

C TOWARDS A BANKING UNION

The establishment of a banking union is a major component of the framework required for a genuine Economic and Monetary Union (EMU). The legislative proposals published by the European Commission on 12 September 2012 regarding the establishment of a Single Supervisory Mechanism (SSM) as part of a “Roadmap towards a Banking Union” represent a major step in this direction. The proposals follow up on the euro area summit statement of 29 June, and are in line with the European Council’s call for an integrated financial framework. This special feature argues that while the building of a banking union is an arduous and complex process, it is nevertheless essential to support an effective EMU. The financial crisis has illustrated the fundamental inconsistency of banking supervision being carried out at the national level in a currency area with a single monetary policy. Under the current setting, fragility in national banking systems can be quickly transmitted to the national fiscal side and vice versa, triggering an adverse feedback loop between fiscal and banking problems. This is damaging from a financial stability perspective and hampers the smooth transmission of monetary policy. In the short term, the SSM should contribute to weakening significantly the link between banks and sovereigns persisting in a number of euro area countries. In the long term, the stronger institutional framework of the SSM should exert a beneficial influence on the euro area and the global economy. From this perspective, this special feature highlights the importance of moving towards a common supervisory system and implementing a common resolution regime. In particular, an independent European resolution authority is urgently required to meet the challenges posed by the resolution of banking institutions, also at a cross-border level. Such an authority is also necessary in order to align the incentives of the SSM and the resolution function.

INTRODUCTION

The architecture of EMU needs to be substantially strengthened to break the adverse link between bank and sovereign risk in some euro area Member States and to reverse the current process of financial market fragmentation in the euro area. The crisis has highlighted the fundamental incongruity of banking supervision being controlled at the national level in a currency area with a single monetary policy. In a monetary union, fragility in national banking systems can transmit quickly to domestic fiscal tensions, and vice versa, giving rise to an adverse fiscal/financial loop that jeopardises both financial and monetary stability, hampering the transmission of monetary policy. To overcome these problems in a consistent manner and to safeguard stability and confidence in the financial system, an appropriate regulatory and supervisory framework is essential.

The ECB supports the conclusions of the Final Report by the President of the European Council on EMU and an integrated financial framework centred around an SSM.¹

The establishment of the SSM should contribute to restoring confidence in the banking sector and to reviving interbank lending and cross-border credit flows through independent integrated supervision for all participating Member States, on the basis of a system that involves the ECB and national supervisors. The SSM will also contribute to the effective application of the single rulebook for financial services and the harmonisation of supervisory procedures and practices, by removing national distortions and better reflecting the needs of an integrated currency area.

The banking union will strengthen the institutional framework in the euro area, creating a true monetary union

With a broader perspective, it will harmonise supervisory procedures and remove national distortions

¹ See the Interim Report by the President of the European Council, *Towards a genuine economic and monetary union*, 12 October 2012, and the Final Report by the President of the European Council in close collaboration with the Presidents of the European Commission, Eurogroup and European Central Bank, *Towards a genuine economic and monetary union*, 5 December 2012 (available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf).

This special feature will, first, review the reasons for establishing the SSM. Second, it will mention the main elements of, and guiding principles behind, the planned SSM. Third, an issue of paramount importance, namely the urgent need to establish a single European bank resolution authority as an essential complement to the SSM, will be discussed. Finally, the special feature will conclude by explaining the importance of macro-prudential policies for ensuring effective supervision, a key lesson from the crisis.

THE MACROECONOMIC AND STRUCTURAL RATIONALE FOR A BANKING UNION

Fragmentation and tensions in bank funding conditions at the national level have impaired the transmission mechanism of monetary policy...

Over the past few years, pressures in funding markets have increasingly triggered a fragmentation of the euro area banking system along national lines. A key feature of the present crisis is the increase in the correlation between the cost of funding of euro area banks and that of their respective sovereigns, particularly in some countries under stress. Countries suffering from a loss of market confidence have become progressively more dependent on domestic sources of funding (where and insofar as they are available) and less responsive to common monetary policy impulses. The divergence in bank funding conditions at the national level, in turn, gives rise to cross-country differences in lending conditions. The retrenchment of credit supply within national borders, coupled with funding pressures, impairs the transmission of monetary policy, which in the euro area, functions primarily via the banking sector. In some jurisdictions, lending conditions for households and firms become tighter (or looser) than they should be given the prevailing monetary policy stance, and less predictable. To a large extent, the need to remedy this situation explains the extraordinary monetary policy decisions made by the ECB in recent months.

