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International Aspects on the European Banking Union (EBU): Dynamism on the Harmonization of the Banking Supervision

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International Aspects on the European Banking Union (EBU): Dynamism on the Harmonization of the Banking Supervision[1]

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Abstract

This paper aims to analyze the direction, objectives, and dynamism of the European Banking Union through the following three viewpoints. First, we describe the contents of the single supervisory mechanism (SSM) and single resolution mechanism (SRM) through an institutional analysis. The SSM was established in November 2014 and the SRM was set up in January 2015. The SRM started as a full-fledged system in January 2016 with the situation that the Single Resolution Board (SRB) is playing a key role with Single Resolution Fund (SRF). We consider the introduction of a new tool such as a bail-in approach and its coordination with conventional tools such as bailouts. Second, we elucidate the feasibility of the European Deposit Insurance Scheme (EDIS). Concerning the establishment of this scheme, the European Commission published a proposal and related documents in 2015. Since the aftermath of the global financial crisis, the Eurozone countries were required to establish an effective common deposit guarantee system for consumer protection through a gradual approach. However, there are problems that Eurozone countries are facing pertaining to harmonization in Germany and setting up a common institution of deposit guarantee. These aspects need strenuous efforts. Third, the paper analyzes the EBU's relationship with the Financial Stability Board (FSB) and the Federal Deposit Insurance Corporation (FDIC). In terms of international aspects of the EBU, we need to focus on a common recognition with FSB's key attributes. It must also be noted that the FDIC has implemented a plethora of resolutions until date. Therefore, the FDIC is also to serve as a vital benchmark for Europe in terms of its functions in actual banking resolution and deposit protection.

Keywords: Banking Regulation, Prudential Policy, Financial Stability, European Union

JEL Classification: F36 (Financial Aspects of Economic Integration), G01 (Financial Crises), G28 (Government Policy and Regulation)

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1. Introduction[3]

As of 2017, the banking supervision of Eurozone banks is proceeding towards unification. The European Banking Union (EBU), which mainly consists of 19 Eurozone member states, has aimed to deepen and complete the Economic and Monetary Union (EMU) in Europe.

This study analyzes EBU's direction, objectives, and dynamism through the following three viewpoints. First, we describe the contents of the Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM). The SSM was established in November 2014 and has been implementing its policies over two years, while the SRM was set up in January 2015 and it started as a full-fledged system in January 2016 with the situation that Single Resolution Board (SRB) has begun to play a key role with Single Resolution Fund (SRF). We consider the introduction of a new tool such as a bail-in approach and its coordination with conventional tools such as a bailout.

Second, we elucidate the feasibility of the European Deposit Insurance Scheme (EDIS). The European Commission published a substantial proposal and related documents in November 2015. Since the aftermath of the global financial crisis (GFC) in 2008, member states in the Eurozone were required to set up an effective common deposit guarantee system for consumer protection through a gradual approach. However, the Eurozone must establish the scheme to make it more robust and credible as soon as possible. Until date, the standard for protecting deposits up to 100,000 EUR was stipulated in the Directive 2014/49/EU[4]. However, the Eurozone is facing problems pertaining to harmonization in Germany, which is a strong opponent country as a core member state. What should we shed light on the points as a viable scheme?

Third, the study analyzes the relationship between the EBU and the Financial Stability Board (FSB), and it compares the characteristics of EBU with that of the Federal Deposit Insurance Corporation (FDIC) in the United States. In terms of

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[3] I truly appreciate precious and informative interview and discussion on the EBU with following special experts and academics: Mr. Didier BRUNEEL (Conseiller, Cabinet du Gouverneur, Banque de France), Mr. Alan CAFRUNY (Professor, Hamilton College), Mr. Galo CEVALLOS (Senior International Advisor, Federal Deposit Insurance Corporation), Mr. Charles GOODHART (Professor and Programme Director, Financial Markets Group, The London School of Economics and Political Science), Mr. Jean-Claude HUYSSEN (Directeur des Agréments, des Autorisations et de la Réglementation, Autorité de Contrôle Prudentiel et de Résolution), and Ms. Machiko TOMITA, Manager, International Department, Deposit Insurance Corporation of Japan).

[4] DIRECTIVE 2014/49/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on deposit guarantee schemes (recast), recitals (23).

international aspects of the EBU, it is essential to focus on a common supervisory and regulatory recognition regarding to the FSB's Key Attributes. For example, the EBU and the FSB have common fundamental viewpoints, such as the bail-in approach and searching for effective banking supervision and resolution. On the other hand, the FDIC was established in 1933 and it has implemented a plenty of resolutions until date. Although the financial supervisory system of the US has been popular for its complicated organization as a whole, after the GFC, it has transformed into a new system along with the creation of the Financial Stability Oversight Council (FSOC) led by the Department of Treasury. Briefly, the distribution of the supervisory and regulatory tasks is trying to work in a harmonized way in the US. To this end, the FDIC is playing a vital role; the Eurozone should refer to FDIC's functions in the area of actual banking resolution and deposit protection.

In the context of the three points mentioned above, the paper aims to elucidate the features of the EBU.

2. Progress of the EBU: Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM)

2.1 Introduction of the EBU

The origin of the EBU can be traced to a document that was published in June 2012 by the European Commission. The project has merely experienced for only five years. Therefore, the proposal has been proceeding with several problems and tried to go over for it. There are some pros and cons, this issue is discussed among advanced economies, particularly in the Europe. Recently, these discussions are being published in the Financial Times (FT). Presenting the point of view of the UK, FT has indicated that the EBU has not been enjoying smooth sailing. On the other hand, to harmonize the banking supervision among the EU member states, in particular, the Eurozone countries, in itself, is the first empiric test in the world with a skill unrivalled by anything on international cooperation of banking supervision.

The EBU consists of the following three pillars as mentioned before: 1) Single Supervisory Mechanism (SSM), 2) Single Resolution Mechanism (SRM), and 3) European Deposit Insurance Scheme (EDIS). Among the three mechanisms, the SSM and the SRM have already started. On the contrary, the European Commission proposed the EDIS in November 2015; however, it has been under discussion so far. Eventually, the European Commission published the Communication document on October 11th in terms of completing the EBU by 2019[5]. The overall design of the EBU is shown in **Figure 1.**

