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Coming Together or Moving Apart?

PANEL: ***European (dis) integration? The political and the economic dimension***

"The European Central Bank as the sole integration engine left?" The Role of the European Central Bank in Saving the European Economy

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The Role of the European Central Bank in Saving the European Economy

Faced with a dangerous resurgence of Euro-scepticism, revealed in different events and upheld by different political groups, both in the most recent EU member states and among the very founding members (including Italy), the European Central Bank, in our opinion, has been able to effectively bond Europe together in a moment of deep economic crisis and inability to start new cooperative policies. Since October 2008, the Governing Council of the ECB has launched numerous non-standard monetary policy measures, refinancing operations, long-term credits for commercial banks in the euro area, monetary easing (by purchasing public and private bonds for 60 and then 80 billion euro a month) in order to support banks and countries in dire straits. In 2012 the ECB took a political stance (with the famous "whatever it takes" speech by Mario Draghi), it decided to exercise its political leadership and remarkably it worked, reining in the costs incurred by governments for servicing their countries' public debt. That same year the ECB also became a champion of a regulatory revolution deciding to swiftly introduce the banking union - the biggest integration project after the single currency. The banking union led to the creation of the Single Supervisory Mechanism (SSM), which became operational in November 2014 to “ensure the safety and soundness of the European banking system”. The ECB thus became responsible for the direct supervision of the 119 most significant banks of the participating countries (these banks hold almost 82% of banking assets in the euro area). The national authorities retain the direct supervision of the less important institutions, of which, however, the ECB can claim direct surveillance. As a result of these processes, a path of economic growth has been resumed in most of the euro area countries, deflation has been averted and the new banking regulations have made the system more transparent and stable.

1. The ECB role in the first phase of the 2008 crisis

The crisis that arose in 2008 can be divided into two phases and the ECB played an important role in both of them.[1] As a brief premise, we can say that the crisis originated in the United States when due to a slowdown in the American economy, thousands of citizens were no longer able to continue paying the mortgage on their house and the banks around the world that had investments related to those mortgages (having bought derivatives that contained them) began to lose money. Because of insufficient information about the capitalization of European banks and their exposure to derivatives, confidence in the market collapsed along with interbank lending, paralyzing the European banking system. The EU Commission, finance ministers and directors of the central banks realized that banking supervision was rather opaque and began to think that the surveillance system should be centralized and banks should be made more transparent.

Several German, French, British, Irish, Danish, Dutch and Belgian banks had heavily invested in the (risky) American mortgage market, nonetheless they were promptly supported by their governments at a considerable cost (bail out): the volume of aid totalled 1.6 trillion euro between 2008 and 2011 (around 13% of the annual EU GNP). [2] The ECB also intervened with several and substantial refinancing operations (by means of reduced rate tenders) with the aim of providing the necessary amount of liquidity to troubled banks. Between 5 and 15 October 2008 the Governing Council issued a first package of unconventional measures, namely refinancing operations through fixed rate tenders (at 3.75%) showing unmistakable willingness to offer unlimited amounts of liquidity. However, the situation did not improve and therefore on March 11th 2009 the rate on these transactions fell to 1.5%: in June, 442 billion euro were allocated to 1121 euro area banks. In total,

[1] F Fauri, *L’Unione Europea: una storia economica*, Il Mulino, 2017.
[2]http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis/why_did_the_crisis_happen/index_en.htm. From now on: Commissione, “Why did the crisis happen”.

the net liquidity provided by the ECB to the banking system in these early years amounted to €525.3 billion.[3]

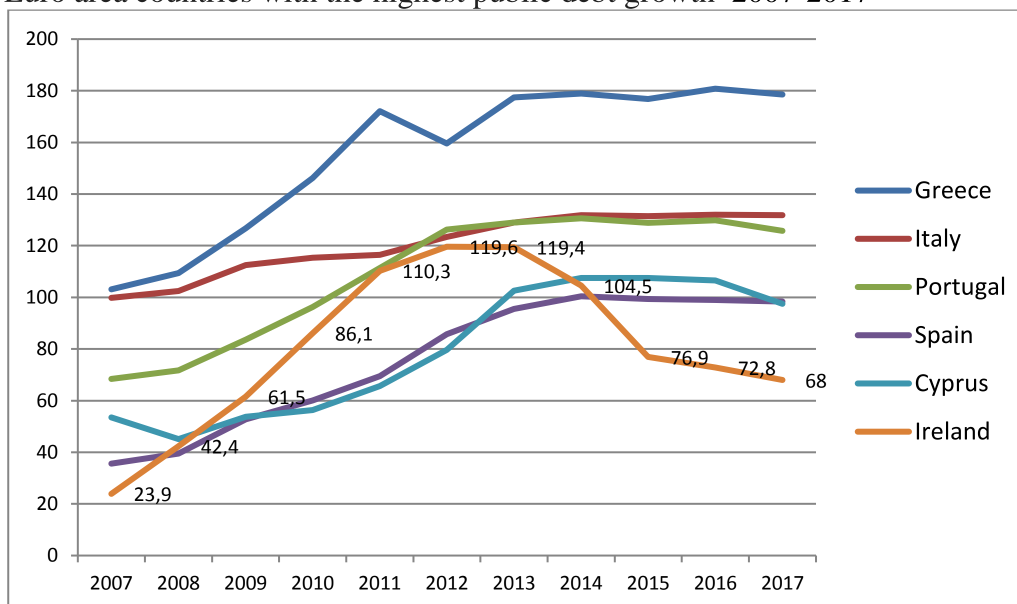
This was the first major ECB test as a lender of last resort (LLR) in times of crisis and it passed it. [4] Today, the literature is quite consistent on the fact that the European Central Bank has fully assumed the role of LLR since the first monetary policy measures of 2008.[5] The ECB injected into the Euro-system liquid assets in a massive and timely manner avoiding the emergence of a generalized banking crisis. The intervention on the debt crisis at the beginning was perhaps less convincing, but credibility was promptly restored by 2010 and asset purchase programs were increasingly introduced to support economic growth across the euro area (see below).

