UNITED KINGDOM IN EU SINGLE SUPERVISORY MECHANISM

MR. NIKHIL KASHYAP*

I. INTRODUCTION

European Union is a land of territorial and national diversity as it has 28 member nations with different culture and languages. This diversity is a challenge as well as an asset. The impact of the financial depression of US has adversely impacted on Europe's financial condition. There can be many causes to this depression. Due to this depression, European Union had to rethink and re-develop its financial policies. Around the World, nationalities have their self supporting regulating system to provide stability to their banking institutions. The tough times sets the rules in motion and prepare itself for the future.

SSM is a point where a big change is being created or realised in European Union. It is developed and designed with an aim to strengthen the financial system from the crisis. It is way to improvise the coordination amongst the member states of European Union. It is a way to reduce the 28 different system approaches for tackling the same problem. This will give a consolidated approach to deal with the crisis or to be particular recession. Therefore a system was devised to have a centralized supervision on banks to provide uniformity and stability to the financial system. It is a way to unite the system of banking in European Union. This will provide a better opportunity to tune the system centrally for better outputs and results.

"Single Supervisory Mechanism" (SSM) is one of the outcomes of the policy drift of the union. It can also be claimed that SSM is the first pillar of the European Banking Union. On 12th September, 2012, European commission[1] proposed for SSM to evolve from the financial crisis which was adopted by European Parliament. European Central Bank (ECB) is made to deal with bad times or crisis situations. ECB is well equipped to deal with all kind of banking crisis in EU. ECB has welcomed the decision of

* Assistant Professor, Amity law School Centre II, Amity University

1. European Comm'n, Commission Proposes New ECB Powers for Banking Supervision as Part of a Banking Union 1 (Sept. 12, 2012), available at europa.eu/rapid/press-release_IP-12-953_en.pdf. Visited on 25 Dec, 2015 at 1430 hrs.

implementing SSM. ECB submitted its comprehensive supervision review on 26th October, 2014.

England plays a very important role in this regard being the London as the financial centre of European Union. There have been occasions when the United Kingdom negotiated or re-negotiated its position as well as participation in European Union. Through this study, the position of England will be discussed in detail with the nuances of SSM.

2. SINGLE SUPERVISORY MECHANISM

The main objective of SSM is to bring national integration of financial policies which will in turn provide financial stability and security. SSM will provide better cooperation and coordination to deal with financial issues of the European Union. Secondly, the SSM aims at reducing the hope of bail out options to EU banks. The aim is to take precautions before the problem create its roots.

The objective of SSM can be best understood in the words of Internal Market Commissioner Michel Barnier. He said: "Banking supervision needs to become more effective in all European countries to make sure that single market rules are applied in a consistent manner. It will be the role of the ECB to make sure that banks in the euro area stick to sound financial practices. Our ultimate aim is to stop using taxpayers' money to bail out banks."[2]

SSM regulation has created a two tier system of supervision. At one level the ECB will be supervising and at national level national authorities are created. It is pertinent to note here is that SSM is not applicable on investment firms etc. ECB is made a supervisor which will be taking care of large banks in EU. There are three main functions of central bank the monetary function, price stability; the financial stability (micro- and macro-prudential supervision); and payment systems.[3] ECB is a centralized and independent institution whose powers were increased due the need in crisis. In other words, ECB is a creation of crisis of 2008.

2. Ibid

3. George S. Zavvos , Towards A European Banking Union: Legal and Policy Implications

3. ECB

The European Central Bank (ECB) is given the position of banking watchdog. ECB will be authorised to supervise banks of the euro zone and banks of other member states that join the banking union. Council Regulation No. 1024/2013[4] provides "opt-in" option for the other European Member States. The regulation is drafted with the aim to provide comprehensive system of supervision on institutions dealing with banking.