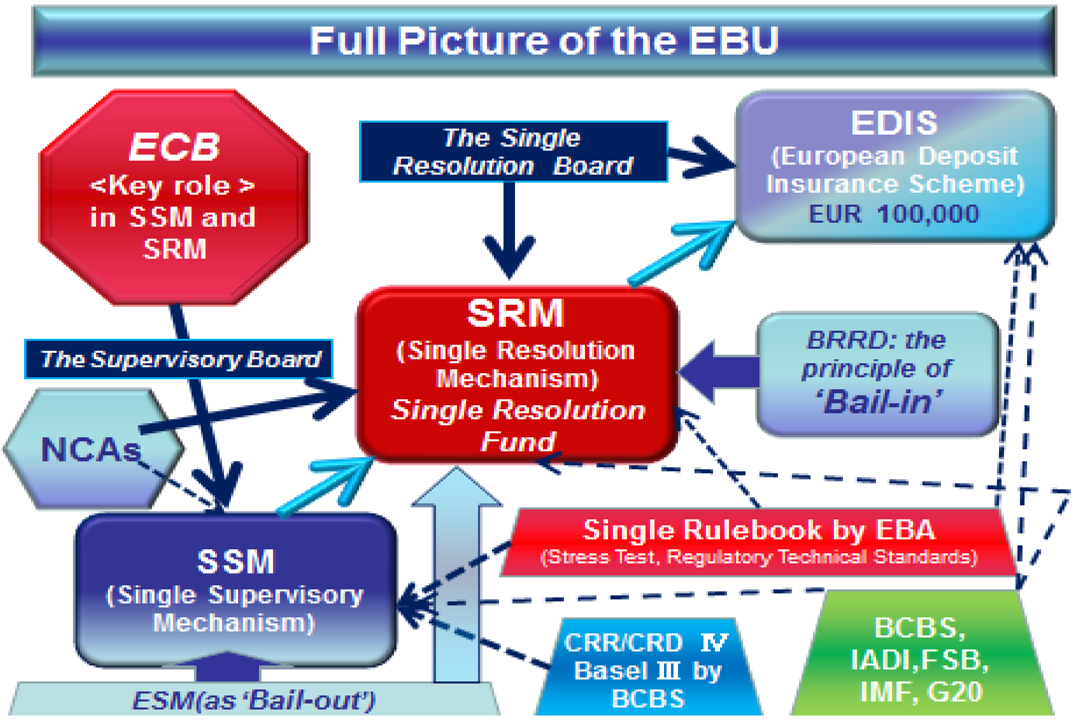


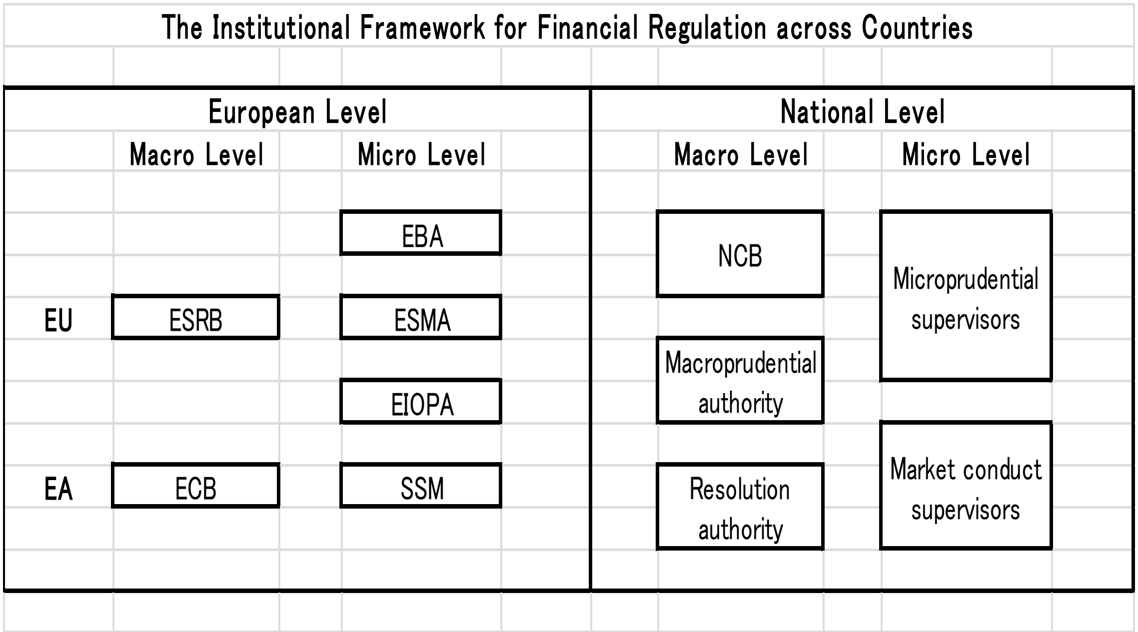
Figure 1: The European Banking Union: Full Picture

Source: Author's

Additionally, **Figure 2** systematizes the financial regulation of the EU and Eurozone, as of July 2016, published by the European Systemic Risk Board (ESRB)[6].

[5] European Commission (2017), *Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union*, Brussels, 11.10.2017, COM(2017) 592 final.

[6] ESRB (2016), *Macroprudential policy beyond banking: an ESRB strategy paper*, July, p. 25.



Note 1) EA means Euro Area.

2) Each institution is distinguished by the scope of mandates. In the national level, these functions often combine in same institution.

Source: ESRB (2016)

Figure 2: The Institutional Framework of Financial Regulation across both of the EU and the EA.

First, under the column marked as 'European Level' in **Figure 2**, the ESRB mandates macro-prudential policy in the domain of the EU. Concerning the micro-prudential policy in the EU Level, the European Banking Authority (EBA) manages the banking sector, the European Securities and Markets Authority (ESMA) mandates the securities, and the European Insurance and Occupational Pensions Authority (EIOPA) manages the insurance sector.

Second, in the Euro Area, namely, in the Eurozone, European Central Bank (ECB) is responsible for the macro-prudential policy and the SSM is involved with the micro-prudential policy. The ECB and SSM are key promoting institutions and mechanisms for the EBU; however, the functions of the ESRB, EBA, ESMA, and EIOPA should also be recognized. This is because the EBU should not only be considered from the viewpoint of Eurozone but also from the overall perspective of the EU in terms of the relationship between the harmonization of banking regulation and single market of the EU.

2.2 Background of establishment of the EBU

The European Commission launched the EBU through the publication of the project in June 2012[7]. The ideas stemmed from the 'de Larosière Report' (a high-level group that looks into financial supervision in the EU: Chaired by Jacques de Larosière, *Report*, 25th February 2009). The global financial crisis (GFC) of 2008 significantly impacted the European economy, thereby contributing to the weakening of the banking sector of the EU. In addition, the sovereign debt problem had occurred. In addition, during the GFC, the EU member states injected a large amount of public money to rescue their own domestic banks (bailouts), which led to a significant expansion in the budget deficits of the member states. As is well known, the United States is a main source of the GFC, thereby the significant banks such as Bear Stearns and Citi were bailed out by the US government, even though AIG as the largest insurance was given aid by the authorities. These dealing with the problem have imposed largely on the US budget.

In this context, as the vicious circle between banking and sovereign debt crises has continued to exit, it has become necessary for the Eurozone countries to strengthen supervision for global systemically important banks (G-SIBs). Concretely, the supervision for the G-SIBs has become one of the important agendas in the meeting of G20 finance ministers and central governors, and the FSB often proposes significant policies. The approach of FSB is not a 'hard approach', but a 'soft approach', which is similar to the Bank for International Settlements (BIS) approach. However, in fact, the FSB is developed as an international standard setting body (SSB), and hence the disciplines and directions are stipulated by the FSB. In addition, the Basel Committee on Banking Supervision (BCBS) mandates the capital adequacy regulations, such as Basel 1, 2 and 3, as the micro-prudential policies. In addition, the Basel capital regulations have progressed in the recent years. The main facts of both micro- and macro-prudential policies can be seen in **Figure 3**.

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[7] European Commission (2012) (Brussels, 6. 6. 2012 COM (2012) 280 final), Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL: establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/ EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/ 2010.

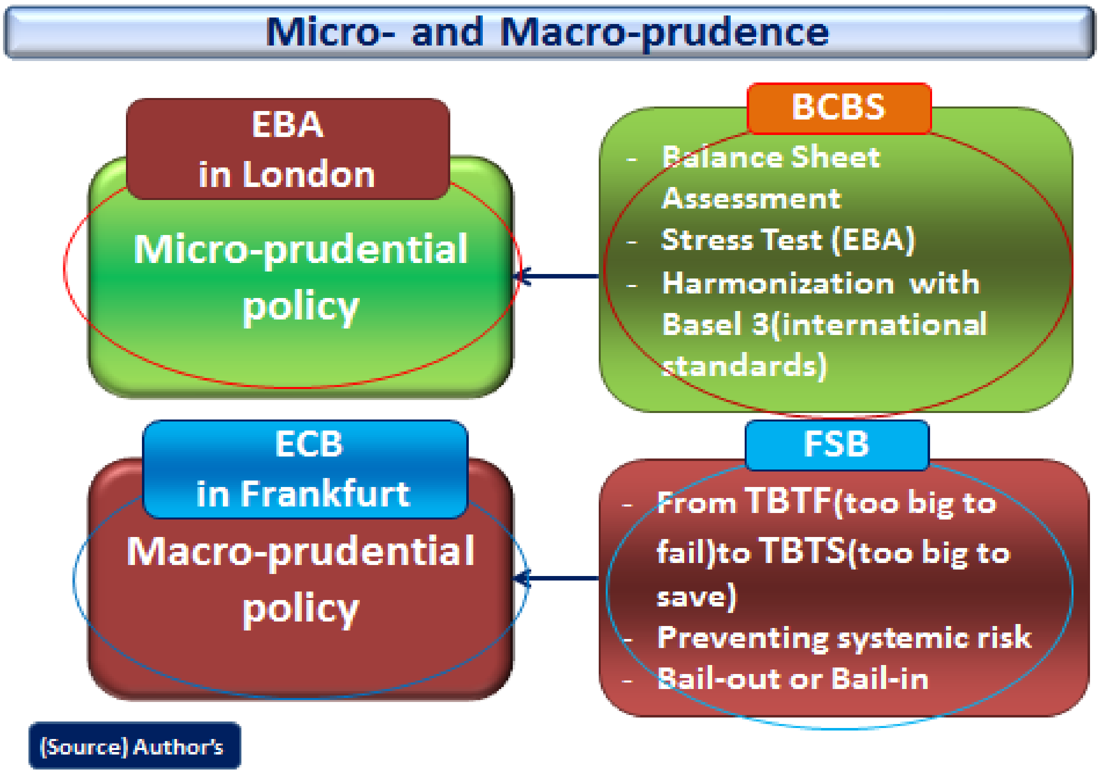

Figure 3: Micro- and Macro-prudential policies: their political domain and controlling institutions.

