[25] https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html

[26] European Commission (2015a). Detailed analysis of the results are found in Véron (2014b).

[27] European Parliament (2014).

issues arise; for instance, if the central bank tried to prevent bankruptcy of financial institutions by adopting a monetary policy stance that is too loose for macroeconomic health. Nevertheless, the SSM was established within the ECB because that was the only possible choice. The ECB's vice president Vítor Constâncio stated as follows in his speech on 29th January 2013:

> The ECB will have clear separate and hierarchical mandates that place price stability separate from other concerns. The ECB also has the advantage of having a very clear, transparent and measurable goal of price stability. This objective has never been compromised and it will not be compromised in the future. Internal procedures can be, and will be, designed in a way that the separation between monetary policy and banking supervision is efficiently implemented. Of course, central banks may during a crisis step in as a lender-of-last-resort. But they might do this regardless of whether they have a supervisory mandate or not.[28]

This quote reveals another important point in addition to the issue of conflict of interest. That is the issue of whether the ECB should become a Lender of Last Resort (LOLR). Jörg Asmussen, a former Governing Council Member said in his submission to the German Court that the OMT interventions would be "ex ante 'unlimited… [a]t the same time, however, the design of OMTs makes it clear to everyone that the programme is effectively limited."[29] The "OMT" is the "Outright Monetary Transaction," under which the ECB is to purchase without limits the short-term bonds issued by euro area member states in the secondary market when the bonds have come under so much speculation that the currency risks leaving the euro. As of June 2015 it has never been put to use. Nevertheless, the announcement of the OMT on 2nd August and 6th September of 2012, together with President Draghi's "whatever it takes" on 26th July 2012, played critical roles in reducing sovereign risk premiums. Even after the German Constitutional Court judged on 7th February 2014 that the "OMT announcement was inconsistent with EU law," markets remained calm. In February 2015, the European Court of Justice's Advocates General Cruz Villalón stated that "in principle, OMT is consistent with EU law," and in June 2015 the Court made a ruling to that extent.[30]

The political agreement to establish the SRM, the second pillar of EBU, was reached between the European Parliament and European Council in March 2014. The main objective of the SRM is the same as that of EBU—to stop the vicious cycle of financial and fiscal crises and minimise the costs to taxpayers and the real economy.

[28] https://www.ecb.europa.eu/press/key/date/2013/html/sp130129_1.en.html

[29] Mody (2015).

[30] Mody (2015), Helmut Siekmann and Volker Wieland (2014), Court of Justice of the European Union (2015a) and(2015b). The Securities Market Programme (SMP) that started in May of 2010 ended with the start of the OMT. SMP was a programme whereby the ECB purchased bonds issued by euro area governments, public institutions and some private institutions. A big difference between the OMT and SMP is that the OMT is accompanied by conditionality, as it takes place within the framework of the EFSF or ESM.

The Single Resolution Board (SRB) was established, based on regulations to establish the SRM, which came into force on the 19th of August 2014. At the same time, another directive made it obligatory for EU member states to establish their National Resolution Authorities (NRAs). The SRM has final responsibility for the resolution of all euro area banks. But in reality there is division of labour with the NRAs, and the SRM is mainly responsible for big banks that operate across borders. The SRB started operations on the first of January 2015, and will “be fully operational, with a complete set of resolution powers” after January 2016 and will “work in close cooperation with” the NRAs.

The third pillar of EBU is taking time. The Single Resolution Fund (SRF) was established by the regulation adopted on 14th July 2014, following the Inter-Governmental Agreement (IGA) on 21st May 2014. It will be applicable from the 1st of January 2016. The agreement of the 21st May also specifies that the contributions to the SRF will be paid in by the banks over the course of eight years, mirroring the eight-year mutualisation phase during which national compartments in the SRF will be gradually merged.

As for the Deposit Guarantee Scheme (DGS), the European Parliament and European Council reached a political agreement over the DGS Directive in March 2014. According to European Parliament (2014), the SRF, DGS and the European Stability Mechanism (ESM) facility will contribute to the third pillar of EBU. DGS sets the upper limit of deposit protection at EUR 100,000, but with exceptions. For instance, if there are special reasons such as having just sold a house, a higher amount will be protected. In addition, depositors will have the guaranteed part of their deposit reimbursed within 7 working days or even sooner to receive a small amount of funds for basic living expenses. The DGS directive admits the possibility of using the funds not just to protect depositors but also for capital injection.

European Commission (2014e) clearly states that a “pan-EU DGS is not currently under discussion” but “could be a potential option in the future once the current banking reforms (e.g. BRRD Bank Resolution and Recovery Directive) have been implemented and the other elements of the banking union such as the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) are in place.” What is possible today is voluntary mutual borrowing by Member State DGS. And five years after its entry into force, “the Commission will submit a report, and, if appropriate, could put forward a new legislative proposal.”

Clearly, EBU is still under construction. Furthermore, when it started its overall picture was not obvious; people involved may even have had differing ideas about the details and implications. One thing that is agreed upon is the goal to sever the vicious cycle of financial and fiscal crises (or taxpayer funded rescues of financial institutions). Towards this goal, EBU is being built from proposals, opinions both for and against, and compromises. And as we see below, Europe is introducing new aspects of integration as policy at the supra-national level.

III. The Liikanen report and banking structural reform

We often discuss banking structural reforms and EBU separately. It would be reasonable if we suppose the purpose of banking structural reforms as being for overcoming the too-big-to-fail problem to save tax-payers, and prevent the moral hazard problem. The banking structural reforms in Europe, however, have another purpose, too, which complements moves toward an integrated European single market. Mr. Michel Barnier, who was the commissioner responsible for internal market and services, mentioned in regard to banking structural reforms that, "…proposals will provide a common framework at EU level—necessary to ensure that divergent national solutions do not create fault-lines in the Banking Union or undermine the functioning of the single market."[31] The reforms are crucial in order to functionally strengthen the EBU and allow for improvements in moving toward a single financial market. In this section, we will review the reforms and the current situation from the standpoint that the reforms play an important role in allowing the EBU to be successful.