With their unlimited firepower, central banks are the only institutions capable of stabilizing the financial system. The ECB has finally recognized an ancient truth when it decided to engage in the unlimited purchase of government bonds: in times of crisis the European Central Bank is the only credible and effective LLR within the eurozone, since it is the only bank that can provide liquidity without limits and prior warning. [6]

2. The second phase of the crisis

The second phase of the crisis was triggered by the use of fiscal policy to bring recession to a halt, which ended up developing budget deficits. The result was a rapid increase in public debt, which led directly to the sovereign debt crisis.[7]

Figure 1
Euro area countries with the highest public debt growth 2007-2017



Source: own elaborations from Eurostat

[3] A.Banfi e F. Di Pasquali, L'operatività della Banca Centrale Europea negli anni della crisi, in Bancaria, 7/8 2012, pp.91-93.

[4] De Grauwe, *Economia dell'integrazione europea*, Bologna, Il Mulino, 2016, p.217.

[5] W. Buiter e E. Rahbari, "The European Central Bank as Lender of Last Resort for Sovereigns in the Eurozone" in *Journal of Common Market Studies*, vol. 50, 2012, pp.6-35. S. Eichler, K. Hielscher, "Does the ECB act as a lender of last resort during the subprime lending crisis? Evidence from monetary policy reaction models" in *Journal of International Money and Finance*, 31, 2012, pp.552-568.

[6] P. De Grauwe, "The European Central Bank as Lender of Last Resort in the Government Bond Market" in *CESifo Economic Studies*, vol. 59, 3, 2013 pp.520-35.

[7] Baldwin e Wyplosz, *The Economics of European Integration*, p.510. See also: G. K. Zestos, *The Global Financial Crisis From US subprime mortgages to European sovereign debt.*, Routledge, 2016.

Eurozone banks and governments were trapped in a tangled web: on the one hand the banks had bought large amounts of government bonds to ensure real support for the country's finances, on the other hand the state had performed a (too) lenient supervision on the banking system.[8] What began as a banking crisis soon became a sovereign debt crisis. The high indebtedness of some states had in fact reduced the bank's bailout capacity and had triggered strong speculative movements.[9] Financial speculation, sensing the Eurozone's (political) weaknesses, attacked the most vulnerable countries at risk of default and/or exit from the euro.

In contrast to the readiness to provide massive aid to the banks, this time the ECB was more reluctant to provide the necessary liquidity to government bond markets. But in 2010, with the onset of the Greek crisis, the ECB intervened through refinancing operations and the purchase of state bonds under stress (first Greek, then Italian, Spanish, Portuguese and Irish) in order to reining in the costs incurred by governments for servicing their countries' increasing public debt (this operation was called *Securities market program*, Smp – see Table 1). ECB intervention succeeded in having a large and persistent effect on a decline in the yields of the intervened bonds in the most distressed sovereign debt markets: in the case of Greece by about 165 basis points on average.[10]

Moreover, in that same year, seventeen eurozone countries decided to set up the European Financial Stability Facility (EFSF - known today as the European Stability Mechanism) to help countries in need during the sovereign debt crisis. The Facility offered financial assistance to euro area countries, provided they committed to undertake certain reforms (aimed at preventing the recurrence of similar crises). The ECB thus led joint financial assistance operations, often with the International Monetary Fund, and began to help the most troubled eurozone countries that required support: Greece, Ireland, Cyprus, Portugal and Spain. The contagion of the Greek crisis to the other countries was thus avoided through this joint intervention (as shown in Fig. 2).[11]

Fig.2 Joint financial assistance to the troubled euro area countries 2010-2015 (€ bn)

- The IMF did not provide financial assistance to Spain - European funds are: EFSF, EFSM, ESM
- Ireland could also count on 17,5 billion of internal funds

Source: own calculations from *EU Financial Assistance* https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance_en.

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[8] https://europa.eu/european-union/topics/economic-monetary-affairs_it e anche European Commission, European Economy, *Economic Crisis in Europe: Causes, Consequences and Responses*, 7, 2009, EC – DGECFIN.
[9] EU Commission, "Why did the crisis happen" and R. Baldwin C. Wyplosz, *The Economics of the European Integration*, McGraw-Hill, Berkshire, 2015, pp.495-510.
[10] Christoph Trebesch and Jeromin Zettelmeyer, "ECB Interventions in Distressed Sovereign Debt Markets: The Case of Greek Bonds", PIE Working Paper, 18-1 January 2018.
[11] Baldwin e Wyplosz, *The economics*, p.487.

