The First Leg of an Ambitious Project: Bargaining Power, Institutional Lock-in Effects and the Single Supervisory Mechanism

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ABSTRACT

The establishment of the Single Supervisory Mechanism (SSM), the first pillar of Banking Union, from 2012 to 2013 represents a radical change in how banking supervision is carried out in Europe and one of the most important steps towards European integration. After the resistance of the Member States to centralized banking supervision, legally unprecedented supervisory powers were invested in the European Central Bank, the ECB. The research question is therefore: how can we explain the establishment of the Single Supervisory Mechanism? According to the findings of this paper, negotiations on the SSM can be divided into two phases where the EU institutions, including the ECB, and the most influential Euro Area Member States were able to impose their preferences to different degrees. Whereas EU institutions and most notably the Commission and the ECB managed to lock-in Member States' positions by instrumentalizing functional pressures for reform in the summer of 2012, the EU leaders and especially Germany, Finland and the Netherlands got it all rolling and could impose their preferences on the sequencing of elements in the euro area leaders' political agreement in June 2012 and on the final SSM Regulation.

Keywords: Banking Union, European Central Bank (ECB), (Liberal) intergovernmentalism, Neofunctionalism, Single Supervisory Mechanism (SSM)

1. Introduction

The establishment of the Single Supervisory Mechanism (SSM) from 2012 to 2013 represents a radical change in how banking supervision is carried out in Europe and one of the most important steps towards European integration.

The SSM is the first pillar of the Banking Union. It sets up a centralized banking supervision for the Eurozone and non-Euro Member States willing to join. The second pillar is the Single Resolution Mechanism (SRM). It is responsible for restructuring and resolving troubled banks in the Eurozone. Negotiations on a potential third pillar, a European Deposit Insurance Scheme (EDIS), and on a common backstop for the single resolution fund, part of the SRM, are currently ongoing. Besides, a single rulebook was established to harmonise regulatory standards in the European financial sector. It applies in all Member States. The four main legislative texts are the Capital Requirements Directive 4 (CRD 4), the Capital Requirements Regulation (CRR), the Deposit Guarantee Scheme Directive (DGSD) and the Bank Recovery and Resolution Directive (BRRD).

The SSM became operational in November 2014 and its main task is to implement the single rulebook and to promote further harmonisation of EU regulation. It supervises directly the 123 largest and most systematically relevant Eurozone banks, which accounts for approx. 85 per cent of the total banking assets. The SSM can also supervise directly the remaining 3.500 less significant banks when it deems necessary to guarantee the consistent application of high prudential standards (ECB, 2015).

The SSM tasks include authorizing banks to operate and assessing their assets and liabilities to ensure compliance with the regulations on exposure limits, leverage, liquidity, transparency of information, and risk management processes (Council of the EU, 2013). Overall, the ECB is "vested with (rather) broad powers to determine and oversee supervisory practices" (Tröger, 2013, p. 10-11). In fact, the ECB is even equipped with a sanctioning power if an institution breaches acts of European Union law.

The SSM within the ECB and its corollary, a comprehensive assessment of the euro area's largest banks, constituted an impressive transfer of national sovereignty to the EU level. It constitutes the most centralized pillar of banking union with a strong ECB empowered as the European supervisory authority.

Puzzle and Research Question

In 2010, based on the recommendations of the De Larosière Report, the so-called "Lamfalussy Framework" was upgraded by three agencies with the legal competences to step in on individual credit institutions. The European System of Financial Supervision (ESFS) was set up for micro-prudential supervision at the European level. It is composed of the following three European Supervisory Authorities (ESAs): the European Banking Authority (EBA) for banking, the

European Securities and Markets Authority (ESMA) for securities and the European Insurance and Occupational Pensions Authority (EIOPA) for insurance (European Commission, 2009a).

The EBA was more of an intergovernmental regulatory body than an independent supervisory authority. For instance, the EBA showed little independent will when applying stress testing rigorously because of its limited capacity to restrict forbearance by national supervisors who overlooked toxic assets and insufficient capital buffers purposely (Financial Times, 2011; Véron, 2013; EurActiv, 2014). The main difficulty at that time was the extreme reluctance of the Member States and their supervisory authorities to exchange information (COM2, November 2016).

Real regulatory power remained in the hands of the national competent authorities as was the preference of many Member States and of those concerned with fiscal burdens and losses of sovereignty such as the UK, France and Germany. Germany demanded that the scope should be restricted to coordination only (Jones et al., 2015; GSC1, November 2016; Council of the EU, 2009a, 2009b).

At the June Euro Area Summit of 2012, the idea of granting the European Central Bank, the ECB, powers in micro-supervision was officially launched and the European Commission formally made a proposal for a Single Supervisory Mechanism in September of the same year. After the resistance of the Member States to centralized banking supervision, legally unprecedented powers were invested in the ECB, which also showed its own will to protect the Euro, which was contested by some Member States, especially Germany.

The research question is therefore: *how can we explain the establishment of the Single Supervisory Mechanism?* To answer this question, this paper aims at identifying the factors most relevant for such explanation. For this purpose, I trace how EU institutions and Member States' preferences and positions evolve and whether they are reflected in the outcome of the negotiations, namely the EU leaders' political agreement on the principle of a SSM within the ECB at the European Council in June 2012, and the final Council regulation setting up the SSM.

The paper analyses the power of these actors in influencing the negotiations on the establishment of the SSM. This could have a positive influence on EU citizen's awareness about the role of EU institutions, and more specifically the political role of the ECB in the SSM negotiations. Although EU negotiations affect our daily lives strongly, we have still a limited knowledge about the mechanisms and the role of power within those negotiations.

Only few theories such as LI, NF, operate at the nexus of explaining institutional change, on the one hand, and the interface of policy and politics, on the other hand. The paper looks at this case through the lens of (liberal) intergovernmentalism and neofunctionalism to construct a case-specific theoretical explanation for the outcome.

According to the findings of this paper, negotiations on the SSM can be divided into two phases where the EU institutions, including the ECB, and the most influential Euro Area Member States were able to impose their preferences to different degrees. Whereas EU institutions and most notably the Commission and the ECB managed to lock-in Member States' positions by instrumentalizing functional pressures for reform in the summer of 2012, the EU leaders and especially Germany, Finland and the Netherlands got it all rolling and managed to impose their preferences on the sequencing of elements in the European Council political agreement in June 2012 and on the final SSM Regulation.

This paper aims at contributing to two main bodies of scholarly literature. *First*, it adds to the emerging literature on politics and political economy of banking union (Salines et al. 2012; Howarth & Quaglia, 2013, 2014; Donnelly, 2013; Spendzharova, 2013; Schäfer, 2015; Epstein & Rhodes, 2016; De Rynck, 2016; Glöckler et al., 2016). *Second*, this paper contributes to the growing literature on EU decision-making dynamics and negotiating modes in the Euro-reforms, including incrementalism (e.g. Meny, 2014; Salines, Glöckler and Truchlewski, 2012), "new" intergovernmentalism (e.g. Bickerton, Hodson and Puetter, 2014; Puetter, 2014; Chang, 2013), and neofunctionalism (e.g. Schimmelfennig, 2014; Fabbrini, 2014). There remains much we do not know specially in the case of banking union reforms like the Single Supervisory Mechanism.