In November 2011, Commissioner Barnier set up the High-level Expert Group (HLEG) to consider banking structural reforms in the EU. He appointed Mr. Erkki Liikanen, former president of Bank of Finland, as the chair. The group published a final report, called the Liikanen report, in October 2012.

Optimal regulation or rules would allow for variations due to the varying banking structures that lead to a double standard in the region. Some banks have to follow some rules at the EU level, while differing national rules apply to others. Conflicting dual systems in one country drive financial arbitrages, which distorts the markets. It is also costly to have several rules and regulations at different levels. This can be a constraint for the ECB, confining its supervision to a limited number of banks. The banking structural reforms mitigate such costs through single regulation and supervision.

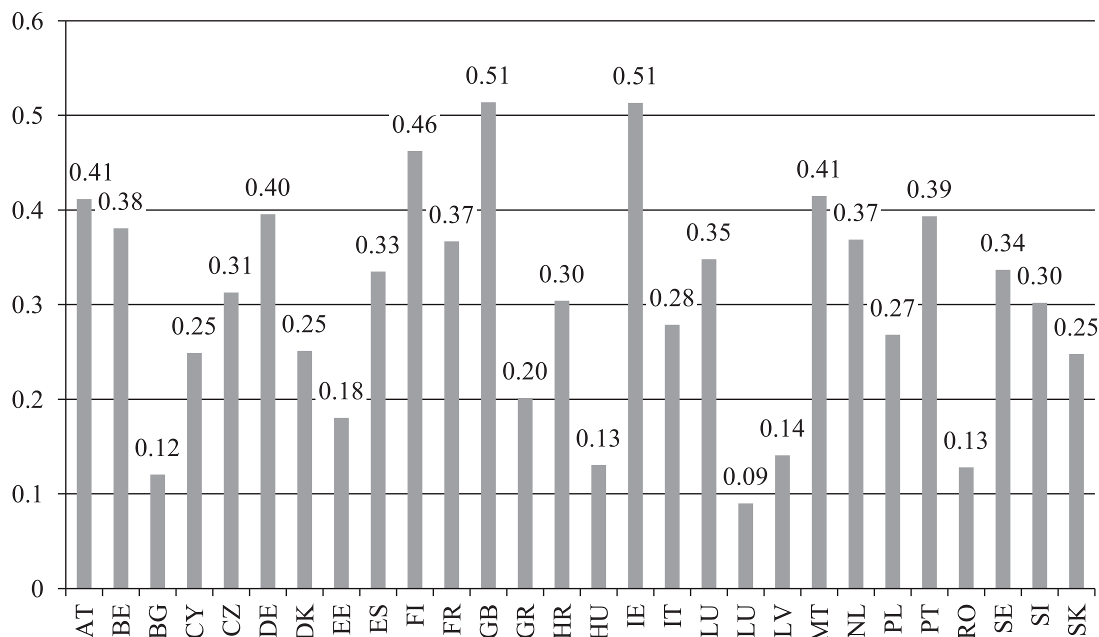
We employ the retail ratio that Martel et al (2012) and Gambacorta and Rixtel (2013) use to compare asymmetries of bank structure among member states. Figure 1 shows the standard deviation of retail ratio on member states, covering 1,455 banks in the region. We obtained the data from Bankscope through Bureau Van Dijk.[32] A higher value means that bank business models are diversified in that country, while a smaller value shows that banks share a similar business model. We observed that the models are more diversified in Ireland and the UK, and the models are more homogenized in Belgium, Luxembourg and Hungary. Germany and France fall in the middle of this range.

The Liikanen report includes prohibition on the proprietary trading and separation of higher risky trading from depository institutions ("subsidiarisation"). It applies to banks whose trading assets share of total assets is more than 15–25%, or whose trading assets are larger than 100 billion Euros, which means the volume of trading activity is higher than a

[31] European Commission (2014f). This statement is consistent to the agreement in G20 designed to prevent "regulatory arbitrage and unintended market access restrictions."

[32] Bankscope—Bureau van Dijk (https://bankscope.bvdinfo.com/)

Figure 1
Standard deviation on the retail ratio (2014)[34]



Source: Bankscope (https://bankscope.bvdinfo.com/) and author's calculation.

certain level. The separation covers the market making activity, and this is stricter than the Volcker rule but less strict than Vicker's report.[33] On the other hand, the degree of separation is less strict than the Volcker rule since the report allows depository institutions to belong to the same group as long as they are different entities. The Volcker rule bans depository institutions belonging to the same group with separated entities conducting the risky trading.

The Commission had considered reforms through the Liikanen report, but the Commission had tasks of more immediate importance, too. Also, it is not easy to coordinate among the interests of the various related countries.[35]

The Commission firstly called for public comments until December 2012 for 6 months,[36] and it held a stakeholder's meeting in May 2013.[37] Its purpose was to collect opinions and deepen discussions. Participants came from various fields: financial, public, private sector, companies, consumers, think-tanks and labor unions. Most of them shared the opinion that the regulation was not enough to overcome the TBTF problem and agreed that banking

[33] See also http://ec.europa.eu/internal_market/consultations/2012/hleg-banking_en.htm and European Commission (2013a).

[34] The retail ratio is defined as $\frac{(Net\ customer\ Loan + Customer\ Deposts)}{Total\ Assets}$. Gambacorta and Rixtel (2013) also defines ranges corresponding to their business models. It shows investment banks distribute below 0.2, investment bank oriented universal banks at around 0.4–0.8, commercial bank oriented universal banks at around 0.8–1.0, and commercial banks at above 1.0.

[35] Even though people perceived that the Commission considered the report seriously, some were still sceptical as to what extent the Commission reflected the report in their proposal. See also Kodachi (2012).

[36] European Commission (2012f).

[37] European Commission (2013b).

structural reforms are necessary in complementing other reforms. However, there was opposition against the separation on market making activities, scope of regulation, and flexibility of scope threshold. Stakeholders requested more information about calculation criterion for the threshold. For an application to foreign institutions, the financial arbitrage was of concern. Some participants argued that separation depending on individual activities would worsen inter-connectedness. The Commission decided to consult for quantitative analyses on the following points: (1) effects on foreign institution activities in the region, (2) effects on banks' ability to supply credit, (3) effects on employment, (4) implementability of separation, and (5) effects on inter-connectedness.

