The Single Market’s Catch-22: Supervisory Centralisation in a Fragmented Banking Landscape

Authors: Yuri Biondi (French National Center for Scientific Research - CNRS), M. Cecilia del Barrio (University of Trento).

Topics

- Supranationalisation of microprudential supervision;
- The ideal "level playing field" and existing national banking specificities;
- Use of National Options and Discretions (NODs).

Summary

The key question that the present policy contribution addresses is whether increasingly centralised powers necessarily bring about better coordination and more financial integration. In fact, the post-crisis banking regulation scenario has been characterised by such centralisation efforts in the EU. From a regulatory viewpoint, this approach is epitomised by the Single Rulebook, whereas from an institutional one, this approach is characterised by the arrangements that shape the Banking Union, which comprise the Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM), and the European Deposit Insurance Scheme (the much debated EDIS that is yet to be finalised).

In this context, supranational authorities (in the present analysis the SSM from a supervisory perspective, and the EBA from a regulatory one) advocate for an increasing centralisation of regulatory and supervisory practices across Member States in order to “reduce regulatory fragmentation and contribute to establishing a level playing field in the banking union”.

The present contribution, instead, draws upon the idea that uniformity is not a realistic and perhaps not even a suitable goal. Thus, supervisory and regulatory efforts across Europe should aim at fairly and

1 Comprising the following legal instruments: Bank Recovery and Resolution Directive (BRRD), Capital Requirements Directive (CRD IV), Capital Requirements Regulation (CRR), Deposit Guarantee Schemes Directive (DGSD), the corresponding technical standards developed by the European Banking Authority (EBA) and adopted by the European Commission (RTS and ITS), as well as the EBA Guidelines and related Q&As. For the purpose of the present analysis, the focus will be mostly placed on CRD IV and CRR.

2 Letter from Daniele Nouy (Chair of the SSM’s Supervisory Board) to MEP Mr. Sven Giegold, 17 December 2017: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter171218_Giegold.en.pdf?e8fedb8e2684a4cbc28506202dd7b76e Beyond specific statements from the relevant authorities, the key tension between fragmentation and the need to strengthen the level playing field is embedded in the de Larosière Report (2009), foundational document of the European System of Financial Supervision (ESFS), which laid the basis not just for the EBA but for the rest of the European Supervisory Authorities (ESAs), i.e., The European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA). In relation to the Banking Union, early documents that formed the basis of the project, have highlighted the need for a single supervisory mechanism as a way of fostering integration in light of the highly fragmented internal market (see for example the European Commission’s Roadmap towards a Banking Union (2012) http://ec.europa.eu/transparency/regdoc/rep/1/2012/EN/1-2012-510-EN-F1-1.Pdf)
satisfyingly strike a balance between integration and an unavoidable level of fragmentation, which stems from long-standing traditions and layered structures of national banking systems. Careful design and management of such a systematic balance between National and EU levels seems, therefore, a more feasible and realistic objective.

With this theoretical mindset, our analysis focuses on the legal and institutional prudential frameworks, and their evolution before and after the crisis. This helps situating our contribution in the distinctive two time windows, namely between the Euro adoption and the global financial crisis (and its spill-over into the Member States debt crisis) and following the crisis. In particular, our analysis examines the large exposures case study, one of the crucial Options and National Discretions (ONDs) granted to Member States by the CRR, which is claimed to be a key obstacle to achieving and smoothly applying the Single Rulebook. Methodologically speaking, to comparatively analyse the variety of banking systems, especially the German, Italian, and French national case studies will be considered, complemented by descriptive statistics of the various banking systems and their evolution over the time windows. Specific attention will be paid to bank balance sheets, bank corporate organisation, micro- and macro-prudential regulation and supervision, taking into account the transfer of competences from the national to the supranational sphere that took place in this realm of prudential oversight.

Table of Contents

1. Introduction
2. Taking banking diversity seriously
3. Variety of Member States’ choice on National Options and Discretions

1 - Introduction

The regulatory and institutional architecture of the EU financial and economic governance has become increasingly complex. The banking realm is no exception: there is a densely integrated coexistence of both legal and social norms, as represented by the articulation between command and control rules and soft law, that is present at every level of the hierarchy of legal sources (Lamandini 2016). In the prudential regulation realm, these overlaps comprise the Basel norms, EU legislative products, and all sorts of regulatory and implementing standards issued by the EBA, not to mention the variety of instruments that the SSM uses to organise its supervisory activities. Such a miscellaneous regime, in turn, mirrors the divergent speed and appetite for integration, as it is possible to distinguish between harmonisation efforts within the whole European Union, on the one hand, and those only related to the Banking Union (BU) process, on the other.