Understanding the scope of ECB is very necessary. ECB will be able to supervise large banks. The criteria for entering into the category of large banks are based on the size, importance and cross border activities of the Bank. Secondly, ECB will be supervising three biggest banks of each member state. Lastly, ECB will be supervising all the beneficiary banks of European Stability Mechanism. The ECB is empowered with exceptional power to supervise any bank that will create a systemic threat. This rider will be exception to all the above mentioned rules. This exception is very important to curb the menace of non adherence to the rules and regulations created by banking union or European Union. ECB will be focussing on the important banking institutions whereas national supervisors will be working in subordination to ECB. ECB will work as the heart of the regulatory mechanism whereas the national authorities will work as real executives of the dictates of ECB.

According to Article 127(6)[5] Treaty on the Functioning of the European Union, only specific supervisory tasks can be conferred on ECB. This is the reason that regulation dealing with SSM provides a list of supervisory tasks that limit as well provide the scope of working of ECB. This list focuses on the supervisory role of ECB. It provides:

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4. Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions; Council Regulation (EU) No 1024/2013 of 15 October 2013, Available at https://www.lb.lt/n24744/reglamentas_1024_2013_en.pdf Visited on 25.12.2015 at 2.30 pm

5. Article 127 Clause (6) The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings

- Monitoring of the compliance of European banking law with regard to liquidity as well as the financial health of the banks.
- The ECB is empowered to act as "host supervision" for the member as well as non member states of the banking union. The host supervisor plays a limited role that is of dealing with liquidity of the bank.
- The ECB will supervise the governance aspect of financial institutions i.e. mainly banks. Governance includes the appointment of management, risk management etc.
- The ECB will further supervise the role of banks with other companies but it shall be limited to banking only.
- ECB will be preparing the banks for crisis through periodic tests etc. Here it is pertinent to mention that SSM Regulation limits the powers of ECB by allowing it to conduct prudential supervisory tasks and not crisis management.
- ECB is empowered to provide or withdraw bank authorisation. The withdrawal of bank authorization is done on the ground non compliance with EU directives and rules. In other words, every bank has to be authorised at national level as well as ECB level. There may be a point in time when there can be a dispute between the national authority and ECB on which SSM Regulation is silent.
- The ECB will be supervising the mergers and acquisitions of banks with national supervisors.
- ECB will be participating in supervisory colleges. They help in developing the cross border cooperation.

The most important rule is that the ECB will be entrusted with power to implement single rule book for all the European Union members. This rule book covers the EU guidelines and directives. ECB is further empowered to tailor the rules for different national regimes and requirements. The only aim that is there with ECB is to minimise maximum national discrepancies from the system.

It is less clear what the ECB's powers are in "bad times", e.g. in a pre-crisis situation.[6] Under ECB, a supervisory board will

6. Concetta Brescia Morra, From the Single Supervisory Mechanism to the Banking Union The Role of the ECB and the EBA. Available at http://eprints.luiss.it/1322/1/02_Brescia_Morra-SEP.pdf visited on 28.12.2015 at 12.30 am.

be established which will work under the governing council. The governing council will be more a formal organization than supervisory council. The powers of ECB will be limited to only the powers provided under the regulation.

ECB will be working with national authorities with regard to macro supervisory powers. It will try to keep an eye on national authorities that they don't indulge themselves into the working of covering of the institutions. The ECB is also empowered to order the national authorities to act in accordance with the national rules in case there is any violation to the national financial regime created by the member state/s of European Union.

Two additional institutions are established to bridge the linkage between the non member states of the union and ECB. The two institutions are European Banking Authority (EBA) and European Stability and Risk Board (ESRB). European banking authority comprises the bank supervisors of member states of European Union.

4. NATIONAL SUPERVISORY AUTHORITIES

National Supervisory authorities work on the banks which do not come under the supervision of ECB. In other words they work on those banks which are left from the supervision of ECB. Further national supervisory authorities will be supervising on branches of banks from other places than European Union. Further these authorities will also supervise issues relating to the consumer protection money laundering etc.