On June 13th of 2013, the Parliament decided to ask the Commission to adopt a follow-up proposal to the Liikanen report, and it passed its own report, "Report on the structural reform of the EU banking sector," or "McCarthy report," by an overwhelming majority.[38]

The Commission proposed "structural measures improving the resilience of EU credit institutions" on January 29th of 2014.[39] It says the banking sector in the EU is bigger than 4.29 trillion euros, which is close to 350% of EU GDP, and there are banks that are "too-big-to-fail" and "too-complex-to-resolve." It intends to strengthen its banking sector and financial intermediaries for further financial stabilization and to save tax-payers through the reforms.

The proposal includes a prohibition on proprietary trading and separation on higher risky trading from depository banks. Higher risk trading is defined as: (1) market making activity, (2) complicated derivatives, (3) investment or supply of funds to complicated securitization, and (4) derivative trading on OTC. Depository banks needs to allocate these activities to different entities, but they could be in the same group as those outliers from the Volcker rule. It also requires transparency on repos and debt-credit transaction for shadow banking to prevent its amplification effects. The scope includes banks whose total assets are larger than 30 billion euros, and whose trading amount is bigger than 70 billion euros or whose trading amount share of total assets is bigger than 10%. It proposes to be applicable to about 30 banks, but these 30 banks cover more than 65% of total assets of all banks in the region. On the other hand, a bank can be exempted from the rule if the supervisor admits that it deals with risks in a managed way through other countermeasures. The deadlines are January 2017 for proprietary trading, and July 2018 for separation.

The application also extends to foreign institutions that do business in the EU, including branches. If the EU approves regulations and supervision taken by another government, and if such a bank satisfies those regulations the bank can be exempted. European banks can also be exempted for their activities in that country.

The proposal was criticized as being an obsolete version of the Liikanen report.[40] Especially, the Commission compromised on the scope threshold because of opposition from several member states including Germany and France. The regulation applies to only 30

[38] European Parliament (2013).
[39] European Commission (2014c).
[40] Barker (2014a).

banks out of 8,000 in the EU, and they can be exempted through specific appropriate procedures. We are skeptical that such reforms could mitigate the asymmetries. If the asymmetries disturb functions of EBU, a series of reforms could not prevent another crisis. However, we would need quantitative analyses to discuss the extent to which the asymmetries disturb the EBU.

The Commission regards the structural reform as a part of European integration, and expects it to contribute to integration through smooth functioning on a single market. It is also hoped that structural reform at the EU level will improve bank activities over borders, the single rule book and the effectiveness of EBU. Therefore, the Commission carefully paid attention to member states by emphasizing their relationship to each national structure. The proposal mentions the significance of a universal bank system.[41]

The Parliament took 18 months to discuss the proposal. Several member states, which reflect opinions from the banking sector, and the banking sector itself were strongly opposed to the proposal, and there was even a possibility that the Commission would turn it down.[42] The most sceptical countries against the proposal were UK, Germany, Sweden and the Netherlands. The banks were also opposed. The UK and France argued that such a proposal deteriorates market liquidity and conflicts with the Capital Markets Union. On the other hand, the ECB was positive regarding the proposal, and Vítor Constâncio, vice president of ECB, warned against different structures among countries and claimed that structural reforms were necessary for preventing financial market fragmentation and regulatory arbitrage.[43]

A feature of the conflict was the prominent conflict among member states, in addition to between the EU and member states. Some countries actively proceeded with structural reforms earlier than the EU. The UK took on reforms that were more inclined toward separate activities, while Germany adopted reforms that were less so. The Commission tried to harmonize such different approaches, and compromised on scope threshold, but still included market making activities for separating activities. Since EU laws trump national laws, Germany and France would have to follow the stricter rules set by the EU if the proposal is adopted. On the other hand, the rules are less strict than those in the UK, and the UK demanded stricter rules.[44] As a result of such conflicts, the structural reforms would disturb EBU, and would not prevent another crisis. The Commission had to coordinate opinions, but the compromise scheme is not sufficient to achieve that purpose, leading to difficult decisions.

They reached a conclusion in June 19th of 2015, finally, through a compromise between the UK and France.[45] The Commission allowed the UK to have stricter rules and implementations than at the EU level.[46] Under different structures and different regulations, the ECB would have more difficulties with supervision. It remains to be seen how effectively the EBU supervises banks. At the same time, analysis on the risks of financial arbitrage is an ur-

[41] European Commission (2014g).
[42] Barker (2014b).
[43] Barker (2015a).
[44] Pop (2014).
[45] European Commission (2015d), European Council (2015).
[46] Barker (2015).

gent task for economists.

At the same time as the EBU, the EU has embarked upon a project to increase direct financing, i.e. financial intermediation not dependent on banks, known as the Capital Markets Union. Jean-Claude Juncker, the new head of the Commission, announced this in July 2014. The financial regulatory reforms may be turning back the clock on European financial integration, but integration is progressing on these fronts.[47]

IV. The new axes of conflict

The history of European integration is a history of shifting sovereignty from nations to a supra-national institution. The member states shared the realisation that integration was necessary for peaceful and prosperous co-existence. At each step of the integration process, they were faced with decisions on how much sovereignty to yield. This was a path of conflict and compromise between the member states themselves as well as between the member states and the EU. Each economic, monetary and financial crisis was an occasion to reconfirm the need for integration and joint counter-measures that deepened integration.

So it was not surprising to see the problem of "democratic deficit" emerge. The question was whether giving up sovereignty for the sake of integration reflected the will of the voters. This led to conflict between "national vs. supra-national," as well as conflict between nations with differing optimal levels of sovereignty.