Economic and financial integration has been an aspiration of European policymakers that can be traced back to the seminal Treaty of Rome. However, in the banking realm, it was not until
1977, when the First Banking Directive was approved, that concrete efforts in the long road to strengthen the common system took place. This step forward at the EU level has to be considered in tandem with the evolution at the international level, with the early creation of the Basel Committee established as the Committee on Banking Regulations and Supervisory Practices (later known as the BCBS), at the end of 1974.\(^3\)\(^\text{3}\) For the sake of brevity, what is important to highlight is the somehow paradigmatic shift from both legal and institutional perspectives: the former is exemplified by the passage from the *minimum harmonisation* principle,\(^4\)\(^\text{4}\) crystallised by the Second Banking Directive enacted in 1989,\(^5\)\(^\text{5}\) to the *maximum harmonization* principle (enacting a centralisation design), epitomized by the enactment of the Capital Requirements Regulation (CRR) in 2013: being a regulation, it is then directly and universally applicable to all the Member States without any further legislation transposing it. The latter is also mirrored, for instance, by the evolving role played by the BCBS, which has shifted from informally endorsing a restricted and consultative mandate - under which they were merely entitled to issue recommendations -, to introduce regulations applicable to active banks almost worldwide.\(^6\)\(^\text{6}\)

However, from a Eurozone perspective, the most radical institutional change in the prudential regulation realm has been the sudden set-up of the Single Supervisory Mechanism (SSM), the first pillar of the Banking Union. There is a substantial literature analysing the SSM’s legal and institutional arrangements, its deficiencies, accomplishments, and challenges in contrast with the previous supervisory frameworks. Our contribution, however, focuses on the institutional effort deployed by the SSM in order to close the gap between centralised rules and decentralised implementation, which characterised the prior status-quo in the EU prudential arena.

The rest of our policy contribution is organised as follows. The next section denotes the diversity and variety of bank types and banking systems that characterise the European Banking Union. The third section addresses the National Options and Discretions (NODs) available in Union

---


\(^4\) One of the key principles set out in the European Commission’s 1985 White Paper on “Completing the Internal Market”, along with two more fundamental premises, i.e. the mutual recognition, and the home country control.

\(^5\) SBD, Directive 89/646/EEC. This Directive was complemented by the Own Funds, the Solvency Ratio, Large Exposures, and Consolidated Supervision Directives, which had been merged into the so-called Codified Banking Directive 2000/12/EC. See Dragomir 2010 for a detailed description of the aforementioned pieces of legislation.

\(^6\) Indeed, according to George Blunden’s words, who was appointed as the first Chair in 1974, “the committee’s objective should *not* be to make far-fetched attempts to *harmonise* the twelve countries’ individual systems of supervision, but should be to enable its members to learn from each other…” [emphasis added] (Goodhart 2011, 47, citing a 1977 paper from Blunden). It is out of question that the legislative technique in order to transpose the these globally-agreed standards to regional and national levels is much more complex than what is depicted here, but nevertheless the soft-law power speaks for itself.
Law as specific regulatory tools that respond to and cope with this structural fragmentation. Some final remarks conclude.

2 - Taking banking diversity seriously

This section provides some evidence of diversity and variety of banking systems in Europe, along with some general considerations on the importance of preserving diversity in the banking sector, especially in the case of Less Significant Institutions (LSIs).

If the purpose is to foster competition and the creation of a level playing field, diversity and non-uniformity seem to represent an obstacle to be removed. Notwithstanding the post-crisis scenario that gave birth to the SSM, EU priorities appear to continue focusing mostly on creating and consolidating a more profitable and competitive banking sector, together with the broader objective of integrating banking and capital markets more deeply (European Commission 2017a/b; Dombrovskis 2018; European Central Bank 2018; Hakkarainen 2018).

The financial crisis and its consequences at the EU level highlighted the need to introduce concrete mechanisms to strengthen financial stability across Europe. In the case of the SSM, the creation of a pan-European common supervisory culture is not short of difficulties: albeit the institutional innovation represented by the Joint Supervisory Teams (JSTs) has been improving swiftly since 2014, some practical considerations such as language, communication barriers, and familiarity with the legal and institutional framework of different member states will need more time to be fully settled.