... and fragmentation could also contribute to negative loops between banking problems and tensions in sovereign funding

It is important to stress that this loop between banking problems and tensions in sovereign funding can undermine national efforts towards re-establishing fiscal sustainability. Indeed, some countries undergoing a fiscal adjustment process may be penalised by financial markets on account of their potential additional burden of supporting the domestic banking system. As a result, their banks face increasing pressures in terms of their refinancing and the fragmentation of the euro area banking system along national lines increases further. Against this background, the need to weaken the spillover chain between banks and sovereigns by taking responsibility for the stability of the banking system at the European level becomes evident. Within the framework of improving the institutional arrangements to ensure a more efficient and consistent solution to banking problems across the euro area, a banking union is a necessary step to improve investors' confidence and to weaken this link between fiscal and banking problems. It would also contribute to achieving a more integrated banking system that supports a full-fledged EMU.

On 12 September the European Commission published a proposal to establish an SSM involving the ECB

The first step towards a banking union took place when the Heads of State or Government at the euro area summit of 29 June 2012 invited the Commission to present a proposal on the basis of Article 127(6) of the Treaty on the Functioning of the European Union to establish an SSM involving the ECB. The Commission published its proposals on 12 September 2012.² In October the European Council reiterated the aim of completing the legislative work by the end of the year and called for further progress to be achieved on other related legislation, including the single rulebook and the new Capital Requirements Directive (CRD IV). Finally, the European Council mentioned, as further objectives, bank resolution arrangements and the harmonisation of national deposit-guarantee schemes.

² See the proposal from the European Commission for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM(2012) 511 final), and the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No.../... conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM(2012)512 final).

THE MAIN ELEMENTS OF THE SSM

The SSM will support and complement the institutional setting of EMU. It should ensure homogeneous standards of supervisory intensity across the euro area. The SSM should assess, in a fully independent and autonomous manner, the banking system and individual banks, so that domestic factors have no impact on the effectiveness and the timeliness of the relevant supervisory decisions. This will be decisive in restoring and maintaining confidence in the banking sector. In turn, it should help to reverse the trend towards financial fragmentation and also help to restart and preserve a well-functioning interbank market.

In this context, the SSM should be better able to address systemic risk, as it will take into account externalities and spillovers in a fully integrated economic area, and be more effective in preventing imbalances over the economic cycle.

The SSM will reinforce and further develop the Single Market for financial services. A single framework for monitoring the banking sector will facilitate common crisis management in the event of future crises. The SSM will also reduce the risk of coordination failures among supervisors in the Single Market, thereby facilitating the role of the European Banking Authority (EBA) with regard to the convergence of supervisory practices across all Member States, as well as the development of a single rulebook.

For participating Member States therefore, building a single supervisory authority around the ECB provides an institutional solution that has the independence, the legal means and, in conjunction with the national supervisory authorities, the resources and technical capability to carry out these supervisory tasks at the European level.

FUNDAMENTAL PRINCIPLES

The Governing Council of the ECB has presented the following set of guiding principles for establishing the SSM.³

First, the ECB, within the SSM, should be able to carry out the tasks assigned to it effectively and rigorously without any risk to its reputation. Second, the ECB should remain independent in carrying out all its tasks. Third, there should be a strict separation between the ECB's new tasks concerning supervision and its monetary policy tasks, as assigned by the Treaty. Fourth, the ECB should be able to have full recourse to the knowledge, expertise and operational resources of national supervisory authorities. Fifth, the SSM should operate in a manner fully consistent with the principles underpinning the Single Market in financial services and in full adherence to the single rulebook for financial services. In this regard, the ECB also welcomes the possibility of involving non-euro area Member States in the SSM to ensure greater harmonisation of supervisory practices within the EU, thus strengthening the internal market. Sixth, the ECB is ready to comply with the highest standards of accountability with regard to the supervisory tasks.