The paper is structured as follows. The first section explains the theoretical framework and the theoretical expectations. The following section outlines the preferences and positions of the actors, namely the larger euro area Member States and the EU institutions, on the most controversial issues during the negotiations on the SSM. Next, the negotiations outcomes are analysed looking at the influence of these actors and whether their preferences are reflected in these outcomes. The last section concludes.

2. Theoretical Framework: The Power-based Politics Approach

2.1 (Liberal) Intergovernmentalism: Decentralized Entrepreneurship

Liberal intergovernmentalism considers national governments as the key dominant actors in European integration and as rational actors which calculate the utility of alternative courses of action and choose the one that maximizes their utility under the circumstances (Moravcsik & Schimmelfennig, 2009). This is a highly complex process where some dynamics are common across states: "the primary interest of governments is to maintain themselves in office... this requires the support of a coalition of domestic voters, parties, interest groups and bureaucracies, whose views are transmitted, directly or indirectly, through domestic institutions and practices of political representation" (Rosamond, 2000, p. 137).

Bargaining theory argues that the outcome of interstate negotiations is determined by the relative bargaining power of the actors, i.e. power and resources available to the Member States, the existence of unilateral policy alternatives and threats of non-agreement, the size and strength of competing coalition of states and patterns of asymmetric interdependence (Moravcsik & Schimmelfennig, 2009). Here, a "coalition" is a set of parties that coordinate among themselves and defend the same position (Odell, 2010).

The power resources available to the Member States could include their GDP growth and stability of their banking sector. The most salient power resource in the case of banking supervision could be the size and diversification of the financial services sector, weighted by health. The advantages that a country with a healthy financial sector might be expected to have in international talks will be diminished if it is close to collapse.

Bargaining power is determined by asymmetries in the relative intensity of national preferences which reflect the costs and benefits of policy coordination to remove negative externalities (Moravcsik, 1993). State governments that gain less from agreement enjoy greater bargaining leverage. They might have a unilateral policy alternative and be in the position to threaten the others with non-agreement forcing them to make concessions.

Since a range of agreements preferred to the status quo can be derived from unilateral and coalitional policy alternatives, relative bargaining power may be determined by the intensity of preference at the margin. When there is time pressure, governments most in favor of agreement will make concessions. However, when there is not, the final agreement will reflect the relative intensity of preferences at the margin and the feasible set. It can be advantageous for governments to exchange concessions thereby adopting a package deal with advantages for all (Moravcsik, 1993).

Member States can use domestic constraints to achieve concessions and make package deals possible. Especially the producer groups have a disproportionate influence in EU decision-making since they can organize themselves much better than the consumer interests (Bailer, 2010; Schneider and Baltz, 2003). Some of the main interest groups whose preferences might be most influential are financial institutions, national regulatory authorities (i.e. national central banks and other authorities), and political parties.

If LI is applicable, I expect that the relative bargaining power of the Member States constitutes the main factor explaining the introduction of the SSM, and that the final regulation establishing the SSM reflects the preferences of the most powerful Member States. To see whether my liberal intergovernmentalist expectations hold, I look at the intensity of issue-specific preferences, for example, which countries have more intense preferences in reaching an agreement for cooperation and which ones not. I look at which countries might benefit more from the agreement, their power resources, i.e. ability to pay, and the vulnerability of certain Member States. I assume that Member States are asymmetrically interdependent. According to Dyson (2010), there exists creditor and debtor countries and this also plays a role in the interstate bargaining process. Creditor states are expected to have higher bargaining power due to their advantageous economic position vis à vis debtor countries.

TE1: *If Liberal Intergovernmentalism is applicable, then I expect that the relative bargaining power of Member States, together with their positions which reflect the interests of domestic actors, explain the euro area leaders' political agreement on the principle of a SSM within the ECB.*

TE2: *If Liberal Intergovernmentalism is applicable, then I expect that the final regulation establishing the SSM reflects for a great deal the preferences of the most powerful Member States.*

2.2 A Complementary Explanation: Functional Spillover and Lock-in Effects

Institutional constrains on Member States' preferences and bargaining positions are investigated since the establishment of the SSM did not happen in isolated events but in a succession of EU summits where Member States' balance of power was changing. Supranational actors like the European Commission and the ECB constitute relevant actors involved in the regulation of the EU financial services sector. Therefore, it seems convenient to consider spillover and path-dependence logics as potential explanatory factors.

Neofunctionalism looks at integration as a process rather than as isolated events as it is the case of intergovernmentalists. The main mechanisms driving integration and implying certain degree of automaticity are the concepts of spillover and path-dependence.

Functional spillover refers to the fact that the integration of one policy field can cause pressures on states which then inevitably must integrate other sector due to their interdependency and to possible unintended consequences or externalities (Wiener & Diez, 2009). I conceptualize functional spillover as the functional incentives to cooperate or arguments in favour of the introduction of the SSM.

Actors responsible for governance at the supranational level are considered to "cultivate" integration because they have interests in deeper integration. In the context of the EU this role is mainly played by the European Commission (Wiener & Diez, 2009). The Commission is which normally pushes for the transfer of competencies from Member States to the EU (Wonka, 2015). However, since the beginning of the crisis, the ECB has played an increasingly important role among the EU institutions to become a fundamental engine of integration. Also, it actively participates in the legislative discussions at the European Council. I conceptualize "cultivated spillover" as the role played by the Commission and the ECB in instrumentalizing the functional pressures for the establishment of the SSM. However, even though the Commission as a policy initiator has the first movement advantage, its agenda-setting power and capacity to cultivate integration mainly depend on its ability to instrumentalize functional pressures by advocating the advantages of further integration (Niemann & Schmitter, 2009; Pollack, 1997).

Commission's power is highest when it is backed up by a powerful Member State and in areas in which the Council decides by QMV (Niemann & Schmitter, 2009; Wonka, 2015). The Commission must not necessarily consider the preferences of all Member States when drafting its proposal but only the positions taken by those governments which are needed to form a sufficiently large majority coalition in the Council. Under unanimity, however, every Member States can threaten the Commission to veto its proposal, thus forcing it to make concessions.

The dynamic and complexity of spillover is likely to trap governments and expose them to unintended consequences triggered by previous commitments. Institutions such as the Economic and Monetary Union, the EMU, once set up, can become subject to lock in effects that constrain the behaviour of the actors who established them. According to Schimmelfennig (2015), crisis bargaining was very much constrained by unintended consequences and path-dependencies of the original decision to create a common currency. I conceptualize these institutional constraints looking at the functional pressures for calming financial markets in the context of an unprecedented banking and sovereign debt crisis and its unintended consequences for the Member States.

If NF is applicable, I expect that functional spillovers create incentives and demands on Member States to establish the SSM. I expect that previous institutional commitments like EMU constraint Member States decisions so the establishment of the SSM goes ahead primarily for the Eurozone countries that cannot extract themselves from the consequences of sovereign debt and bank crises and have to move forward. I expect the Commission and the ECB to play the leading role in the establishment of the SSM and that the preferences and interests of EU institutions can be found in the final SSM Regulation.

TE1: *If Neofunctionalism is applicable, then I expect that the preferences and position of the Member States, which are constrained by functional pressures instrumentalized by the Commission and the ECB to safeguard the Euro and the proper functioning of EMU, explain the euro area leaders' political agreement on the principle of a SSM within the ECB*.