Source: Author's

2.3 Concrete issues faced by the EBU

In this section, we can list up to six points, to be specific, on the considering of the SSM and SRM.

First, it is on the Supervisory Review and Evaluation Process (SREP). This is one of the most important terms in the process of banking supervision direction. For the unification of banking supervision, the ECB published a document in November 2014, titled Guide to banking supervision. This document describes the following three points in detail: 1) principle of banking supervision, 2) function of SSM, and 3) implication of supervision in the SSM. In particular, the following points are analyzed in the SREP: 1) business model of banking, 2) governance, 3) capital, and 4) liquidity risk. In addition, risk management of each individual institution is examined[8]. In addition, the standards

[8] Lautenschläger, S (2016), "European banking supervision – much achieved, but still much to do", Speech in Bundesbank symposium 'Dialogue on banking supervision',

for evaluating the operation of 127 banks (as of 2016) are stipulated.

Second, it is about the Options and Discretions (ONDs). It focuses on how much room is remained of discretion of interpretation for each individual rule towards the EU's regulation. Until date, the SSM compiled the special issue on interpretation in the field of ONDs, and public comment has published on the definition and the status of the ONDs. Chair of the SSM, Danièle Nouy, explained the issue behind unifying the ONDs, as far as possible. Thereby, it is not easy to make the various meanings unified on the ONDs standardized.

Third, it is about the Total Loss Absorbing Capacity (TLAC). In the aftermath of the GFC, the need to strengthen capital of the banking sector as a buffer was heightening. This is the point that is related with the arrangement of the BCBS in BIS. In addition, the FSB shows the motion request the G-SIBs to keep the enough TLAC (especially, in August 2016). On the contrary, there is a concern that setting the TLAC may have induced a negative effect on the lending by banks.

Fourth, it is on the Joint Supervisory Teams (JSTs). The staffs from the ECB and National Competent Authorities (NCAs) supervise Eurozone's banking institutions on a conjoint basis. The organization of the ECB on banking supervision was contrived to establish cooperation between the ECB and NCA. The organizational structure is very lucid; to be specific, clarified distinguishing between macro- and micro-prudential sectors. However, the organization faces the challenge of how to address the home-host problem (relationship between home countries' supervision and host countries' supervision). The Chair of the SSM, Danièle Nouy mentioned about the home-host problem in the interview by Helsingin Sonomat in September 2016. The question that arises here is what the chair thought of the operations of major non-Eurozone banks, such as the Swedish Nordia, in the Eurozone (such as in Finland), in that situation; these big banks were not supervised by the ECB because the ECB directly supervised only the Eurozone banks. The Chair Nouy replied that there is no reason to deny the cooperation (between the Swedish authority as a home country and the Finnish authority as a host country) might work well. Additionally, she explained that the ECB has initiated a discussion with Swedish authority, thereby automatically involving the Finnish authority[9]. The Chair pointed out that the ECB only guarantees a smooth allocation of responsibilities between the home and host authorities. Therefore, we cannot read the more concrete involvement of the ECB for them. We can assume that a negotiation between the

Frankfurt am Main, 1 June.

[9] This passage on the interview was including the author's codicil for lucid explanation in the paper.

authorities has the most important meaning.

Fifth, it is on the need to introduce bail-in in the SRM. We need to reconsider both its advantages and disadvantages. The bail-in approach, which does not introduce public funds, uses private banks' funds and makes creditors bear the burden of the loss of the failing banks. Additionally, in fact, the approach considers the use of contingent convertible bonds (CoCo bonds); therefore, the bail-in approach will have a broader penetration into the society and the system of imposing creditors for the failing banks' losses has been formulated recently. However, the financial markets always demand a quick response from the authorities during the exigencies. Therefore, practical measures are required during such situations including governmental rescue and backup systems as safety nets.

Sixth, it is on the results of stress tests. The results published by the EBA in July 2016 showed a capital shortage in Italian banks. It implied that the common and robust deposit guarantee scheme is acutely needed and needs to be strengthened to prevent the enlargement of risk of resolution and a bank run. At the global level, the International Association of Deposit Insurance (IADI), which is chaired by the governor of the FDIC, needs to strengthen the effective power to cope with these issues. This point relates to the EBU's relationships with international SSBs. We should pay our attention to the issue how the relationships between the FDIC and the IADI, and the EBU and the SSBs, respectively after the EBU is completed.

In its July 2016 special issue, *The Banker* ranked the European banks as per their capital strength. We can see it on the global position of the European banks and its capital information in detail.

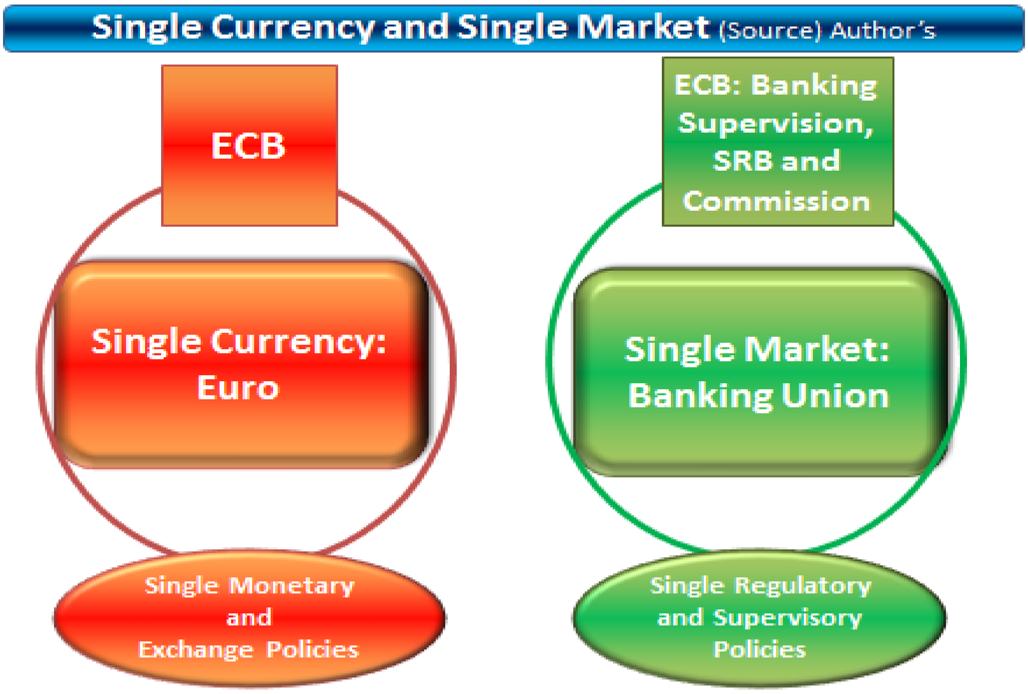

Figure 4: Single Currency and Single Market: Monetary and Exchange Policies vs Regulatory and Supervisory Policies
Source: Author's

2.4 Implications of single currency and single market and the measures implemented by the EBA

Figure 4 shows the political field of the single currency (Euro) and the single market (EBU) in the EU. As a result, of former field is the Euro and as a typical fruit of latter is the EBU. Concerning the Euro, the ECB manages monetary and exchange rate policies as a unified methodology; however, the ECOFIN and ECB consult on matters pertaining to the exchange rate policy. Concerning the EBU, the ECB also plays a substantial role in implementing supervisory policy through its Banking Supervision sector, namely, SSM, particularly to supervise the important institutions of Eurozone, systemically. Additionally, the SRB oversees the bank resolution in the single methodology. These two domains interact with each other. When the authorities perform banking supervision, they must implement regulatory and supervisory policies by grasping the monetary policy situation existing during the time. For example, the quantitative easing policy of ECB, such as CBPP3 (Covered Bond Purchasing Programme 3), CSPP (Corporate Sector Purchasing Programme), and Negative Interest Rate Policy, are being implemented in the current scenario.

Additionally, the EBA has played a key role in supervisory harmonization in Europe. The EBA's headquarters are currently located in London, and it is the EU's regulatory setting body in banking sector. However, the headquarters would be moved to another city in the EU as a result of the Brexit. As mentioned above in **Figure 1** and **2**, the EBA is one of the ESAs (European Supervisory Authorities), and one of the ESMAs and EIOPAs in Paris and Frankfurt, respectively. Since its establishment in 2011, the EBA has been working as an institution not only in Eurozone but also in the whole of the EU. The functions of the EBA are as follows: 1) making a single detailed rulebook on technical matters 2) setting technical and professional standards on banking regulation and 3) mediating conflicts of interests among authorities of the member states with the aim of resolving them. Additionally, the EBA (2016) explains the dealing with unification of supervisory habits diversified among the member authorities for the convergence of banking supervision[10].