The Greek sovereign debt crisis caused the fall of the government, a 6.8% decline in GDP in 2011 and a record unemployment rate that reached 27% in 2013. Nevertheless, the generous EU-IMF loans and the ensuing financial stabilization appeased market fears and avoided the "Grexit" - the exit of Greece from the EU. The intervention in favour of Ireland materialized soon after: starting from December 2010, a joint assistance program for €85 billion enabled the country to support the collapse of its major banks. In the following years, Ireland was the first EU country to successfully bring to a close a joint macroeconomic assistance program: government debt as a percentage of GDP declined from 119 to 68 percent (see Fig.1) and real GDP growth reached 4.8% by 2014. Today the Celtic Tiger no longer depends on international financial assistance.

EU financial assistance was then requested by other countries that had fallen into difficulties: Portugal, Cyprus and Spain, and thanks to prompt and well-calibrated interventions, the sovereign debt crisis was put under control (and did not seriously affect Italy, where the rescue cost would have been significant).[12] Furthermore, in 2011 and 2012 timely injections of liquidity such as the two loans to European banks for over €1 tr. at negligible rates (called Ltro or long term refinancing operations see Table 1) were also provided.

But the decisive signal that stopped the speculative activities on the debt crisis came from Mario Draghi in July 2012. In his famous speech, he declared in fact that the euro was irreversible and that the Central Bank would have preserved it at all costs:

> *We think the euro is irreversible. And it's not an empty word now, because I preceded saying exactly what actions have been made, are being made to make it irreversible. But there is another message I want to tell you. Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.*[13]

The ECB had thus decided to exercise its political leadership, the message was strong enough to change market expectations and the eventual bond buying operation was never started. The ECB president had in fact soon after announced the launch of a three-year bank refinancing operation (in September) through the purchase of unlimited amounts of government bonds if necessary (a program known as Omt or Outright Monetary Transactions – see Table 1). But real interest rates on government debt in most distressed EU countries declined substantially, without the ECB actually proceeding with purchases of state bonds. It was enough for the Central Bank to declare its commitment to intervene to cool speculation down while bond yields started dropping.[14]

In the following Table, we have listed all non-conventional or non-standard measures the European Central Bank has put into place since the 2008 crisis broke out.

[12] D. Heisenberg, "From the Single Market to the Single Currency" in D. Dinan, *Origins and Evolution of the European Union*, Oxford University Press, 2014, p.246 sgg.

[13] Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London, 26 July 2012, Sito BCE.

[14] L. Rapone, *Storia dell'integrazione europea*, Carocci, 2015 p.165

TABLE 1 The ECB non-standard monetary policy measures since 2008

2008-2010	*First non-standard measures* The ECB bought covered bonds for a total of € 525,3 bn
2010-2012	*Securities markets program - Smp* The ECB launched a program for the purchase of government bonds issued in euro on the secondary market with simultaneous sterilization. Thus, the program did not change central bank liquidity, but helped restore the appropriate functioning of the monetary policy transmission mechanism.
2012	*Compulsory reserve ratio reduction* In January the ECB reduced the compulsory reserve ratio from 2 to 1%.
2011-12	*Long term refinancing operations - Ltro (Big Bertha)* The ECB lent money at very low interest rates (1%) to eurozone banks. On December 22, 2011, 523 banks participated in the LTRO auction for €489.191 bn; on February 29, 2012, 800 banks participated in the LTRO auction for € 529.53 bn.
2012	*Outright monetary transactions - Omt* These purchases of government bonds on the secondary market have never been activated, but the message was strong enough to change market expectations and curb speculation on government bonds.
2014	*Targeted long term refinancing operations-* (TLTROs) They provided financing to euro area credit institutions with a maturity of up to four years at attractive conditions. They were meant to provide incentives for bank lending to the real economy. Overall, outstanding TLTRO credit stood at €761 billion at end of March 2017.
2014	*Asset-backed securities – Abs* ABS are part of the ECB's asset purchase programme with the aim of helping banks to fulfil their main role: providing credit to the real economy.
2014	*Forward guidance* The ECB started providing information about its future monetary policy intentions, based on its assessment of the outlook for price stability.
2014	*Banking Union* based on: the *Single Supervisory Mechanism* (SSM) and the *Single Resolution Mechanism* (SRM)
2015	*Quantitative Easing* The ECB started buying predetermined amounts of government bonds from commercial banks in March 2015 in order to inject money into the euro area, support economic growth and help inflation levels return below, but close to, 2% Under this programme ECB purchases between March 2015 and September 2016 have amounted to €1.14 trillion, corresponding to 11.3% of 2014 euro area nominal GDP.[15]
2014-6	*Negative Deposit Facility Rate* The interest rate on deposits with the central bank in two years went down from 0.10% to -0.40%.[16]

Source: BCE and Bundesbank online site, www.Sole 24 Ore.com; E. Marelli, M. Signorelli, *Politica Economica. Le politiche economiche nel nuovo scenario europeo e globale,* Giapppichelli, Torino, 2015, p.330 sgg.

This active commitment by the ECB continued in subsequent years, in particular to reverse the deflationary tendencies. In 2014, the Governing Council of the ECB initiated a new program for the purchase of asset-backed securities (ABS) and guaranteed government bonds in order to inject liquidity into the system. And from 2015 the Quantitative Easing (QE) was introduced, that is a monetary easing operation consisting in the ECB's acquisition of government bonds for €60 billion a month "until September 2016 or even later until the inflation does not take a sustained path towards 2%".[17] In March 2016, this government bonds purchase program rose by €20 billion a month, reaching €80 billion, and then in August of the same year Draghi announced that the QE would extended to 2017.[18]

[15] L. Gambetti, A. Musso, "The macroeconomic impact of the ECB's expanded asset purchase programme (APP)", ECB Working Paper Series No 2075 / June2017.