A strict separation between the monetary policy and supervisory mandates will ensure independence in carrying out both tasks

³ See the ECB's Opinion of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (CON/2012/96) (available at http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2012_96_f.pdf).

The SSM will include all credit institutions to preserve a level playing field

The ECB or national authorities should both be able to activate the macro-prudential instruments

The separation between the monetary policy and supervisory mandates will be reflected in the organisational arrangements and include appropriate governance structures

The principles can be detailed as follows.

First, to enable the SSM to conduct effective supervision, the proposed SSM regulation entrusts the ECB with specific supervisory tasks associated with the necessary corresponding supervisory and investigatory powers and direct access to information. This is essential to ensure that the SSM performs its tasks effectively. The inclusion of all credit institutions under the scope of the SSM is important to preserve a level playing field among banks and prevent segmentation in the banking system.

The proposed conferral of macro-prudential supervisory powers on the ECB is welcome since the ECB will be able to coordinate the use of macro- and micro-prudential policies. The proposed SSM regulation should enable the activation of macro-prudential instruments provided by EU law, including the counter-cyclical buffers and any other measures aimed at addressing systemic or macro-prudential risks, by either the national macro-prudential authorities or the ECB. It should be open to them to apply more stringent requirements, if deemed necessary and subject to prior notification. The national authorities and the ECB will cooperate closely in this field. In particular, given their responsibility for financial stability, and their close proximity to, and knowledge of, national economies and financial systems,⁴ the national authorities should have sufficient tools at their disposal to address macro-prudential risks related to the particular situation of participating Member States, without prejudice to the possibility for the SSM to also act to contain such risks in an effective manner by imposing more stringent measures. In view of the importance of a functional separation between macro- and micro-prudential supervision, on the one hand, and the Governing Council's responsibility for financial stability, on the other, specific procedures should be envisaged within the SSM framework for the involvement of the Governing Council with regard to the ECB's decisions on macro-prudential policy measures.

Second, the ECB has to perform the tasks conferred on it by the proposed SSM regulation without prejudice to the objectives of the European System of Central Banks (ESCB) as provided in Article 127 of the Treaty.⁵ The ECB will be required to ensure that its activities within the SSM neither affect the ESCB's performance of any of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank, nor compromise its institutional setting. Under the Treaty and the Statute,⁶ the ECB enjoys full independence⁷ in executing its tasks, which includes any supervisory tasks conferred on it by virtue of Article 127(6) of the Treaty.

Third, it is essential to strictly separate monetary policy and the supervisory tasks conferred on the ECB, to prevent potential conflicts of interest and ensure autonomous decision-making for the performance of these tasks, while ensuring compliance with the ESCB's institutional framework. To that end, appropriate governance structures are needed to ensure separation between these tasks, while allowing the overall structure to benefit from synergies. In this respect, it should be ensured that, under the proposed SSM regulation and within the context of the Treaty framework, the new supervisory board will constitute the centre of gravity of the ECB's supervisory function. Besides the heads of supervision of the competent authorities in the participating Member States,

4 See the ECB's Opinion of 25 January 2012 on a proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and a proposal for a Regulation on prudential requirements for credit institutions and investment firms (CON/2012/5) (OJ C 105, 11.4.2012, p. 1).

5 See Articles 127(1) and 282(2) of the Treaty and Article 2 of the Statute.

6 See Articles 130 and 282(3) of the Treaty and Article 7 of the Statute.

7 The concept of central bank independence includes functional, institutional, personal and financial independence (see, for example, the ECB's Convergence Report 2012, p. 21).

the supervisory board should also include, as observers, representatives of national central banks that perform supervisory activities ancillary to those of the national competent authorities when provided for by statute.

Furthermore, the supervisory board should have, to the largest extent possible, the necessary tools and expertise to perform its tasks effectively, while respecting the ultimate statutory responsibilities of the ECB's decision-making bodies. In this context, the framework for the functioning of the supervisory board should ensure equal treatment with regard to the participation of representatives of the competent national authorities of all the participating Member States, including those which have established close cooperative links with the ECB. Lastly, also taking into account the experience of the various national central banks already performing supervision, the ECB will be required to establish appropriate internal rules and procedures to ensure adequate separation within the functions supporting these tasks.