It is in this milieu that the SSM approach to supervision and the coexistence of alternative structures in the national banking sectors might give rise to potential conflicts of interest. For instance, the key distinction between shareholder value banks and stakeholder value ones that the literature on alternative banking has elucidated (see for instance Butzbach and von Mettenheim 2015, providing further references), lays at the heart of the nature of the bank itself: is shareholder profit maximisation the ultimate purpose of these entities, or do they hold a broader institutional and social function? Another related aspect is ownership

---

7 The criteria to differentiate Significant Institutions (SIs) from LSIs is formally described in Art. 6, para. 4 of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (henceforth “SSM Regulation”).

8 For some of the early challenges faced by the setup of the SSM, see the European Court of Auditors’ Special Report 2016 “Single Supervisory Mechanism - Good start but further improvements needed”, available at https://www.eca.europa.eu/Lists/ECADocuments/SR16_29/SR_SSM_EN.pdf
heterogeneity. In this respect, the Treaty on the Functioning of the European Union (TFEU) in its article 345 explicitly protects “the rules in Member States governing the system of property ownership”, which implies protecting institutional diversity in relation to the coexistent ownership structures in the European banking sector (Ayadi et al. 2010). Moreover, this heterogeneity of bank models attempt to account for and cover a larger variety of citizens’ needs and values. A long-standing tradition of mutualist, cooperative and public banks exists in several EU Member States, serving material share of EU customers, as well as a material share of EU private and public sector entities.

In fact, these are not mere theoretical or ethical considerations. The last global financial crisis has been a living proof of the shortcomings and the consequences of excessive shareholder-value orientation in the banking realm (Biondi and Graeff 2017; Graeff 2017). This proof provides evidence that the multiple objectives of shareholder maximization value, solvency, and the enhancement of financial stability do not go hand in hand: there is an inherent tension between a short-term managerial orientation, focused on material distributions to shareholders and possibly excess leverage and irresponsible risk-taking, and a longer-term horizon concerned with sustainability. In line with these observations, a recent SSM thematic review on profitability and business models has pointed out that “pre-crisis [return on equity] RoE levels in some cases may have been inflated by excessive risk-taking and leverage” (ECB 2018, 11). Moreover, the global financial crisis raised concerns on the stability of a banking system comprising only bank entities similarly devoted to market-based finance, due to procyclical and uniform effects between bank portfolios and market price dynamics. In contrast, the resilience of the banking system as a whole may be strengthened by the existence of a variety of bank types and business models, in case of local or systemic disruptions (Romano 2014; Bavoso 2017).

From this perspective, accounting for diversity may be understood differently from merely revindicating national particularities and more proportionality in the application of the rules against a one-size-fits-all approach backdrop. There are some fundamental nuances that have to be considered. Firstly, both regulators and supervisors are – at least at a formal level - aware of the need to adjust abstract rules to concrete scenarios (Dietz 2015). For instance, “in carrying out its supervisory tasks, the ECB should have full regard to the diversity of credit institutions and their size and business models, as well as the systemic benefits of diversity in the banking industry of
the Union”. The abovementioned thematic review on profitability and business models has remarked, in relation to the SIs universe, that “there is no one-size-fits-all approach to profitability as even strategies among the best-performing banks have largely differed with regard to cost and income” (ECB 2018, 16). In this regard, it is important to distinguish some concepts that tend to be mixed up. Our argument in favour of acknowledging diversity and variety should not be misled by the potential regulatory arbitrage effects that might arise as a consequence of including or creating differentiated categories or status via regulation. As a matter of fact, our argument should be protected against such regulatory arbitrage between regulated and unregulated entities. A solution to this regulatory conundrum would be to move towards an activity-based instead of an institution-based framework; however, and in spite of its desirability, this change is not expected to take place in the short run.

With these considerations in mind, what follows is a cursory glance into some basic features that account for diversity and local specificities in the banking sector, in order to illustrate the challenges that are faced by an increasing supervisory centralisation, with particular insights into the German, French, and Italian banking sectors.

---


10 A potential framework towards the idea of having a common set of rules applicable to the banking and non-banking sector could be given by some of the elements that the SSM’s last thematic review on profitability and business models has identified as positive “strategic steering capabilities” (ECB 2018, 15): effectiveness of asset-liability management, distribution channels, capacity to measure ex ante and ex post profitability individually, and their capacity to break down the cost structure. Although these elements are just a small fraction of what might constitute a good and sound banking management, there is an analytical effort from the supervisor’s side in order to identify common concepts.