The most recent financial crisis was no exception. The EU responded to the crisis with EBU, banking structural reform and capital markets union. But all member states are sovereign democratic states whose presidents, chancellors and prime ministers are mandated to adopt policies that reflect the will of the people. Structures that result from years of customs and arrangements are not easily changed by agreements at supra-national level. Building a supra-national entity such as the EU involves constantly solving optimisation problems regarding how much sovereignty to give up for the sake of integration. Thus, it is inevitable that there will be conflicts between the national and the supra-national, and between nations with differing optimal levels of sovereignty.

The EBU and other post-crisis measures were no exceptions. For example the SSM of the EBU is against the principle of subsidiarity,[48] because the range of supervision is expanded. What is new here is the emergence of new combinations at both ends of the axes of conflict. These combinations are formed by the public and private at national and supra-national levels.

First, there is the "taxpayers vs. banks with global operations"—a private vs. private conflict. Depending on who represents the taxpayers, this conflict can take two different

[47] European Commission (2015c). Through stricter regulations, banks have decreased their activities across borders and increased investment in government bonds. The EBU is intended to improve this situation.

[48] To quote from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:ai0017, the "principle of subsidiarity aims at determining the level of intervention that is most relevant in the areas of competences shared between the EU and the EU countries. This may concern action at European, national or local levels. In all cases, the EU may only intervene if it is able to act more effectively than EU countries at their respective national or local levels."

forms. If an EU institution (such as the Council, ECOFIN, Commission, Parliament, etc.) represent the taxpayers, this conflict becomes one of supra-national private vs. supra-national public (representing taxpayers). If instead the member state governments prioritise the interests of banks, this conflict becomes the more usual one of sovereignty vs. supra-national on the surface, but in the background the sovereign state is the opponent of taxpayers behind the supra-national EU.

An example of the latter is the judgement against the UK on 22nd January 2014 in the European Constitutional Court.[49] The UK objected to the introduction of the European Short Selling Regulation (article 28) which allows direct intervention by the European Securities Markets Authority (ESMA) of the ESFS "in exceptional circumstances." Given Chancellor Osbourne's declaration in June 2015 to end "banker bashing," this type of conflict can be expected to repeat itself.

The UK is not the only example. The separation of banks' proprietary trading and other risky activities at the core of the Liikanen report was disagreeable to member states such as Germany, France and Belgium where universal banking was the norm. The governments of Germany and France had the interests of these banks in mind when they took a series of measures. They showed strong objection to the Liikanen report,[50] and supported preserving the universal banking model for most of the banks, while admitting the importance of separating investment activities.[51]

Furthermore, as stated in the previous section, Germany and France proceeded with their own structural reform of the banking sector, before reforms at the EU level took shape. This can be seen as an attempt to establish a kind of reform with minimal effect on their own banking system and to take the initiative at the EU level discussions. Related bills were submitted in February and approved in May of 2013 in Germany, submitted in December of 2012 and established in July of 2013 in France. The reforms in these two countries do not include market-making as the object of separation. And in Germany, the separation applies only to banks with assets related to high risk of over 100 billion euro or over 20% of total assets. Finance Minister Schäuble stated that German-style banking sector reform should be the model for Europe,[52] and demanded market-making be excluded from separation.[53]

On the other hand, national policy authorities may choose to represent taxpayers instead of private sector banks. This turns the "taxpayers vs. banks with global operations" conflict into a "supra-national private vs. national and supra-national public (representing taxpayers)" conflict. As an example, it is interesting to compare the responses of the UK on the one hand and Germany and France on the other, as they each took the opposite of their traditional stances. The disagreement between these two camps traditionally arose from the difference over the optimal degree of sovereignty kept from supra-national entities, with the UK

[49] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2459815
[50] Wilson (2013).
[51] European Commission (2013c).
[52] Comfort (2014).
[53] European Commission (2013c).

being more reluctant. This convention applied to the present case as well, with the UK having a strong interest in preserving independence over financial regulatory policy to protect the City's position as the financial centre of Europe. For this reason, Continental Europeans had to limit the scope of EBU to the euro area, when actually they saw EBU as an integral part of the Single Market (which applies to the EU as a whole). In addition, the UK opposed the EU's imposition of an upper limit on banker bonuses of "200% of wages if agreed by shareholders and 100% otherwise," on account that it led to wage hikes, lower competitiveness and exodus of top talent out of Europe.[54] However, when it came to the capital requirement ratio the stances were unconventional, it was the UK that demanded stricter application—against Germany and France which demanded and realised a relaxation.[55]

The second type of conflict is small and medium sized financial institutions vs. taxpayers, another "private vs. private" conflict. Here again, national governments have a choice over which side to support. With respect to the third pillar of EBU, the German government chose the small and medium sized financial institutions over taxpayers. The third pillar includes the deposit guarantee system DGS, and Germany is reluctant to become a part.[56] Germany has three types of bank: commercial banks with global operations, savings banks and credit unions. The latter two are relatively small non-profit institutions, but together make up over 70 percent of the total deposit market. They have a well-established mutual assistance system and deposits are fully protected. Therefore it is not at all in their interest to take part in a deposit guarantee system with other financial institutions, especially overseas.[57]

German small and medium sized banks also influenced the establishment of EBU's first pillar, the SSM, because German Savings Banks were the ones most hesitant to come under the supervision of the ECB. In the event, all German Savings Banks, save one (Hambourg), stayed under the supervision of German supervisory authorities.[58]

The third type of private vs. private conflict is the individual private agent vs. supra-national public (representing taxpayers). This is the case where private sector individuals or politicians find EU policies objectionable, and file a complaint before the European Court of Justice (or national courts). President Draghi's "whatever it takes" and OMT had a large effect in calming down European markets, thereby serving the interests of European taxpay-

[54] Here "wages" means "basic pay." In November of 2014, Chancellor Osborne abandoned his challenge in the European Court of Justice, refusing to "spend taxpayers' money on a legal challenge now unlikely to succeed." The upper limit on bonuses applies only to banks with more than 50 billion euro worth of assets, but according to Arnold and Agnew (2015) the European Banking Authority (EBA, a part of the ESA of the ESFS) proposed "removing these national exemptions for smaller lenders and non-bank institutions" in March 2015, which would include "hundreds of so-called 'shadow banking' groups and smaller lenders…such as Black Rock, KKR Capital Markets, ICAP, Metro Bank."