[16] When policy rates enter negative territory, high-deposit banks increase risk-taking which in turn reduces financial constraints for higher risk firms. Glenn Schepens, "Bank lending under negative policy rates" in *Research Bulletin*, No. 43 13 February 2018.

[17] A. Merli, "QE si parte con 60 miliardi al mese" in *Il sole 24 ore,* 23 gennaio 2015.

[18]http://www.repubblica.it/economia/2016/12/08/news/bce_draghi_quantitative_easing-153692315/
http://www.repubblica.it/economia/2016/03/10/news/bce_tassi_interesse_qe_draghi-135165475/

The most immediate and striking impact was the weakening of the exchange rate and its positive effect on exports. Finally, in March 2017 the eurozone was out of the feared deflation territory with the inflation rate back around 2%. Not only that, also bank credit has finally increased - in January 2017 loans to businesses grew by 2.3% on an annual basis while lending rates to companies dropped by 113 basis points. [19]

3. The evolution of European financial supervision and the role of the ECB: the first phase

According to several economic observers, the main responsibility for the financial crisis, which broke out in 2008 in the USA and quickly spread to Europe, is found in the failure of European banking supervision and regulatory functions, which had been organized on a national basis while the banking sector had become international.[20] The lack of centralized banking supervision prevented the ECB, for example, from taking measures to control the hypertrophic expansion of bank credit in the pre-crisis years. In parallel, even the national control systems worked poorly: the supervision performed by the individual central banks of the national credit system through inspection checks aimed at avoiding the occurrence of systemic crises and was not able to prevent abnormal credit growth. The crisis also brought to light the opacity of European banking supervision, and it soon became clear that information on the capitalization of banks and their exposure to derivatives was insufficient. A good preventive treatment of financial crises consists, in the words of Asdrubali, of increasing "micro-economic supervision of banks and financial intermediaries and centralizing regulation to optimize the capital requirements and accounting standards of financial institutions."[21]

In particular, the aforementioned crisis highlighted some of the problems in the supervision of financial institutions in Europe, which had, however, already emerged. In fact, in October 2008, the European Commission commissioned a group of experts chaired by Jacques de Larosière, an internationally renowned banker (and former Governor of the Bank of France), to formulate a report containing proposals to strengthen the European regulatory framework across all financial sectors.
In February 2009, the report was published and highlighted the following issues:

- The absence of macro-prudential supervision;
- The lack of early warning mechanisms; and
- The differences between the national micro-prudential supervisory systems (structures, rules, powers, sanctioning systems). In particular, it recognized:
  - The lack of cooperation between national supervisory authorities;
  - The impossibility of common decision-making processes between the supervisory authorities;
  - The impossibility to contest surveillance practices on a "cross-border" basis; and
  - The insufficient endowment of resources of the level three Committees.[22]

The de Larosière report was very innovative in that it proposed regulatory arrangements in which micro- and macro-prudential supervision are jointly deployed and the interactions with economic policies are also taken into account. Specifically, the de Larosière model proposed to:

- Set up a European body responsible for macro-prudential supervision to monitor systemic risk; and
- Replace the level three Committees, made up of representatives of the national supervisory authorities, with the same number of European supervisory authorities to confer a certain number

[19] A. Merli, "Due anni di Qe in aiuto all'Eurozona" in *Il sole 24 ore*, 8 marzo 2017.
[20] De Grauwe, *Economia dell'integrazione monetaria*, 2016, p.266. Heisenberg, "From the Single Market to the Single Currency" p.249.
[21] P. Asdrubali DG ECFIN, "Epidemie Finanziarie: Patologia e Terapia della Crisi Globale", Seminario presso l'Università di Bologna, Campus di Forlì, 26 aprile 2012.
[22] The Level 3 Committees were introduced by the Lamfalussy Committee's Final Report, the Committee of Wise Men chaired by Lamfalussy, which in 2001 issued proposals to speed up the regulatory process and harmonize supervision within the European Union. In particular, the approach to European regulation was divided into 4 levels and the Level 3 Committees (CEBS, CEIOPS and CESR) were established between 2001 and 2004 and are the forerunners of the current European Supervisory Authorities (ESAs).

of powers, and in particular:
- To give binding addresses to national authorities;
- To make decisions directly applicable to financial intermediaries;
- To prepare binding technical standards; and
- To have the responsibility to authorize and monitor certain specific institutions within the European scope (for example, the rating agencies).

The Expert Group chaired by de Larosière therefore identified a new European System of Financial Supervision (ESFS) (see Figure 3) to be applied to all European countries, which became operational on January 1st, 2011.

In detail, the new ESFS is made up of several organizations:

• The European Systemic Risk Board (ESRB), which is responsible for macro-prudential oversight of the financial system (based in Frankfurt);

• Three European Supervisory Authorities (ESAs), which are sector-specific with micro-prudential supervisory tasks and are the heirs to the level three Committees (same offices):

-The European Banking Authority (EBA), based in London;
-The European Securities and Markets Authority (ESMA), based in Paris; and
-The European Insurance and Occupational Pensions Authority (EIOPA), based in Frankfurt.

