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The Single Supervisory Mechanism and the Assessment of Hungary's Possible Approach

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I. ABSTRACT

Due to the European financial and sovereign debt crisis occurred in 2008, the decision-makers of the European Union decided to take steps to avoid a further possible turmoil and created a mechanism to ensure the efficiency of financial supervision across the union. This financial integration of Europe is called the banking union. The milestones of the union are: the single rulebook for the capital requirements of credit institutions (i.), the Single Supervisory Mechanism (SSM) lifting prudential supervision of credit institutions to a European level (ii.), a Single Resolution Mechanism (SRM) (iii.) and the common deposit insurance system (iv.). The Single Supervisory Mechanism is one of the crucial parts of the banking union, since it has the task to extend the European integration to the field of financial supervision. The executer of this task shall be the European Central Bank, so in the future the ECB will be responsible for both, the monetary policy of the union and the financial supervision of the significant European credit institutions. The ECB – with the contribution of the national competent authorities – shall supervise the most significant banks of the European Union. The SSM will be mandatory for the Euro-zone Member States and voluntary for the rest. However, it is unclear whether how many non-euro zone Member State will decide to participate. According to the Hungarian situation, it is unlikely that Hungary likely participates, because of the uncertainty regarding the untested practice of the SSM.

II. PREFACE

The motto of this paper is to provide an insight to the Single Supervisory Mechanism, because of 2 (two) reasons. First, the SSM Regulation was adopted on 15th October 2013 and it shall be put into force on 4th November 2014. The non-euro zone Member States of the union have time to decide on the participation until June 2014. For this reason at this moment, it is inevitable to sum up the pros and cons of the participation.

Now, it is opportune to test the advantages and disadvantages of participation to get enough information to make a responsible decision.

For the above-mentioned reasons this paper undertakes to analyse the tasks, powers and significance of the Single Supervisory Mechanism. As a second step, it comprises the possibility of a close cooperation for Member States out of the Euro-zone, in general. Furthermore, the paper shall provide a profound assessment specifically in connection with a possible close cooperation agreement of Hungary.

The significance of a close cooperation is mainly up to the quality of that cooperation, in comparison of the alternate national system. Thus, it would be reasonable to compare the significant aspects of the Hungarian national system and the SSM. Nevertheless, this paper will not provide that comparison, since the recent Hungarian legislation introduced in 2013 – regarding its key points – is mainly identical with the substance of the European legislation; in particular, it was designed in conformity with the provisions of CRR[1] and CRD IV.[2] For this reason, this paper will not provide a point-by-point analysis on the pros and cons of participating in the SSM in comparison with staying out and supervise under the recent national legislation.

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[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

[2] Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Instead, this paper provides a profound analysis on the SSM and on the possibility of a close cooperation. In addition, it will be summarized what aspects should be considered in relation to accession to the SSM.

III. Abbreviations

AQR	Asset Quality Review
Basel III.	Global, voluntary regulatory standard on bank capital adequacy, stress testing and market liquidity risk. Agreed upon by the members of the Basel Committee on Banking Supervision in 2010–11.
CRDIV	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN Council	Economic and Financial Affairs Council
EFSF	European Financial Stability Facility
ESCB	European System of Central Banks
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
Euro	Official currency of the eurozone
Euro group	Official meeting of the finance ministers of the eurozone
JST	Joint Supervisory Team
MNB	Magyar Nemzeti Bank (National Bank of Hungary)
NCA	National Competent Authority
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
SSM Regulation	Council Regulation (EU) No 1024/2013
TFEU	Treaty on the Functioning of the European Union

IV. INTRODUCTION

As the waves of Europe's financial and sovereign debt crisis are losing strength, the significance of the forthcoming European Parliament election in May, 2014 is to decide which direction should be chosen for the future of the European integration. The Union is undoubtedly at the crossroads regarding the fact that the crises clarified: the existing road cannot be continued anymore, renewal is inevitable. There are 2 (two) choices in front of the new European Parliament elected 22-25 May,[3] and moreover the new European Commission, elected by the parliament. On one hand, they can endeavour to achieve full integration, at the end of the day creating an entity, which can be called as United States of Europe. On the other hand, for some Member States, for instance, for the United Kingdom, and recently for Hungary United States of Europe is not acceptable, and they want deep integration in some issues, but strong sovereignty in others. These Member States are eager to create a European Union of potent sovereign nations.