EBC will be having two branches. The branch will be of Governing Council. Second branch will be Supervisory board. The governing council will comprise of the members of the Executive Board of the European Central Bank and the Governors of the national central banks of the Euro area Member States.[7] Supervisory board is a new body created by SSM Regulation. Supervisory board comprises of the supervisors of banks of the participating Member States, i.e. of the 17 Euro area Member States; members of the ECB Executive Board; and banking Supervisors of any other Member State that opts in.[8] The major difference between the powers of governing council and supervisory board is that of the

7. Supra Note 4
8. Ibid

taking of the legally binding decisions. The governing council can take legally binding decisions where as supervisory board is not empowered to do. Supervisory conducts the inquiries and submit its recommendations as well as decisions to the governing council for approval.

There are few criticisms relating to the functional structure of SSM. SSM is having a problem of with regard to the participation in governing council. The first structural objection can be that the non eurozone members cannot participate in the governing council. This may lead to the conflict with regard to the decisions of the council. This may further lead to the non compliance of the decisions of the council. Secondly, the supervisory board has to prove its independence of decision making with regard to the matters dealing with the collective responsibility. The working of the supervisory board or the council has to be made bias less with regard to any nation or their interests. The collective interest of financial stability and profit should be kept as the only rationale of decision making.

The working of the SSM Regulation depends on the participation of the European Union members. It is to be seen how the decision of UK to opt-out from the banking union can affect the working of the union.

5. UNITED STATES & UNITED KINGDOM SUPERVISORY MODEL

United States (US) aims at financial stability and market discipline. In US, the bail-out has been an option with the financial institutions. In the recent past government in US has given bail out to its banks on various occasions. The existing US supervisory model aims at ending the expectation of bail-out through market discipline.

US has come up with various tools that helps in maintaining the discipline required for better and smooth functioning of the financial institutions of the country. The first tool is the reporting of the gaps to the congress by the supervisory board. Second tool is to bring in ambit the non-banking institutions as well as

26. Article 2 of Directive 2008/95/EC

27. Ibid. at p. 3.

28. Case 73049/01, Judgement of 11 January 2007, European Court of Human Rights

other financial organizations under the supervision of supervisory council through widening the scope of the supervisory council.

US established the 'Financial Stability Oversight Council'[9] in the year 2010. This institution was established with the aim to avoid like financial crisis created 2008. This council has 10 voting members and 05 non voting members. The main purpose of the council is to provide a forum for the financial institutions to discuss the risks involved in financial stability of the nation. According to Section 112 of Dodd-Frank Act, there are three purposes of the council.

> *Section 112 reads as "A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and (C) to respond to emerging threats to the stability of the United States financial system. Firstly identify risks to the financial system that may arise from large, complex financial institutions;"*

Items (1) and (2) are arguably directed at minimizing the chances that particular firms will be viewed as too big to fail, or too connected to fail, or otherwise pose risks to the financial system. Item (3) is arguably a more general catch-all for any factors that might destabilize the financial system.[10]

The main functions[11] of the council are provided as under:

1. To enhance the Coordination amongst the financial regulators.
2. To facilitate data collection as well as evaluation by providing

9. This institution was developed through the dodd Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, 124 Stat 1394), also known as the Dodd-Frank Act.
10. Edward V. Murphy, Financial Stability Oversight Council: A Framework to Mitigate Systemic Risk available at https://www.fas.org/sgp/crs/misc/R42083.pdf visited on 25.12.2015 at 4.30 pm
11. Section 112 Clause 2 of deals with duties of Financial Stability Oversight Council.

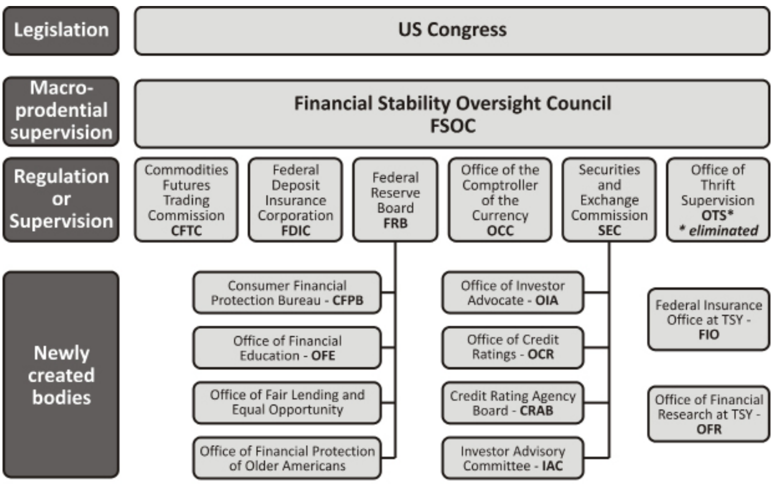
well trained and skilled staff to deal with the confidential information of the banking institutions. The data is collected from office of Federal Reserve, Financial Research and other regulatory institutions which are evaluated by the FSOC.