11 This supervisory centralisation feature refers to the SSM and thus, for the time being, euroarea countries only. However, for the illustrative purposes of this section, and in light of the sources used, some references will be made not just to the euro area but to the EU as a whole.
Chart 1 and Chart 2 provide an overview of the variety of bank business models across the EU. As the reflected by these visual aids, cross-country differences in asset value per bank (Chart 1) mirror a variety of bank business models in Member States. As the ECB’s Report on Financial Structures (2017, 34) acknowledges, “whereas loans comprise the most important position in almost all banking sectors, the importance of financial assets held for trading in France and Germany, for example, reflects the presence of large banks with sizeable investment banking activities in these countries”. In the Italian case, albeit not minor, financial assets held for trading occupy a less preeminent role (Chart 2).
Another indicator (Chart 3) that serves to illustrate not just the diversity of the banking scenario but also organisational issues that touch upon the SSM and the human resources that are employed from the NCAs is given by the number of staff per financial institution (especially in light of the cross-border missions promoted by the SSM and the need to create such cross-border teams, and strengthen the amount of ECB staff in conducting on-site inspections, which has been...
pointed out as a weak point by the European Court of Auditors in an early report on the functioning of the SSM).12

As the next section elucidates, one last structural factor that helps better understand the exercise of specific National Options and Discretions is given by the type of exposures held by Monetary Financial Institutions (MFIs). Albeit Germany, France, and Italy are among the countries with the largest exposures of domestic long-term debt by MFIs (Chart 4), there are certain nuances that should be considered when getting a closer look: “while in Germany and France domestic long-term debt accounts for 47% and 38% of the total exposure respectively, in Italy and Spain this instrument accounts for more than 90%. In Germany and France, the level of long-term debt issued in other euro area countries also tends to be significant, although it is decreasing slightly (27% and 19% of total exposure respectively)” (ECB 2017b, 19). The report further highlights a slight decrease in the amount of domestic long-term debt for Germany, while a slight increase has been recorded in France and Italy.

Variety of Member States’ choices on National Options and Discretions

It is in this context of diversity across banking systems that the notion of National Options and Discretions (NODs) will be examined. These terms were originally coined by the former Committee of European Banking Supervisors (CEBS 2010, 19), the predecessor of the EBA, who defined options as “a situation in which competent authorities or Member States are given a choice on how to comply with a given provision, selecting from a range of alternatives set forth in Community legislation”, while discretions may exist where competent authorities or Member

12 See footnote 8.
States have “a choice as to whether to implement, or not to implement, a given provision”. The relative importance of these provisions has been increasing with the adoption of the maximum harmonisation principle, acting as the only regulatory bulwark of national specificities but, at the same time, being a potential source of legal fragmentation (Kudrna and Puntscher-Riekmann 2017).

The harmonising efforts in the NODs framework is not a novelty from the SSM. However, previous attempts carried out by the Commission contemplated the potentiality of “possible legitimate” options and discretions (European Commission 2007, 2). Compared to these pre-Banking Union endeavours, the innovative aspect of the ECB’s approach to NODs is that the aim is not to eliminate NODs themselves but, instead, to ensure that these tools are uniformly decided upon in all Banking Union countries (Kudrna and Puntscher-Riekmann 2017). This approach has been put into practice by means of the adoption and implementation of the following legal instruments:

- Guideline (EU) 2017/697 of the European Central Bank 4 April 2017 on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9).
- Recommendation of the European Central Bank of 4 April 2017 on common specifications for the exercise of some options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/10).

In relation to the first two legal tools, and in compliance with article 4 (3) of the SSM Regulation, a public consultation was launched from November 11, to December 16 2015, supplemented by a public hearing that took place on December 11, 2015. Responses to the public consultation were received from a broad range of stakeholders: “public authorities, credit and financial institutions, market and banking associations and individuals” (ECB 2016a, 2), from both euro area Member States and non-euro area ones. The comments were of a wide spectrum, from amending specific technical aspects, to questioning the powers of the ECB to issue these regulatory tools, and level playing field concerns expressed by some respondents that advocated for a wide use of the ECB’s powers in order to make those tools applicable to LSIs.
Along with these broad level playing field considerations, some European constituencies have been vocal about acknowledging and protecting the variety of financial regulatory regimes that characterise the Europe’s environment. Albeit it is out of the scope of the present contribution to provide an in-depth analysis into different Member States, industry representatives, and their respective associations position during the abovementioned public consultation, there are some aspects that deserve to be highlighted. For instance, associations representing specific credit institutions’, such as the BVR (National Association of German Cooperative Banks) and the VDB (Association of German Guarantee Banks), have a strong concern for the application of national accounting regimes and the scope of application of the proposed regulation and guide. However, at the EU level it is possible to detect some nuances among the different industry associations: the European Savings and Retail Banking Group (ESBG) & World Savings and Retail Banking Institute (WSBI) has advocated for the application of the regime only to SIs, whereas the European Banking Federation (EBF) has clearly supported the view of harmonising the exercise of options and discretions between SIs and LSIs.

