Peterson Institute for International Economics

Policy Brief

NUMBER PB13-17 JUNE 2013

A Realistic Bridge Towards European Banking Union

Nicolas Véron

Nicolas Véron, *visiting fellow at the Peterson Institute for International Economics since 2009, is also a senior fellow at Bruegel, the Brussels-based economics think tank, to which he has contributed since 2002. His earlier experience combines both public policy, as a French senior government official, and corporate finance in the private sector. He has published numerous policy papers on financial systems and financial regulation at the global and European level, and is the coauthor of* Smoke & Mirrors, Inc.: Accounting for Capitalism *(2006) and coeditor of* Transatlantic Economic Challenges in an Era of Growing Multipolarity *(2012).*

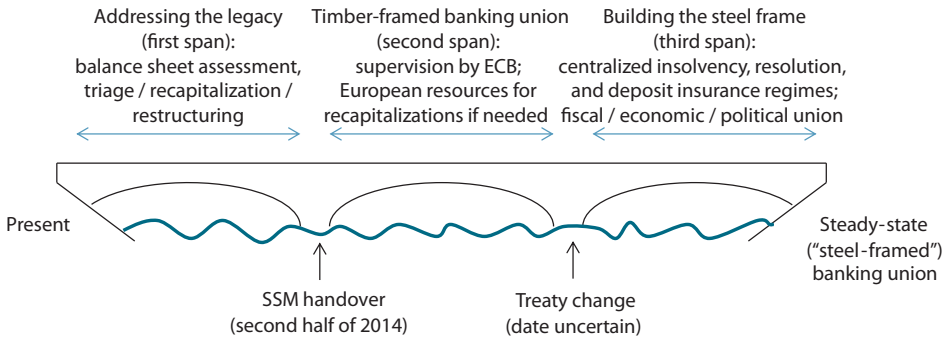
Note: The author expresses gratitude to Bill Cline, Zsolt Darvas, Martin Kessler, Jacob Funk Kirkegaard, John Olcay, Francesco Papadia, René Smits, Ted Truman, Steve Weisman, and others who gracefully agreed to review an early version of this text.

European leaders took a radical step when they announced in late June 2012 the start of a transfer of the key instruments of banking policy to the European level, or banking union. Inevitably, obstacles are appearing as the implications of this decision become apparent. Measured against commitments specified in December of last year, all elements of the banking union agenda are behind schedule. Worse, there is increasing doubt about the euro area leaders' proclaimed imperative to break the vicious circle between banks and sovereigns—the pervasive financial feedback and related fragmentation of the European financial space that has been observed since at least mid-2011, also known as "doom loop."

This Policy Brief argues that a successful transition towards European banking union is both necessary and possible, but requires a clearer acknowledgment of the policy sequence than has been apparent in most public and policy discussions so far. Specifically, the importance and complexity of the handover of supervisory authority over most of Europe's banking system to the European Central Bank (ECB), expected in the second half of 2014, appears underestimated in much of the current debate. This handover will be preceded by a comprehensive assessment of bank balance sheets, which in turn implies the negotiation and execution of restructuring plans for those banks that the assessment process will have found severely undercapitalized. Botched assessments would be severely detrimental to the ECB's credibility, and by implication, to euro area stability. No clear framework exists at this point for bank restructurings, which will inevitably be contentious and will require careful preparation.

This 2014 handover (see figure 1) is the first of two milestones that will define the eventual success or failure of the

Figure 1 The bridge towards European banking union



SSM = Single Supervisory Mechanism
ESM = European Stability Mechanism

banking union project, on which the sustainability of the euro itself depends. The second milestone, unlikely to be met in the short term, will be a change in the European treaties that will establish the robust legal basis needed for a sustainable banking union and for interdependent components of Europe's four-fold agenda, which also includes fiscal union, economic union, and political union. Together, these two milestones suggest the image of a bridge that would allow Europe to cross the choppy waters that separate it from a sustainable policy framework.

Short-term policy efforts should focus on the first span, namely the combination of ECB-led balance sheet assessment and restructuring of weaker banks that is needed for a successful handover of supervisory authority in 2014. Time is short. Given the centrality of Germany's domestic politics in Europe's current policymaking process, no major progress is likely to be achieved before that country's general election on September 22. This implies that the last three months of 2013 will be crucial to address unresolved policy challenges, and thus maximize the chances of restoring trust in Europe's banking system and fostering economic recovery.

THE BANKING UNION PROJECT AND THE ACTION SO FAR

The concept of a banking union stems from the tension between the EU single market in financial services, on the one hand, and the continued conduct of most banking policy at the national level, on the other hand. The abolition of capital controls within the European Union in the late 1980s, the introduction of a single currency in most EU member states in the 1990s, and a more assertive application of EU competition policy to the financial sector in the 2000s have resulted in a unique degree of regional financial integration. But this has not been matched by corresponding adaptations of the banking policy framework, despite partial efforts towards regulatory harmonization and supervisory coordination. In principle, the case for banking union thus predates the crisis (e.g., Cihak and Decressin 2007 and Véron 2007).

However, the trigger for banking union was the euro area crisis, and especially the realization that the lack of European banking policy integration led to a fragmentation of the euro area's financial space in times of instability. Policy and financial interdependencies between individual member states and the banks headquartered in them created a sharp correlation between their respective funding conditions—or the doom loop (e.g., Véron 2011 and Marzinotto, Pisani-Ferry, and Wolff. 2011). As a consequence, identical borrowers in different euro area countries could not have identical access to credit, and the ECB's single monetary policy was transmitted differently to economic actors across different member states.

In the longer term, a functioning banking union requires at least four pillars that correspond to the key components of banking policy in a developed financial environment. The corresponding areas are: (1) prudential regulation of banks, covering bank capital, leverage, liquidity, and risk management; (2) banking supervision; (3) bank resolution, which involves both a decision-making process and, to the extent that orderly resolution may entail a cost, a funding mechanism; (4) deposit insurance. The scope of each of these pillars corresponds to a growing body of international standards issued by global financial authorities hosted by the Bank for International Settlements in Basel. [1]

This list should not be considered exclusive. Other policy areas relevant to a banking union include competition policy applied to the banking sector, including state aid control in the European Union; conduct-of-business regulation and supervision, including consumer protection and anti-money laundering/combating the financing of terrorism (AML/CFT) policy; and also taxes that apply to financial services and/or institutions, or even housing market policy, which experience suggests has significant impact on banking system stability.[2] However, the four pillars listed above together represent a now widely accepted consensus view on what are the indispensable components of a banking union (Cihak and Decressin 2007; Fonteyne et al. 2010; Pisani-Ferry et al. 2012; Goyal et al. 2013; Coeuré 2013). [3]

The decision to move towards banking union appears to have coalesced in April and May 2012 (Véron 2012) and led to the landmark Euro Area Summit Statement of June 29, 2012, which starts with the motivation to break the doom loop ("We affirm that it is imperative to break the vicious circle between banks and sovereigns"). The same exact words were repeated in subsequent summit declarations later in 2012.[4] The June 2012 declaration included the commitment to establish a

1. Respectively: (1) the Basel Accords, including Basel III, issued by the Basel Committee on Banking Supervision since 1988; (2) the Core Principles for Effective Banking Supervision, also issued by the Basel Committee since 1997; (3) the Key Attributes of Effective Resolution Regimes for Financial Institutions, first issued by the Financial Stability Board (FSB) in 2011; and (4) the Core Principles for Effective Deposit Insurance Systems, issued jointly by the Basel Committee and the International Association of Deposit Insurers in 2008.