The debate is far not over yet, and both solutions possess effective pros and cons. The supreme argument supporting full integration may be that this is the only potential way how the EU will be able to make up for the competitive disadvantage it has, compared to its biggest competitors, China and the US. Regarding the globally significant issues, like creation of a competitive economy in relation to the world market or the fight against global warming fragmentation is extremely inefficient, and there is a real need not only for cooperation, but for 1 (one) centralized decision making entity. At the same time, representatives of the counter-concept say that full integration leads to the inevitable oppression of the most powerful members of the union, for the reason that small Member States do not have the same ability to enforce their interests.

At this time, it is hard to have a final decision on that matter, but a solution suitable for each Member State may be reachable. In my view, the desirable direction is to endeavour to full integration and to centralized, fast decision-making process in the most significant global

[3] http://www.europarl.europa.eu/us/en/elections_2014.html;jsessionid=B325D8B4821E92930998576CD141F38E (date of access: 01.05.2014)

issues to maintain and improve the role of the European Union in the global sphere. Besides that, it is desired to maintain national competences in all the other issues to avoid the distortion of democratic values and to create an efficient level of decision making, because except the huge common issues and comprehensive strategies, decision making is more effective when it is closer to the entities, it affects.

As regards the future of the banking union, in particular the future of the Single Supervisory Mechanism, it is inevitable that the higher level of the integration is the more supportive ambit to the fruition of a universalized financial sector within the European Union. The Single Supervisory Mechanism is a crucial step towards the creation of a banking union, which is the only tool in the hands of the EU decision-makers right now to prevent the next possible financial and sovereign debt crisis. It was immediate to create and have the SSM function because of 2 (two) separate motives.

At first, the introduction of the SSM helped to solve the already existed crisis with ex tunc effect, in as much Germany was willing to finance the common European assistance to avoid bankruptcy for countries like Ireland and Spain, only if they give up parts of their financial supervisory independence. In other words, these mainly Mediterranean Member States accepted the direct European recapitalization of their banks in a situation, in which they would no longer be in a position to do so. In exchange of that, a political pact came into fruition regarding the lifting up of the financial supervision from national to a European level.[4]

Secondly, the SSM's main goal to hinder or at least decrease the possibility of financial turmoil in Europe with ex nunc effect. To achieve this goal, the SSM has far more devices than the other European bodies have had so far, like the European Banking Authority and the European Systemic Risk Board. The EBA is responsible for the micro-prudential supervision, but only in a non-binding manner.[5] The ESRB has macro-prudential responsibilities, but it has the same problem as the EBA, namely it also lacks the competence to make binding decisions.[6] The biggest achievement of the SSM is that it includes both, macro- and micro-

[4] Verhelst, 2013, p. 9
[5] ibid, p. 32
[6] ibid, p. 36

prudential supervisory tasks and more importantly powers to be able to decide in a binding manner.

The SSM and the whole Banking Union points to a utopia, in which the European financial system is a unified entity, as such a coequal partner of the determinative actors of the global economy. Coequal partnership means a certain degree of independence as well, for instance in relation to credit rating agencies. During the crisis there were several disagreements between European decision-makers and the 3 (three) big credit rating agencies. The debate was mainly about the different evaluation of the credit worthiness of different Member States by the prevalent credit rating agencies, incorporated in the US, and the European institutions. There is an explicit need between the decision-makers of the European Union to set up an own European rating agency, to reach independence and creditability. However, it is just 1 (one) little detail of why it is necessary to establish the Single Supervisory Mechanism, and later the banking union. The Single Supervisory Mechanism offers the possibility to supervise, so predict and avoid discrepancies in the financial system on a European level. European level of supervision could be decisive, regarding the fact that the European financial system is highly interconnected between the Member States, sometimes a problem occurs in a supervised institution at one Member State, and the effects of that take place within the same institution, in another.