Particularly, there are several assessment tools, such as desk-based reviews, for assessing the convergence of banking supervision and the scope of the supervisory practices.

In the following sections, this paper discusses the international cooperation for the financial stability, to be precise, harmonization of banking supervision. Additionally, it is necessary to consider the issue from another perspective. Particularly, it is important to focus on establishing cooperation among authorities within the same country. For example, in Japan, the Financial Services Agency, as a governmental body and the Bank of Japan, as the central bank, co-operate for performing banking supervision. Although these inspection bodies are different from each other (the former has been more robust and stricter when compared to the latter so far), both institutions conduct banking inspections. In other words, the existence of domestic institutional cooperation is a prerequisite to facilitating international cooperation. Similar cases can be seen in Japan and Switzerland, among others. For example, Swiss Financial Market Supervisory Authority (FINMA) and Swiss National Bank (SNB) concluded a Memorandum of Understanding (MoU) and stipulated the cooperative relation between both authorities[11].

As mentioned above, it would be important to address several problems if we make the banking supervision and bank resolution rule-based. Additionally, we should shed light on how the ECB and the EBA allocate their respective roles. Moreover, both the institutions must adjust the direction of the BCBS on the micro- and macro prudential

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10 EBA (2016), *EBA Report on the Convergence of Supervisory Practices*, 14 July.

11 Swiss National Bank (2010), *Memorandum of Understanding in the field of financial stability between the Swiss Financial Market Supervisory Authority FINMA and the Swiss National Bank SNB*, 23 February.

policies.

3. Signs of a Common Deposit Guarantee System: European Deposit Insurance Scheme (EDIS)

3.1 Proposal of EDIS and its contents: Purposes and subjects of unification of the deposit guarantee system in Europe

It would be essential to set EBU as one of the pillars for establishing a common deposit guarantee scheme. Although the SSM and SRM have progressed from the proposal to implementation stage, the establishment of EDIS is still a pending matter. However, the standard amount for deposit protection of EUR 100,000 has already been stipulated in the DIRECTIVE 2009/14/EC[12]. Therefore, it is essential to complete the task for implementation.

A reference to the DIRECTIVE 2014/49/EU can explain how the European Commission, as a legislative body, considers the need for harmonizing the deposit guarantee schemes in the EU[13].

The Commission has aimed to deepen or achieve the single market status through the following two perspectives in the field of financial institutions: 1) freedom of establishment of institutions and 2) freedom of providing financial services. Moreover, the Commission's ultimate goals are as follows: 1) stability of banking system and 2) protection of depositors.

In Japan, the Deposit Insurance Corporation of Japan (DICJ) protects insured deposits up to JPY 10,000,000, in principal, plus accrued interest until the day of failure per depositor and per financial institution for deposits[14]. The US FDIC generally sets a coverage limit of USD 250,000. For example, for a single account, that is, a deposit account owned by one person, without named beneficiaries, the coverage limit is set at

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12 DIRECTIVE 2009/14EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, *Official Journal of the European Union*, 13.3.2009, L 68/3. The coverage level is also referred in DIRECTIVE 2014/49/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on deposit guarantee schemes (recast), recitals (23).

13 DIRECTIVE 2014/49/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on deposit guarantee schemes (recast), in *Official Journal of the European Union*, L 173/149.

14 DICJ, *Operations of DICJ: (1) Deposit Insurance Occupation* (http://www.dic.go.jp/english/e_kikotoha/e_gyomu/index.html).

USD 250,000 per owner[15]. In the EU, the DIRECTIVE 2014/49/EU stipulates a coverage level EUR 100,000 for the 'aggregate deposits' of each depositor in the event of unavailability of deposits[16]. Concerning this point, the standard coverage limit set by the US outweighs that of the EU and Japan.

In addition, in the EU, although it is still in the proposal stage, the Commission published the concrete design in November 2015[17]. However, even though Germany is one of the most important countries to proceed with the European Economic and Monetary Union (EMU), German authorities are very prudent with regards to the implementation of EDIS. Particularly, the Deutsche Bundesbank expressed concern with regards to the introduction of the EDIS. In June, Mr. Andreas Dombret, the member of the Executive Board of the Bundesbank and member of the Supervisory Board (SSM) of the ECB, expressed his concern about the risk for introduction of the EDIS that the Commission speeds up the process to deal with[18]. He pointed out this issue during his speech at the banking symposium organized by the Bundesbank in Frankfurt, which was also officially published by the Bank. He insisted that the EU should look at alternative solutions, other than EDIS, to strengthen the elements of the deposit guarantee schemes in Europe.

In relation to the effectiveness of the EDIS, Professor Dirk Schoenmaker, earlier suggested, analyzed, and proposed the financial trilemma. In addition, he proposed the design of the Deposit Insurance and Resolution Authority[19].

3.2 Placing the deposit guarantee system: The financial trilemma

This financial trilemma is different from the famous international financial trilemma. The latter refers to the impossible trinity of the three conditions: 1) maintaining the fixed

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15 FDIC, How Are My Deposit Accounts Insured by the FDIC? (https://www.fdic.gov/deposit/covered/categories.html)

16 DIRECTIVE 2014/49/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on deposit guarantee schemes (recast), in *Official Journal of the European Union*, L 173/149, Article 6(1). Also, the DGS was analyzed in the Haentjens, M. and P. de Gioia-Carabellese (2015), *European Banking and Financial Law*, Routledge, p.128.

17 European Commission (2015), Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, Strasbourg, 24.11.2015 COM(2015) 586 final.

18 Deutsche Bundesbank (2016), *Dombret: Deposit insurance need not necessarily be European*, 2 June.

19 Schoenmaker (2013), *Governance of International Banking*, Oxford University Press, p. 134, Figure 7.1

rate (exchange stability) 2) free movement of capital and 3) independent monetary policy. **Figure 5** shows that the three conditions are inconsistent in the Schoenmaker's financial trilemma.

In other words, banks that are operating internationally (2nd factor in the Fig. 5) have to abolish their own banking supervisory and resolution policy (3rd factor in the Fig. 5) for achieving financial stability (1st factor in the Fig. 5). Owing to the high dependency on banking transactions in the Eurozone, the member states have experienced global financial crisis and repeated Euro crisis; therefore there is a need for these countries to make their financial system sound and robust. To this end, they must delegate banking supervision and resolution to a single institution in the Eurozone.

In addition, the system of bank resolution works closely with deposit guarantee scheme because both the systems have been formulated in response to urgent circumstances. During the global financial crisis, as the deposit guarantee schemes in the EU are diversified, deposits among the EU member states were transferred to countries where the deposits are sufficiently guaranteed. History shows that bank runs always occur during banking crises. The unification of the coverage level of deposits and a pan-European deposit guarantee scheme are indispensable for formulating an ex-ante measure. However, an organization can proceed in either one of the following two directions: one is related to setting a single institution for deposit guarantee, while another is the use of the existing SRB as a management body that cooperates moderately with national deposit guarantee authorities. The former approach involves drastic measures, wherein and the establishment of a new system would need capital investment and throwing up experts from each member state. On the contrary, the latter is pragmatic. As per the blueprint 'Completing EMU (Five presidents' report)', proposed on 22 June 2015 by the European Commission, the Commission aims to set up a bridge bank mechanism for the SRF as the Stage 1 (from 1 July 2015 to 30 June 2017) and to establish a credible back-stop to the SRF[20]. Particularly, it is feasible to set up a back-stop through the credit provided by the European Stability Mechanism (ESM). In addition, the ESM that originally injects capital for failing banks through a bailout approach needs to be reconsidered on its functions. In addition to 'Completing EMU', the Commission published a reflection paper on the 'Deepening of the EMU' on 31 May 2017 to revise the roadmap for the EMU[21].

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[20] European Commission (Reported by Juncker, J.-C. in close cooperation with Tusk, D., Dijsselbloem, J., Draghi, M. and M. Schulz) (2015), *Completing Europe's Economic and Monetary Union*, 22 June.
[21] European Commission (2017), *Reflection Paper on the Deepening of the Economic and Monetary Union*, COM (2017) 291 of 31 May 2017.