2. With the exception of AML/CFT, these additional policy areas are not standardized or coordinated at the international level to the same extent as the four previously listed.

3. The inclusion of common deposit insurance in this list was controversial in EU policy circles until early 2013 but has been recently endorsed by prominent European policymakers as a long-term prospect. See e.g., Jim Brunsden and Rebecca Christie, "Dijsselbloem Says EU Needs Long-Term Common Deposit Backstop" *Bloomberg News*, May 7, 2013.

4. Euro Area Summit Statement, June 29, 2012; European Council Conclusions, October 18, 2012, item 12; European Council Conclusions, December 14, 2012, item 10.

Single Supervisory Mechanism (SSM), with direct supervisory authority over Europe's banking system being handed over to the ECB; and the future possibility, "when an effective SSM is established," of direct recapitalizations of individual banks by the European Stability Mechanism (ESM, the common fund set up in 2012 by the 17 euro area members). In December 2012, EU leaders agreed to complement the SSM with a Single Resolution Mechanism (SRM). In the meantime, the EU legislation establishing the SSM (SSM Regulation) was finalized with four major changes from the European Commission's initial proposal published in September 2012: At the insistence of Germany, most smaller banks with less than 30 billion euros in assets were exempted from the direct supervision of the ECB and remain under national oversight; non-euro area member states of the European Union may join the SSM as participating member states; the European Parliament gained additional powers over appointments of the chair and vice-chair of the newly formed Supervisory Board that would coordinate bank supervision within the ECB; and the planned handover of authority to the ECB was delayed from the initially envisaged date of March 1, 2014 to the summer or fall of 2014, as discussed below.

Simultaneously, the European Union has initiated further efforts to harmonize its bank regulatory, resolution, and deposit insurance framework. This includes the adoption of the Capital Requirements Regulation (CRR) and fourth Capital Requirements Directive (CRD4); the ongoing legislative discussion of a Bank Recovery and Resolution Directive (BRRD), initially proposed by the European Commission in early June 2012, only weeks before the decision to start the shift towards banking union; and the parallel legislative discussion of a Deposit Guarantee Scheme (DGS) Directive, initially proposed by the European Commission in 2010, but long stalled. It must be noted however that none of these texts represents completion of the banking union agenda. CRD4 still gives significant discretion to national supervisory authorities in some areas and further steps will be needed to reach the stated objective of a true "single rulebook" (de Larosiere 2009).The BRRD and DGS directive refer to national, not European, insolvency regimes, special resolution regimes for banks, and deposit guarantee systems, with an aim at harmonization and convergence, but not supranational integration.

TWO MILESTONES: 2014 HANDOVER, TREATY CHANGE

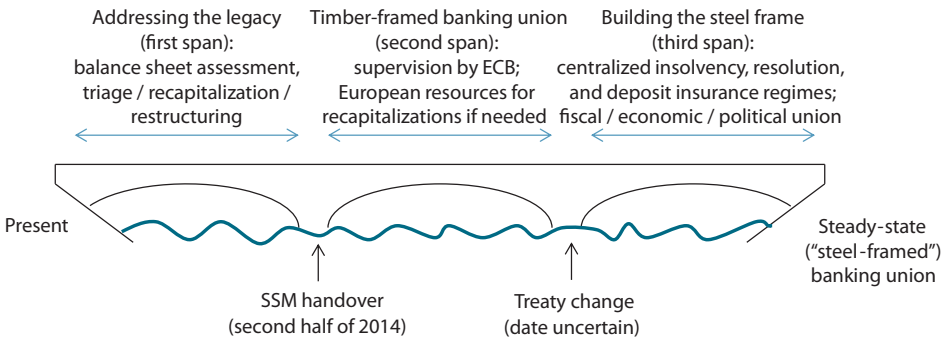
The complexity of the banking union agenda made it impossible from the start to imagine that it could be completed in one single step. The harmonization of Europe's banking policy framework had started well before the crisis, and the decisions made so far fall well short of a banking union. Sound thinking about banking union needs to integrate both the long-term, steady-state policy framework, and the transition that may get Europe from here to there. The German finance minister has expressed this double concern by referring to a "timber-framed" banking union that would eventually be replaced by a "steel-framed" one (Schäuble 2013).

Thus, it is useful (though obviously simplistic) to think of the future sequence as structured by two key milestones (see figure 1). The first is when the credibility and effectiveness of the transition towards banking union will first be meaningfully tested: This will happen by the 2014 handover of supervisory authority to the ECB. The second is when the steady-state framework can be decided upon, which is dependent on a treaty change. Thus the image of a bridge, in which each of these milestones forms a separate pile. The usefulness of this imagery is that it helps identify the different challenges of each different phase of the project—i.e., each span of the bridge.

- The first span, in late 2013 and 2014, is likely to be the shortest but carries major risks and opportunities as the execution of the handover will determine all later steps of the banking union endeavor. It is the phase in which the "legacy" of past supervisory failures will be addressed, a painful process which is further analyzed below. Policy decisions in that first phase must establish that (1) the ECB can be an effective supervisor, and that (2) the banking union project can help mitigate or break the doom loop. If one of these conditions is not met, the later phases of the project, no matter how well-designed, are unlikely to succeed.
- The second span (which would start in late 2014 and last until treaty change) is the "timber-framed" banking union. With a single supervisory mechanism in place, this will be an imperfect but workable arrangement that combines national resolution regimes with some form of central decision-making. By necessity, this framework will be less than fully consistent, as resolution regimes and deposit guarantee systems will remain largely dependent on diverse national arrangements, even as supervision is supranational and there is also a supranational overlay for resolution decisions and funding.[5]
- The third span, following the adoption of treaty change, holds the promise of resolving these tensions with a consis-

5. The assumption is made here that no major policy initiatives will be needed in the area of deposit insurance, in either the first or second span of the bridge. This is based on the fact that disorderly deposit flights have not occurred in Europe so far in spite of sizeable confidence shocks. This remains an optimistic assumption though.

Figure 1 The bridge towards European banking union



SSM = Single Supervisory Mechanism
ESM = European Stability Mechanism

tent European banking policy framework. It will mark the edification of the permanent, "steel-framed" banking union. Given the extensive nature of the changes involved, this phase can be expected to last a number of years before the steady-state is fully established.

This is a long-haul project that will require much continuity of purpose. The next sections explore it in more detail, starting from the end with the need for treaty change, and moving backwards to identify conditions for a potentially successful transition.