Fourth, it is essential for the SSM to be able to leverage the expertise and resources of national supervisors in performing the new supervisory tasks. In-depth qualitative information and consolidated knowledge of credit institutions are essential, as well as reliable quantitative information. Through appropriate decentralisation procedures (to be defined within the SSM), while preserving the unity of the supervisory system and avoiding duplication, the SSM will be able to benefit from the closer proximity of national supervisors to the supervised entities and, at the same time, ensure the necessary continuity and consistency of supervision across participating Member States.

It will also be important to ensure that the ECB's final responsibility for supervision within the SSM is matched by control powers over the SSM as a whole and the supervised entities, as well as by very close cooperation arrangements with the competent national authorities, including specific rules in emergency situations and adequate information flows. Therefore, there should be efficient arrangements for information flows within the SSM to also prevent any duplication of reporting obligations for credit institutions.

Fifth, the proposed SSM and EBA regulations must ensure that the new framework will be consistent with the Single Market. The following two main elements may contribute to achieving this aim. First, the proposed SSM regulation should allow Member States wishing to join the SSM to engage in appropriate close cooperation mechanisms and to participate fully in the activities of the supervisory board on an equal footing with euro area Member States, i.e. with the same rights and obligations. Second, the conferral on the ECB of tasks concerning the prudential supervision of credit institutions for euro area Member States creates a new institutional framework which may require adjustments to the governance of the EBA. The proposed EBA regulation should provide for the necessary adjustments to the governance structure and powers of the EBA, in particular by providing for equal treatment between the national supervisory authorities and the ECB, while safeguarding the ECB's independence.

Moreover, in consideration of its new central role in the SSM, the ECB will contribute to ensuring that the national competent authorities participating in the SSM assume mutually consistent positions in the EBA's decision-making bodies on issues falling within the scope of the ECB's supervisory tasks, including the development of specific rules in this area as appropriate, without prejudice to the supervisory tasks remaining with national competent authorities. Lastly, appropriate arrangements might be developed in order to ensure smooth cooperation of the SSM with the non-participating Member States.

The national supervisors and the ECB will both be part of the same unified institutional framework so that the SSM should benefit from the essential knowledge of national supervisors

National competent authorities participating in the SSM will assume mutually consistent positions in the EBA's decision-making bodies

Accountability is essential and warranted for a well-functioning SSM

Sixth, democratic accountability is the indispensable counterbalance to independence. The ECB is already subject to accountability and reporting obligations which should be fully maintained for its existing tasks. Similar obligations will be established under the proposed SSM regulation with a view to its new supervisory tasks. Building on those statutory obligations, separate and adequate forms of accountability should be designed, also in accordance with the Core Principles of the Basel Committee on Banking Supervision. These accountability mechanisms should reflect the following considerations. First, they should respect the ECB's independence. Second, accountability should take place at the level at which decisions are taken and implemented. Accountability mechanisms should therefore be designed primarily at the European level, without prejudice to existing accountability arrangements of national supervisors, which also apply to their respective supervisory tasks not entrusted to the SSM, and occasional exchanges of views of the Chair or members of the supervisory board with national parliaments, as appropriate. Third, robust mechanisms should be in place to safeguard the confidentiality of supervisory information.

OTHER BUILDING BLOCKS OF A BANKING UNION

A common resolution regime is essential for the banking union...

While establishing the SSM would represent a major step forward towards a banking union, the banking union would be incomplete without commensurate progress towards a common resolution regime. The lack of such a common regime has increased the cost of bank failures for taxpayers and complicated their handling, particularly (but not exclusively) in cross-border cases. More harmonised deposit guarantee mechanisms would also contribute to achieving a more complete banking union.