We can therefore also identify two distinct phases of ECB intervention in supervision, as described for monetary policy. In the first phase, which ended in 2010, macro-prudential supervision was entrusted to the European Systemic Risk Board (ESRB), which went live on December 16, 2010, when the relevant founding regulation also came into force (EU Regulation No. 1092/2010).

The scope of the activity of the ESRB is not limited to the banking system because it has to control insurances, asset management companies, shadow banking entities, financial market infrastructure, and other financial markets and institutions. In pursuing its macro-prudential mandate, the ESRB monitors and assesses systemic risks and issues reports and recommendations. It has a decision-making body, the General Council, chaired by the ECB President, and a Steering Committee, which sees the presence of the ECB Vice-President as well as the President of the ESRB.

In this first phase, the three ESAs, which are EU agencies with their legal personality represented by their respective presidents, were also created. They develop regulatory and implementation technical standards, which are then adopted by the Commission; they also issue guidelines and recommendations and intervene when there are breaches of EU law by national supervisory authorities and in the case of emergency situations and disagreements between national competent authorities.

The main decision-making body of each ESA is the Supervisory Board, which is composed of the chairman, the head of the competent supervisory authority of each Member State, and a representative of the following entities: the Commission, the ECB, the ESRB and the other two ESAs.

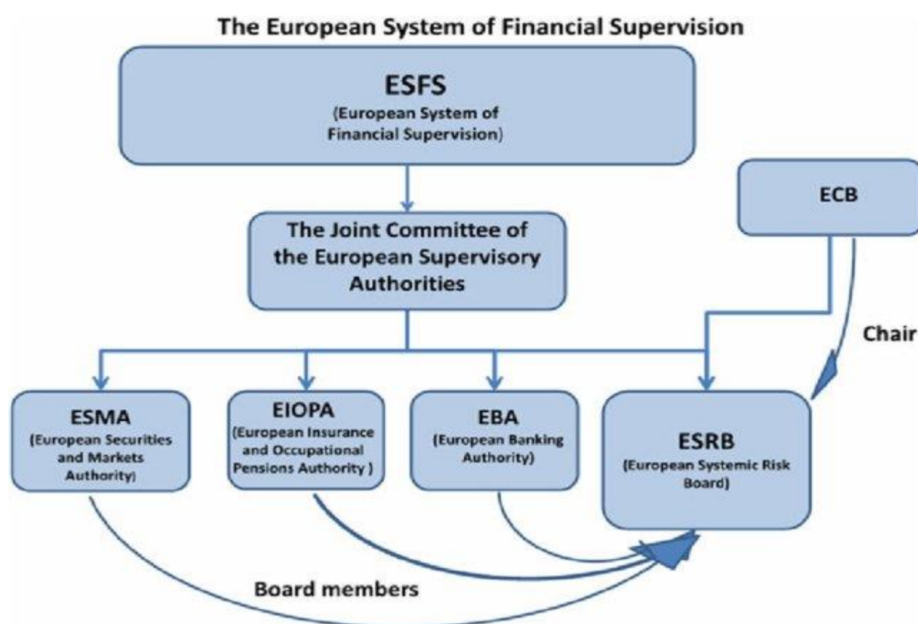
Although the ESRB is quite complex, the relevance of the role of the ECB is indeed evident: it is in charge of an important part of the responsibility for macroprudential oversight of the European financial system through the activity of the ESRB. In addition, a representative of the ECB is appointed to the Board of each ESA.

4. The evolution of European financial supervision and the role of the ECB: the second phase

The new European System of Financial Supervision (ESFS) had to be able to avoid other financial crises. On the contrary, very soon, in 2012, the fears for holding the Monetary Union highlighted the need to break the "vicious circle" between banks and sovereign debt caused by the fragmentation of domestic markets.

It was thus evident that banks, from an operational point of view, were the most integrated financial institutions in the single market but that the controls on their activity were held by the individual States. The latter were no longer able to rescue a large banking group with their debt if it entered into a crisis. It became clear that individual countries had to accept the delegation of elements of their sovereignty to more solid supranational supervisory institutions.

Figure 3. The European System of Financial Supervision (ESFS).



Source: ECB

Consequently, in June 2012, the euro area Heads of State and Government set up the Banking Union in order to make the Eurozone banking systems less tied to sovereign debt. This ambitious project includes, as well as a uniform regulation (single rulebook), the following pillars:

- A single supervisory mechanism;
- A single resolution mechanism; and
- A common deposit guarantee scheme.

The Banking Union project, considered the most important integration project after the single currency, has developed rapidly with regard to the implementation of the first two pillars but has had more difficulties with the third, which still remains an incomplete project.

The implementation of the first pillar of the Banking Union, the Single Supervisory Mechanism (SSM), took place by launching EU Regulation no. 1024/2013 (the Regulation on the Single Supervisory Mechanism) on October 15, 2013, which specifically assigns to the ECB new tasks related to the prudential supervision of credit institutions. The latter Regulation represents, together with the "Framework Regulation on the Single Supervisory Mechanism" n. 468/2014 of the ECB, the main reference source at the European level for the exercise of banking supervision; the Framework Regulation also establishes in detail the division of competences and the modalities of collaboration between the ECB and the National Competent Authorities (NCAs).