TREATY CHANGE WILL BE NEEDED—BUT NOT NOW

To understand why a sustainable banking union cannot be completed within the legal framework defined by the current European treaties—known as the Treaty on European Union (TEU) and Treaty on the Functioning of the European Union (TFEU) and respectively based on the Maastricht Treaty (1992) and the initial Rome Treaty (1957)—it is useful to refer to the four banking union pillars as introduced above.

1. Prudential regulation of banks is not yet harmonized, even after the landmark adoption of the Capital Requirements Regulation. However, in principle, full harmonization in this area is possible on the basis of Article 114 TFEU, which forms the basis for Single Market legislation.

2. On supervision, Article 127(6) TFEU provides the legal basis for the Single Supervisory Mechanism and most legal scholars appear to consider this basis robust. There are four limitations associated with this article though:

   - It enables the council to "confer specific tasks upon the ECB concerning policies relating to the prudential supervision of credit institutions and other financial institutions," implying that some other supervisory tasks must remain at the national level.
   - It explicitly excludes insurance undertakings from the scope of ECB supervision.
   - As it is part of Title VIII TFEU on Economic and Monetary Union and specifically designates the ECB as supervisory authority, it makes it difficult to grant non-euro area countries equal status in the governance of the supervisory system (the SSM Regulation attempts to square this circle but cannot achieve it entirely).
   - As the ECB's own governance is built to address the necessities of monetary policy, it subordinates supervision to the ECB's decision-making bodies as designated in the treaty—namely the Governing Council and Executive Board—and to the European System of Central Banks' "primary objective (…) to maintain price stability" (Article 127(1) TFEU).

   None of these limitations prevents the establishment of the SSM and its subsequent buildup, but each of them may conceivably be reconsidered in a future treaty revision. The fourth limitation is of particular concern to those who believe that there might be conflicts between the objectives of monetary policy and supervisory policy. There is no universal consensus on this issue (e.g., Pisani-Ferry et al. 2012 and Wymeersch 2013). Many countries have separated banking supervision from central banks, either partly (e.g., Japan, United States) or near-entirely (e.g., Australia, Canada,

China, Sweden, Switzerland). Other jurisdictions have kept supervisory and monetary policy functions under a single roof (e.g., Hong Kong, Saudi Arabia, Singapore). In the United Kingdom, separation was introduced in the late 1990s and then reversed in the early 2010s.[6]

3. Resolution authority, unlike supervision, is not explicitly referred to in the treaties. Moreover, any special resolution regime for banks is defined as an alternative to insolvency. Thus, a genuine European bank resolution regime, unlike the coordination mechanism involving national resolution regimes that is currently envisaged in the SRM debate, would require a matching European insolvency regime, at least for banks, if not for other companies (Véron and Wolff 2013). But insolvency is a national competency under current treaties—unlike in the United States, where the Founding Fathers made bankruptcy one of a limited list of explicitly federal competencies in article 1, section 8 of the US Constitution.

   Moreover, to the extent that a resolution authority needs to be backed by fiscal authority to be credible, it may be argued that a European fiscal authority is required to establish a European resolution authority. However, this link is less direct than for the next item, deposit insurance.

4. Any deposit insurance system, even when pre-funded by the banking sector, requires a government guarantee, which may be implicit but must be credible, to fulfill its trust-enhancing function. Thus, a European level of deposit insurance cannot be credibly envisaged without a European fiscal capacity.

In other terms, and even leaving aside adjustments to the SSM that may be deemed important, a future "steel-framed" banking union will require, among other things, a European fiscal capacity, a European insolvency regime for banks, and a European resolution authority. None of these is explicitly provided for in the current treaties.

Two existing articles of the TFEU may be considered to provide a potential implicit basis for part of this agenda, but arguably not for all of it and certainly none without controversy. Article 114 TFEU on the European Internal Market may provide a basis for a resolution authority, as it did for the creation of the European Banking Authority (EBA) and other European Supervisory Authorities (ESAs) in January 2011, and of other European bodies such as the European Aviation Safety Agency or the European Medicines Agency. However, the Meroni jurisprudence of the European Court of Justice[7] places limits on the decision-making discretion that such agencies may enjoy, which could prove incompatible with the autonomy required for an effective resolution and/or deposit insurance body. Article 352 TFEU, also known as the flexibility clause, states that "If action by the [European] Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures." A literal reading of this article suggests ample scope for the introduction of new policies and instruments, given the breadth of the "policies defined in the Treaties" and the "objectives set out in the Treaties." However, there is a widespread reluctance among member states to interpret this article in an extensive manner, and the European Court of Justice has also occasionally placed limits on what it believes is the possible use of this flexibility clause.

Similarly, it is doubtful that the agenda described above can be entirely met with one or several separate intergovernmental treaties outside of the EU framework, as was the case with the treaty establishing the ESM (February 2012) and the Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (the so-called Fiscal Compact of March 2012). This is because of the need for resolution, insolvency, and fiscal policy to be subject to adequate judicial review and political scrutiny. The interdependencies needed between these policies and the EU institutional framework as established by the TEU and TFEU are likely to be too pervasive to be practically handled in distinct treaties.

A separate question is whether needed treaty changes can be achieved through the "simplified revision procedures" introduced by the Lisbon Treaty and specified in Article 48(6) TEU. The "ordinary revision procedure" (Article 48(2) to (5) TEU) requires an intergovernmental conference, and in some cases a convention, to make amendments to the treaties, and the amendments must then be "ratified by all the Member States in accordance with their respective constitutional requirements." By contrast, the simplified procedures, while also requiring unanimity of member states, only require a decision of the council, not a convention or intergovernmental conference; such a deci-

6. Euro area countries have a special status in this debate as their national central banks are bound by their membership in the Eurosystem and thus the scope for conflict between supervision and monetary policy at the national level is limited. Most euro area countries do not have supervisory authorities separate from the national central bank but there are exceptions to this pattern, including BaFin in Germany.

7. Judgment of the European Court of Justice, Meroni & Co., Industrie Metallurgiche S.A.S. v High Authority of the European Coal and Steel Community, June 13, 1958.

sion must be "approved by the Member States in accordance with their respective constitutional amendments," which at least in some member states lowers the procedural bar compared to "ratification" including in terms of parliamentary vote and/or referendum. The simplified procedures can only apply to part 3 of the TFEU, and the corresponding changes "shall not increase the competences conferred on the [European] Union in the Treaties." But it is difficult to see how at least some aspects of the above agenda could be construed as not increasing the competences conferred on the European Union. Thus, the simplified revision procedures of Article 48(6) TEU could at best be used only for part but not all of the agenda to establish a steady-state banking union.

In sum, changes in the European Treaties appear to be an inescapable step on the path towards permanent banking union, and are likely to require the ordinary revision procedure with all its implications for negotiation and ratification.