It is in this context that the last two legal instruments on the previous list deserve some more attention. These instruments were directed to the National Competent Authorities (NCAs) when exercising NODs in relation to Less Significant Institutions (LSIs). While the extent of the supervisory powers conferred to the SSM has been explicitly clarified in the case of the SIs, the same cannot be said for the LSIs: on the one hand, NCAs are responsible for their everyday supervision, but on the other hand, “the ECB shall be responsible for the effective and consistent functioning of the SSM” (art. 6.1 of the SSM Regulation). In this sense, the European Court of Justice had the chance to elucidate further the question and clarified that “under the SSM the national authorities are acting within the scope of decentralised implementation of an exclusive

---

13 As the ECB (2016a, 32) acknowledges, “a large number of respondents opposed the potential exercise of the option in Article 24(2) of the CRR requiring institutions that at present exclusively apply national GAAP in their reporting to apply IFRS for prudential reporting purposes”. Some of the associations representing potentially affected credit institutions argued that, apart from the costs and extra resources that the introduction of IFRS for prudential purposes implies, recitals 19 and 39 of the SSM Regulation explicitly refrain competent authorities from introducing amendments to the applicable accounting regimes.

14 Other EU-level associations, such as the EACB (European Association of Cooperative Banks), took no position regarding the scope of application of the proposed instruments. Some national associations, such as the Associazione Bancaria Italiana (ABI), were explicitly in favour of the application of the discussed framework to both types of credit institutions, whereas the French Banking Federation did not express any specific view on this. A full list of the answers received during the Public consultation on the exercise of options and discretions in Union law, can be obtained at the following link: https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/reporting_options.en.html

15 It is important to highlight, however, that art. 4, para 1, (a) to (i) of this Regulation lists those tasks that have been conferred to the ECB in relation to all credit institutions in participating Member States (v.gr. the authorisation and withdrawal of such authorisation to credit institutions).
competence of the Union, not the exercise of a national competence”. Such a consideration was not short of criticisms, but it nevertheless help broaden the tasks developed by the Directorate General of the SSM that deals with the supervision of LSIs (Directorate General Micro-Prudential Supervision III – DG MS III), and the subsequent cooperation with the national authorities.

The supranational authority has highlighted that harmonisation of the NODs for the LSI sector aims “to ensure a level playing field across credit institutions” (ECB 2017c, 16). It is at least questionable how the level playing field can be attained in the case of SI and LSIs altogether. Leaving aside that the main objective of prudential regulation should be that of preserving the soundness of individual institutions and overall financial stability – whereas in the EU regulatory framework, competition concerns and the creation of the level playing field seem to be the primary objective – the way the SSM concretely applies the proportionality principle deserves to be examined, considering the different banking landscapes within the SSM countries, their diverse structure, and the fact that national systems (and the various bank types within them) do not appear in direct competition with each other, while cross-border credit institutions do.

The idea that centralisation is appropriate in all circumstances may be questioned due to both theoretical and pragmatic reasons. From a theoretical perspective, it is useful to acknowledge diversity and the existence of alternative business models other than those pursuing shareholder-value-maximisation and market-making (Ayadi et al. 2009; Ayadi et al. 2010; Butzbach and von Mettenheim 2015; Romano 2014; Masera 2013; Jordan 2018) in order to enhance the resilience of the financial system. A pragmatic standpoint concerns more than an idyllic view of the national specificities and traditions that should be protected: cooperation from NCAs and their local knowledge may constitute a fundamental input for the SSM, and the policy learning exercise