Although the ECB is given considerable responsibility, the whole system involves national supervisory authorities, both in the decision-making processes and in the supervisory enforcement

phase, achieving "an adequate balance between unitary system and operational decentralization." The sharing of responsibilities between the ECB and the national competent authorities (NCAs) is based on the concept of significance, which allows a distinction to be made between more significant banks and less significant banks in the euro area. The criteria by which the significance of a credit institution is determined are the following: the size of the bank, the importance of the bank for the EU economy or for any participating member country, and the relevance of its cross-border activities.

In particular, a credit institution is considered "significant" if at least one of the following conditions is met:

• The total value of its assets exceeds thirty billion euros;

• The ratio between its total assets and the GDP of the member country within which the institution is established exceeds 20%, with the exception of entities whose total asset value does not exceed five billion euro;

• It is considered one of the three most significant credit institutions in a member state;

• It can receive direct assistance from the European Stability Mechanism; and

• The total value of its assets exceeds five billion euro, and the ratio between its cross-border assets (or liabilities) held in more than one member country and its total assets (or liabilities) is more than 20%.

The SSM became operational in November 2014. Since then, the ECB has become responsible for the direct supervision of "significant banks" (in 2016, a total of 125 banking groups in the 19 Eurozone countries, which accounted for 82% of total bank assets). According to the latest data published, as of April 1, 2018, ECB direct supervision involves 118 European banking groups.

The national competent authorities (NCAs) are delegated the direct supervision of the other "less significant" institutions (in 2016, a total of 3200 institutions), of which the ECB can, however, acquire direct surveillance. In any case, the NCAs adhere to the guidelines issued by the ECB. Consequently, credit institutions subject to decentralized supervision are promptly informed about the decisions of the SSM regarding the transfer of the supervisory functions to the ECB, or vice versa.[23].

According to the Framework Regulation, the ECB is also responsible for authorizing credit institutions, ensuring compliance with regulatory and prudential requirements, and other regulatory requirements. In addition, the ECB cooperates closely with the other authorities that make up the ESFS, and in particular with the EBA, whose duties were partly redefined to avoid possible conflicts with the ECB.

Cooperation between the ECB and national competent authorities, as well as any relationship with supervised entities, is achieved through the establishment of ad hoc structures by the ECB and the so-called joint supervisory groups, called Joint Supervisory Teams (JST), which are trained both by the ECB staff and by national supervisors of the countries where the banks are located.

For each significant bank supervised, a special JST has been formed, and the size, nature and risk profile of the bank determines the organizational structure of the same supervisory group. In particular, such a JST has the task of exercising supervision over banks under its responsibility and for implementing the decisions approved by the Supervisory Board and the Governing Council. At the head of each joint supervisory unit is an ECB coordinator (usually of different nationality with respect to the subject monitored), who is responsible for the implementation of supervisory activities.

The SSM, the first pillar of the Banking Union, was implemented rapidly, not having encountered any significant internal conflicts in the euro area. In addition, it was noted that a single

[23] Regardless of the aforementioned criteria, the SSM in accordance with Article 6 of the Regulation, can qualify as significant an institution or an intermediary, in order to ensure supervision with a higher quality standard. According to the indications of Article 43 of the Framework Regulation, the ECB verifies the possession by the supervised entities of the requisites regarding the significance on an annual basis; with the same frequency the national supervisory authorities assess the situations of the other intermediaries as less significant, in order to verify whether the conditions can exist for them to be subject to direct supervision by the ECB. If a credit institution or a significant group is not able to meet the above criteria for three consecutive calendar years, it may be retrained as a less significant institution.

supervisory function could not cope with the countless fragmentations and multiple systemic contagions that the long years of crisis have brought to light.

The single supervisory mechanism had to be assisted by another supranational instrument of the same scale, in order to be able to standardize the models for the reorganization and resolution of those banks in which the ECB had recently become responsible for supervisory purposes.

In fact, if the funding of bank resolutions had remained with national governments, it would not have been possible to break the vicious circle between sovereign debt and those of the banks. Therefore, an attempt was made to remedy this situation with a Single Resolution Mechanism (second pillar) for banks controlled directly by the ECB.[24] Basically, they wanted to create a unitary mechanism that was, first of all, able to strengthen crisis prevention, and second, to change the impact these had on stakeholders. What they wanted to avoid were the generalized forms of sharing costs due to the insolvency of a bank, which in some way placed the debt burden of its bankruptcy on the community.

The first step toward the definition of the new mechanism was carried out by the Directive 59/2014/EU, the Bank Recovery and Resolution Directive (BRRD). Although the latter has harmonized procedures, it has retained discretionary power at the national level. Accordingly, the various states maintained a wide margin of decision-making, which could accentuate differences in administrative practices.

Since 2016, this gap has been filled with the creation of the Single Resolution Mechanism (SRM), which has made it possible to reduce the burden of damage to taxpayers and to greatly reduce the pressure on public budgets.[25]

The SRM operates with the assistance of the national competent authorities (NCAs) as well. In particular, a single resolution authority (the Single Resolution Board, or the SRB) was established, and as a complement to it, a Single Resolution Fund (SRF) was set up to finance resolution programs.