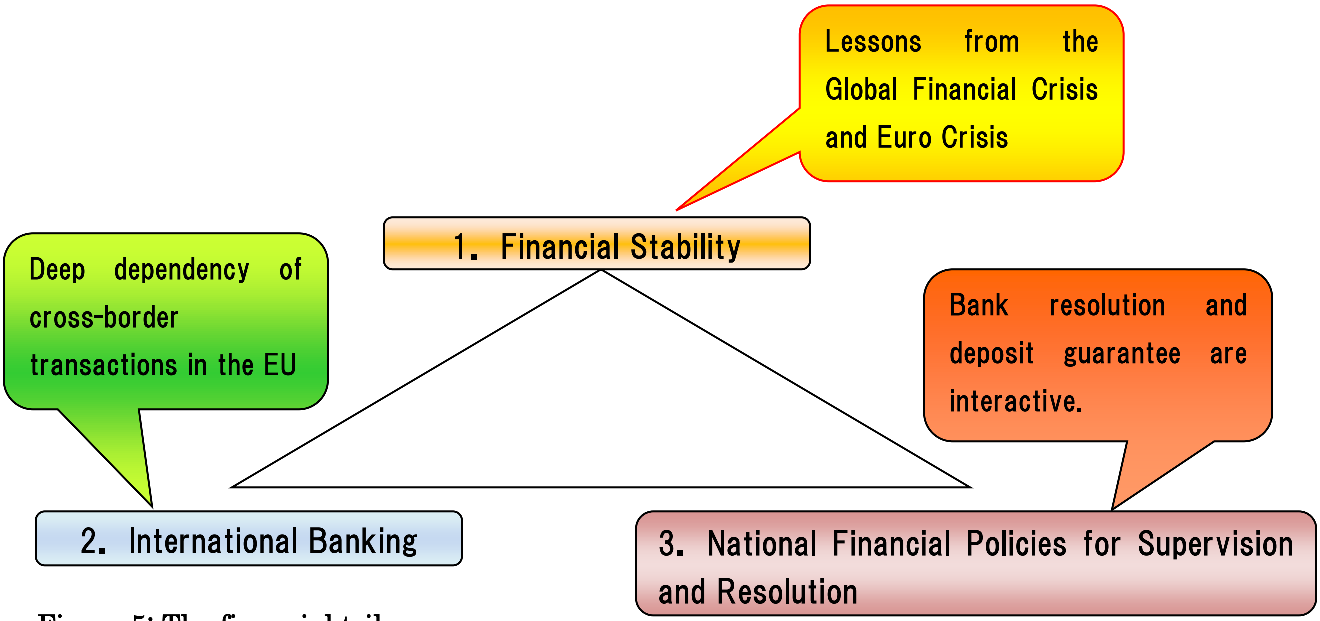

Figure 5: The financial trilemma

Source: Compiled and added some comments by author based on Schoenmaker (2013), *Governance of International Banking*, Oxford University Press, p. 7 (Original source of the trilemma was written in Schoenmaker (2011), 'The Financial Trilemma,' *Economic Letters*, 111, 57-59.

3.3 How is the situation under which the European banks are managing nowadays? : Interest rates, stock markets, and attitude of the European banking sector

Subsequently, we investigate the economic situation under which the Europe's banks are managing. There are four tables as follows: 1) short-term interest rates, 2) stock markets, 3) bank lending to private sector, and 4) the situation of LIBOR (London Interbank Offered Rate).

(1) Short-term interest rates

Money Market Interes Rates								
(Annual Rate %; Average of the Period)								
		EURO AREA					United States	Japan
		Overnight deposits (EONIA)	1-month deposits (EURIBOR)	3-month deposits (EURIBOR)	6-month deposits (EURIBOR)	12-month deposits (EURIBOR)	3-month deposits (LIBOR)	3-month deposits (LIBOR)
2013		0.09	0.13	0.22	0.34	0.54	0.27	0.15
2014		0.09	0.13	0.21	0.31	0.48	0.23	0.13
2015		-0.11	-0.07	-0.02	0.05	0.17	0.31	0.09
2015	Dec.	-0.20	-0.19	-0.13	-0.04	0.06	0.53	0.08
2016	Jan.	-0.24	-0.22	-0.15	-0.06	0.04	0.62	0.08
	Feb.	-0.24	-0.25	-0.18	-0.12	-0.01	0.62	0.01
	Mar.	-0.29	-0.31	-0.23	-0.13	-0.01	0.63	-0.01
	Apr.	-0.34	-0.34	-0.25	-0.14	-0.01	0.63	-0.02
	May	-0.34	-0.35	-0.26	-0.14	-0.01	0.64	-0.03
	Jun.	-0.33	-0.36	-0.27	-0.16	-0.03	0.65	-0.03

Table 1: Money Market Interest Rates in the Euro Area, the US and Japan (2013- June 2016)

Source: ECB (2016), *Economic Bulletin*, Issue 5 – Statistics (Original Source: ECB).

(2) Stock Markets

Stock Market Indices								
(Indicated of the Starndard by Points; Average of the Period)								
		Dow Jones EURO STOXX Indices					United States	Japan
		Benchmark		Main Industry Indices (extract)				
		Broad Index	50	Financials	Industrials	Health Care	Standard & Poor's 500	Nikkei 225
2013		281.9	2,794.0	151.5	402.7	629.4	1,643.8	13,577.9
2014		318.7	3,145.3	180.0	452.9	668.1	1,931.4	15,460.4
2015		356.2	3,444.1	189.8	500.6	821.3	2,061.1	19,203.8
2015	Dec.	346.0	3,288.6	180.2	494.9	811.0	2,054.1	19,202.6
2016	Jan.	320.8	3,030.5	161.6	463.6	769.6	1,918.6	17,302.3
	Feb.	304.3	2,862.6	144.0	449.9	732.6	1,904.4	16,347.0
	Mar.	322.2	3,031.4	155.9	483.1	746.9	2,022.0	16,897.3
	Apr.	323.4	3,031.2	153.6	491.4	772.7	2,075.5	16,543.5
	May	319.5	2,983.7	150.8	491.9	755.7	2,065.6	16,612.7
	Jun.	312.2	2,910.8	141.7	481.3	761.3	2,083.9	16,068.8

Note: Main Industry Indices are chosen by Author.

Table 2: Stock Market Indices in the Euro Area, the US and Japan (2013- June 2016)

Source: ECB (2016), *Economic Bulletin*, Issue 5 – Statistics (Original Source: ECB).

(3) Bank Lending to Private Sector

Result of the Bank Lending Survey (BLS)

(%; Strengthening of banks' credit standards and banks' positive demand for lending for private sector)

Country	ENTERPRISES						HOUSE PURCHASE						CONSUMER CREDIT					
	Credit Standards			Demand			Credit Standards			Demand			Credit Standards			Demand		
	16Q1	16Q2	Average	16Q1	16Q2	Average	16Q1	16Q2	Average	16Q1	16Q2	Average	16Q1	16Q2	Average	16Q1	16Q2	Average
Euro Area	-6	-7	11	17	16	-5	4	-2	8	32	30	1	-3	-5	6	16	21	-2
Germany	-6	-3	5	22	6	3	21	28	3	21	7	9	3	0	0	13	26	8
Spain	0	0	11	-10	0	-3	-11	-11	19	-11	-11	-11	-20	-10	10	20	0	-10
France	4	-14	8	13	24	-16	0	-15	3	26	40	6	0	0	-2	43	30	-3
Italy	-38	-13	17	38	25	3	-13	-38	3	75	50	12	-25	-25	9	25	25	11
Netherlands	0	0	11	24	21	-4	14	0	19	89	74	-10	30	0	14	-30	0	-21

Table 3: Result of the Bank Lending Survey (BLS)

Source: ECB (2016), *The euro area bank lending survey*, July 2016, Table A.

The **tables 1, 2,** and **3** are estimated as follows. First, the low interest rates affect the profitability of banks. The situation of low interest rates is beneficial for collecting funds; however, it has a negative effect on bank lending. Conversely, generally, this interest rate level scenario induces activation of the short-term financial markets. ECB's negative interest rate and quantitative easing policies have given rise to the sentiment of ease in the financial markets. This point introduces the expansion of bank lending and contributed towards easing bank lending.

Second, we can see the stagnancy of stock markets. The period considered in the **Table 2** shows that the financial sector has been flagging. This market environment affects the capitals in the balance sheets of banks. The flagging stock markets and stagnancy in the financial sector stocks are negative factors for banks in the status that the capital strength would take on an increasingly important role in tune with the direction of the BCBS and the FSB. Particularly, obligating the total loss-absorbing capacity (TLAC) as a buffer during a crisis negatively affects the whole banking sector in some aspects.