V. THE FRAMEWORK OF THE SINGLE SUPERVISORY MECHANISM

V.1. THE LEGAL FRAMEWORK OF THE SYSTEM

The system of financial legislation in the EU is quite complex, it consists provisions on the European and on national level as well. Both level of legislation consist substantive matters and procedural legislation. This cross-linked structure of regulation makes it complex to find and implement the recent legislation aiming to reach the banking union in Europe. Regarding

the procedural side of the regulation, the SSM Regulation[7] is prevailing; it regularizes all the significant aspects of the procedural rules of the European-wide financial supervision. Its power to do so is delegated by Article 127 (6) of the Treaty on the Functioning of the European Union,[8] which says the Council has the power to confer specific tasks upon the European Central Bank, concerning prudential supervision matters.[9] For this reason, the Regulation establishing the European Banking Authority and conferring specific tasks to it[10] has become old-fashioned, thus a modification is just in progress in the form of an ordinary legislative procedure, in consistence with the SSM Regulation. At the end of this process, the ECB shall carry out its tasks within the Single Supervisory Mechanism, which mechanism is built on the cooperation of the ECB and the national competent authorities, guaranteed by the SSM Regulation,[11] without prejudice to the legislation established the EBA. However, this cooperation does not take place on an equal basis, within the SSM the ECB is the lead supervisor, with national supervisors in an assisting role.[12]

As a next step of procedural regulation on EU level, Article 6 (7) of the SSM Regulation[13] authorizes the ECB to adopt an ECB Regulation on the framework of the practical arrangements of the SSM Regulation.[14] These 2 (two) regulations, mentioned above embody the nucleus of the Single Supervisory Mechanism.

Regarding the Hungarian legal system, there are 2 (two) key acts implementing procedural rules in financial supervision. As a general provision in the public administration, the Act on

[7] 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
[8] Guarracino, 2013, p. 202
[9]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. (Article 127 (6) TFEU)
[10] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC
[11] Article 6 (1) of Council Regulation (EU) No 1024/2013
[12] Verhelst, 2013, p. 9
[13] Council Regulation (EU) No 1024/2013
[14] Article 6 (7) of Council Regulation (EU) No 1024/2013: "The ECB shall, in consultation with national competent authorities, and on the basis of a proposal from the Supervisory Board, adopt and make public a framework to organise the practical arrangements for the implementation of this Article."

the general rules of administrative proceedings and services[15] provides the basic rules of supervisory and investigatory procedures of the Hungarian National Bank. With the same significance, but with a more specialized scope, there is another act playing important role on the procedural side of the legislation: the Act on the Hungarian National Bank.[16] This act has been revised recently, since the parliament just adopted it in 2013, because the unification of the national bank and the financial supervisory authority made it requisite to create a harmonised legal background with the implication of supervisory goals, tasks and powers into the renewed national bank act.

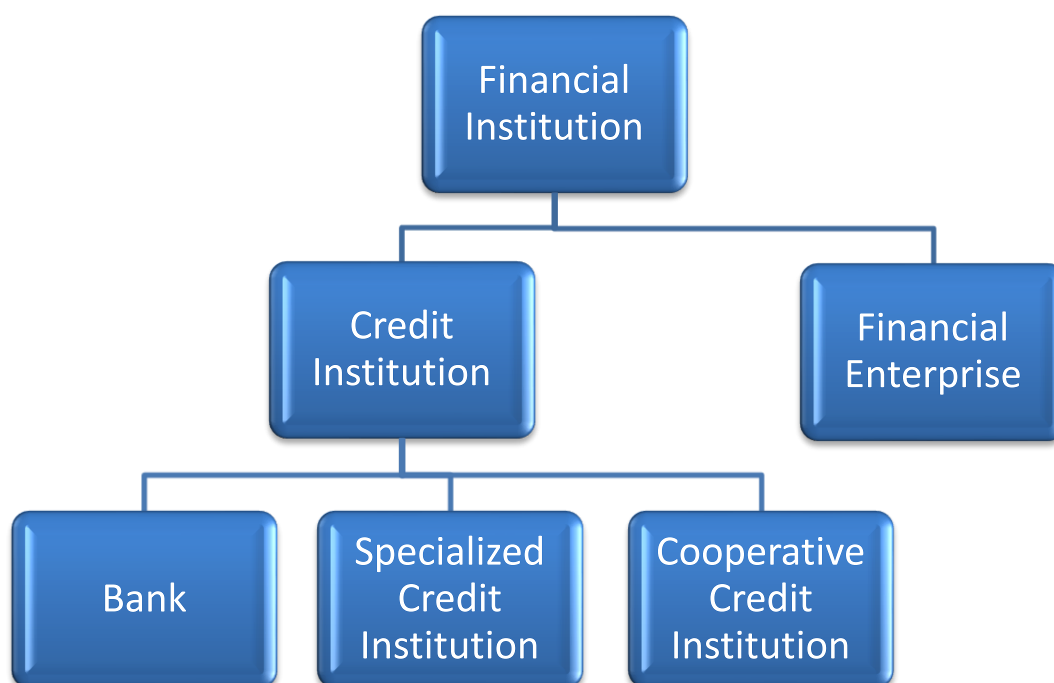
With the Act on the Hungarian National Bank at the end, the list of key-procedural provisions is finished. However, if we would like to have a full view on the entire financial legislation, we have to take into account the other side of the coin as well: the substantive provisions. Considering the substance of financial supervision is quite actual, since the core of EU-level provisions came into force in 2013: Council Regulation on prudential requirements for credit institutions (CRR)[17] and Directive on access to the activity of credit institutions and the prudential supervision of credit institutions (CRD IV).[18]