The main objective was the financial stability of the Eurozone using the instruments set up by the BRRD, in coordination with a process of centralization of bank insolvency resolution procedures through the allocation of decision-making powers to the SRB. This was expected to allow for more rapid and effective management of bank insolvencies and not having to resort to a regulatory framework based on the division of responsibilities between national supervisory authorities, where a lack of, or a partial coordination between, could result in inefficiencies in decision-making that would be difficult to manage.

The regulatory agreement on the establishment of the SRM is the Regulation 806/2014, while the mode of operation of the SRF, as well as the pooling of funds and their transfer, were reassigned to a separate intergovernmental agreement signed by member countries adhering to the Banking Union. The signing of the agreement took place on May 21, 2014, at the hands of twenty-six EU countries (all of the member countries except for the UK and Sweden, which decided not to join the SRM). In a separate statement, the signatory states agreed to a period of time to complete the ratification process, and consequently, the SRM has been in force since January 1, 2016. It was arranged that the range of the SRM application would include all credit institutions, financial holding companies, investment firms, and financial institutions established in each country participating in the SRM and at the same time subject to the direct supervision of the ECB: in substance, the parameters of the SRM application are the same as that of the single supervisory mechanism (SSM). As for the banks that are not under the direct supervision of the ECB, resolution responsibilities shall be referred to the national resolution authorities, except in cases where it is necessary to resort to the SRF; in these cases, the SRB is responsible for the resolution, regardless of the significance of the bank.[26]

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[24] See Capriglione F e Troisi A. (2014), L'ordinamento finanziario dell'UE dopo la crisi, Milano, UTET giuridica, p.88.

[25] According to Eurostat data at the end of 2013, financial support had increased the public debt by 250 billion in Germany, by 60 in Spain, by 50 in Ireland, by 40 in Greece. In Italy public support contributed for only four billion, all already reimbursed.

[26] National resolution authorities are significantly involved in the resolution of a credit institution, as they assist the SRB

The SRB is made up of a president, a vice-president, four full-time members, and representatives of member countries where banks (or their subsidiaries) operate in distress; the ECB and the European Commission representatives, who are qualified as permanent observers, also have the right to participate and are allowed access to all the documentation they request. As of January 1, 2016, the SRF is funded by annual ex-ante contributions by the banking sector: the goal is to achieve, by the deadline of the transitional period in 2024, a target level corresponding to at least 1% of the amount of guaranteed deposits of all the banks authorized by the SRM of member countries.

In summary, in the second phase of the evolution of the banking supervision in Europe, the ECB has been given direct responsibility for the micro-prudential supervision of the most important banks in the euro area. It also actively collaborates with the competent national supervisory authorities in the supervision of less relevant banks.

Furthermore, the ECB is an important player in the resolution mechanism as well, operating within the SRB with its own representatives as permanent observers, as well as in the decision-making mechanism concerned with the use of the SRF, together with the European Council, the European Commission and the SRB.

4.1. The Brexit: consequences for the further integration of banking supervision in Europe

The referendum on "Brexit" took place on June 23, 2016, and as is well known, it ended with a vote in favour of the United Kingdom exiting the EU. On March 29, 2019, the consequences will materialize. Brexit will have a strong impact not only on the operations of UK banks but also on the banking system of the European Union; the latter could become less important at the international level, since the United Kingdom has always been the most developed and international European financial centre. The British HSBC is the largest bank in Europe, and among the top 10 banks, 3 are British, and among the top 50, as many as 6 are British.

Clearly, the scenario presented to the banks will depend on the negotiations in progress. In the case of a hard Brexit, the United Kingdom will become the third country from the point of view of the EU. European banks operating in the United Kingdom will lose some of the prerogatives they have enjoyed so far; for example, they may need a new authorization to continue doing their business in the UK.[27]

In any case, the Brexit has caused the EU financial intermediaries to rethink their presence in the United Kingdom and perhaps to relocate certain activities. However, the changes brought about by the Brexit will be far greater than a simple transfer of some banks currently operating in the United Kingdom to other countries. For sure, EU supervisors will have to monitor closely the situation of cross-border banking groups; it is necessary to ensure that they are well monitored and possibly subject to resolution measures. This will not only affect banks operating in the United Kingdom but also those active in other countries. It could also affect European banks that operate outside the European Union.

It must also be considered that the British policy makers have helped, since the birth of the European Union, write European legislation on financial supervision together with other European legislators. Given the importance of the British financial centre, they have often managed to make their principles and preferences prevail in the final regulations. Brexit could destroy the knowledge and relationships that have been created over the years in EU decision-making bodies and could impose different ways of relating among the supervisors: the ECB in its role as EU supervisor and the UK supervisors, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority.

In this regard, it is worth mentioning that the European Commission on September 20, 2017, following the consultations carried out, presented some proposals to take into account the recent market developments. It emerged from this document that the decision of the United Kingdom to

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in defining and implementing resolution plans. In the event that the individual national authority does not act in accordance with the decisions of the SRB, the Regulation provides that the same SRB can take the resolution action itself to replace the national authorities.

[27] S&P Global Market Intelligence

leave the EU requires more integrated supervision within the EU27 and a new analysis of relations with third countries regarding supervision, to ensure adequate management of all the risks in the financial sector.