... the lack of such a framework has complicated the management of bank failures and increased costs to taxpayers

A common resolution regime is crucial to manage crisis situations in an as orderly, effective and efficient manner as possible. A rapid adoption of the existing legislative proposals on bank recovery and resolution⁸ is thus warranted as such a resolution regime does not exist in the EU at present. Many Member States do not yet have a fully adequate legal framework for swift and effective bank resolution, nor do they have adequately financed ex ante resolution funds at their disposal. As a result, during the present crisis, policy-makers have been faced with an augmented version of the classic supervisory dilemma of whether to let an institution fail, with a potential risk of undermining financial stability, or to bail out the institution using taxpayers' money, thus fuelling moral hazard. For cross-border banks, the problems are even more severe. The number of authorities involved – each operating under a different legal framework and each focusing mainly on national interests – severely complicates a cost-effective and swift resolution of such institutions.

Without a common resolution regime, the institutional framework is unbalanced and could lead to costly delays in the resolution of banking problems

Moving towards a common supervisory system without corresponding progress towards a common resolution regime would therefore result in an incomplete institutional framework. Leaving resolution powers at the national level could stand in the way of a cost-effective and swift resolution of banking problems. National authorities – eager to avoid any costs to their taxpayers and reluctant to bail-in domestic parties – would have an incentive to procrastinate, exercise supervisory forbearance and seek generous central bank liquidity support for overly extensive periods of time.

The Commission's recent proposal on bank recovery and bank resolution is an important and positive first step in this direction

The Commission's recent proposals on bank recovery and bank resolution are an important first step towards an efficient and financially sound area-wide bank resolution regime. It aims to provide a harmonised toolbox at the EU level. Nonetheless, to overcome the challenges surrounding the orderly resolution of cross-border institutions, an independent European resolution authority is

⁸ See the proposal for a directive of the European Parliament and of the Central 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 (COM/2012/0280 final).

urgently required to align the incentives of the SSM and the resolution function. To this end, a common authority, free of the constraints of national mandates, is needed to exercise the bank resolution function in an independent manner across the euro area. This authority should have the tools to address banking crises pre-emptively, safeguarding financial stability and minimising taxpayers' exposure to losses. When created, the European resolution authority will use homogeneous tools, principles and procedures and implement them consistently across all banks and countries in its jurisdiction.

In a banking union, the resolution authority and the SSM are natural complements. The SSM removes what has thus far been the guiding principle of the EU's cross-border supervisory framework, namely home country control. Under the current setting, national resolution authorities – responsible for funding resolution and covering insured depositors – have an incentive to request cheap emergency financing for as long as possible in the hope that this may “turn things around”, rather than to take swift resolution action. The ECB, on the other hand, as a supervisor, may be exposed to criticism for being excessively severe and putting national funds at risk in the event it pushes for resolution action at the national level. Therefore, once banks are regulated and supervised at the SSM-wide level, a common resolution authority is the inevitable complement.

MACRO-PRUDENTIAL POLICIES

Another major component that is essential for an effective supervisory area is macro-prudential policy. Before the crisis, banking supervision in most (but not all) countries was fundamentally “micro-based”, i.e. it was focused on ensuring the safety and soundness of individual institutions, while taking the rest of the financial system as a given. From a policy perspective, as a result of the crisis, there has been an increased interest in the macro-prudential approach to bank regulation and supervision. Consequently, the international debate among academics and policy-makers has shifted focus to how to detect and prevent systemic risks, and how regulators and supervisors can reorient and complement their activity to curb these risks.

While risks to financial stability stemming from credit booms and other cyclical phenomena are well documented, the recent crisis suggests that the traditional supervisory approach is insufficient to prevent structural changes that facilitate a build-up of systemic risks. In this sense, it is broadly recognised that the deregulation of and financial innovation in the banking sector in most developed countries in the last 15 years have led to a profound overhaul of banks' business models, altering their incentives to take on more risk, including new forms of tail risk.

The crisis has significantly raised awareness of these macro-prudential aspects and the endogenous nature of many systemic episodes of financial instability. It has also shown that individual credit institutions may be “systemic” for a variety of reasons: on account of their interconnectedness and cross-exposure with other banks, market interlinkages and through the domestic fiscal sector, to name just a few. As a result, banking fragility can more easily affect the real sector of the economy. The crisis has also illustrated that contagion can easily extend across countries, especially in a currency area, through a variety of channels, notably the interaction between the banking and fiscal sectors.

Under these conditions, the micro-based approach – which looks at the impact of deregulation on a single institution while the rest of the system is assumed to be stable – is likely to overestimate the efficiency gains and underestimate the potential negative externalities derived from the inherent risks in certain types of financial innovation.