Moreover this analysis is based on a narrow determination of the changes needed. Considered from a broader perspective, the consolidation of authority at the European level implied by banking union cannot be sustainable without a parallel enhancement of the empowerment of European citizens in European institutions through adequate channels of representation and accountability, or political union. In addition and also in a long-term view, a sustainable banking union may entail further policy integration in other areas than banking policy defined in a narrow sense, including housing policy and various aspects of tax policy. The upshot, to use categories that have become widespread in the European public policy debate in 2012, is that banking union cannot be separated from parallel and significant progress towards fiscal union, economic union, and political union. This "fourfold agenda" cannot be achieved in one step, but nor can any of its components be completed in isolation from the others (Véron 2012).

After much discussion, European policymakers seem to have recently accepted both the inevitability of such future treaty change, and the need to envisage short-term steps towards banking union (the first two spans of the bridge) before such change can happen. In April 2013, EU member states declared that, in addition to implementing the conclusions of the European Council meeting of December 14, 2012 and thus establishing a Single Resolution Mechanism by 2014, "they are also ready to work constructively on a proposal for Treaty change made in accordance with provisions of Article 48 TEU."[8] Separately in May 2013, a joint French-German declaration stated that "a Single Resolution Mechanism (…) should be established on the basis of the current treaties."[9] These policy pronouncements are consistent with the recognition that the treaties will eventually need to be changed, but also that it is premature to set a deadline or even a tentative timeframe for such changes, given the magnitude of the associated political and policy challenges.

THE 2014 HANDOVER AND PRE-HANDOVER ASSESSMENT

Before treaty change, the key milestone for banking union will be the handover of direct supervisory authority over the majority of Europe's banking system to the ECB.[10] At the time of writing, it appears likely that the SSM Regulation will be published in either July or September 2013. Given that the regulation "shall enter into force on the fifth day following that of its publication in the Official Journal of the European Union" (Article 28 of the final compromise text of the SSM Regulation[11]) and that "the ECB shall assume the tasks conferred on it (…) 12 months after the entry into force of the Regulation" (Article 27(2)), the handover will be scheduled one year later. The working assumption used here is that the corresponding handover date will be in September 2014.

The ECB has an option to unilaterally delay the handover from that date. Article 27(2) of the final compromise text of the SSM Regulation states that "If (…) it is shown that the ECB will not be ready for exercising in full its tasks (…), the ECB may adopt a decision to set a date later than the one referred to in the first sub-paragraph to ensure continuity during the transition from national supervision to the SSM, and based on the availability of staff, the setting up of appropriate reporting procedures and arrangements with national supervisors." Exercising this delaying option carries risks in terms of the credibility of the entire process, but cannot be ruled out altogether. In the rest of this analysis however, the baseline assumption is that this delaying option will not be exercised.

The key to understanding the importance of the 2014 handover is to note that it will mark the end of a process (the first span of the bridge) as well as the start of a new phase (the second span).This is because the handover needs to be based on an assessment of the banks over which the ECB would assume supervisory authority, and this assessment will carry

8. Declaration of the Informal Meeting of [Finance] Ministers and [Central Bank] Governors, Dublin, April 12, 2013, Declaration by Member States, annexed to Revised Note of the Council of the European Union 8417/1/13 REV 1, April 17, 2013.

9. French-German joint declaration "Together for a stronger Europe of Stability and Growth," May 29, 2013.

10. At least 130 banks will be directly supervised by the ECB. They are estimated to collectively represent more than 80 percent of euro area banking assets, and more than 55 percent of total EU banking assets, even assuming that no country outside the euro area joins the SSM.

11. Council of the European Union Interinstitutional File 2012/0242 (CNS), April 16, 2013.

consequences. The quality of this assessment will be the first and most crucial test of the credibility of the ECB in its supervisory capacity, and of the banking union endeavor more broadly.

Article 27(4) of the SSM Regulation states that "From the entry into force of the regulation [September 2013 in our baseline], in view of the assumption of its tasks […], the ECB may require the competent authorities [national supervisors] of the participating Member States [in the SSM] and the persons referred to in Article 9 [individual banks and their staff] to provide all relevant information for the ECB to carry out a comprehensive assessment, including a balance-sheet assessment, of the credit institutions of the participating Member State. The ECB shall carry out such an assessment at least in relation to the credit institutions not covered by Article 5(4) [which means that all banks subject to the ECB's direct supervisory authority will be assessed]. The credit institution and the competent authority shall supply the information requested." In complement to this mandate, the European Banking Authority has indicated that it would conduct a new round of EU-wide stress tests with a timetable in accordance to the ECB's assessment, and that national supervisors should start conducting "asset quality reviews" before the end of 2013.[12]

The combination of publicly led triage, recapitalization, and restructuring has been the key to the resolution of most systemic banking crises in the past.

The ECB's direct access to information under Article 27(4) of the SSM Regulation is a crucial enabler for the pre-handover assessment to constitute a credible process of "triage" that would divide the examined banks into three broad categories: those that are sufficiently capitalized; those with capital needs that can realistically be met by arm's-length investors; and those that are severely undercapitalized or insolvent, and thus require some form of public intervention as an alternative to a court-ordered insolvency. The combination of publicly led triage, recapitalization, and restructuring has been the key to the resolution of most systemic banking crises in the past (Posen and Véron 2009). Prominent cases include Sweden in 1992–93, Japan after 2002 (following many years of insufficient policy action), and the United States in the spring of 2009 (the Supervisory Capital Assessment Program, more often referred to as stress tests).

The European Union has attempted to proceed with triage before, but these attempts have broadly failed, offering a cautionary tale for the ECB. The main precedents are the EU-wide stress tests conducted by the Committee of European Banking Supervisors (CEBS) in July 2010 and by its successor entity, the EBA, in July 2011. Their results were contradicted a few months following their release by disorderly developments at some of the tested banks, including Allied Irish Banks, Dexia, or Marfin Popular Bank (later known as Laiki Bank) in Cyprus; this shortcoming, which was due to flaws in the governance of the process rather than the performance of EBA staff (which was generally recognized as high quality), significantly and perhaps permanently impaired the credibility of the EBA.

The strong legal basis for access to information in the SSM Regulation resolves one problem that had seriously hampered the efforts of the CEBS and EBA in 2010 and 2011, which were dependent for key information on national authorities which did not necessarily have strong incentives to cooperate. However, two main other challenges remain, one operational and one more fundamental. None of them will be easy to address.

The first challenge is the sheer logistical and technical magnitude of the exercise that the ECB will have to perform. It will require the effective capacity to form an informed judgment on the true capital needs of each banking group included in the scope of the assessment, the number of which is expected to be between 130 and 200 (compared to only 19 in the US Supervisory Capital Assessment program of 2009). The enormity of this challenge is compounded by the complex structures of many European banks, and by the near-complete lack of supervisory experience of the ECB until the creation of the SSM. Moreover, some of the choices the ECB will need to make in determining the assessment methodology will inevitably be controversial, in an echo of the debate about EU stress tests in 2010 and 2011. In particular, the valuation of banks' sovereign debt portfolios may be debated at length as it was in 2011, even though the improvement in market conditions since mid-2012 has made this issue less intractable than it has been in the past.