---

16 Case T 122/15, Landescreditbank Baden-Württemberg — Förderbank, v European Central Bank (ECB), para. No. 72, last sentence.
17 For further details on the tasks carried out by the SSM in relation to LSIs see ECB 2017c.
18 In the specific case of exemptions to large exposures, the relevant legal tool states: “Options and discretions in relation to the exemption of exposures from the application of the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013 should be consistently applied to both significant institutions and less significant institutions to establish a level playing field for credit institutions in the participating Member States, limit concentration risks arising from specific exposures, and ensure that the same minimum standards are applied across the SSM for the assessment of compliance with the conditions specified in Article 400(3) of the same Regulation.” [emphasis added] Guideline (EU) 2017/697.
19 The BCBS 2014 Supervisory Framework for measuring and controlling large exposures, for instance, does not refer to the level playing field concerns as the SSM does. In fact, these BCBS Standards are meant to be applicable to “all internationally active banks” (p. 3), which is not the situation of the LSIs, for instance.
20 Some of these literature (Romano 2014, Masera 2013) address the US situation, but their considerations are applicable to the present context too.
that fosters the development of the *common supervisory culture* is only possible if national authorities have an incentive to endorse and uphold it.

The previous section has denoted the structural features of banking system across Member States. Drawing upon this analysis of the variety and diversity of European banking systems and their respective population of bank entities, this last section of our policy contribution zooms in on specific choices on NODs in the German, French, and Italian cases. Recent literature examining the use of NODs by national authorities provides important insights into the politics of regulatory differentiation. This scholarship gives an overview of the three potential explanations that account for such diversification: the first one is given by the Eurozone membership, the dividing line being indeed between eurozone members and non-members; the second hypothesis, inspired by the varieties of capitalism literature, focuses on the institutional structure of the banking systems divided in three distinctive groups: liberal, coordinated, and dependent market economies; while the third and last source of regulatory differentiation is given by the distinction between “emerging markets of the post-communist member states” and those member states that have not gone through major economic transformations in the last thirty years (Kudrna and Puntscher-Riekmann 2017, 14). Albeit conceptually useful, these broad characterisations do not account for nuances and different choices adopted by the three aforementioned countries.

In this respect, it is important to highlight that NODs are specific creatures of the EU bank regulatory framework. As it has been described before, in its capacity as competent authority for the SSM countries, the ECB has exercised the NODs available in Union Law not only in relation to SIs, but has specified its use by NCAs in relation to LSIs too, in order to enhance equal treatment of both categories of credit institutions and foster a level playing field. Concerning specific cases — such as the exemptions to large exposures provided in Article 400 (2) of Regulation (EU) No 575/2013, exercised by the ECB in article 9 of Regulation (EU) 2016/445 — the last paragraph of the latter regulation specifies that these provisions shall apply in case the Member States in question have not exercised the option under Article 493 (3) of Regulation (EU) No 575/2013. In plain English, this last article allows Member States to apply the same exemptions to large

---

21 Their study tested these hypothesis and found no systematic differences between subsets of Member States characterised by the varieties of banking capitalism or between members and non-members of the eurozone, finding that the most critical source of differentiation is given by what the paper calls “the EU11 new post-communist Member States” and “EU17 old Member States”, and thus concluding that the key driver of such differentiated implementation has been the “concerns of the EU11 host-countries to protect capital and liquidity in the local subsidiaries of foreign banking groups” (Kudrna and Puntscher-Riekmann 2017, 23).

22 As per the Whereas Number 5 of the ECB Recommendation of 4 April 2017 on the use of NODs in relation to LSIs.
exposures as those provided in Art. 400 (2), which are exercised by competent authorities, for a transitional period.

As Chart 5\(^{23}\) illustrates, even within this subset of NODs, there is still room for variation not only across Member States, but also between the choices made or not by the NCAs from these countries and the SSM. To start with, the SSM has decided that the limit on the value of a large exposure shall not be lower than EUR 150 million\(^{24}\), whereas the rest of the examined countries have not exercised such a limit. Other interesting nuances stem from the other subparagraphs of Articles 400 (2) and 493 (3) – which are twin articles in terms of the legislative technique, as both refer to the same exposures from subparagraphs (a) to (k) – for instance:

- The Italian competent authorities did not use the exemption provided in letter (d), concerning exposures to regional or central credit institutions with which the credit institution is associated in a network, and which are responsible for cash-clearing operations within the network. This approach could be explained by the fact that, for instance in the case of the legislative reform that has recently fostered the reorganisation of the Italian cooperative bank sector into a joint banking group, alternative models of organisation, such as Institutional Protection Schemes (IPS) – which feature the German banking sector - have not gained policy momentum.\(^{25}\)

- Letter (e) and the exemption granted to those exposures incurred by credit institutions when one operates on a non-competitive basis and promotes specific sectors of the economy under some form of government oversight, has been partially exercised by the German authorities, what can be explained by the importance of the public banking sector in the country, representing one of the so-called three pillars, together with the private bank and the cooperative bank sectors, accounting for a 26% of total banks’ assets (EBF 2018).