3. The Council can designate the institutions for prudential regulation by Federal Reserve. This assessment is made on various parameters.

4. To decide the applicability of regulations on financial market utilities.

5. The FSOC will evaluate the rules for better consumer financial protection.

6. FSOC US SUPERVISORY SYSTEM[12]



Source: Deutsche Bank Research, Macro-Prodential Financial Supervision in the US (12 April 2012)

UK has a financial policy Committee to monitor and assess the various processes in financial system. The existing regulatory mechanism is an integrated structure.

Historically, Bank of England use to monitor financial institutions. It had power to issue directions to other banks which was rarely used. The Financial Services and Markets Act 2000 (FSMA) defines the pre existing regime. This act came into effect from end of 2001. The Financial Services Authority (FSA) was established

12. Rosa M Lastra, Missing Pillars of Banking Union Available at: http://ec.europa.eu/finance/financial-analysis/docs/conferences/140925-rosa-lastra_en.pdf visited on 28.12.2015 at 12.30 am.

under the Act. It regulates business as well as it has the power to make rules. Then came the Financial Services Act, 2012 developed the existing regulating system. The Current system of financial market regulation is a tripartite system involving the Financial Policy Committee (FPC) the Prudential Regulation Authority (PRA), and the Financial Conduct Authority (FCA). The PRA and FCA are the successors of FSA. The PRA is a part of the Bank of England and deals with the prudential regulation of the financial institutions. FCA deals with the Conduct regulation of the financial institutions and in addition to it deals with residuary micro prudential regulation. FPC was established with the aim of assisting the Bank of England as well as keeps a check on financial stability and to recommend changes with regard to systemic risks in the financial markets. In the new system the Bank of England is overall responsible for the financial stability of the system.

Now let us discuss the role of the above stated tripartite system.

PRA main function is to promote steady and stable working of the financial system. PRA also regulates various deposit taking institutions. PRA main objective is to ensure the smooth functioning of the business of its authorised persons while taking into the consideration of UK financial system. PRA is also empowered to regulate the institutions and minimise the destabilisation of the system. It is pertinent to mention here that PRA has to look that it does not affect the competition in the market by its working.

FCA works as a residuary agency after PRA. FCA regulates the conduct of various stakeholders for the better functioning of the markets. FCA focuses on consumer protection which in turn creates faith on the markets in UK. This further ensures healthy competition in the market. FCA has a wide rule making power. It is also empowered to take an enforcement action. The existing regulation requires cooperation as well as coordination of between PRA and FCA. PRA can order refrain to the FCA with the objective of maintaining stability in UK financial market. Further they need to coordinate with the Bank of England to achieve the stability in financial markets.

FPC is authorised to give directions to FCA and PRA. FPC is also considered as sub-committee of the board of directors of Bank of England. FPC comprises of 10 voting members, 5 executives from Bank of England, 4 external members, chief executive of the

FCA, a non-voting representative from Her Majesty Treasury and FPC is chaired by the Governor of the Bank of England. The main function of FMC is to maintain financial stability of the institution. It further takes care of the systemic risks in the Bank and tries to remove them.