[55] Barker and Masters (2012). Banks headquartered in the UK actually welcomed these moves by Germany and France. This makes it possible to see it as a new type of conflict between supra-national private vs. national public.

[56] Germany also opposes issuing euro bonds to fund a Fiscal Union, a unified EU-level fiscal authority. Unlike the right to issue currencies, sovereignty over budgeting and taxation cannot be transferred to the EU under the present German constitution. And revising the constitution requires a national referendum. On the 12th of May 2013, Finance Minister Schäuble said that a Treaty change was necessary in order to realise EBU's second and third pillars. Chancellor Merkel is also strongly against German taxpayers funding capital injection into southern European banks. Before the ESM (European Stability Mechanism) started operation on 8th October 2012, the Chancellor emphasized in June that an EU level single supervision was a pre-condition.

[57] Sakamaki and Sakai (2004).

[58] Masters, Schäfer and Wilson (2012), Wilson, Wiesmann and Barker (2012).

ers. But conservative politicians in Germany argued that this was against EU law, only to have the European Court of Justice rule against them. In July of 2014, a group of university professors in Germany filed a complaint before the German constitutional court, claiming that the SSM had no legal basis in the EU treaties.[59] And the Landeskreditbank Baden-Württemberg, otherwise known as L-Bank, filed a complaint before the European Court of Justice in April 2015, to avoid being supervised by the ECB.[60]

These are some of the examples of conflicts that do not fit the more traditional "sovereign vs. supra-national" and "between nations that do not agree on the optimal level of transfer of sovereignty." Such unconventional conflicts existed before; for instance in the realm of competition policy. But in the post-crisis EU, their importance has increased, reflecting the economic and political weight of the financial sector and the fact that the result can lead directly to crises.

In the coming years, national governments will continue to choose which side of the private agents in conflict to which they will listen. This choice affects the probability of another crisis. What is unique in Europe is the existence of a supra-national public entity that can represent one of the sides. As seen in the examples above, the EU organisations often choose to represent the interests of taxpayers instead of politically astute industries.

V. Summary

The financial reforms taking place in the EU have important implications for other nations and regions. When economies become linked through giant international financial markets, financial supervision, regulation, resolution and deposit insurance all need to catch up with the reality of the risks this imposes. And, banks as well as financial intermediaries must be resistant to crises and their aftereffects. But since supra-national arrangements involve loss of sovereignty, the process inevitably involves conflict and compromise. Europe already has supra-national institutions that cover the justice, administrative and legislative branches, and they all participate in the process by providing venues for proposals, discussions, conflict resolution, co-operation, approval of bills, supervision, etc. In contrast, such supra-national institutions barely exist for the world as a whole, yet. The need for such institutions increase as economies and financial markets around the world become more and more interdependent. The discussions in the previous sections point to the following.

First, Europe is taking concrete measures to stop the vicious cycle of financial and fiscal crises and the resulting burden on taxpayers to save banks. The different EU institutions are rapidly producing ideas towards attaining this goal, and tirelessly moving forward step by step by tackling the problem of difference of opinion and interest. However, the outcome is

---

[59] http://www.euractiv.com/sections/euro-finance/german-economist-group-attacks-european-banking-union-303775. As a pre-euro example, several constitutional objections were put forward in Germany against the ratification of the Maastricht Treaty. The Federal President had to wait for its dismissal by the Constitutional Court before signing the ratification document. Details are found in Kaji (2004), pp. 100–104.

[60] http://www.europeanpublicaffairs.eu/the-future-of-the-banking-union-ecbs-supervisory-role-challenged-at-eus-court/

far from perfect. Even the supervision part which has already started, the first pillar of EBU, is still in a state of progress. It is not wrong to say that the crisis became serious because supervision of EU financial markets was not integrated. But the problem is that there is no model of a unified supervisory body successful in avoiding a repeat of the crisis. When the single central bank was established, it was modelled after the Bundesbank, the most successful central bank in Europe, if not the world. But, with single supervision, there is no model. Even some Landesbanken in Germany bought sub-prime securities, and many EU banks invested heavily in Greece. The search for financial supervision conducive to stable prosperity has only just begun.

The second and third pillars of EBU have even more tasks ahead. Even if the first pillar is successful, crises can come from outside the EU. If a crisis occurs and the effects were minimised under the supervision of the ECB, there is still uncertainly over resolution and the funds for such.

With EBU under construction in this way, Europe is simultaneously moving forward with banking structural reform and a capital markets union. The steps are consistent with the original goal. Institutional arrangements provided by EBU do not promise much if the banks themselves are structurally prone to crises. And diversification in financial intermediation allows smaller damage and faster recovery from crises.

Second, there are three benefits to financial reform within the framework of regional integration.

The first benefit is the role of the supra-national institution as a spokesperson of taxpayers. This role of the EU should be emphasised, when EU voters tend to focus more on problems such as the democratic deficit. National governments often stand by their financial institutions in the conflict between the latter and taxpayers because the financial institutions have more financial and lobbying power. This is a malfunctioning of democracy in the eyes of taxpayers. But, if a supra-national organisation exists and takes action to reflect the voice of ordinary citizen, democracy can function better. This dynamic is sustained by the fact that supra-national institutions do not have the same level of automatic legitimacy as national institutions. The supra-national entities must remind voters of their *raison d'être* far more frequently than national ones. In addition, if the European Court of Justice rules in one's favour, that ruling takes precedence over that of national courts.

The second benefit is the existence of several supra-national organisations whose tasks cover justice, administration and legislation. Importantly, all of them get involved in the integration and reform process from their own unique angles. For instance in EBU, the Commission and the Commissioner, the Council and its President, the Commissioner for Economic and Financial Affairs, the European Parliament, the European Court of Justice and those who present their cases there were all involved in their own way. All of them have their differing interests and constituents, creating a better balanced (if more conflict-prone) environment to build on. The final picture of EBU was unknown in the beginning, EBU developed gradually out of interaction and compromise. Contrast this with a country like Japan which is not a part of a supra-national integration process. None of the agents involved

have a supra-national perspective. If only one supra-national body existed, that would also limit the range, quality and quantity of ideas. Europe could have embarked upon financial regulatory reform without the EU, but it is hard to imagine that the whole process would have advanced with this much speed and scope.[61] When the EU institutions are practically in competition to eliminate the vicious cycle of financial and fiscal crises and protect taxpayers, the wonder is whether the anti-EU movements are ignorant of all this.