One favorable circumstance here is that the ECB will be in the process of building a permanent institution, even as it conducts the one-off process of pre-handover assessment. Thus, bank examiners from national authorities who participate in the process, either on behalf of their national employer or seconded to the ECB or recruited by it, will have strong

12. EBA press release, "EBA recommends supervisors to conduct asset quality reviews and adjusts the next EU-wide stress test timeline," May 16, 2013. In recent public debate, "asset quality reviews" and "balance-sheet assessment" have been used interchangeably by some commentators. The understanding here is that asset quality reviews would be conducted by national supervisory authorities in preparation for, and support of, the ECB's balance-sheet assessment, but the exact semantics may change in the forthcoming months.

incentives to serve the ECB's objectives even if that involves highlighting past supervisory failures of the national authorities. Such incentives will be markedly different from the ones that ruled national authorities' supervisory staff during the 2010 and 2011 stress tests, and are better aligned with the objective of restoring trust in the European banking system. Furthermore, the ECB will be able to also hire private-sector companies to help it in the assessment task (Draghi 2013). But even so, this operational challenge entails very high execution risks. The ECB will have little time to demonstrate that it is able to address these risks adequately.

The second, more fundamental challenge in the current absence of a robust policy framework is the likely misalignment of incentives between the ECB and at least some member states, which will retain authority over resolution processes and be liable for any public funding. The obvious linkages between the reputation of the ECB as a supervisor and its credibility as a monetary institution, combined with the frustrating recent experience of the EBA with stress tests as referred to above, create powerful incentives for the ECB to conduct the 2014 pre-handover assessment in a rigorous manner. Those member states which insist on the credibility of euro area monetary policy—a group that includes Germany—should in principle be supportive of such rigor and aligned with the ECB in this respect (moreover a significant share of Germany's banking system will not be covered by the assessment, given the exemption of small banks including many German savings and cooperative banks). However, each member state will find itself at political and financial risk if the ECB detects significant levels of undercapitalization in banks headquartered on its territory, and some such member states may be inclined to dispute the assessment methodology that will have led the ECB to such conclusions.

Specifically, problem banks, i.e., those found severely undercapitalized or insolvent in the pre-handover assessment, must be properly handled without major financial stability consequences, which generally rules out court-ordered insolvency processes. These problem banks are unlikely to find capital on an arm's-length basis. Because it is difficult to imagine that large capital gaps identified during the pre-handover assessment could remain unaddressed for a significant period, they will thus require rapid public intervention to restructure them. In order to avoid potentially disruptive uncertainty, the aim must be that restructuring plans are announced for all problem banks together with the results of the comprehensive assessment, in anticipation of the actual handover of authority to the ECB. Of course, the identification of the member states that will be most affected depends on the number and identity of problem banks, which by definition are unknown at this moment. However, if the assessment process is rigorous, this number could end up being significant.

In sum, the pre-handover assessment will likely to need to be complemented by pre-handover restructuring of problem banks identified in the assessment. There is essentially no alternative: A botched assessment, comparable to the collective failures of risk analysis that marked the 2010 and 2011 stress tests, would be disastrous to the credibility of the ECB and could have wide-ranging destabilizing consequences for the European financial and monetary system. Conversely, a well-managed process, with an effective framework to deal with problem banks as identified through the assessment, holds the promise of restoring trust in the European banking sector to an extent that has eluded policymakers since the start of the crisis in mid-2007. Depending on the perspective, the handover can be depicted either as a time bomb, or as a crucial milestone on the path to euro area crisis resolution. If the 2014 handover is a failure, the banking union may become a bridge to nowhere.

Options to address the pre-handover restructuring of problem banks are further explored in the next two sections, with emphasis on the financial and governance aspects respectively.

THE FINANCIAL EQUATION OF 2014 RESTRUCTURING: LEGACY, BAIL-IN, AND BREAKING THE DOOM LOOP

As previously emphasized, it is not possible to predict at this point how many problem banks will be identified in the ECB's 2014 pre-handover assessment, assuming it is rigorous, or in which countries they will be located or how large their capital gaps will be. If the capital gaps identified are small, the 2014 pre-handover restructuring as described in the previous section will be comparatively easy to carry out. However, based on the observation of past systemic crises and of moderate current growth prospects in Europe, policymakers must prepare for the possibility of important capital gaps with an impact that may be macroeconomically significant. The debate on how to share the burden associated with future restructuring has been dominated by three concerns: assigning responsibility for past supervisory failures, referred to as "legacy" in the European policy discussion; shifting at least part of the cost to private claimants, often referred to as "bail-in" in contrast with past bailouts; while breaking the doom loop crisis-propagation mechanism as identified since 2011, and more generally preserving financial stability. Combining these three concerns will involve difficult trade-off and political decisions.

Legacy

In a joint communication following a meeting near Helsinki on September 25, 2009, the three ministers of finance of Finland, Germany, and the Netherlands declared that "Principles that should be incorporated in design of the instrument for [future] direct recapitalization [of banks by the ESM] include: (…) the ESM can take direct responsibility of problems that occur under the new supervision [by the ECB within the SSM], but legacy assets should be under the responsibility of national authorities." This position was intended to restrict the scope for direct recapitalization of banks by the ESM, the possibility of which was introduced in the June 29, 2012 statement that marked the start of the banking union endeavor and stated that "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 recapitalize banks directly." The European Council conclusions of December 14 mention in a more open-ended manner that "an operational framework, including the definition of legacy assets, should be agreed as soon as possible in the first semester 2013" for future direct bank recapitalizations by the ESM.

The reference to legacy assets, however, gives the misleading impression that assets that carry risks from the past can be neatly separated from the rest of a bank's balance sheet. This is generally not the case. A large share of assets in a typical European bank have long maturities and thus may be considered legacy long beyond any specific cut-off date, and thus the separation of legacy assets from non-legacy assets is bound to be impractical.

The relevant distinction is not between legacy and non-legacy assets, but rather between legacy and non-legacy losses. The 2014 pre-handover assessment would force banks to crystallize losses that had not been properly acknowledged until then, and these "legacy losses" would determine the identification of the capital gap that may result at least partly in a recapitalization or a restructuring by public authorities, possibly entailing a public cost. The assumption of such public cost at the European level, e.g. by the ESM, would more effectively contribute to breaking the doom loop, but the perception (and in at least some cases, reality) of past supervisory failures at the national level can be expected to make it politically impossible. Thus, it appears inescapable that public costs resulting from legacy losses in the 2014 pre-handover restructuring should be borne by the national public purse. For European banks with a significant level of cross-border activity, the capital gap may be filled by an ad hoc combination of national contributions from different member states, as was indeed the case in 2008 and later with Fortis and Dexia.