TE2: *If Neofunctionalism is applicable, then I expect that the final regulation establishing the SSM reflects for a great deal the preferences of the European Commission, the ECB and the European Parliament.*

3. Explaining the Establishment of the Single Supervisory Mechanism

3.1 Negotiating the SSM: Key Events and Main Issues

In the week of the 28-29 June EU Summit, the Spanish Prime Minister Mariano Rajoy, after long hesitations, officially requested external financial assistance since the country could not borrow from the markets at such high costs any longer (Emmanouilidis, 2012). After this, the Member

States’ heads of government held a meeting in Rome in order to demonstrate a coming together ahead of the summit. However, due to their different positions on how to tackle the Spanish sovereign debt crisis problem, the need for short-term intervention in the markets and on how to achieve a greater political and financial union, common agreement was not possible (Financial Times, 2012a).

On 12 September 2012, acting on the decisions made at the Euro area summit, the Commission presented two legislative proposals: a Council regulation “conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions” (European Commission, 2012b); and a Regulation of the EP and of the Council amending EBA regulation. The latter was demanded by non-euro zone countries, among them the most vocal was the UK. They feared the adoption of financial legislation that would damage the British financial sector and that the EBA would be influenced by euro area Member states (Cameron, 2012). They demanded an EBA voting reform, a double majority of Member states inside and outside the SSM.

On 19 March 2013, an agreement on nearly all aspects of the SSM was made in informal meetings between the EP, Council and the Commission (EUobserver 2013a). A final vote in the EP was postponed until September 2013 due to disagreements between the EP and the ECB. The EP approved the establishment of the SSM in the eurozone in its plenary session on 12 September 2013 with a “sweeping majority” (Vogel, 2013).

The main controversial issues in the summer of 2012 were how to tackle Spain’s sovereign debt crisis and the vicious circle between its sovereign and its banks, whether to allow the use of ESM funds for the direct recapitalization of European banks, and the introduction of a SSM for the Euro zone as a solution to this problem. Here, the choice of the authority in charge of the new mechanism was also a controversial issue.

There were three options: to give supervisory powers to the ECB based on Article 127(6) TFEU; to transfer supervisory powers to an EU level authority like the existing EBA; or to create a new EU agency under the patronage of the Commission indirectly based on Article 114 TFEU or if not possible, based on the general treaty catch-all provision Article 352 TFEU (Deutsche Bank, 2012; CPEC, December 2016; CLS1, December 2016).

The main contentious elements of the Commission’s proposal for a Council regulation “conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions” were the scope of the new mechanism, its governance structure and the separation of monetary functions and supervisory tasks, and its timetable to start operating.

3.2 Actors' Preferences and Positions

Member States

Spain, France, and the Southern Coalition

In June 2012, Spain needed between €60bn to €100bn to recapitalize its cash-starved banks and sought to use the ESM for this purpose rather than asking Europe for a bailout which would increase its borrowing costs adding more debt to the country's balance sheet (Telegraph, 2012). The Spanish Finance Minister, Cristóbal Montoro, claimed that Spain did not have access to the financial markets and argued, "the amounts needed by the Spanish banking sector are perfectly feasible, they are not a big deal, what is necessary is that the European institutions look for ways for direct recapitalization to have more Europe, not to help anyone" (El País, 2012a, p.1, my translation).

The Italian Prime Minister Monti repeatedly insisted on using the ESM to decrease borrowing costs for Spain and Italy by buying sovereign bonds on the secondary market (Spiegel Online International, 2012c). Monti was under strong pressure from Italy's main parties to obtain successful results in the June EU Summit to get support for his economic reforms in the parliament (Financial Times, 2012a).

The French government became the voice of Spain, Italy and the so-called Southern coalition when Hollande supported Monti's proposal for using the ESM to buy debt of countries in the open market. He claimed, "We need to use all existing mechanisms to stabilise markets, to give confidence, to fight speculation" (Financial Times, 2012a, p. 1).

At the Euro Area Summit in June 2012, Spain, Italy and France formed the coalition of states that pushed for ESM support for direct recapitalization and for a fully-fledged European Banking Union including a SSM (El País, 2012b). These countries fully supported the idea of introducing a SSM because they were hoping that joint supervision would also mean a joint deposit guarantee scheme and joint resolution mechanism so that the responsibility for the banking sector would be a joint EU matter (GSC1, November 2016; GSC3, March 2017).

France, Italy, Spain and other countries of the Southern coalition also supported the Commission's proposal for the SSM regulation. They were in favour of the ECB as supervisory authority for two main reasons. First, these countries supported the idea of having a strong and powerful ECB supervisor because they hoped that once the ECB would take supervisory powers and responsibility, it would also take the economic responsibility. They saw it as their saving (GSC1, November 2016). In Spain, the president of Caixabank, Isidro Fainé, supported the introduction of a SSM to build credibility in Spain (El País, 2012d). Second, because of their financial situation, one could argue that they were not in the position to confront the ECB because they were extremely dependent on the ECB liquidity (COM2, November 2016).

Spain, France, Italy, Belgium and Luxembourg were in favour of a single system of supervision where all Eurozone banks would be under ECB direct supervision. Because of the characteristics of its national banking system and the problems of its *cajas*, Spain had an interest in having one single system including large and small banks (Bloomberg, 2012e; COM3, December 2016).

The French government supported the preferences of its four dominant and transnationally active bank groups (Groupe Crédit Agricole, BNP Paribas, Groupe BPCE and Société Générale) and demanded direct ECB supervision of all 6,000 lenders in the Eurozone (FBF, 2012; Crédit Agricole, 2014; BFM Business, 2012; Financial Times, 2012c; COM3, December 2016). For France, it was essential that all Eurozone banks would fall under the same supervision since its banking system was dominated by five large institutions which would all end up under the ECB's supervision (FBF, 2012; Moscovici, 2012).

In an informal meeting held in Malta with Hollande and the Prime Ministers of Italy, Spain and Portugal, Rajoy stated that, "Europe cannot be stopped. We want that Europe continues making progress, and that the decisions taken are respected agreeing on the SSM as soon as possible" (El País, 2012c, p. 2, my translation). French, Belgian and Italian finance ministers also pressed for fast progress (Bloomberg, 2012e). President Holland pushed for the rapid construction of the SSM to be fully operational in 2013 since Southern Europe needed recapitalization very urgently (Moscovici, 2012; Le Monde, 2012).

Germany and the Northern Coalition

German Chancellor Angela Merkel's position towards the EU during the euro zone crisis reflected predominantly the belief that the "mutualization of risks" had to go hand in hand with the "mutualization of responsibilities" (Merkel, 2011). The political narrative that solidarity could only be one side of the coin was shared mainly by the Netherlands and Finland conforming the so-called Northern coalition.

Ahead of the EU Summit in June 2012, in contrast to Spain, Italy, France and other Southern European countries, Germany, the Netherlands and Finland publicly opposed to direct bank recapitalization via the ESM (Beurs, 2012; Dutch government, 2012). Germany, the leader of this camp, preferred not to change the ESM's structure, which gives bailouts to countries with strict conditionality (Spiegel Online International, 2012c). The German finance Minister, Wolfgang Schäuble publicly opposed the use of the ESM for direct recapitalization since this instrument implies conditionality (Schäuble, 2014). The main political argument of the German government against ESM direct bank recapitalization was the protection of its taxpayers. The German government feared that German taxpayers' money, and perhaps the money of German banks, could be used to save troubled banks of mostly Southern European countries.