- Letter (h) represents another interesting exemption, which is granted to exposures to central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in national currencies, considering the hybrid and quasi-monetary nature of sovereign debt and its specific conditions of issuance and

---

\(^{23}\) The YES/NO binary coding provided by the EBA dataset indicates whether the competent authorities or Member States have exercised the NODs or not; however, such binary coding is to some extent a simplification as national authorities might have the chance to decide in more granular ways.

\(^{24}\) Article 395 (3) last paragraph states that competent authorities might set a lower limit than EUR 150 million.

\(^{25}\) For a proposal delineating the alternative of the aforementioned IPS, see Vladimiro Giacché’s contribution: https://www.academia.edu/37035363/Vladimiro_Giacch%C3%A9_La_riforma_del_credito_cooperativo_riflessioni_e_valutazione_di_scenari_alternativi_Bolzano_5_luglio_2018_testo_con_grafici_
refinancing. Germany and the SSM have exercised such prerogative, whereas Italy and France have not. This item relates to the political debates on the so-called vicious circle or “doom-loop” between sovereigns and banks that was out in the public eye during the eurozone sovereign debt crisis, which the creation of the SSM was meant to break.

As this brief description and the corresponding chart 5 illustrate, local circumstances are still part of the regulatory and supervisory architecture. A sound implementation of the rules and a responsive on-going supervision require not only coordination between the national and supranational authorities, but also a dose of coherence (Quaglia and Spendzharova 2018), which can be characterised as the degree of consistency between the different layers of regulations and policy objectives that need to be carefully juggled.

---

26 On the public debate on sovereign debt management, see Biondi 2018.
<table>
<thead>
<tr>
<th>Nature of the option or discretion</th>
<th>Directive 2013/36/EU</th>
<th>Regulation (EU) N° 575/2013</th>
<th>Denomination</th>
<th>Description of the option or discretion</th>
<th>DE</th>
<th>FR</th>
<th>IT</th>
<th>SSM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large exposures</td>
<td>Article 395(1)</td>
<td>Large exposure limits for exposures to institutions</td>
<td>Competent authorities may set a lower large exposure limit than EUR 150 000 000 for exposures in institutions</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(a) and 493(3)(a)</td>
<td>Exemptions or partial exemptions to large exposures limits</td>
<td>Competent authorities may bilaterally exempt covered bonds falling within the terms of Article 129(1), (3) and (4).</td>
<td>Y</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(b) and 493(3)(b)</td>
<td>Competent authorities may bilaterally exempt asset items consisting claims on regional governments or local authorities of Member States</td>
<td>Y, partly</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(c) and 493(3)(c)</td>
<td>Competent authorities may bilaterally exempt exposures incurred by an institution to its parent undertaking or subsidiaries</td>
<td>Y, partly</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(d) and 493(3)(d)</td>
<td>Competent authorities may bilaterally exempt exposures to regional or central credit institutions with which the credit institution is associated in a network and which are responsible for cash-clearing operations within the network.</td>
<td>Y, partly</td>
<td>N</td>
<td>493(3)</td>
<td>N</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(e) and 493(3)(e)</td>
<td>Competent authorities may bilaterally exempt exposures to credit institutions in due by credit institutions, one of which operates on a non-competitive basis and provides or guarantees loans under legislative programmes or its statutes, to promote specified sectors of the economy under some form of government oversight and restrictions on the use of the loans, provided that the respective exposures arise from such loans that are passed on to the beneficiaries via credit institutions or from the guarantees of these loans.</td>
<td>Y, partly</td>
<td>N</td>
<td>493(3)</td>
<td>N</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(f) and 493(3)(f)</td>
<td>Competent authorities may bilaterally exempt exposures to institutions, provided that those exposures do not constitute such institutions’ own funds, do not last longer than the following business day and are not denominated in a major trading currency.</td>
<td>Y</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(g) and 493(3)(g)</td>
<td>Competent authorities may bilaterally exempt exposures to central banks in the form of required minimum reserves held at those central banks which are denominted in their national currencies.</td>
<td>Y</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(h) and 493(3)(h)</td>
<td>Competent authorities may bilaterally exempt exposures to central governments in the form of statutory liquidity requirements held in government securities which are denominted and funded in their national currencies provided that, at the discretion of the competent authority, the credit assessment of those central governments assigned by a nominated External Credit Assessment Institution is investment grade.</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(i) and 493(3)(i)</td>
<td>Competent authorities may bilaterally exempt 50% of medium or long-term risk off-balance sheet documentary credits and of medium or low-risk off-balance sheet undrawn credit facilities referred to in Annex I and subject to the competitive authorities’ agreement, 80% of guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions.</td>
<td>Y</td>
<td>N</td>
<td>493(3)</td>
<td>Y</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(j) and 493(3)(j)</td>
<td>Competent authorities may bilaterally exempt legally required guarantees used when a mortgage is issued by issuing mortgage bonds is paid to the mortgage borrower before the final registration of the mortgage in the land register, provided that the guarantee is not used as reducing the risk in calculating the risk-weighted exposure amount.</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large exposures</td>
<td>Articles 400(2)(k) and 493(3)(k)</td>
<td>Competent authorities may bilaterally exempt assets items constituting claims on and other exposures to recognised exchanges</td>
<td>Y</td>
<td>N</td>
<td>493(3)</td>
<td>N</td>
<td>Y</td>
<td></td>
</tr>
</tbody>
</table>