The same principle, however, also applies after the handover, over the second span of the bridge. To the extent that the balance-sheet assessment conducted by the ECB in 2014 will have been comprehensive, losses that may materialize at a later stage (in or after 2015) will no longer be attributable to national legacy responsibilities. It would thus be contentious to assign such future losses, including on assets which have entered a bank's balance sheet before 2014 but were vetted during the pre-handover assessment, to individual member states. We return to this aspect below in the subsection on the doom loop.

Bail-in

During the first few years of the financial crisis starting in mid-2007, most EU member states have appeared to see no alternatives to bailouts of private creditors (and even in some cases of shareholders) to resolve banking crisis situations. This stance, which was both generous to the private sector and onerous to the public purse, started with the rescue of Germany's IKB in late July 2007, and has been uniformly applied for more than three years until late 2010, in some contrast with parallel developments in the United States (Goldstein and Véron 2011). Gradually, from late 2010 until late 2012, losses have been more frequently imposed to at least some creditors, under various (and sometimes contested) legal frameworks and far from systematically. In almost all cases until early 2013, such "haircuts" have only affected junior or subordinated creditors, while senior unsecured ones have remained whole.[13] In early 2013, losses were imposed on senior unsecured creditors and also to uninsured depositors of Laiki Bank and Bank of Cyprus. Thus, the European consensus has moved considerably over a few years, from systematic bailouts towards a more significant recourse to bail-ins.

Special resolution regimes for banks did not exist in most EU member states in 2007, but have been introduced in many of them since 2008. They are in the process of being harmonized, and in many cases reinforced, through the Bank Recovery and Resolution Directive (BRRD), initially proposed by the European Commission in early June 2012 and currently under discussion. It is expected that the BRRD will enshrine a clearer hierarchy of bank liabilities into European legislation,

13. Denmark was an exception with a more rigorous treatment of creditors and uninsured depositors of two problem banks in 2011, even though its policy framework was later modified. Cases of losses imposed on junior creditors included Anglo Irish Bank in 2010; Agricultural Bank of Greece, TT Hellenic Postbank, and a number of Spanish banks in 2012; and SNS Reaal in the Netherlands in early 2013.

signaling that the use of public funds should only be envisaged after all (unsecured) creditors, and possibly uninsured depositors as well, have shared some of the restructuring burden. However, significant discretion is also likely to remain in the hands of national resolution authorities.

Bail-ins and special resolution regimes represent progress for the European Union, but they are not a magic formula. Even under the somewhat optimistic assumption that the BRRD will have been adopted and fully transposed into national legislation by all member states at the time of the 2014 pre-handover restructuring, the extent to which they will enable policymakers to avoid bailing out private-sector claims on problem banks will depend on circumstances. Concerns about contagion within the banking system, the imposition of losses to systemically or politically important creditors (such as pension funds), loss of public trust in the financial system (which forced the Cypriot authorities to impose capital controls, an experience that euro area policymakers may be wary of repeating) or negative shocks to the economy will all play a role, again depending on the magnitude of the capital gaps identified by the ECB's assessment. It would be entirely unrealistic to envisage bank resolution regimes, which aim to maintain trust and preserve financial system stability, as purely mechanistic, rules-based processes. Also, the BRRD in its current version envisages private-sector-funded resolution funds at the national and possibly European level, but such funds will take time to build up and they therefore are unlikely to play an important role in the 2014 pre-handover restructuring.

Breaking the Doom Loop

As previously noted, the goal of "breaking the vicious circle between banks and sovereigns" has been affirmed forcefully in successive declarations of the European Council, and is likely to be reaffirmed in the future. One year later, the doom loop has not been broken, but several developments are bound to affect policymakers' thinking:

- Market conditions have improved and risks of euro area breakup have receded, making contagion prospects less immediate.
- The discussion about legacy, including in the context of the German general election cycle, has made it near-impossible to envisage direct recapitalizations by the ESM until at least some time after the 2014 handover, contrary to the initial hopes of some observers, particularly in Spain and other member states.
- The divergence of credit conditions across member states has been confirmed and increasingly documented, not least by the ECB. Misallocation and/or scarcity of bank credit represent an increasingly evident drag on Europe's economic recovery prospects, particularly in the periphery (e.g., Darvas 2013).

Markets are forward-looking, and the doom loop is framed by expectations about the future. It can only be broken if investors are convinced that idiosyncratic sovereign liabilities associated with national banking sectors stop once the legacy issues are dealt with. This entails a credible commitment that any future public cost following the 2014 restructuring will be borne at the European level, and an implementation of the pre-handover restructuring in a way that does not discriminate among claimants on the basis of their nationality or the nationality of the problem bank. These conditions are not incompatible with the principle of national responsibility for legacy losses, but they have two implications that may be politically contentious.

The first implication is that the parameters for bail-in cannot be left at the discretion of national authorities. If investors are persuaded that, say, senior uninsured creditors of a Spanish or Italian problem bank will suffer large haircuts during the 2014 pre-handover restructuring, but those of a problem bank with the same capital gap will be guaranteed by the national government in Germany or the Netherlands, then the doom loop will be exacerbated instead of being mitigated. This is not a theoretical concern: for example, S&P (2013) writes "We believe that governments *with sufficient capacity* [emphasis added] will continue to support senior creditors of systemically important banks for about the next three to five years." One assumes this challenge is what the German finance minister had in mind when he called for "a mechanism to restructure or wind up the weakest banks in an orderly, predictable and *uniform* fashion throughout Europe" (emphasis added; Schäuble 2013). It has not been addressed or even sufficiently debated to date, and we return to it in the next section.

The second implication is that an unambiguous and credible commitment must be made by the European Council that after the 2014 handover (either immediately, or following a predetermined transition phase of no more than, say, 12 months following the handover date), European-level funding of the cost of future bank restructurings will be the default option rather than an *ultima ratio*. This is implied by the insistence on dealing comprehensively with "legacy" issues at the time of the handover, and must be made explicit. The nature of the corresponding European financial resources may include the

ESM, a European levy on the financial sector, or a combination thereof—the key consideration being its pooling at the European level that enables a dissociation from national balance sheets and sovereign credit conditions. Of course, the more rigorous the pre-handover assessment, the more limited the likelihood and extent of post-handover reliance on European funding for restructuring, as banks would have comparatively stronger balance sheets at the time of the handover and would thus be, all things equal, less susceptible to require public intervention in the future.

The bridge metaphor helps clarify the distinction. The direct public funding of bank restructurings, if needed at all, would be national over the bridge's first span and European over the second span and beyond. The recourse to bail-in may help reduce such public cost, but its parameters should not depend on nationality.

The Pain and the Gain

If a significant number of problem banks are identified in the ECB's 2014 pre-handover assessment with large capital gaps, the corresponding restructurings will not be painless.

First, it is possible that one or several member states may be threatened by liquidity shortages as a consequence of their respective shares of the bank restructuring burden. The European Union has a policy framework in place to address such situations, with ESM assistance on the already established pattern of ESM lending to governments. Experience suggests that it is a difficult process, but this is a consequence of the insistence on national responsibility for legacy losses.