Third, overall, there seems to be a smooth progress concerning bank lending to private sector. However, this scenario was introduced through the ECB's non-standard measures. Briefly, this is the result of the mechanism of working of the negative interest rate and quantitative easing policies by the ECB; particularly, it is related to the latter policy, corporate sector purchase programme (CPSS) is working. However, although the banks' stances on lending are easing, major countries in the Eurozone are divided in detail by country and quarter.

(4) Situation of the LIBOR (London Interbank Offered Rate)

Change of LIBOR												
Results of the LIBOR on 16 September 2008 (right after the Lehman Brother's collapse) and on 16 September 2016 (after exactly 8 years) (%)												
	Overnight		1 Week		1 Month		3 Monthes		6 Monthes		1 Year	
	16 Sep. 2008	16 Sep. 2016	16 Sep. 2008	16 Sep. 2016	16 Sep. 2008	16 Sep. 2016	16 Sep. 2008	16 Sep. 2016	16 Sep. 2008	16 Sep. 2016	16 Sep. 2008	16 Sep. 2016
US $ Libor	6.43750	0.42044	3.87500	0.45228	2.74750	0.53178	2.87625	0.85711	3.01625	1.24733	2.95250	1.54489
€ Libor	4.41750	-0.40157	4.49063	-0.38714	4.53188	-0.37400	4.96625	-0.32086	5.18938	-0.20829	5.34313	-0.07300
£Libor	6.79375	0.22875	6.48750	0.24563	5.50125	0.26938	5.79125	0.38031	5.89000	0.52719	5.98625	0.74763
Swiss Franc Libor	3.00000	-0.79160	2.86667	-0.80400	2.30833	-0.80620	2.73250	-0.74380	2.87000	-0.64240	3.14167	-0.47660
¥Libor	0.94375	-0.04357	0.91250	-0.05271	0.73000	-0.09629	0.89250	-0.03943	0.98125	-0.01121	1.16375	0.08714

Note: As for 16 Sep. 2008, the data are at 3:49 p.m. at London time. As for 16 Sep. 2016, the data are at 11:45 a.m. at London time.

Table 4: Change of LIBOR from 16 Sep. 2008 to 16 Sep. 2016

Source: Compiled by author based on the data of Intercontinental Exchange (ICE), *Report Center* (www.theice.com).

Table 4 shows the situation of the USD LIBOR, Euro LIBOR, GBP LIBOR, Swiss Franc (CHF) LIBOR, and JPY LIBOR. These data provide a comparison between data collected as of 16 September 2008 and data collected as of 16 September 2016. The former day was right after the Lehman Brothers applied for the Chapter 11, and the latter day was exactly eight years after the former one. We can pay attention to the high level of overnight LIBOR on 16 September 2008; the USD LIBOR, GBP LIBOR, Euro LIBOR, and CHF LIBOR were 6.43750%, 6.79375%, 4.41750%, and 3.00000%, respectively. These figures show that the USD and GBP were highly demanded in the short-term financial markets. Moreover, we can see from the table that although the USD LIBOR recorded a high overnight demand as percentage, it ranged from about 2.7% to 3.0% through one-month to one-year term as a moderate level. On the contrary, the GBP LIBOR showed the range from about 5.5% to 6.0% through the same period as a high level.

In addition, eight years after the collapse of the Lehman Brothers, on 16 September 2016, in the overnight, the USD LIBOR and GBP LIBOR were 0.42044% and 0.22875%, respectively. These figures showed the plus level; however, the Euro LIBOR, CHF LIBOR, and the JPY LIBOR were −0.40157%, −0.79160%, and −0.04357%, as a negative level, respectively. An assessment of the environment can show that it is hard for the European and Japanese banks to maintain their profitability.

Chair of the SSM, Madame Nouy, strongly expressed that profitability was a key issue for the SSM to cope with from now and improving of the profitability of banks would be able to strengthen of the European banks' capital[22].

Concisely, the financial market's environment has not been allowed optimism, despite the implementation of the quantitative easing. In addition, the Basel Ⅲby the BCBS demands the private banks for more strong capital and TLAC as a buffer in crises. Therefore, in the midst of boosting the micro-prudential policy as a macro-prudential measure, the EBU aims to unify the deposit guarantee scheme as an essential safety net during financial crises.

4. Financial Stability Board (FSB) and Federal Deposit Insurance Corporation (FDIC)

4.1 Role of the FSB: Importance of FSB in the aftermath of the global financial crisis

The FSB is an international financial regulatory body whose headquarters is located in Basel, Switzerland. As one of the important SSBs, the FSB uses the soft-law approach that does not have legal constraints like the approach that the BCBS uses for setting banking regulatory policies. It differs from hard-law approach that has legal bindings. Therefore, the FSB submits proposals to the G20 almost every time in advance, and it has already become an indispensable institution for deciding the direction of international financial regulation.

Since the global financial crisis in 2008, financial regulatory matters have been attracting attention in the globalizing world. The following periods in the US are related to the process of financial regulation as a whole: 1) the 'regulation period' appeared in the 1930s and the period introduced several regulations, such as the Banking Act of 1933 (Glass–Steagall) after the Great Depression in 1929, 2) the 'de-regulation period' from 1970s to 1990s was in tune with globalization and facilitated regulations such as the Gramm-Leach-Bliley Act of 1999, and 3) the 're-regulation period', in the aftermath of the global financial crisis in 2008, witnessed regulations such as the Dodd-Frank Wall Street Reform and the Consumer Protection Act of 2010. Although the Trump

[22] ECB Banking Supervision (2016), *Interview with Helsingin Sonomat, Interview with Danièle Nouy, Chair of the Supervisory Board of the ECB*, conducted by Anni Lassila on Monday 12 September 2016 and published on 21 September 2016.

administration is trying to revise the Dodd-Frank Act this year, the global trend is still in the 're-regulation period', and hence the FSB has been considering regulation for shadow-banking as well as conventional regulations in the field of banking, securities, and insurance sectors. Originally, the FSB's mandate could be placed in the macro-prudential policy in aforementioned **Figure 3**.

In October 2011, the FSB first proposed the key attributes at the plenary session that showed the twelve important principles on the international financial regulation. As of 2017, the twelve principals have not been changed fundamentally (**Table 5**).

	Twelve Essential Features in the Key Attributes
1	Scope
2	Resolution authority
3	Resolution powers
4	Set-off, netting, collateralisation, segregation of client assets
5	Safeguards
6	Funding of firms in resolution
7	Legal framework conditions for cross-border cooperation
8	Crisis Management Groups
9	Institution-specific cross-border cooperation agreements
10	Resolvability assessments
11	Recovery and resolution planning
12	Access to information and information sharing

Table 5: FSB's 12 Key Attributes
Source: FSB (2014), *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 15 October.

In August 2016, the FSB published documents on several directions of bank resolution for globally systemically important banks (G-SIBs)[23]. Particularly, the FSB's methodologies and ideals were shared with the EBU to stipulate legally not to rely on nationalization as a means of bank resolution or rely on bailout funds, namely, depend on spending of public funds. In addition, a deposit insurance funded by private sector, bank resolution fund, or funding institution would be recovered ex-post by banking industry to promote bank resolution and impose the costs of providing temporary finance[24]. Moreover, the FSB is trying to play a role with regards to TLAC that would

[23] Financial Stability Board (2016), *Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank ("G-SIB")*, 18 August.
[24] *Ibid.*

act as a buffer for absorbing losses in crises. These situations imply that the FSB has been implementing macro-prudential policy as well as targeting the micro-prudential policy.

4.2 Function of the FDIC: The vital features and differences between the EBU and the FDIC

To analyze the EBU, it is very beneficial to consider the policy of the FDIC in the United States[25]. The FDIC is an institution that embraces the bank resolution and the deposit guarantee policies. On the contrary, in the EU, the SRM and the EDIS are separate mechanisms and the periods of their respective implementations are different. In this context, emphasis must be put on how we can consider bank resolution and the protection of depositors during crises.

The FDIC is one of the most distinguished deposit insurance institutions in the world. It has experienced many issues over the past 80 years since its establishment in 1933. Certainly, the Great Depression triggered by a sharp slump in stock prices in New York Stock Exchange in 1929 led to the establishment of the FDIC. It has advanced methodology of designing and rich measures of bank resolution. In the aftermath of the global financial crisis in 2008, the Dodd-Frank Act made the FDIC strengthen its functions, and the Act raised its coverage level of deposit to USD 250,000. This standard limit is about twice the Japanese standard. At present, the FDIC is working in the cooperation of comprehensive banking supervision and bank resolution. Under the Financial Stability Oversight Council (FSOC) established by the Dodd-Frank Act, the FDIC coordinates with several important bodies, such as the Office of the Comptroller of the Currency (OCC) that supervises the national banks affiliated by the Treasury.