Before the crisis, banking supervision was, in most countries, fundamentally “micro based”, i.e. it was focused on ensuring the safety and soundness of individual institutions

As the recent and previous crises have shown, the traditional approach is clearly insufficient to prevent the build-up of systemic risks

In the long term, the micro-prudential objectives can only be achieved if an effective macro-prudential supervisory system is in place

At the same time, in the long term, the macro-prudential perspective is an essential complement to the micro-prudential perspective. In this respect, the most basic objectives of micro-prudential supervision are, first, to safeguard depositors (and the taxpayer who might be liable to cover any losses on deposits) who are likely to be uninformed about the risks taken by the bank and, second, to tame the negative externalities for the economy derived from the failure of a single institution. From this perspective, operatively, it is important to note that in the long term, these micro-prudential objectives can only be achieved if an effective macro-prudential supervisory system is in place and working effectively in combination with the micro-prudential precautions.

In the presence of rapid financial innovation, a merely micro-prudential supervisory approach may lead to an underestimation of the build-up of systemic risks in the economy. An illustrative example is provided by a credit boom. During such a boom, most banks would typically show high levels of bank profitability and very contained measures of bank risk, thereby offering a comforting view of the solvency of individual banks from a micro-prudential supervisory perspective. Yet historical experience shows that strong credit growth often occurs at the cost of increasing systemic risks, for instance, by relaxing lending standards or by excessive reliance on short-term market funding.

In fact, micro- and macro-prudential instruments are largely the same, although each is applied using a different perspective

Macro-prudential objectives can be reached using largely the same instruments used to achieve micro-prudential objectives, and such a holistic approach does not necessarily imply or require a new supervisory toolbox. Indeed, while some instruments have been developed with the express purpose of mitigating systemic risk (i.e. new macro-prudential instruments), the majority are already regularly used by national banking supervisors. In the latter case, what changes is that these instruments are applied with a broader perspective, internalising the systemic externalities that can be produced endogenously within the financial system.

In this regard, European legislation contains a variety of macro-prudential policy instruments, including counter-cyclical capital buffers, surcharges differentiated across banks according to their contribution to systemic risk, and liquidity and leverage requirements to be implemented over time. Others, such as loan-to-income or loan-to-value ratios, continue to be governed by national legislation. The proposed conferral of macro-prudential powers on the ECB will allow it to coordinate the use of macro- and micro-prudential policies. The proposed SSM regulation enables the macro-prudential instruments provided by EU law to be activated at the initiative of either the ECB or the national authorities. Hence, it recognises that the national authorities have an interest in using some of these instruments for domestic regulatory purposes. Overall, a balance would need to be found between recognising those interests and preserving the integrity and effectiveness of the single supervisor.

CONCLUDING REMARKS

The banking union will strengthen EMU, in particular by ensuring consistency in supervisory standards and addressing systemic risks.

The establishment of a banking union will be a major component of the institutional framework required for a genuine EMU. The crisis has brought to the fore the limitations derived from participating Member States having national responsibility for banking policies in a currency area with a single monetary policy. It has shown that fragility in national banking systems can transmit quickly to domestic fiscal deficits, and vice versa, giving rise to adverse fiscal/financial feedbacks that are deleterious for both financial and monetary stability, and hinder the transmission of monetary policy. The SSM will ensure homogeneous standards of supervisory intensity across the euro area as a whole. It will address systemic risk in a more efficient manner by taking a wider perspective and considering externalities and spillovers. At the same time, competent national

authorities will continue to bring their expertise to this area and will also address macro-prudential risks. The SSM will also be able to act more decisively to prevent the creation of strong imbalances over the economic cycle.

Even with a common supervisory system, however, a banking union would be incomplete without the establishment of a European resolution authority free of the constraints of national mandates. There must be certainty that each bank, however large and important, can exit the market if necessary, with the least possible cost in terms of systemic stability and use of collective resources. Only a dedicated authority, with jurisdiction over the same geographical area as the single supervisor, can perform this function effectively.

Yet only with an efficient European resolution authority can the banking union achieve its goals.