Non-negligibly for the above-mentioned reasons, the Hungarian sector act has been annulled to avoid fragmentation and structural mistakes within the progress of harmonization. Hence, in 2014 the new Act on Credit Institutions and Financial Enterprises[19] came into force in Hungary changing all the relevant provisions necessary to implement harmonization. The most significant issues of harmonization are the following. The new act is supplemented with provisions required by EU legislation, in particular with the introduction of chiselled capital requirements and buffers to banks and financial institutions and new corporate governance rules providing higher standards from prudential aspect.[20] For the requirement of completeness, it has to be mentioned that the Credit Institutions Act also comprises procedural provisions, since the 2 (two) other, purely procedural code mentioned above cannot meet with

[15] Act CXL of 2004 on the General Rules of Administrative Proceedings and Services
[16] Act CXXXIX of 2013 on the Hungarian National Bank
[17] Regulation (EU) No 575/2013
[18] Directive 2013/36/EU
[19] Act CXXXVII of 2013 on Credit Institutions and Financial Enterprises
[20] http://www.jogiforum.hu/hirek/31008 (date of access: 05.05.2014)

the requirement of speciality in relation to the particular types of procedures. The act on general rules of administrative proceedings comprises all the procedures in public administration from financial supervision to fire protection license procedure. As it is like that, it can only lay down the basic principles. The National Bank Act provides a more specialized level, but it still does not have the possibility to go into the details in particular procedures, since it comprises procedures from the authorization process to take up a business of a credit institution, to the authorization process of executive officers. For this reason, the Credit Institutions Act has the chance to provide the detailed rules of all the procedures related to credit institutions and financial enterprises. For a better understanding, the framework of financial institutions is provided below:

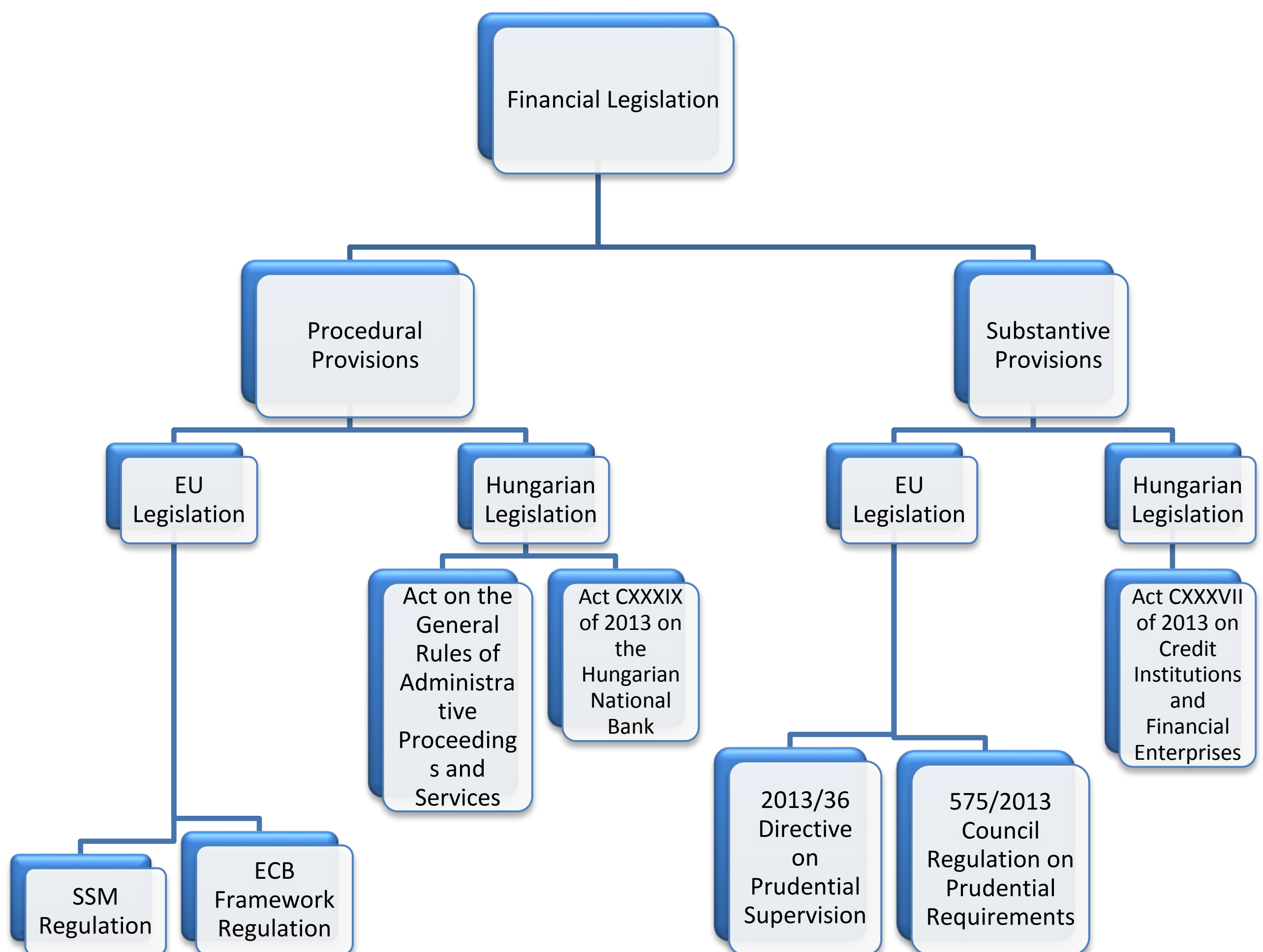
System of financial institutions in Hungary