The FDIC has been places 'CAMELS' at the centre of political discipline for the supervision of its target banks and bank resolution. The CAMELS shows these six points: 1) Capital Adequacy (C), 2) Asset Quality (A), 3) Management (M), 4) Earnings (E), 5) Liquidity (L), and 6) Sensitivity to Market Risk (S)[26].

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[25] In particular, the aftermath of the global financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act was approved to prevent the inducing financial crises by excessive banks' risk taking (signed by the President on 21 July 2010). In the Act, the reform of the FDIC was required. See, FDIC, *Annual Report*, various issues. And the US regulatory system is relatively complicated. On the structure of the US regulatory framework, see, Kushmeider, R.M. (2005), 'The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation,' *FDIC Banking Review*, Volume 17, No. 4.

[26] I truly appreciate Mr. Velo Cevalos who is the Senior International Advisor of the

As per the *2015 Annual Report* of the FDIC, the FDIC protects USD 6.4 trillion of deposits, covering over 500,000,000 accounts of 6,300 banks as deposit insurance. Moreover, it supervises 3,995 financial institutions and manages 470 receiverships, whose total assets are worth USD 23.9 billion[27].

One of the FDIC's features is to implement the deposit insurance function by taking all the authority on bank resolution. However, in relation to the mandate of direct banking supervision, the national banks are supervised by the OCC, whereas the bank holding companies are supervised by the Federal Reserve (Fed). Therefore, the FDIC does not necessarily supervise the global systemically important banks directly. To be concrete, as of 31 December 2015, the 4008 state banks whose deposits are guaranteed by the FDIC and the state banks that are not the members of the Federal Reserve System (FRS), who can be considered state non-member (SNM) institutions, are supervised by the FDIC. This feature of the FDIC is different from the EBU. In the framework of the EBU, the ECB directly supervises systemically important banks and the SRB mandates bank resolution of systemically important banks. Although the SRB is independent from the ECB, the EBU and SRB collaborate and interact closely. Moreover, the chair of the SRB was from Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), which is a German banking supervisory authority. However, in the US, under the FSOC, the initiative of the FSOC is taken by the Treasury, OCC, Fed and FDIC are demanding to cooperate, but there are respective intrinsic domains and long history of separation on operations. In addition, the US has a two-tier banking system that consists of national and state banks. The two-tier system exists until date. On the contrary, the EBU is a relatively new system. Under the EBU, the banking supervision, bank resolution, and deposit insurance of banks would be connected and information on systemically important banks would be shared more closely; therefore the EBU could be consistent with the three banking regulatory domains when compared the US banking regulatory system.

This paper focuses the banking supervision. However, its connection with securities supervision from now will be requested to construct a 'financial union'. At the EU level, the Banking Union and Capital Markets Union will be combined to construct the Financial Union, as per the Five Presidents' Report mentioned above. Therefore, it is vital to establish cooperation between the EBA and ESMA. Moreover, we can see the

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FDIC for explanation on the vital role of the FDIC. The meeting of interview and discussion was held at the headquarters of the FDIC in Washington D.C. for seventy minutes on 15 April 2016. I am most grateful to him for consideration and precious opportunity.

[27] Federal Deposit Insurance Corporation (2016), *2015 Annual Report*, 18 February.

placing of the banking and securities' functions in the conventional global markets through **Figure 6**.

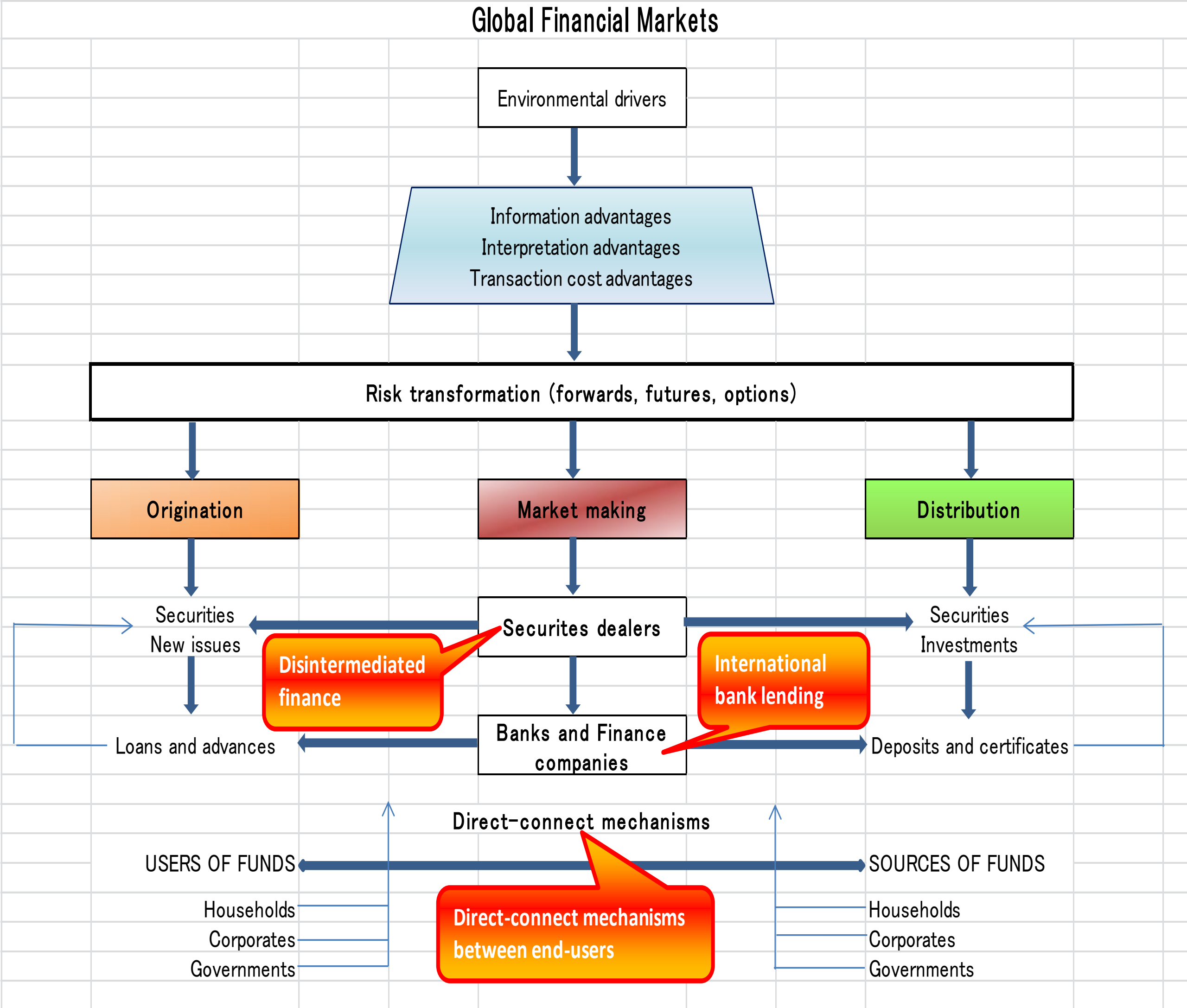

Figure 6: Conventional Placing of Banks' Lending Activities and their Functions in Global Financial Markets

Source: Smith, R.C. and I. Walter (1992), 'Global Financial Markets', in Newman, P., Milgate, M. and J. Eatwell (eds.), *The New Palgrave Dictionary of Money & Finance*, Macmillan Press (Author's notes are added).

5. Concluding Remarks

The EU must cope with the severe Eurozone crisis as a union. It is very different from the response to such situations by the United States, Japan, and the UK. In particular, in the aftermath of the monetary integration, it is becoming more important to 'deepen' the European integration rather than to 'extend' the Eurozone member states from 19 countries[28]. The EBU that was proposed in 2012 denotes the progressive development of the single market, and the handling the EBU will deepen European integration. The EU has been making efforts to be close to the ideal design of a financial union by cultivating the 'Genuine Economic and Monetary Union' for implementing the 'Completing Economic and Monetary Union'.

How can we estimate EU's power to respond to the crises? As the **Figure 7** shows, it can be divided into three crises and responses in terms of the long-term perspective.