At the EU Summit in June 2012, the Northern coalition led by Germany pushed for European control as a prerequisite to allow for making ESM funds available to Spanish banks (Beurs, 2012; Dutch government, 2012; GSC1, November 2016). At the summit, Germany was asking for a SSM since it was not willing to just pour money into the badly supervised Spanish banks (GSC1, November 2016). In addition, Dutch Prime Minister Mark Rutte said that he, like the Finns, wanted conditions on Spain if the ESM funds were to bail out its banks (Spiegel Online International, 2012b).

To ensure that initial capital shortfall and legacy assets would be dealt with at the national level, Schäuble, backed by ministers from Sweden, the Netherlands and Poland, demanded the SSM to carry out a comprehensive assessment including an asset quality review and rigorous stress tests before it would start operating (Financial Times, 2012c; Bloomberg, 2012e; GSC1, November 2016). In a joint declaration after a meeting of their finance ministers in Helsinki, they argued that, "the ESM can take direct responsibility of problems that occur under the new supervision, but legacy assets should be under the responsibility of national authorities," (Finnish Ministry of Finance (2012); EurActiv, 2012, p. 1).

German finance minister Schäuble accepted the political agreement and the need for a SSM with reluctance fearing that after joint supervision, there would also be the need for a joint deposit guarantee scheme and joint resolution. The coalition parties FDP (*Freie Demokratische Partei*) and CDU (*Christlich Demokratische Union Deutschlands*) were far from enthusiastic about the idea of a Banking Union, with FDP MPs saying that a Banking Union would be "a new admittedly creative way to tap German solvency" and that "every eurozone country has to take responsibility for its own banks" (EU Business, 2012, p.1).

Germany like the Commission, see below, was not fully thrilled towards the option of the ECB (COM2, November 2016; EP1, December 2016; CLS2, February 2017; PR3, February 2017). But at the end it had no choice but to support the idea of taking the ECB as European supervisory authority based on Article 127(6) TFEU. Among other reasons, choosing another independent body would have needed a treaty change. Germany pushed for a credible SSM. In a speech in 2012, Merkel said, "The situation in Spain has shown how important it is to strengthen the banking sector and minimize the risks of contagion between banks and state finances. For this purpose, we need a credible European banking supervision that reacts in an objective way having no regard for national interests" (Merkel, 2012a, p. 2, my translation).

Germany pushed therefore for keeping monetary policy and the new supervisory tasks of the ECB strictly separated because it was afraid that the ECB could use monetary tools to complement its new supervisory tasks (Reuters, 2012; COM3, December 2016; COM2, November 2016). In the Treaty, the decision-maker is the Governing Council, which oversees monetary policy. Therefore, Germany demanded to keep the ECB Governing Council as far as possible from the decision-making process in the SSM and insisted on the creation of a separate supervisory body in the ECB (COM1, March 2016; PR3, February 2017). The Netherlands also supported the separation of tasks within the ECB (Dutch government, 2012).

Germany pushed for single supervision only for systemic banks or that receive bailouts (Politico, 2012; Schäuble, 2012; COM3, December 2016). Merkel advocated a limited scope including only systemically relevant banks thereby excluding the *Landesbanks* and *Sparkassen* from direct ECB oversight (Financial Times, 2012b; Merkel, 2012a; GSC1, November 2016). Germany believed that the ECB was never going to be able to supervise all 6,000 banks. This position was also shared by Belgium despite its concentrated banking system (PR2, February 2017). But more importantly, Germany wanted to shield its regional savings banks in which mainly German conservative politicians are from ECB direct supervision (COM2, November 2016). These banks are considered as having a public function in the country with strong ties to local and regional governments and traditionally dependent on them for financial support (Süddeutsche Zeitung, 2012).

German cooperative and savings banks vehemently opposed to being supervised by the ECB arguing that they do not pose systemic risk (Financial Times, 2012b; BVR, VöB, DSGV, 2012). They wanted that only the biggest systemic relevant financial institutions to be subject to direct ECB supervision because of their size and internationalization (BVR, VöB, DSGV, 2012). On the contrary, the president of the German private banking association strongly supported the centralization of supervision of all banks to the European level as way to end the privileges that the German public banks had in the German market (Financial Times, 2012b; BDB, 2012a, 2012b, 2013, 2014).

In contrast to Germany, the Netherlands supported direct ECB supervision of all euro area banks (Dutch government, 2012). The country's three largest banks, ING, Rabobank and ABN Amro, had a very strong interest in European supervision. All the small and local Dutch cooperative banks were part of bigger groups and participated in joint liability schemes with Rabobank (Howarth and Quaglia, 2016). In a statement of the Dutch Ministry of Finance, it is stated that, "the Cabinet is in favour of the European supervision of all banks of the euro area because of the risks that also groups of small and middle size banks can pose to the national and European financial stability" (Dutch Ministry of Finance, 2012, p. 6, my translation).

During the negotiations on the SSM, the Northern coalition led by Germany followed the "go-slow approach" arguing that "quality has to go before speed" and considered the deadline of 1 January 2013 for the start of the SSM as not realistic (Bloomberg, 2012d; Dutch government, 2012; Dutch Ministry of Finance, 2012). Many others in the European Council, including Finland and Slovakia, supported this (Jones et al., 2015).

Table 1. Member States' Preferences on the Establishment of the SSM

Issues	France and the Southern Coalition	Germany and the Northern Coalition
SSM Political Agreement		
ESM Direct bank recapitalization	In favour	Against
Principle of a SSM	In favour	In favour
Principle of a SSM within the ECB	In favour	Against
SSM Regulation		
Start of SSM	1 January 2013	No firm deadline Comprehensive assessment first
Scope of SSM	Single system All 6,000 banks	DE: Only big, systemically important banks NL: All 6,000 banks
Separation of monetary and supervisory tasks	In favour	(Strongly) in favour

Source: own elaboration

Spain, France, Italy and other Southern European countries had intense preferences on allowing the ESM to directly recapitalize their banks and to purchase sovereign bonds in the secondary market. Germany, on the contrary, did not have intense preferences on this. Germany and countries that form the Northern coalition such as then Netherlands and Finland, had the best alternative for non-agreement, which was the status quo. They were not in the necessity of achieving a successful outcome in the SSM negotiations as fast as possible.

Northern European countries such as Germany, the Netherlands, Sweden and Finland, have survived to the crisis better than France and Southern European countries like Spain and Portugal. Germany is considered the biggest economy in the EU and the Member State with the highest rate of GDP growth from 2011 to 2013 (The Economist, 2011). It is able to save its banks if necessary. They have higher bargaining leverage in the negotiations and have the power to impose conditions since the decision-making rule of the SSM Regulation is unanimity and their vote is necessary to have an agreement.

On the contrary, Spain and countries of the Southern coalition are the most interested and eager to reach an agreement. Their bargaining power is therefore lower. Spain had one of the lowest percentages of GDP growth from 2011 until 2013. From the perspective of the financial markets, during the crisis and before the intervention by the ECB, there was a huge rise in the risk premia of the periphery government debt in comparison with the German bond (Gual, 2013). At the end of 2012, the French national banking system had one of the highest percentages (assets as a percentage of total bank assets) of exposure to at-risk countries like Spain and Italy (21.9) (BIS, 2012; Howarth & Quaglia, 2016). Moreover, this country had one of the lowest GDP growths in 2012 and 2013. During these years, the country's public debt raised to a record level. France was the weakest of the Eurozone triple AAA (Financial Times, 2011).