Second, widespread restructuring of problem banks may accelerate restructuring in the nonfinancial sector, as "pretend and extend" credit would stop being provided to unviable economic agents under the pattern colloquially known as "zombie banks lending to zombie borrowers." The extent of this adjustment will be dependent on the extent of problems uncovered in the balance-sheet assessment.

On the other hand, the potential gains from a well-managed assessment and restructuring process are considerable. Breaking the doom loop would decisively enhance the resilience of the European financial system and mitigate the economic impact of sovereign fragility. Moreover, lifting the dark cloud of uncertainty that currently hovers above Europe's banking sector will enhance confidence to an extent that has not been achieved since 2007, and can be expected to have a momentous positive impact on credit provision and European growth prospects. The precedent of the United States in and after 2009, among others, is encouraging in this respect. Restoring trust in Europe's banks will not be sufficient to put Europe back on a sustainable expansion trajectory, but it is arguably a necessary component of any credible growth strategy.

Moreover, it might be argued that the national public costs associated with legacy losses in problem banks are already priced in, at least to a significant degree: In this narrative, investors expect countries with weak banking systems to be burdened by their future cleanup; this affects current sovereign yields, even if the amount of future restructuring burden is a matter of assumption. If this assumption is even partly true, the likelihood of member states losing access to market funding as a consequence of the 2014 pre-handover restructuring would be limited. The lifting of current uncertainty over contingent sovereign liabilities from problem banks might even have a positive impact on sovereign credit conditions.

Even so, the period preceding the 2014 handover and the announcement of restructuring plans for problem banks is likely to be affected by significant market volatility, and investors' reactions cannot be reliably predicted in advance. It will be important for European policymakers to put in place robust communication channels with the investor community, and to keep as much flexibility as possible to address unexpected developments. This also argues in favor of a political agreement on significant centralization of decision-making, as no member state will gain from unnecessary market volatility in this delicate transition.

THE SRM AND GOVERNANCE OF BANK RESTRUCTURING

While the previous section addressed the question of funding, it leaves open the equally difficult issue of how individual decisions on bank restructuring might be made, with possible implications on the use of public funds, both before and after the 2014 handover. European leaders decided in December 2012 to complement the BRRD with the establishment of a Single Resolution Mechanism (SRM), but the terms of this debate are still confused and confusing.

To start with, it is not obvious whether the SRM can be in place at the time of the 2014 pre-handover assessment and restructuring. As previously emphasized, the success of this first phase (the first span of the bridge) is a precondition for any future banking union development. It would make little sense to focus on the SRM if it only enters into force in 2015[14] and the prior restructuring phase is botched. Moreover, the design of the resolution mechanism in the phase that follows the 2014 handover (the second span of the bridge metaphor)

14. Rebecca Christie, "Barnier Says EU Bank Resolution Should Start January 2015," *Bloomberg First Word*, June 7, 2013.

will build on the numerous lessons that will certainly be learnt during the experience of the pre-handover assessment and restructuring phase.

There is no clarity yet as to what form the SRM may take, and a range of options may be considered (see Véron and Wolff 2013). The joint French-German declaration of May 29, 2013 refers to a "single resolution board involving national resolution authorities and allowing quick, effective and coherent decision-making at the central level," thus implying a collective, possibly protracted decision-making process. By contrast, an early draft of the proposal from the European Commission has been reported as giving a prominent role to the commission itself.[15] This proposal has not been published by the commission at the time of writing.

There is no clarity yet as to what form the SRM may take, and a range of options may be considered.

Even after publication of the commission's proposal, and given the German general election cycle, the political choices on the steering of the 2014 pre-handover restructuring and the SRM are unlikely to be made by European leaders before the last quarter of 2013 at the earliest. The legislative timeline to establish the SRM before the 2014 pre-handover restructuring appears exceedingly tight, given that the term of the current European Parliament ends in the spring of 2014.

There are a number of requirements for the decision-making system that needs to be in place to manage the 2014 pre-handover restructuring, whether or not it is called a single resolution mechanism:[16]

- It must allow for rapid decision and flexibility, while limiting legal uncertainty to the extent possible. Restructuring plans will need to be negotiated on a case-by-case basis and may involve complex tailor-made financial engineering. These require considerable skills, flexibility, and financial acumen. Each case is specific, and any mistake, misjudgment or unnecessary delay can be extremely costly. A consensus-based committee decision framework is not well-suited for this task.
- It must ensure uniformity of bail-in parameters across member states, as analyzed in the previous section. A divergence of practices would exacerbate the doom loop and may impair European financial stability.
- It must be able to manage the cases of problem banks with significant cross-border operations throughout the geographical perimeter of the SSM. An abundant literature establishes that for such banks, the restructuring process is bound to be significantly more effective and less costly to the public if the decision-making process is centralized (e.g., Véron 2007), and this is reinforced by the crisis experience on cases such as Fortis and Dexia.
- It must ensure a Europe-wide level playing field for banking consolidation. Mergers and acquisitions are a normal component of bank restructuring strategies and can be expected to play an important role in the pre-handover restructuring phase. However, national authorities have had until now an inherent tendency to favor intra-country consolidation for a number of reasons that include information asymmetries, economic nationalism, and a widespread legacy in Europe of past use of banks by governments as instruments of national economic policies. In a European context in which many national banking markets are highly concentrated among a few large domestic banks, this may lead to economically suboptimal patterns of consolidation that may also in some cases reinforce the doom loop rather than mitigating it.

It will be a challenge to meet all these conditions, given political constraints and the absence of a legally robust European resolution regime, which probably requires treaty change as discussed above, and in any event will not be in place in 2014, or even 2015. It will be even more difficult in the absence of a European financial facility for bank recapitalization that could have created incentives for member states to cooperate. Moreover, even national resolution regimes, to the extent that they will be in place following adoption of the BRRD, will be untested in most member states and raise major operational and legal issues.

A key factor is the control of state aid by the European Commission in the context of such restructuring. Through state aid control, the commission's Directorate-General for Competition Policy (DG COMP) has become a prominent player in determining bank restructuring strategies throughout the European Union, and has developed a unique operational capability in this area. The continued need to ensure consistency of competition policy enforcement suggests that DG COMP's financial crisis task force will play an important and possibly central role in any European framework for the restructuring of

15. Alex Barker, James Fontanella-Khan, and Peter Spiegel, "EU banks blueprint sets up clash with Germany" *Financial Times*, June 4, 2013.

16. ECB President Mario Draghi noted at a news conference on June 6, 2013: "We are confident that the single resolution mechanism will be in place by the time the single supervisor takes over (…) A different thing would be the existence of a single resolution authority." Gabriele Steinhauser, "A Single Resolution 'Nothaurity'," *Wall Street Journal*, June 7, 2013.

problem banks in the 2014 transition. DG COMP's competition policy mandate makes it an awkward agent for system-wide bank restructuring, but it may have to assume leadership—as it has already done to a significant extent in the case of Spain—only because it has more of the needed experience than any other player, and for lack of a better alternative.