7. SSM: THE ROAD AHEAD

SSM started with the limitation i.e. geographical limitation. It covers some part of European Union. Secondly, SSM only monitors the banking sector. It leaves other parts of the financial sector untouched. The other part of the financial sector refers to insurance sector as well consumer sector etc. This list is not exhaustive but only suggestive. Though SSM was a great achievement after 2008 crisis in the European Union is that there was an agreement on the centralising power to provide financial security and stability. It was a task to achieve as there was legal as well as political reluctance in the EU. At the same time, the compromise to get the financial security or stability is much wider, as the ECB will take the role of the banking supervisor. All the EU level choices will be made or dictated by ECB. This might result in difficult situations as there can be points of disagreement between the situations. The question remains unanswered is that if the European Commission may get in conflict with the ECB, who will be dealing with that situation? This kind of discontentment would tarnish the image of the banking union and in return will reduce the credibility for national and foreign investments at all levels. With regard to banking there will be a transfer of power from the national level institution to the union level institutions.

Now the second phase of the banking union will be implemented from 1st January, 2016 which will bring in Single Resolution Mechanism (SRM). SRM is the other pillar that will be working in coordination with SSM. SRM is also considered as corollary to SSM. SRM is a result of EU Regulation which got enforced on 19th August, 2014. SRM is applicable on all the members of SSM. The countries who are not the members of SSM cannot participate in SRM. SRM will comprise of Single Resolution Mechanism as well as European Resolution Fund. SRM will have similar power of ECB with regard to the de-authorizing any bank from carrying out its banking services. In future, SSM and SRM will be working in coordinated as well as systematic to avoid the situation of crisis in European Union.

8. UK IN EUROPEAN BANKING UNION

In today's world, no country can flourish in isolation. Economy of every country is based on the foreign investments which get attracted to national policies. Foreign investments or financial soundness of a country go hand in hand. National legislations which don't complement the investments affect the financial status of a country. UK is part of the European Union though it is outside the eurozone. UK is one of the biggest business centres of the world as well as European Union. UK always had an option of not being a member of EU. But it chose to be part of it. Subsequently UK had the choice of becoming the part of the banking union.

To take the decision, UK should consider the aspect of reliability by the world of its markets and its financial institutions. No doubt the benefit is mutual. If UK becomes the part of Banking Union it will provide the stability to the union. The pertinent question arises that other member states of European Union have surrendered their sovereignty to the banking union with the motive to seek help for their domestic banks whose financial condition are at risk and UK has such interest from the union or not?

UK has decided to keep its power of regulating its financial conditions rather than becoming the epicentre of finance of eurozone. UK has been regulating its financial institutions in much stricter ways at it is done in banking union. This point is very relevant as the UK has more stringent regulations with respect to liquidity and other support systems for stable financial conditions of the country. Financial institutions in UK have agreed to implement Vickers Commission[13] which majorly deals with concept of retail ring fencing. European Union is applying the same principles of retail ring fencing to its institutions. UK has similar banking operations that are there of the Banking Union. But there are occasion as to the points of reservations exists between UK and EU. To site an example, UK has taken ECB to the European Court of Justice with regard to the location of the clearing houses. Britain has also objected over the financial transaction tax which was levied by the 11 member European Union state. They claimed

13. Independent Commission on Banking, Final Report Available at http://www.ecgi.org/documents/icb_final_report_12sep2011.pdf visited on 29.12.2015 2.30 pm.

that this move would generate unequal amount of taxes between the European Union member states.

Banking Union was proposed in European Union. UK had an option of becoming part of the banking Union through 'Opt-in' option. The first question that is required to be answered is what will be the affect of the banking union on the financial status of Britain. EU designed a much better and a stable financial system in accordance with the crisis it had to face since 2008. The first fear that exists in the mind of Britain is the power will be concentrated in the hands of ECB which will consider the financial interests of the Eurozone above the interests of European Union. The financial sector of Britain had an apprehension that being a part of the banking zone would lead to more conflicts and tense situations that may worsen the conditions of financial stability of Britain.

The second uncertainty that exists is how the Britain based banks will take the control of assets that are in the hold of ECB. Further, there can be a point at which conflicts with regard to the control of assets arise which is under the control of Bank of England.