Furthermore, this document also shows that even if financial integration brings many advantages, it opens up possible channels of contagion between the Member States in the event of negative shocks, as demonstrated by the experience of the financial crisis in 2008. Inadequate supervision in one Member State could, therefore, be a source of risk for consumers and financial market participants operating in other Member States. In addition, there is also a risk that market participants can actively exploit any differences in supervisory rules to increase their short-term profits. For example, the risk that the UK will approve supervisory rules that are not too stringent in order to maintain foreign banks in the UK could be realized. Obviously, regulatory arbitrage is an operational possibility that financial authorities must try to avoid, also because too-soft rules could lead to further crises.

In the proliferation of the debates on Brexit, at least one change to the European supervisory system has already been decided on: on November 20, 2017, the EU-27 ministers selected Paris as the new seat of the European Banking Authority (EBA). Furthermore, the role of the European Banking Authority in fostering supervisory convergence in the EU banking sector has been strengthened.

In summary, Brexit is a story that certainly goes against the financial integration of Europe, but the latter process is equally showing huge progress. The work on the completion of the European Banking Union is well underway, and the project seems to attract countries outside of the euro area, in particular, the Scandinavian countries and those of Eastern Europe.

Even in the presence of Brexit, with the progress achieved in the realization of the Banking Union, banks are expected to begin to enjoy the benefits of a broad and integrated market and to further expand beyond national borders to create a banking sector that finances the economy of Europe in a truly reliable and efficient manner.

Conclusion

In our opinion, despite the growing feelings of euro-scepticism and euro-pessimism among many member countries, the European Central Bank has been the glue that has bound the EU together during and after the economic crisis. After 2008, the ECB introduced non-standard monetary policy measures, along with long-term credits for commercial banks and its *quantitative easing* bond-buying program.

These asset purchases supported economic recovery and growth across the euro area and helped the Eurozone return to inflation levels below, but close to 2%. However, if results prove the power of central bank intervention in times of crisis, this power also needs the weaker countries with deep-rooted fiscal/debt problems to address their problems through other instruments in order to embark on a sustainable growth path.

We also hold that the European Central Bank has fulfilled its role of lender of last resort and has carried forward the most revolutionary program after the monetary union: the banking union. Thanks to the Single Supervisory Mechanism and the Single Resolution Mechanism (to ensure the efficient resolution of failing banks with minimal costs for taxpayers), the EU banking system is currently more transparent and stable than ever before.

Thanks to the monetary policy of the ECB, not only has Europe emerged from the crisis, but many countries of the European Union are experiencing a period of growth. Although the EU is not an optimal currency area, the crisis has not brought about the end of the euro; indeed, the common currency has roughly maintained its value and has successfully defended euro area countries against the worst effects of the economic crisis by providing European companies with a stable market for international trade and investment. In fact, there is no doubt that the European Central Bank has supported most of the efforts to prevent bankruptcies caused by sovereign debt, to avoid turbulent

and systematic collapses of important financial institutions, and at the same time, the disintegration of the euro.[28] In the end, no country had to abandon the monetary union risking the collapse of what has been built so far.

Furthermore, in order to respond to the turbulence of 2012, a number of initiatives have been undertaken, including the creation of a single supervisory authority within the ECB. Thus, in the short span of two years, in 2014, the European banking supervision went live based on close cooperation with competent national authorities.

The ECB is responsible for ensuring the effective and consistent functioning of the single supervisory mechanism, with a view to carrying out invasive and effective banking supervision that contributes to the security and soundness of the banking system and the stability of the financial system. Integrated banking supervision has two main objectives:

1) Strengthening the banks, which helps overcome financial fragmentation, improves the transmission of monetary policy, and restores the supply of credit to households and businesses. Throughout the euro area, there has been a convergence in lending rates to values corresponding to historical lows; and

2) Requiring the banks to have an adequate capital base and to promote a sustainable balance between risks and returns, which represents the first line of defence against risks to financial stability.

Consequently, monetary policy has been able to pursue its objective of price stability, since risks to financial stability have been and are still being suppressed by effective supervisory action. It is also noted that the euro area economy has been expanding for almost five years. One of the main drivers of the recovery was undoubtedly the monetary policy of the ECB, whose shares have been significantly integrated by banking supervision at the euro area level.

Regarding the possible crisis situations of banks, the sharing of funds for the resolution of such situations represents the most ambitious objective of the new single resolution mechanism: a broad process of solidarity in the banking sector is taking shape at the European level, since the fund is expected to intervene independently of the location of the credit institution and the articulation of the banking group that is insolvent. In other words, with the Single Resolution Fund (SRF), there is a possibility of breaking the existing relationship between an insolvent bank and the nationality of the financial intermediaries, to support the resolution of the relative crisis (and also to break the vicious circle between private and public indebtedness). Thus, the banks do not have to depend on the budgets of national governments, since the resolution itself would be hindered if the national government concerned was not equipped with adequate financial resources to run to the rescue of the bank in question. There are still some areas to be fixed. For example, the European Systemic Risk Board (ESRB) and the ESAs are EU agencies, whereas the ECB oversees Eurozone countries. This leads us to think that a stronger integration could be achieved if the pillars of the European Banking Union were extended to the banks of the European countries that have not yet adopted the euro.

A final element to consider is the Brexit. A strong European banking and financial system, as well as being profitable and stable, must also be able to compete with the financial systems of other advanced economies, such as that of the United States. London has always been the most important financial centre in Europe. At present, one wonders whether any other euro area country will be able to replace it and how the relationship between the legislators and the supervisory authorities of the European Union and those of the United Kingdom will be articulated.

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