EU institutions

In June 2012, the President of the European Council, Herman Van Rompuy, published the report "Towards a genuine Economic and Monetary Union", which was drafted in close collaboration with the presidents of the Commission, the Eurogroup and the ECB. The Four Presidents' Report proposed a stronger EMU architecture putting forward far-reaching proposals for integrated frameworks for budgetary matters, economic policy and for the financial sector (Van Rompuy, 2012). It favoured an "integrated financial framework to ensure financial stability in particular in the euro area and (to) minimize 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" (Van Rompuy, 2012a, p. 3).

The report proposed the principles of what later became the Banking Union which was designed to tackle the sovereign-bank nexus and the enforcement problems of national regulation in an integrated financial market. The establishment of a SSM, part of the banking union project, was considered a necessary step to restore confidence in European banking systems and – in words of the European Council President Herman van Rompuy (2012) – "complete" EMU, thus saving the euro and protecting it better from future shocks. On 12 September 2012, the European Commission published the report "A Roadmap towards a Banking Union".

The ECB together with the Commission promoted the need for a centralized supervision and resolution of banks calling for a banking union (De Rynck, 2016; Epstein & Rhodes, 2016; The Wall Street Journal, 2012). The EP had also already a vision of what the banking union should be and pushed for joint supervision, joint resolution and joint deposit guarantee scheme when the legislative proposal of the EBA was negotiated in 2010 (EP ECON Committee, 2010, Art. 12a-12e; EP1, December 2016).

When the financial crisis turned into a sovereign debt crisis in countries like Spain in the course of 2011 and 2012, there were truly existential questions about the Euro Area and its survival. At this point, the political narrative adopted especially by the EU institutions was that to save the euro it was necessary to take banking supervision out of the hands of the national supervisors because that is what maintained the vicious link between banks and sovereigns (CPEC, December 2016). The ECB saw these arrangements as the only way to "break the adverse link between banks and sovereigns in some euro area Member States and to reverse the current process of financial market fragmentation in the euro area" (ECB 2012a, p. 2).

The use of the ESM for direct bank recapitalization was considered by some people to be part of the banking union since it was the trigger to start negotiations on the SSM (GSC1, November 2016). For this reason, the Commission and the ECB heavily supported direct recapitalization via the ESM (Emmanouilidis, 2012). The ECB President Mario Draghi suggested that the ESM could be used to recapitalize banks (The Wall Street Journal, 2012). Using the ESM funds for direct recapitalization was the only way to break the “vicious circle” between banks and sovereigns. The Commission and the ECB were very cleverly linking it all to the Spanish banking crisis and the need to use the ESM funds for direct bank recapitalization (GSC1, November 2016).

Originally, the Commission had preferences for creating something new which would not be the ECB. Because of many reasons like the potential conflicts of interests between monetary policy and supervision, it wanted to build the single supervisor under the Article 114 TFEU as an agency. This article relates to the functioning of the Internal Market and the decision-making rule is QMV under co-decision. Although the Commission did not want this power, it saw the ECB as just one option because from a legal point of view, it was not obvious that supervisory tasks should be read as supervision. Otherwise, the Treaty would speak about entrusting supervision to the ECB. Basically, there were fears within the Commission that the ECB would become an extremely powerful institution and an engine of European integration (GSC1, November 2016; COM2, November 2016; CLS2, February 2017). However, after the European Council conclusions, the Commission supported the option of the ECB and never came back on that. Initially, the EP supported the Commission’s idea to use Article 114 since it was ordinary legislative procedure whereas Article 127(6) was consultation (CLS1, December 2016; PR3, February 2017).

There was a readiness of the ECB side to take this power, which was new. The previous president Trichet was more reluctant about the ECB taking over banking supervision (CPEC, December 2016). According to the Four Presidents’ Report, these powers should be conferred on the ECB. At the end, the Commission was told by the Commission and the Council legal services that there was an explicit and specific legal base in the treaty which is Article 127(6) that foresees that if this function is created, it should be seated in the ECB (COM3, December 2016). The Commission’s proposal is therefore based on Article 127(6) of the TFEU. It requires unanimity in the Council and the EP has the right of consultation (European Commission, 2012b).

Concerning the Commission’s proposal, the ECB Governing Council assigns the supervisory tasks to a new body within the ECB: the supervisory board (European Commission, 2012b). Due to the urgency of setting up an effective SSM, it proposes the 1 January 2013 as the date for the entry into force of the Council regulation. From this date, the ECB can apply its supervisory tasks to any banks, in particular banks which have received or requested public financial assistance, while the most significant credit institutions of European systemic importance shall be subject to ECB supervision as of 1 July 2013. The ECB will assume in full its tasks in relation to all other banks as from 1 January 2014 at the latest (European Commission, 2012b).

The ECB and the EP supported the Commission's proposal of allocating all supervisory competences to the ECB, regardless of the size of the banks (EP2, February 2017). The ECB President Mario Draghi stated that a decisive supervisor should include oversight of all 6,000 banks to guarantee a level playing field (Financial Times, 2012b). The European commissioner for the Internal Market in charge of the reform, Michel Barnier, also pushed for a strong single supervisory mechanism "with real teeth" (Bloomberg, 2012a; Bloomberg, 2013)

The EP pushed for a strict separation between monetary policy and supervisory tasks within the ECB (EP1, December 2016). Besides this, its preferences had one central point: the democratic accountability of the ECB as the main actor in the SSM. The EP was "uncomfortable with the ECB's high degree of political independence" (Gilmore, 2013). It wanted to be the body to which the SSM is accountable (EP1, December 2016). The EP wanted to have access to minutes of the ECB's Supervisory Board, while the central bank feared that sensitive information could reach the public and therefore, was only willing to disclose a summary of the board's proceedings.

The EP demanded that the two pieces of legislation for the establishment of the SSM should be treated together, namely under the ordinary legislative procedure thereby enhancing the bargaining position of the EP (Politico, 2012; CLS1, December 2016). From the beginning, the EP made clear that it would make its approval for the new amendments of the EBA, on the voting arrangements, dependent on the Council's concession to include the EP in the legislative process of the SSM Regulation (Bundesministerium der Finanzen, 2013; CLS1, December 2016).

Table 2. EU Institutions' Preferences on the Establishment of the SSM

Issues	European Commission	ECB	European Parliament
SSM Political Agreement			
ESM Direct bank recapitalization	In favour	In favour	In favour
Principle of a SSM	In favour	In favour	In favour
Principle of a SSM within the ECB	In favour	(Strongly) in favour	In favour
SSM Regulation			
Start of SSM	1 January 2013	1 January 2013	1 January 2013
Scope of SSM	Single system All 6,000 banks	Single system All 6,000 banks	Single system All 6,000 banks
Separation of monetary and supervisory tasks	In favour	In favour	In favour

Source: own elaboration

3.3 Actors' Influence on the Outcome

At the 28-29 June EU Summit, Euro area leaders agreed, after long discussions, on the need to break the "vicious circle between banks and sovereigns". They agreed on two immediate measures to calm the markets in Spain and Italy: direct bank recapitalization, which could be possible when the Member States would not be able to do so, and EFSF/ESM support without a full programme (Emmanouilidis, 2012; Bloomberg, 2013). In addition, the Commission was asked to prepare soon proposals for a SSM involving the ECB and the Council should consider the proposals as a matter of great urgency by the end of 2012 (European Council, 2012). The Euro Area Summit statement stated:

> We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalise banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which could be institution-specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding (Euro Area Summit Statement, 28 June 2012, p. 1).