Chart 5: NODs – Large Exposures Exemptions exercised by Germany, France, Italy and the SSM. Source: EBA Supervisory Disclosure Dataset, adapted to the selected countries and applicable articles (highlighted areas were part of the original dataset).
Concluding remarks

This contribution has aimed to shed light on some of the policy challenges stemming from the existence of a fragmented and diverse banking landscape in the context of an increasingly supervisory centralisation.

Our analysis argues that uniformity and centralisation may not provide the optimal solution and may even involve unexpected consequences in presence of structural diversity and a variety of banking systems and bank types in these systems throughout European territories. As a matter of fact, the very implementation of the SSM has been already mobilising and exploiting the collaboration of local authorities (central banks, prudential authorities, and also teams from the supervised banks). Moreover, the very existence and diversified application by Member States of National Options and Discretions provides further evidence of a complex reality to be regulated and supervised.

The coordination between the supranational and the national levels seems to require a “shift in characterization over the crisis from harmonization as rule-making to harmonization as institution-building” (Moloney 2014, 39). Such shift calls for more than a cooperative framework between supranational and national authorities and both parties’ goodwill. The need for coherence is twofold: on the one hand, there is a clear call for coordination between SSM and local authorities, which spreads from the acknowledgement of local particularities or structural conditions, to the matters of supervisory liability and the preservation and recovery of the stability of the banking system as a whole.27 On the other hand, cohesion is also needed when it comes to aligning the two key policy areas for which the ECB in responsible for: monetary policy and micro-prudential supervision. But coherence, coordination and cooperation are also required when macruradvisory regulation and policy are at stake, as shown by the global financial crisis that gave momentum to the creation and implementation of the SSM. The latter may then be reconsidered as another fundamental step in completing the EU monetary and financial architecture after the introduction of the Euro currency and the Eurosystem administered by the ECB. The SSM is only one of the gears in this monetary and financial machinery, the one that

27 See in this regard a comment to a recent ruling of the European Court of Justice in a case against the National Central Bank of Bulgaria - C571/16 of 4 October 2018: https://www.linkedin.com/pulse/eu-court-justice-rules-liability-national-banking-emanuel-van-praag/ This decision has opened up the possibility to render banking supervisors liable, as it has ruled that there is no room for special protection against liability for these authorities, while asserting that the deposit guarantee directive confers rights on individuals against the national banking supervisor. Considering the rising number of cases in which the SSM has been taken to court recently (Dawson and Bobic 2018, forthcoming), the potential implications of a joint liability should not be left aside.
points to joint management of bank money aggregates and sovereign debt securities that are often employed as safe assets and then included in money and treasury management.

References


Romano, Roberta. 2014. “For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture.” *Yale Law Journal on Regulation* 31, no. 1, [http://digitalcommons.law.yale.edu/yjreg/vol31/iss1/2](http://digitalcommons.law.yale.edu/yjreg/vol31/iss1/2)