As I mentioned above, the Credit Institutions Act provides the detailed rules of procedures related to credit institutions and financial enterprises. These procedures are including but not

limited to the foundation of a credit institution; the merger (takeover, fusion), demerger of a credit institution; the amendment of the articles of association of a credit institution; the acquisition of a qualifying interest in a credit institution and for escalating the qualifying interest up to the threshold limit; the election or appointment of executive officers of a credit institution; the taking up of business of a credit institution; the amendment of the scope of activities of a credit institution and the termination of operations of a credit institution.[21] According to Hungarian law, all the above mentioned procedures are subordinate to the permission of the National Bank of Hungary.

The system of financial legislation in the EU in relation to Hungary



[21] Section 14 (1) of Act CXXXVII of 2013

V.2. Scope of the SSM's competences

The Single Supervisory Mechanism is in order to achieve a goal, not less than the creation of a unified supervision of credit institutions that are determinative in relation to the proper operation of the European economy. To be able to achieve this ambitious goal, the creators of the SSM were able to find the aurea mediocritas in relation to 1 (one) of the most decisive features of the system, namely the extent of the regulation. It is not that difficult to admit, that a too broad extension would have imposed an incredible workload to the European Central Bank and would have caused the possibility of just creating a bigger turmoil in the field of financial supervision, instead of unifying, harmonizing and making it more transparent. The present regulation has the power to make a difference and reach the goals of its creation, so from the opposite perspective, the Council, the European Parliament and the European Central Bank has managed to avoid creating and adopting a regulation with significant tasks, but with useless, futile powers assigned to it.

Going on a golden mean, the Single Supervisory Mechanism embraces only essential tasks in relation to credit institutions determined as significant ones, within the Euro-area. As it can be noticed from the statement above, the legislator has confined reasonable limits from 4 (four) sides, restricting the scope of the regulation.

Firstly, the rules of the Single Supervisory Mechanism are mandatory only for credit institutions under the financial supervision of a Euro-zone Member State. It cannot be different, since the SSM confers determinant supervisory powers to the European Central Bank, but Members States out of the Euro-zone do not have a single voice in the top management of the ECB. For this reason, it is voluntary for Member States outside the Euro-zone to decide whether they want to join to the SSM in a special liaison, called a close cooperation or not. If Member States out of the zone predominantly choose not to join, it should not be a real problem in terms of its proper functioning, since the Regulation assigns the specific rules for cross border activity of significant credit institutions incorporated in a non-Euro Member State, but providing services within the Euro-area.