A compromise between the two coalitions was reflected in the statement of the Eurozone leaders after the summit in June 2012. Euro area leaders agreed, on the one hand, on the possibility of ESM direct bank recapitalization and, on the other hand, on the creation of a SSM for the euro zone. Although a compromise was found, the key is the *sequencing* of elements. The ESM direct bank recapitalization instrument would entail appropriate conditionality through a Memorandum of Understanding and would only be possible after an effective single supervisory mechanism involving the ECB would be in place (Bloomberg, 2012b).

Germany and other countries of the Northern coalition were able to influence the negotiations on the establishment of an ESM direct bank recapitalization instrument by setting the sequencing of the elements in the compromise. They demanded the introduction of a SSM as a control mechanism and as a necessary condition for creating an ESM direct bank recapitalization instrument which was later not used because of Germany's list of conditions.

EU leaders' agreement on the creation of a SSM was a fake condition because although the ESM direct recapitalization instrument was agreed, it was never used at the end. Spain did not get access to ESM funds for direct recapitalization but instead received a loan with conditionality via the Sovereign. Despite being part of the picture at the beginning, it was killed from the inside because of German insistence on a plenty of conditions which make it unusable (COM2, November 2016).

In the following summit in October 2012, Merkel won a major victory over Hollande and Rajoy by backtracking on the June summit agreement to use the ESM to recapitalize banks directly and pushing back the SSM due to German elections in September 2013 (Telegraph, 2012).

Only in June 2014 did the Euro Area Members reach a political agreement on the conditions on which the ESM will be able to recapitalize banks directly. The ESM direct recapitalization instrument was adopted on 8 December 2015 by the ESM Board of Governors (ESM, 2014).

France and the Southern European countries supported the creation of a SSM and were eager to reach an agreement since this constituted a pre-condition for getting access to ESM funds for direct bank recapitalisation. Moreover, Spain since the election of Rajoy was closer to Germany for political reasons (COM3, December 2016).

Table 3. Actors' positions and outcome of the negotiations on the SSM political agreement

Issues	France and the Southern Coalition + EU institutions	Germany and the Northern Coalition	Outcome
ESM direct bank recapitalization	In favour	Against	ESM direct bank recapitalization
Principle of a SSM	In favour	In favour	SSM
Principle of a SSM within the ECB	In favour	Against	SSM within ECB

Source: Own elaboration

The relative bargaining power of the Member States, especially that of Germany, Finland and the Netherlands, and their need for a credible commitment can explain the sequencing of elements in the compromise to introduce the SSM, but it cannot explain why Germany and the countries of the Northern coalition accepted the creation of an ESM direct bank recapitalization instrument which triggered the political agreement on the principle of a SSM within the ECB.

The preferences and positions of these Member States were constrained by the functional pressures to safeguard the functioning of EMU, which were instrumentalized by the European Commission, the ECB, and the President of the European Council Van Rompuy before and during the summit in June 2012. France, Spain and Italy also put pressure on Germany to accept a SSM within the ECB (CLS2, February 2017).

Germany needed these countries' agreement on the Stability and Growth Pact during this time and was pressured by Italy, Spain, and France, to agree on giving the euro zone's permanent rescue fund, the ESM, the power to give aid directly to troubled banks (Spiegel Online International, 2012a). The political narrative based on functional pressures for reform and the importance of saving the Euro in the context of a banking and sovereign debt crisis in Spain made the Member States' cost-benefit analysis changed (PR1, February 2017; CLS2, February 2012).

There were fears that financial markets would lose trust in the Euro, which would be a major issue for the Northern countries, and more especially for Germany, who profits highly from the position of the Euro (Moravcsik 2012). At the end of 2012, the German national banking system had one of the highest percentages (assets as a percentage of total bank assets) of exposure to at-risk countries such as Spain and Italy (25.9) (Howarth & Quaglia, 2016).

These conditions facilitated the influence of EU institutions in the negotiations, which strategically instrumentalized functional demands for breaking the vicious circle between banks and sovereigns, and the establishment of a SSM and eventually a banking union for the euro zone. This can be seen in the numerous reports and communications from the Commission, the ECB, and the European Council President like the Four Presidents Report and the Commission's report "A Roadmap towards a Banking Union", among others.

There were two possibilities: ESM intervention, leaving supervision at national level, or SSM, and possible liabilities would then be reduced since this mechanism would be in place (COM1, March 2016; CPEC, December 2016). And the idea of the SSM was officially launched by President Van Rompuy (2012) when he called for an integrated supervision on the European level (Van Rompuy, 2012a).

Besides this, Member States' political agreement on the principle of a SSM within the ECB was also partly due to smart manoeuvring from Mario Draghi, the President of the ECB. The ECB realized that there was time pressure and therefore less reluctance to give the ECB a role in banking supervision. The President of the European Council and the President of the ECB managed during the night to extract the reference to the creation of the SSM based on the very treaty article which refers to the ECB, Article 127(6) TFEU (COM2, November 2016).

Given the potential impact that supervisory measures may have on public finances and the markets in the participating Member States, and because of the Meroni jurisprudence, according to which EU agencies cannot make discretionary decisions, the only possibility was an EU institution (CLS2, February 2017). An agency under the Commission would not have started with the same credibility as the supervision under the ECB because there was already Article 127(6) through which it was legally possible and relatively straightforward because only the unanimous Council was needed to agree to it, and the ECB was an existing entity with a solid reputation (CPEC, December 2016; GSC1, November 2016).

As a result, not only the EU leaders' but also the Commission were trapped by the European Council conclusions of June 2012 so the Commission's proposal had to look for ways to establish the SSM within the ECB (COM2, November 2016). Interestingly, this was very little contested by the Member States, also not by Germany (COM5, February 2017). The ECB, therefore, influenced the negotiations at the highest political level at the European Council while it was undertaking unconventional monetary policies like the Outright Monetary Transactions (OMT) and the Quantitative Easing (CLS2, February 2017). This circumstance indirectly gave the ECB political power and facilitated the creation of a group of Southern European countries which were naturally nodding to whatever request of the ECB (COM2, November 2016).

The EU leaders' political agreement on the principle of a SSM was therefore a short-time and quick decision. It was seen as a strategy to calm the financial markets because its entry into force was delayed by the Northern coalition led by Germany during the negotiations in September and October 2012 once the crisis abated.

Although the Commission, the ECB and the European Council President framed the SSM and the SRM as the two main pillars of banking union and therefore as a legislative package in the Four Presidents' Report, this received, however, only a lukewarm response when it was presented to the European Council with all 27 Member States represented. It was endorsed in the summit but EU leaders could not agree on anything (PR3, February 2017). The SRM was thought about, but not agreed because the negotiations on the bail-in provisions part of the Bank Recovery and Resolution Directive (BRRD) were still ongoing (COM4, January 2017). The European Council conclusions tersely state:

> Following an open exchange of views, where various opinions were expressed, <u>the President of the European Council was invited to develop, in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the ECB, a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union</u>, which will include concrete proposals on preserving the unity and integrity of the Single Market in financial services and which will take account of the Euro Area statement and, inter alia, of the intention of the Commission to bring forward proposals under Article 127 (European Council conclusions, 28-29 June 2012, p. 3).