The third benefit is the traditional one, an extension of the "hiring a conservative central banker" argument. After joining the euro, Greece maintained sovereignty in banking supervision. The fact that this was not consistent with stabile prosperity was made painfully clear by the crisis. After the crisis, sovereignty in banking supervision was passed to a supra-national body, the SSM, which has improved Greek banks' prospect of recovering and maintaining soundness. The scenario applies in general to other policies and other nations. Policies can be better conducted at supra-national level, if a sovereign nation cannot do so in ways that ensure economic health.

References

Admati, Anat, and Hellwig, Martin (2014), *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It*, Princeton University Press

Arnold, Martin and Harriet Agnew (2015), "UK banks fight back against EU bonus cap extension", *Financial Times*, June 3, 2015

Barker, Alex and Quentin Peel (2012), "Berlin Pressed on Banking Union Plan", *Financial Times*, September 10, 2012, http://www.ft.com/intl/cms/s/0/52cb041a-fb35-11e1-a983-00144feabdc0.html#axzz3ZbSweJ3S

Barker, Alex and Brooke Masters (2012), "EU set for clash on banking rules, *Financial Times*, May 1, 2012, http://www.ft.com/intl/cms/s/0/0d630b52-938e-11e1-8ca8-00144feab49a.html#axzz3aJiRJime

Barker, Alex (2014a), "EU bank reforms set out to reduce complexity and curb speculation", *Financial Times*, January 29, 2014, http://www.ft.com/intl/cms/s/0/e1fc5f90-88b4-11e3-bb5f-00144feab7de.html#axzz3aJiRJime

Barker, Alex (2014b), "EU's Hill considers shelving bank structural reforms", *Financial Times*, December 4, 2014, http://www.ft.com/intl/cms/s/0/9fe30148-7bd1-11e4-a7b8-00144feabdc0.html?

[61] Of course there are problems unique to financial reform within the context of regional integration. With the higher number of potential leaders with differing interests, the project can run aground. Past achievements at the supra-national level, such as the Single Market and financial liberalisation, can be reversed or damaged by crises, "variable geometry" (two-speed Europe) can also cause frictions. But these problems can point towards improvements. Furthermore, EU bureaucracy is not the source of financial reform. It remains true that financial institutions were at the heart of the Lehmann and euro crises.

siteedition=intl#axzz3aJiRJime

Barker, Alex (2015a), "EU reforms to break up big banks at risk", *Financial Times*, January 29, 2015
http://www.ft.com/intl/cms/s/0/09025d06-a7d1-11e4-97a6-00144feab7de.html#axzz3aJiRJime

Barker, Alex (2015b), "EU finance ministers back drive to tackle 'too big to fail' banks", *Financial Times*, June 19, 2015,
http://www.ft.com/intl/cms/s/0/44f225ba-1673-11e5-8095-00144feabdc0.html#axzz3dwY6qRVy

Comfort, Nicholas (2014), "Schaeuble Says German Bank Split Law Can Serve as European Model", Bloomberg, 20 January 2014,
http://www.bloomberg.com/news/articles/2014-01-20/schaeuble-says-german-bank-split-law-can-serve-as-european-model

Cecchetti, Stephen G and Enisse Kharroubi (2015), "Why does financial sector growth crowd out real economic growth?", BIS Working Papers No 490

Cecchetti, Stephen G, and Enisse Kharroubi (2012), "Reassessing the impact of finance on growth", BIS Working Papers, no 381

Council of the European Union (2014), "Single Resolution Fund: Council agrees on bank contributions", Press Release, Brussels, 9 December 2014,
https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/146129.pdf

Court of Justice of the European Union (2015a), "According to Advocate General Cruz Villalón, the ECB's Outright Monetary Transactions programme is compatible, in principle, with the TFEU", Press Release No. 2/15,
http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-01/cp150002en.pdf

Court of Justice of the European Union (2015b), "The OMT programme announced by the ECB in September 2012 is compatible with EU law", PRESS RELEASE No 70/15, Luxembourg, 16 June 2015, Judgment in Case C-62/14, Gauweiler and Others,
http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-06/cp150070en.pdf

European Commission (2012a), European Commission Press Release: New crisis management measures to avoid future bank bail-outs, Brussels, 6 June 2012, http://europa.eu/rapid/press-release_IP-12-570_en.htm

European Commission (2012b), Communication on "A roadmap towards a Banking Union", COM (2012) 510 final

European Commission (2012c), Communication on "A blueprint for a deep and genuine economic and monetary union—Launching a European Debate", COM (2012) 777 final/2http://eur-lex.europa.eu/resource.html?uri=cellar:c3f084ef-909d-4258-bb26-50b16cc542b1.0011.03/DOC_1&format=PDF

European Commission (2012d), "Commission sets out the next steps for stability, growth and jobs", Press release, Brussels, 30 May 2012,
http://europa.eu/rapid/press-release_IP-12-513_en.htm

European Commission (2012e), “Update—The banking union”, MEMO, Brussels, 22 June 2012,
http://europa.eu/rapid/press-release_MEMO-12-478_en.htm?locale=en

European Commission (2012f), “Summary of the Replies to the Consultation of the Internal Market and Services Directorate General on the Recommendations of the High-level Expert Group on Reforming the Structure of the EU Banking Sector”, December, http://ec.europa.eu/internal_market/consultations/2012/hleg-banking/replies-summary_en.pdf

European Commission (2013a), Follow-up to the Liikanen report—16-17.05.2013, Presentation, Brussels, 17 May 2013,
http://ec.europa.eu/internal_market/bank/docs/structural-reform/20130517-stakeholder-meeting/presentation_en.pptx