In the authors opinion the difference between the banking policies of EU and UK are not much. Further shift in banking policies will not affect the competitiveness of the Britain in dealing with the world. A very important point to be noted here is that the Banking Union has a 'Double Majority' voting system which means that if EBA proposes any rule or regulation or proposes any major change in the system it requires the approval of eurozone members as well as non eurozone members or outside members.

It can be summarised that as of now there was no threat to Britain from becoming the member of European Banking Union as they have a re-course to ECJ for the settlement of issues. The European Economic Community was started in 1958 with 6 nations. From European Economic Community the European Union was formed which consists of 28 Nations as on date. Euro (A single currency) was introduced in year 1999 replacing the European Currency Unit. The European Union has a whole should focus on strengthening the single currency system and share the wealth and prosperity as a community at large.

9. CONCLUSION

It is important the European Banking Union see its conclusive end as it is important to realize the dream of one single market. The European Banking union will also improvise on the stability end of the financial institution. It is a method to avoid the crisis situations that may arise in future. European banking union will be regulation the liquidity as well the financing option of the banks with special regard to cross border financial transactions. The mitigation of the risk is another factor that has to be considered by the European banking union. The aim of the European banking union is to bring the banking regime of across European Union in order to achieve its goals of stability and prosperity.

The question still remain unanswered is that whether the European Banking Union can be successful with the epicentre of finance of European Union i.e. UK not being the member of the union. There are 19 members of the Banking Union whereas EU has 28 members. There is only one chance of success of the banking union when there is coordination between the non members of the banking union with the banking union. This coordination can be seen in the future in case the power is given by EU to the banking union to update the rules and regulations that govern the nation based banking system. No doubt, there can be a case where there can be conflicts or discontentment but the arbitration of those matters is a necessity for the smooth functioning of the banking union. Banking union has to be prepared with one aspect of implementation of the rules created by it or European Union in its strict sense. The aim of every member of European Union should be to focus on providing a profitable and stable financial market.

The threat exists of regulatory arbitrage as UK remains out from the banking Union. The first task of the banking union is to control the risk of arbitrage. The road in the future is not easy for banking Union or EU as UK may opt to move out of EU to maintain its freedom to decide on economic issues. The other option is that EU creates its own epicentre of financial market which is not easy and it is a long term process. This will require planning and support from the all the concerned stakeholders as it requires human resource, infrastructure, universal acceptance etc. It will never be simple to create another financial centre.

Another fear should be the long term effects of the experiment i.e. banking Union. The main concern that can arise anytime is that there is a requirement of management of member states or eurozone and other sector of European Union. There can be a time when the competitiveness of the financial institutions across European Union is judged by the membership of banking union. Or there can be a state when the UK based banking operations don't remain that profitable as they could be before banking union. In future it can be said, that there can be a point of tensions when UK may take a call to withdraw from European Union. This will be very disadvantageous for UK as well as EU. AS of now there are many points of conflicts between the members of EU and Britain. The question that can arise is that with the banking union in place it will be difficult for UK to protect its interests.

This condition could be best explained in the words of Howard Davies in the year 2012:

> *"I suspect that a banking union of some kind will be implemented, and soon. Otherwise, the eurozone banking system will collapse. But the consequences of such a step for Europe's great free-trade experiment could be serious, and, if not managed carefully, could lead to Britain's withdrawal. The political stakes are high – and the outcome is likely to reflect that."*[14]

Banking union has two main functionaries SSM and SRM. Both these functionaries have faced criticisms. In future these systems have to be proving their importance as well as convert theory into the reality of oneness and uniformity. The question that time will be answering is that of the delivery of results from the above stated mechanisms. There will be an issue of accountability that needs to be answered beyond the politics as well ideological differences. There is reluctance to change and adopt the uniformity created by the banking union. It is in human nature that there is reluctance to change and acceptance towards the change. As the Bentham said, "Greatest happiness of the greatest number" should be the aim of European Union and as well as the European Banking Union.

14. Howard Davies, European banking union raises unanswerable questions, Available at: http://www.theguardian.com/business/economics-blog/2012/jun/29/eurozone-banking-union-questions