Despite widely reported and announced by the Commission after the euro area summit 2012, all that was agreed then was the SSM and not banking union (GSC1, November 2016; GSC3, March 2017; PR1, February 2017). According to the Dutch government, Banking Union was not agreed in the EU Summit in June 2012 or in the next months of September and October 2012. The statement of the Dutch government states that, "Besides a SSM, a banking union also comprises a European Deposit guarantee scheme and a European resolution fund and authority. […] A European public backstop may also be required. No agreements have yet been reached in the European Council in these areas. However, the four presidents, led by Mr Van Rompuy, are working on a road map which fleshes out the steps toward a full banking union" (Dutch government, 2012, p. 7, my translation).

SSM Regulation and Operational Start

The SSM Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions, with the aim of contributing to the safety of credit institutions and the stability of the financial system within EMU (Council of the EU, 2013).

The ECB has the following main tasks in relation to all credit institutions established in the euro area Member States and non-euro area Member States willing to join: to authorise credit institutions and to withdraw authorisations of credit institutions; to assess their assets and liabilities to ensure compliance with the regulations on exposure limits, leverage, liquidity, transparency of information, and risk management processes; and to carry out supervisory reviews, where appropriate in coordination with EBA, stress tests and their possible publication (Council of the EU, 2013, Article 4).

In contrast to the Commission's proposal and the preferences of the ECB and the Southern European countries, the entry into force of the SSM Regulation was 3 November 2013 and the start of the SSM operations was 4 November 2014 because of the transitional year agreed to carry out a comprehensive assessment. This comprehensive assessment, including an asset quality review, of the credit institutions of the participating Member States, as well as rigorous stress tests, was foreseen in Article 33 of the SSM Regulation (Council of the EU, 2013).

The final regulation then reflected the preferences of Germany, the Netherlands and Finland which at the EU Summit on 18-19 October 2012 demanded for more careful deliberation on the SSM institutional design and detailed information on the operational criteria of the ESM which delayed the start of the ECB as European supervisor in detriment of the Spanish demands for saving its cash-starved banks (European Council, 2014; Jones et al., 2015).

Scope of Supervision

In the euro area (and countries outside the euro area wishing to join) the SSM empowers the ECB to directly supervise large financial institutions since their safety and soundness is essential to ensure stability of the financial system. However, since smaller institutions can also pose a threat to financial stability, the ECB exercises supervisory tasks in relation to all credit institutions authorised in participating Member States (Council of the EU, 2013).

The ECB has all the tasks of banking supervision defined in Article 4 of the Regulation. However, for the financial institutions set out in Article 6(4) of the Regulation, which are deemed "less significant", the ECB shall exercise some supervisory functions, set out in Article 6(5), mainly general instructions, and the national competent authorities shall exercise the rest of the functions, Article 6(6). The significance shall be assessed based on the following criteria, set up in Article 6: (i) size; (ii) importance for the economy of the Union or any participating Member State; (iii) significance of cross-border activities (Council of the EU, 2013).

In practice, this means that the ECB directly supervises all large banks, and the national competent authorities the rest. However, the ECB has a manual override, set out in Article 6(5): "When necessary to ensure consistent application of high supervisory standards, the ECB may at any time, on its own initiative after consulting with national competent authorities or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions referred to in paragraph 4, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM" (Council of the EU, 2013).

At the end, a two-level system with a centralized level (ECB) and a decentralized level (national competent authorities) was a compromise between those who, like the Commission, France and the Southern European countries, preferred a single system covering all 6,000 euro banks and Germany who preferred not to include its smaller banks under the ECB supervision. It was a typical European compromise because all euro zone banks are not covered upfront but the ECB may move in and take supervision directly of any bank in Europe, including the German *Sparkassen* (COM3, December 2016; GSC1, November 2016).

In this element of the SSM Regulation, although the French government, its finance ministry officials and banks regularly expressed their concern since its banking system was dominated by five large institutions, which would all end up under the ECB's supervision, Germany's preferences prevailed over those of other Member States. However, Germany's preferences were not fully reflected in the outcome since, although indirectly supervised, whenever the ECB wishes to, it can move in the *Landesbanken* and *Sparkassen*.

Governance Structure and Separation from Monetary Policy Function

The SSM is defined in Article 6 of the Regulation as being composed of the ECB and national competent authorities. Due to their long-established expertise in the supervision of credit institutions within their territory and their specificities, national competent authorities shall assist the ECB in the exercise of its supervisory tasks (Council of the EU, 2013).

In the Regulation, it is mentioned that monetary policy functions and supervisory tasks should be carried out in full separation to avoid conflicts of interests and to guarantee that each function is exercised according to the applicable objectives. A Single Supervisory Board (SSB) in charge of preparing decisions on supervisory matters should be established within the ECB. This Board should be chaired by a Chair, have a Vice Chair, and include four representatives from the ECB and one representative of the national competent authority in each participating Member State. The EBA and the Commission can be invited as observers (Council of the EU, 2013).

The draft decisions of this Board would be deemed adopted by the ECB unless expressly rejected by the ECB Governing Council within 10 days, as set up in Article 26 of the Regulation. In principle, the Governing Council adopts the decision proposed by the SSB by silence procedure and it is only exceptionally that they intervene explicitly.

However, due to the legal constraints to create a truly independent body within the ECB, recital 85 of the SSM Regulation indicates that "the TFEU could be amended to make the ordinary legislative procedure applicable and to eliminate some of the legal constraints it currently places on the design of the SSM (e.g. […] and go even further in the internal separation of decision making on monetary policy and on supervision)" (Council of the EU, 2013).

Here the German position on having a clear separation between monetary policy and supervisory tasks within the ECB can be seen in these last provisions of the Regulation. To separate both ECB's tasks, the ECB was obliged to set up a SSB responsible for supervision. Germany, backed up by the Netherlands and Finland, was the one who more strongly demanded the so-called Chinese wall between these two functions. And the position of Germany is still very strongly in favour of establishing a clearer separation of tasks and it is one of the things they want to change when revising the Treaties (COM3, December 2016).

Accountability and Reporting

The ECB should be accountable for the exercise of its supervisory tasks towards the EP and the Council as democratically legitimized institutions representing the EU citizens and the Member States. That should include regular reporting, and responding orally or in writing to questions by the EP, and by the Eurogroup (Council of the EU, 2013).

At the request of the EP, the Chair of the SSB of the ECB can also participate in hearings on the exercise of its supervisory tasks by the ECON committee of the EP. In the EP, there is a Banking Union Working Group where all political groups of the ECON committee are represented (EP1, December 2016). In addition, upon request, the Chair of the SSB, Danièle Nouy, shall hold confidential oral discussions behind closed doors with the Chair and Vice-Chairs of the ECON committee of the EP concerning its supervisory tasks, Article 20 (Council of the EU, 2013). And together with the Council, the EP has a joint role in the appointment of the Chair and Vice Chair of the Supervisory Board and in initiating their dismissal.

These accountability provisions of the regulation were neither in the Commission's proposal nor in the Council general approach, and mostly reflected the preferences of the EP. The EP obtained these concessions during the informal meetings with the Commission and the Council Presidency after strategically linking the Commission's proposal for the SSM Regulation and the amendment of the EBA Regulation since the decision-making procedure for the SSM Regulation was consultation and not ordinary legislative procedure as in the EBA regulation. Even in the Council there was no direct opposition to it because the Member States, especially Germany and France, wanted the agreement to proceed quickly for the financial markets (CLS1, December 2016).