European Commission (2013b), Stakeholders’ meeting—Reforming the Structure of the EU Banking Sector, Brussels, 17 May 2013,
http://ec.europa.eu/finance/bank/docs/structural-reform/20130517-stakeholder-meeting/conclusions_en.pdf

European Commission (2013c), Consultation on reforming the structure of the EU banking sector Joint German and French response, Brussels, 15 May 2013

European Commission (2014a), Communication from the Commission: A reformed financial sector for Europe, COM (2014) 279 FINAL,
http://ec.europa.eu/internal_market/finances/docs/general/20140515-erfra-communication_en.pdf

European Commission (2014b), Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0049

European Commission (2014c), Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on structural measures improving the resilience of EU credit institutions, COM/2014/043 final—2014/0020 (COD), 29 January 2014 http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52014PC0043

European Commission (2014d), “Commissioner Barnier welcomes the Signature of the intergovernmental Agreement (IGA) on the Single Resolution Fund, Statement”, Brussels, 21 May 2014,
http://europa.eu/rapid/press-release_STATEMENT-14-165_en.htm

European Commission (2014e), Deposit Guarantee Schemes—Frequently Asked Questions, MEMO, Brussels, 15 April 2014
http://europa.eu/rapid/press-release_MEMO-14-296_en.htm

European Commission (2014g), Structural measures to improve the resilience of EU credit institutions—frequently asked questions, Brussels, 29 January 2014
http://europa.eu/rapid/press-release_MEMO-14-63_en.htm?locale=en

European Commission (2014f), Structural reform of the EU banking sector—Press Release, Brussels, 29 January 2014

http://europa.eu/rapid/press-release_IP-14-85_en.htm?locale=en

European Commission (2015a), Understanding... Banking Union, Finance Newsletter, 27.02.2015,
http://ec.europa.eu/information_society/newsroom/cf/fisma/item-detail.cfm?item_id=20758&newsletter_id=166&lang=en

European Commission (2015b), Finalising the Banking Union: European Parliament backs Commission's proposals (Single Resolution Mechanism, Bank Recovery and Resolution Directive, and Deposit Guarantee Schemes Directive),
http://europa.eu/rapid/press-release_STATEMENT-14-119_en.htm

European Commission (2015c), Capital Markets Union,
http://ec.europa.eu/finance/capital-markets-union/index_en.htm

European Commission (2015d), Speaking notes of Commissioner Jonathan Hill on Bank Structural Reform at ECOFIN meeting, European Commission—Statement, Luxembourg, 19 June 2015,
http://europa.eu/rapid/press-release_STATEMENT-15-5237_en.htm?locale=en

European Council (2015), Restructuring risky banks: Council agrees its negotiating stance, 19/06/2015 11:00 Press release 474/15 Economy & finance,
http://www.consilium.europa.eu/en/press/press-releases/2015/06/19-restructuring-risky-banks-council-agrees-negotiating-stances/

European Parliament (2013), Report on reforming the structure of the EU banking sector, (2013/2021(INI)), Committee on Economic and Monetary Affairs, Rapporteur: Arlene McCarthy,
http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2013-0231+0+DOC+XML+V0//EN

European Parliament (2014), Banking Union, Fact Sheets on the European Union—2014,
http://www.europarl.europa.eu/RegData/etudes/fiches_techniques/2013/040204/04A_FT%282013%29040204_EN.pdf

European Systemic Risk Board,
https://www.esrb.europa.eu/about/background/html/index.en.html

Gambacorta, Leonardo and Adrian van Rixtel (2013), "Structural bank regulation initiatives: approaches and implications", BIS Working Papers, No. 412, April 2013

Kaji, Sahoko (2004), "*Kokusai Tsukataisei no Keizaigaku*" (in Japanese, The Economics of the International Monetary System), Nihonkeizai Shimbunsha

Kitami, Ryoji (2014), "*Bei Ei EU Dokufutsu no Ginkokisei, Kozokaikakuho ni tsuite*" (in Japanese, Banking regulation and Structural Reform legislations in the US, UK, EU, Germany and France) FSA Institute (Financial Research Centre), DP 2014-7

Kodachi, Kei (2012), "*Ginko no Trading Gyomubunri wo motomeru EU no Kento – Liikanen Report -* " (in Japanese, EU discussion on bank separation – Liikanen Report -), Nomura Shihon Shijo Quarterly, 2012 Autumn

Masters, Brooke, Daniel Schäfer and James Wilson (2012), "Relief at new bank supervision rules", *Financial Times* December 13, 2012,

http://www.ft.com/intl/cms/s/0/5feb0344-4530-11e2-838f-00144feabdc0.html?siteedition=intl#axzz3ZbSweJ3S

Markovic, Frank (2015), The Future of the Banking Union: ECB's supervisory role challenged at EU's court, 9 April,
http://www.europeanpublicaffairs.eu/the-future-of-the-banking-union-ecbs-supervisory-role-challenged-at-eus-court/

Martel, Merck, Adrian van Rixtel and Gonzalez Mota (2012), "Business models of international banks in the wake of the 2007-2009 global financial crisis", Bank of Spain, Revista de Estabilidad Financiera, No. 22

Mody, Ashoka (2015), "The nod-and-wink lender of last resort- how unlimited are "unlimited" purchases of sovereign bonds, and can the ECB legally accept losses on par with private creditors?"13th January 2015,
http://www.bruegel.org/nc/blog/detail/article/1539-the-nod-and-wink-lender-of-last-resort/

Okina, Yuri (2014), "*Fuanteika suru Kokusai Kinyu System*" (in Japanese, The Destabilising International Financial System), NTT Publishing

Pop, Valentina (2014), "British EU commissioner causes controversy on banking reform", EU Observer, December 5, 2014,
https://euobserver.com/economic/126801

Sakamaki, Kazuhiro and Shinichi Sakai (2004), "Oushu Yonkakoku no Yokinhokenseido" (in Japanese, Deposit Insurance Systems in Four European States", Yokin Hoken Kenkyu No.2