Even assuming that the experience and authority of DG COMP is leveraged to the maximum possible extent, there is probably no perfectly elegant way to resolve this challenge. Still, Europe's leaders have a window of opportunity to agree on a joint and/or delegated decision-making process that ensures sufficiently swift and uniform handling of the 2014 restructuring in a manner that preserves financial stability, mitigates the doom loop, and minimizes the public cost. But at the time of writing, it is not possible to say with confidence that Europe's leaders will take advantage of this opportunity.

A POSSIBLE SEQUENCE

Bringing together all the pieces of the above analysis, we present here a possible sequence of events that illustrates the possibility, at least in principle, of successfully bridging all aspects of the transition towards a banking union.

This of course is not intended as a forecast: The current European circumstances are far too complex for such predictability. The goal is only to demonstrate that, assuming a sufficient degree of lucidity and diligence in the policy process, the numerous constraints that apply to the European banking debate can be simultaneously addressed in a reasonable manner. Market and political risks will remain elevated at each step of the process, but the banking union equation is not (yet) impossible to resolve.

First Span of the Bridge: Addressing the Legacy (2013–14)

- **Q3 2013:** publication of the final SSM Regulation; start of operational buildup of the ECB's own supervisory capability; decisions by non-euro member states to join or not the SSM from the outset; progress towards finalization of the BRRD.
- **Q4 2013:** adoption of the BRRD and of the DGS directive; preliminary asset quality reviews by national authorities in anticipation of the 2014 handover; clarification of the European decision-making system for bank restructuring in the pre-handover phase; negotiation of the agreement between the ECB and national supervisors on the conduct of the 2014 pre-handover assessment and future modalities of cooperation.
- **Q1 2014:** start of transposition of the BRRD into national legislation of individual member states; finalization of the European decision-making system for pre-handover bank restructuring; start of the pre-handover balance sheet assessments by the ECB with the cooperation of national supervisors.
- **Q2 2014:** completion of transposition of the BRRD in individual member states; completion of pre-handover balance sheet assessments and corresponding stress tests coordinated by EBA; start of preparation of restructuring plans for problem banks.
- **Q3/Q4 2014:** decision on restructuring plans for problem banks; announcement of the results of the assessments and stress tests, and communication on the restructuring plans; market-driven recapitalization of those banks found undercapitalized but not severely so; implementation of the restructuring plans of problem banks, with funding from member states to the extent needed and bail-in to the extent possible; if any member states experience liquidity shortages as a consequence, negotiation of ESM assistance to those member states; effective handover of direct supervisory authority to the ECB.

Second Arch of the Bridge: The "Timber-Framed" Banking Union (Starting Late 2014/Early 2015)

- Further buildup of the ECB supervisory capabilities; adjustment of European bank resolution mechanisms on the basis of lessons learnt during the handover; any new public expenditure in newly emerging banking situations covered by European resources (including the ESM and/or contributions from the European financial sector); further harmonization of EU banking regulation; preparation and negotiation of treaty change.

Third Arch of the Bridge: Building the "Steel-Framed" Banking Union (Following Treaty Change)

- Implementation of treaty change and transition towards permanent banking union: adjustments to the SSM, including possibly more autonomy from monetary policy and equal governance rights and responsibilities for non-euro member states; creation of a European insolvency regime for banks; establishment of a European special resolution regime for banks and of the European Resolution Authority to administer it; creation of a European deposit insurance system with adequate funding and European fiscal backstop; broader EU reform (fiscal union, economic union, political union) to ensure the sustainability of the broader institutional and policy framework.

REFERENCES

Cihak, Martin, and Joerg Decressin. 2007. *The Case for a European Banking Charter*. IMF Working Paper 07/173. Washington: International Monetary Fund.

Coeuré, Benoit. 2013. *The Single Resolution Mechanism: Why it is needed*. Speech at the International Capital Markets Association's Annual Meeting and Conference, Copenhagen, May 23. Frankfurt: European Central Bank.

Darvas, Zsolt. 2013. *Can Europe Recover Without Credit?* Bruegel Policy Contribution 2013/03, February. Brussels: Bruegel.

Draghi, Mario. 2013. *Strengthening financial resilience*. Speech at the 2013 International Monetary Conference in Shanghai, June 3. Frankfurt: European Central Bank.

Fonteyne, Wim, Wouter Bossu, Luis Cortavarria-Checkley, Alessandro Giustiniani, Alessandro Gullo, Daniel Hardy, and Sean Kerr. 2010. *Crisis Management and Resolution for a European Banking System*. IMF Working Paper WP/10/70, March. Washington: International Monetary Fund.

Goldstein, Morris, and Nicolas Véron. 2011. *Too Big To Fail: The Transatlantic Debate*. PIIE Working Paper 11-2. Washington: Peterson Institute for International Economics.

Goyal, Rishi, Petya Koeva Brooks, Mahmood Pradhan, Thierry Tressel, Giovanni Dell'Ariccia, Ross Leckow, Ceyla Pazarbasioglu, and IMF staff team. 2013. *A Banking Union for the Euro Area*. IMF Staff Discussion Note SDN/13/01. Washington: International Monetary Fund.

De Larosiere, Jacques and co-authors. 2009. *Report of the High-Level Group on Financial Supervision in the EU*. Brussels: European Commission.

Marzinotto, Benedicta, Jean Pisani-Ferry, and Guntram Wolff. 2011. *An Action Plan for Europe's Leaders*. Bruegel Policy Contribution 2011/09, July. Brussels: Bruegel.

Pisani-Ferry, Jean, Andre Sapir, Nicolas Véron, and Guntram Wolff. 2012. *What Kind of European Banking Union?* Bruegel Policy Contribution 2012/12, June. Brussels: Bruegel.

Posen, Adam, and Nicolas Véron. 2009. *A Solution for Europe's Banking Problem*. PIIE Policy Brief PB09-13. Washington: Peterson Institute for International Economics.

S&P (Standard and Poor's). 2013. "What Are The Potential Rating Implications of the Proposed Eurozone Banking Union?" Standard & Poor's *RatingsDirect*, May 14, 2013.

Schäuble, Wolfgang. 2013. "Banking union must be built on firm foundations." *Financial Times*, May 13.

Véron, Nicolas. 2007. *Is Europe Ready for a Major Banking Crisis?* Bruegel Policy Brief 2007/03. August. Brussels: Bruegel.

Véron, Nicolas. 2011. "Stress tests are not enough to fix the banks." *Financial Times*, July 15.

Véron, Nicolas. 2012. *Challenges of Europe's Fourfold Union*. Testimony to the US Senate Committee on Foreign Relations, August.

Véron, Nicolas, and Guntram Wolff. 2013. *From Supervision to Resolution: Next Steps on the Road to European Banking Union*. PIIE Policy Brief PB13-5. Washington: Peterson Institute for International Economics.

Wymeersch, Eddy. 2013 (forthcoming). *The Single Supervisory Mechanism*. Cambridge: European Business Organization Law Review.