The compromise allows for a comprehensive and meaningful record of the meetings (Gilmore, 2013). The green parliamentary Sven Giegold, responsible for the negotiations together with

Marianne Thyssen, noted that "the European Parliament obtained strong control mechanisms, beyond what national parliaments usually have" (EU Observer 2013c, p. 1).

Table 4. Actors' positions and outcome of the negotiations on the SSM Regulation

Issues	France and the Southern Coalition + EU institutions	Germany and the Northern Coalition	Outcome
Start of SSM	1 January 2013	No firm deadline	4 November 2014 1 transitional year for comprehensive assessment
Scope of SSM	Single system All 6,000 banks	DE: Only big, systemically important banks NL: All 6,000 banks	Two-level system ECB supervises 120 big banks directly, delegating the day-to-day supervision for smaller banks to national supervisors
Separation of monetary and supervisory tasks	In favour	(Strongly) in favour	Single Supervisory Board Governing Council adopts SSB decision by silence procedure

Source: Own elaboration

In general, the preferences of the most powerful Member States, Germany and countries of the so-called Northern coalition like Finland and the Netherlands, are reflected in the substantive provisions of the main issues of the SSM Regulation. On the insistence of these countries, the operational start of the SSM was delayed to the 4 November 2014 due to the introduction of a transitional year before the start of the SSM with a comprehensive assessment including an asset quality review and stress tests of the financial institutions in the euro area. Moreover, instead of a single system covering all 6,000 banks of the euro zone as it was preferred especially by the Commission, France and the Southern European countries, a two-level system is created where certain small regional banks like the German *Sparkassen* deemed "less significant" are not directly supervised by the ECB. In addition, a SSB is created responsible for supervisory decisions whereas the ECB Governing Council takes the final decision by the silence procedure.

These elements were not in the Commission's proposal for the SSM but were introduced and imposed during the negotiations within the Council most notably at Germany's insistence. During the decision-making process under unanimity in the Council, the preferences of the most powerful Member States prevailed over those of France and the Southern European Member States. Their preferences also prevailed over those of the Commission because the Commission absolutely wanted to have an agreement (PR2, February 2017). Therefore, the second liberal intergovernmentalist expectation holds since the SSM Regulation reflects for a great deal the preferences of the most powerful Member States, namely Germany, Finland and the Netherlands.

However, even though the preferences of these countries are reflected in the final regulation, the Commission played a very important role because of its speed in making the proposal just nine weeks later after the European Council summit of June 2012 (COM5, February 2017). There was political momentum and the Commission pushed for more integration and did it in a very short period of time taking advantage of the urgency and the necessity of the agreement (PR1, February 2017). But the Commission' proposal was significantly altered due to demands especially from Germany, Finland and the Netherlands.

Interestingly, it was the EP which got a strong role in the SSM Regulation even though it had consultation only since it strategically linked both files and because at that time there was a group of members of the ECON committee of different parties who although had different views on many things, managed to cooperate and have influence by taking a strong position against the Council (CLS1, December 2016; EP2, February 2017).

4. Conclusion

The aim of this paper was to explain the establishment of the SSM by looking at the political dynamics behind this outcome. The negotiations on the first leg of banking union were divided into two main decision-making moments: the EU leaders' political agreement on the principle of a SSM within the ECB at the European Council summit of June 2012; and the negotiations on the Commission's proposal for setting up the SSM.

Following the first liberal intergovernmentalist expectation, the relative bargaining power of the Member States, especially that of Germany, Finland and the Netherlands, and their need for a credible commitment, can explain the *sequencing* of elements in the compromise to introduce the SSM, but it cannot explain why Germany and these countries of the Northern coalition accepted the creation of an ESM direct bank recapitalization instrument which triggered the political agreement on the principle of a SSM within the ECB. Therefore, in accordance with the first neofunctionalist expectation, the preferences and positions of these Member States were constrained by the functional pressures to safeguard the functioning of EMU, which were instrumentalized by the European Commission, the ECB, and the President of the European Council Van Rompuy before and during the summit in June 2012.

The political narrative based on functional pressures for reform and the importance of saving the Euro in the context of a banking and sovereign debt crisis in Spain made these Member States' cost-benefit analysis changed (PR1, February 2017; CLS2, February 2012). These conditions facilitated the influence of EU institutions in the negotiations, which strategically instrumentalized functional demands for breaking the vicious circle between banks and sovereigns, and for the establishment of a SSM for the euro zone. This can be seen in the timing and content of the numerous reports and communications from the Commission, the ECB, and the European Council President like the Four Presidents Report and the Commission's report "A Roadmap towards a Banking Union".

France, Spain and Italy joined the position of the EU institutions and put pressure on Germany to accept the ESM direct recapitalization instrument and a SSM within the ECB (CLS2, February

2017). Although it was Germany the one who asked for a SSM, France and the Southern European countries hoped that an SSM would lead to a SRM and a single deposit guarantee scheme as next steps in the banking union project thereby lifting the responsibility for their banks to the European level.

Besides this, the ECB realized that there was time pressure and therefore less reluctance to give the ECB a role in banking supervision. The President of the European Council and the President of the ECB managed during the night to extract the reference to the creation of the SSM based on the very treaty article which refers to the ECB, Article 127(6) TFEU (COM2, November 2016). As a result, not only the EU leaders' but also the Commission were trapped by the European Council conclusions of June 2012 (COM2, November 2016).

During the negotiations on the SSM Regulation, the preferences of the most powerful Member States prevailed over those of France and the Southern European Member States. Their preferences also prevailed over those of the Commission because the Commission absolutely wanted to have an agreement (PR2, February 2017).

On the insistence of these countries, the operational start of the SSM was delayed to the 4 November 2014 due to the introduction of a transitional year with a comprehensive assessment including an asset quality review and stress tests of the financial institutions in the euro area. Moreover, instead of a single system covering all 6,000 banks of the euro zone as it was preferred especially by the Commission, France and the Southern European countries, a two-level system was created where certain small regional banks like the German *Sparkassen* deemed "less significant" are not directly supervised by the ECB. In addition, a SSB was created responsible for supervisory decisions whereas the ECB Governing Council takes the final decision by the silence procedure. Therefore, the second liberal intergovernmentalist expectation holds since the SSM Regulation reflects for a great deal the preferences of the most powerful Member States, namely Germany, Finland and the Netherlands.

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Annex

List of interviewees:

Acronym	Position	Date	Place
European Council			
Cabinet of the Presidency of the European Council			
CPEC	Official	December 2016	Brussels
European Commission			
COM1	Official	March 2016	Brussels
COM2	Senior Official	November 2016	Brussels
COM3	Senior Official	December 2016	Brussels
COM4	Official	January 2017	Brussels
COM5	Senior Official	February 2017	Brussels
Council of the European Union			
General Secretariat of the Council			
GSC1	Senior Official	November 2016	Brussels
GSC2	Official	November 2016	Brussels
GSC3	Official	March 2017	By phone
Council Legal Service			
CLS1	Official	December 2016	Brussels
CLS2	Senior Official	February 2017	Brussels
Permanent Representations			
PR1	Senior Official	February 2017	Brussels
PR2	Official	February 2017	Brussels
PR3	Official	February 2017	Berlin
European Parliament			
EP1	Member of Parliament Assistant	December 2016	Brussels
EP2	Senior Official	February 2017	Brussels