Siekmann, Helmut and Volker Wieland (2014), "The German Constitutional Court's decision on OMT: Have markets misunderstood?", CEPR Policy Research No.74, October,
http://www.voxeu.org/sites/default/files/image/FromMay2014/PolicyInsight74.pdf

Spiegel, Peter and Quentin Peel (2012), "Brussels urged not to raise hopes on eurozone", *Financial Times*, September 7, 2012,
http://www.ft.com/intl/cms/s/0/1572ac30-f90a-11e1-945b-00144feabdc0.html#axzz3ZbSweJ3S

Van Rompuy, Herman (2012), "Towards a Genuine Economic and Monetary Union", Report by President of the European Council, Brussels, 26 June 2012, EUCO 120/12, PRESSE 296, PR PCE 102

Véron, Nicolas (2011), "Europe must change course on banks", *VoxEU*, 22 December,
http://www.voxeu.org/article/europe-must-change-course-banks

Véron, Nicolas (2014a), "Europe's Single Supervisory Mechanism: Most small banks are German (and Austrian and Italian)", 22nd September,
http://www.bruegel.org/nc/blog/detail/article/1437-europes-single-supervisory-mechanism-most-small-banks-are-german-and-austrian-and-italian/?utm_source=Bruegel+Update&utm_campaign=774dedb655-Bruegel+Update&utm_medium=email&utm_term=0_cb17b0383e-774dedb655-273940750

Véron, Nicolas (2014b), "Europe's Banking Union starts on an encouraging note", 27th Oc-

tober,
http://www.bruegel.org/nc/blog/detail/article/1466-europes-banking-union-starts-on-an-encouraging-note/

Véron, Nicolas (2015), "Europe's Radical Banking Union", Bruegel Essay and Lecture Series,
http://www.bruegel.org/publications/publication-detail/publication/880-europes-radical-banking-union/?utm_source=Bruegel+Updates&utm_campaign=e3e8bac78c-Publication+Alert&utm_medium=email&utm_term=0_eb026b984a-e3e8bac78c-278081625

Wilson, James (2014), "Germany rejects whole-bank ringfencing", *Financial Times*, January 30, 2014
http://www.ft.com/cms/s/0/593458ce-6ae8-11e2-9871-00144feab49a.html#axzz2sufmm9Ua

Wilson, James, Gerrit Wiesmann and Alex Barker (2012), "Germany's small banks fight union plans", *Financial Times*, December 2, 2012,
http://www.ft.com/intl/cms/s/0/efc129b0-3b00-11e2-b3f0-00144feabdc0.html#axzz3dwY6qRVy

Zingales, Luigi (2015), "Does Finance Benefit Society?",
http://faculty.chicagobooth.edu/luigi.zingales/papers/research/Finance.pd

Appendix

	Banking Union												
	Single Supervisory Mechanism	Single Resolution Mechanism	Deposit Guarantee Schemes	Single Rulebook	European System of Financial Supervision	Taxation of the financial sector	Bank Recovery and Resolution	Banking Structural Reforms				European Market Infrastructure Regulation	Insurance Guarantee Schemes
				CRD				EU	UK	Germany	France		
1994/5			Deposit Guarantee Schemes enter into force										
1997/2													Commission proposed
2006/7				CRD I entered into force									
2008/10			Commission proposed a revision to EU rules on deposits to improve depositor protection guarantee schemes	Commission proposed CRD II									
2008/12			Parliament adopted amendments										
2009/2	De Larosiere report		Council adopted amendments										
2009/6				Council recommended establishing a single rulebook									
2009/7				Commission proposed CRD III									
2009/9				Council and the European Parliament adopted CRD II	Commission proposed to set up ESRBs and ESAs				Turner review				
2010/6									British government established the Independent Commission on Banking (ICB)				
2010/7			Commission proposed a thorough revision of the Deposit Guarantee Schemes for harmonization and simplification.										Commission modified the proposal
2010/9					Parliament adopted the proposal				ICB published an issues paper			Commission proposed	
2010/11				Council and the European Parliament adopted CRD	Council adopted the proposal								
2011/1					ESRBs and ESAs started their work								
2011/4									ICB's interim report				
2011/7				Commission proposed CRD IV									
2011/9						Commission proposed a harmonized Financial Transaction Tax for the entire European Union			ICB's final report				
2011/11								Commissioner Michel Barnier set up High-level Expert Group					
2012/2												Parliament and Council reached agreement	
2012/5	Draft of 'Towards a Genuine Economic and Monetary Union' by President of the Commission												
2012/6	Euro area summit agreed to set up SSM before 2012						Commission proposed		Government published the white paper				
2012/7												European Parliament adopted	
2012/8												Entered into force	
2012/9	Commission proposed to set up SSM												
2012/10	Interim report of 'Towards a Genuine Economic and Monetary Union' by President of the Commission							Liikanen report			Government proposed a new law on separation and regulation of banking activities		
2012/12	Final report of 'Towards a Genuine Economic and Monetary Union' by President of the Commission											Commission adopted technical standards	
2013/2						Commission modified the proposal			Government published Banking Reform Bi	Government approved draft bank-separation law			
2013/3	Parliament and Council reached agreement												
2013/5								Stakeholders meeting on Bank Structural Reform		Bundestag approved the bank reform			
2013/6				Council and European Parliament adopted CRD IV									
2013/7		Proposed by the Commission		CRD IV entered into force							French parliament adopted the law		
2013/9	Parliament adopted the proposal												
2013/11	Entered into force												
2013/12			Parliament and Council reached agreement				Parliament and Council reache		Parliament adopted the banking reform bill				
2014/1				CRD IV applied				Commission proposed banking structural reform		Entered into force	Entered into force		
2014/2												Commission adopted new technical standards	
2014/3		Parliament and Council reached agreement											
2014/4		Parliament a	Parliament adopted the proposal										
2014/6			Enter into force										
2014/11	Fully operational												
2015/1		Entered into force					Entered into force						
2015/7										Deadline for the separation	Deadline for the separation		
2016/1		Fully operational(bail-in and resolution functions apply)											
2017/1								Deadline for the proprietary trading					
2018/7								Deadline for the separation					
2019/1									Deadline for the separation				