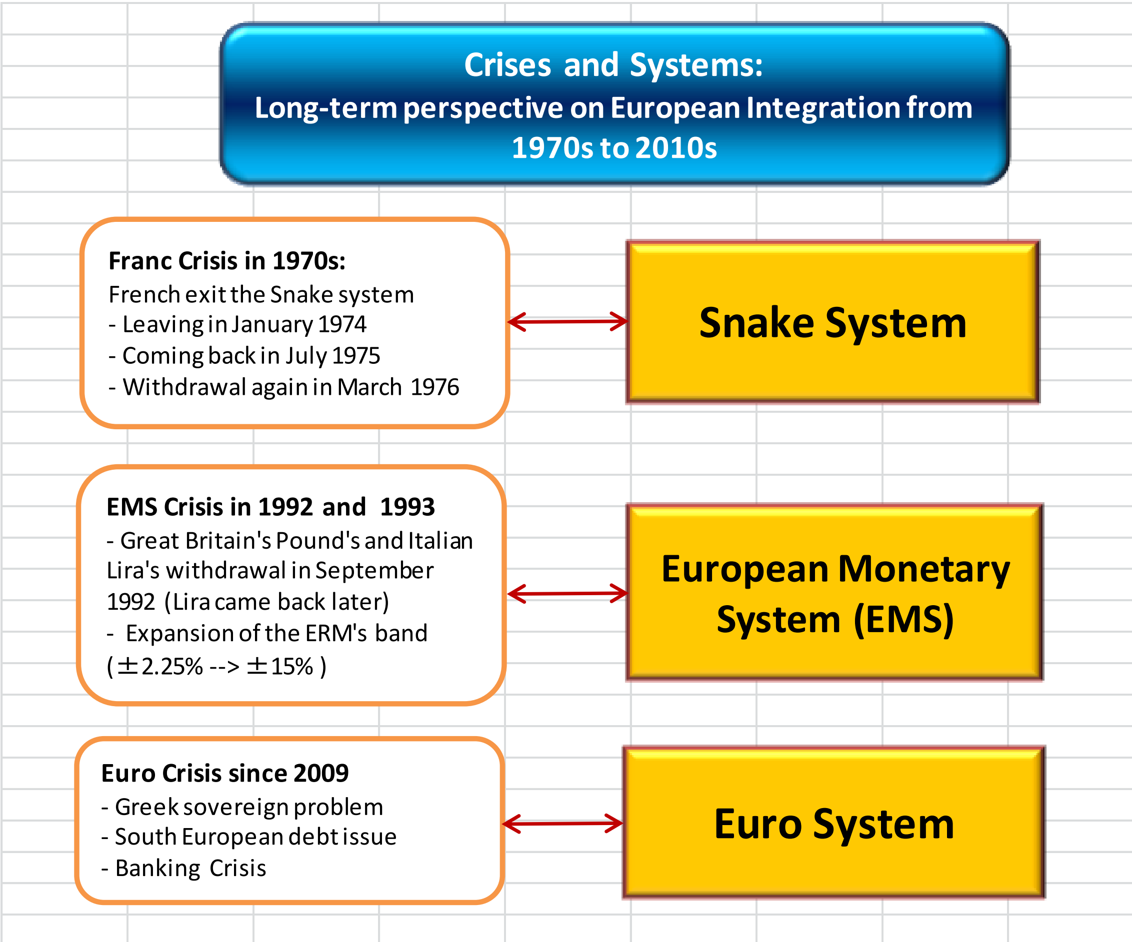

Figure 8: Crises and Systems: Long-term Perspective from 1970s to 2010s

Source: Author's

First, in relation to the French franc crisis under the Snake system in 1970s, the EEC countries set up the narrow exchange rate fluctuation band in 1972 and made it

[28] The new roadmap on the deepening the EMU was published on the end of May 2017 by the European Commission.

systematic. However, as exchange speculation occurred after the collapse of the Bretton Woods system, France faced severe speculations of selling French francs, and suffered the limitation of response of raising the interest rates. Therefore, France exited the Snake system in January 1974. Although rejoined the system in July 1975, it left the system again in March 1976. The French minister of finance was Valéry Giscard d' Estaing, at the time. He recommended the French President Georges Pompidou that France had to make franc exit from the Snake system due to the negative effect of the oil crisis at that time[29]. Conversely, this was the period when Raymond Barre attempted to restrain the French economy[30].

The second crisis is the European Monetary System (EMS) crisis that took place from September 1992 to July-August 1993. Owing to the denial of Denmark's referendum on the Maastricht Treaty in June 1992, namely, the Denmark Shock, the European exchange rates became very unstable. Moreover, after the western Germany and eastern Germany were integrated in 1990, the Bundesbank raised its interest rate. However, other member states, which participated in the Exchange Rate Mechanism (ERM), were not able to follow its tight monetary policy. Therefore, the exchange speculation emerged from an anxiety of maintaining the rates among the ERM member states. Eventually, the UK pound exited the ERM and the Italian Lira left the ERM in September 1992. However, the Lira came back to the mechanism later.

The third crisis is the Eurozone crisis. This crisis consists of the following three crises, 1) Greek debt crisis, 2) southern European debt crisis, and 3) banking crisis. The Eurozone has been constantly in and out of the crisis. Moreover, recently, Eurozone faced the historical turning point when the UK decided to leave the EU due to the referendum on 23 June 2016. While this time a major 'out-sider' country decided to exit EU, the exit of the core original six countries from the EU, namely, Germany, France, Italy, Belgium, the Netherlands, and Luxembourg, would introduce the tremendous crisis for the Eurozone and the EU. However, there is the 'acquis-communautaire', which means the accumulation of EU law, the institutional framework of the EU is robust and it is hard to collapse. In addition, the competences of technocrats of the EU institutions are distinguished on the design of framework to cope with the crises; in particular, its

[29] Frank, R. (2006), 'Les problems monétaires et la création du SME,' in Berstein, S. and J.-F. Sirinelli (with participation of Valéry Giscard d'Estaing), *Les années Giscard : Valéry Giscard d'Estaing et l'Europe 1974-1981*, Armand Colin, p. 16.

[30] Professor Yasuo Gonjo elucidated the French coping with the European integration in 1970s precisely based on the various archives in France. See Gonjo (2013), *The historical origin of monetary integration: Great transformation of capitalism and the Europe's choice*, Nihonkeizai-Hyoronsha (in Japanese).

advantage appears in the methodology to implement various policies.

As a whole, the EU faced the crises three times in approximately 40 years in the monetary and financial fields. Moreover, these three crises happened in Snake System, EMS, and Euro System, respectively. However, the EU overcame these crises, and its efforts to deal with the crises every time has improved the accuracy of its system and progressed in practical.

The EBU is one of most inevitable projects that can contribute towards deepening the single market in the EU after the euro is introduced as a single currency. It exists in the third category in the abovementioned. Nowadays, the EBU is in parallel with Capital Markets Union (CMU); these two bodies will formulate the Financial Union together in the overall framework as the Genuine EMU and the Completing EMU.

The CMU consists of the following five pillars[31]: 1) capital raising for innovation, start-ups, and non-listed companies, 2) making it easy for enterprises to participate in open markets and to raise capital, 3) investing in long-term, infrastructure, and sustainable forms, 4) fostering investment by retail sector and institutional investors, and 5) boosting capacity of banks to underpin the economies more widely[32].

As mentioned, the harmonization and unification of banking supervision and bank resolution have certainly progressed, although there are issues that have to be dealt with in near future. It is necessary to cope with the harmonization of deposit guarantee scheme in the Eurozone. Moreover, it is also important to introduce and expand bail-in in bank resolution, even though the unification of the deposit guarantee system is now being discussed and is at the proposal stage. Moreover, comparison with the US FDIC and reference to its approach are beneficial for Europe to make the most of advantage of construction of the EBU.

The banking supervision of the EU that stemmed from the 'de Larosière Report' has moved to be unified, particularly in the Eurozone, with the following purposes of 1) stabilization of financial system and 2) protection of depositors when the crisis has repeated. It is a product of will to create more robust and sound system whenever the EU overcomes several crises. The style is somewhat based on a vision-led methodology, and hence the gap between the vision and real situation is often criticized in public. Conversely, as the global banking supervision is prone to gradual harmonization, the

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31 European Commission, *Capital Markets Union, Implementation Table*.

32 In the website of European Commission on the CMU, the respective issue of five pillars, the detail elements are categorized in the implementation table. And the CMU was analyzed in the French famous banking journal, namely, Revue Banque (2015), 'Union des Marchés de Capitaux: Quels Marchés Financiers pour l'Europe?' décembre, Supplément au n°790.

EBU approach and implementation of the proposal are strongly stressed globally.

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