Secondly, the SSM Regulation refers only to credit institutions,[22] and does not encompass the other players of the financial world, such as financial enterprises, insurers, investment firms, other market infrastructure providers or entities engaged in 'shadow banking' activities. The scope of the system is as wide as it is with the admittance of the fact, that it is not only credit institutions that can pose a threat to the stability of the financial system.[23] Nevertheless, it would be firmly a major success to create an effective unified supervision at least over the banking-sector solely. Not underestimating other sectors, there is a firm assumption that with a consolidated European level bank supervision, so with a well-functioning bank-sector, Europe's financial and sovereign debt crisis could not have happened in the form as it has.

Thirdly, the SSM Regulation comprises provisions only on essential tasks of credit institutions. The evaluation criteria of essential tasks will be profoundly unfolded in the next chapter due to structural reasons.

Fourthly, the SSM Regulation concerns only to credit institutions, which are evaluated by the ECB as significant ones. The Council has adopted this approach during the legislative procedure, which reduced the credit institutions subject to direct ECB supervision from 6.000 to approximately 150, but nevertheless representing around 80% of the banking assets in the Euro Area.[24] As regards the evaluation procedure itself, both the SSM Regulation and the Draft ECB Framework Regulation contain specific detailed provisions. In summary, this legal background provides 5 (five) essential criteria which make possible to decide whether a credit institution can be described as a significant one or not. These are the following: the size of the institution (**i.**); the national/EU economic importance threshold (**ii.**); the level of cross-border activity (**iii.**); the requisitioning of public financial assistance from the European Stability Mechanism (**iv.**) and finally the criteria for determining the 3 (three) most significant banks in a participating Member State (**v.**).

i. As regards the size criteria, the regulations contain unequivocal rules for determination. With respect of point (i) of the first subparagraph of Article 6 (4) of the SSM Regulation, point (i) of the second subparagraph provides detailed rules on how to assess the

[22] Article 1 of Council Regulation (EU) No 1024/2013
[23] Ferran, Babis, 2013, p. 5
[24] ibid, p. 4

size of a bank in relation to evaluating significance. A credit institution should be considered as significant, if the total value of its assets exceeds Euro 30 billion. The legal background is useful and complete in itself, since the ECB Framework Regulation shall provide the basis also for the evaluation process.[25] It is a decisive factor in determining size how to assess groups of credit institutions, since Europe's financial sector is highly interconnected. To exclude the possibility for groups to avoid the supervision of the SSM, all credit institutions that are part of a significant group will be subject to direct supervision by the ECB on a consolidated and on an individual basis as well.[26] Nevertheless, some of the details are still unclear.[27]

ii. As regards the national/EU economic importance threshold, the regulation is complete. On the basis of point (ii) of the first subparagraph of Article 6 (4) and point (ii) of the second subparagraph of the same Article of the SSM Regulation, Article 56 and 57 of the Draft ECB Framework Regulation lay down that if the ratio of the bank's total assets over the GDP of the participating Member State of establishment exceeds 20 %, the bank is determined as significant, unless the total value of its assets is below Euro 5 billion. It means that beside the absolute criteria of size, another relative threshold is set up. This relative threshold takes into consideration the ratio between smaller Member States and their banks determinative to their economy, even below of the absolute criteria of size. It is an important step towards the creation of a prudential environment on EU level, since these banks below the size criteria can get in the scope of the SSM, and that is how smaller Member States can benefit from the security of the supervision of the ECB. It is not that difficult to admit that even though these banks in themselves do not mean any threat to the European financial sector, they are able to cause significant problems to their home countries. The crisis of even a small Member State can easily continue to spill over and become a European-wide trouble, as we had the chance to see in relation to Member States, such as Greece, Portugal, Ireland, Italy, and Spain.[28]

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[25] Article 51 (1) and (2) of the Draft ECB Framework Regulation: "If the supervised entity is part of a supervised group, the total value of its assets shall be determined on the basis of the year-end prudential consolidated reporting for the supervised group in accordance with applicable law. If total assets cannot be determined on the basis of the data referred to in paragraph 1, the total value of assets shall be determined on the basis of the most recent audited consolidated annual accounts prepared in accordance with IFRS and, if those annual accounts are not available, the consolidated annual accounts prepared in accordance with applicable national accounting laws."

[26] Public Consultation on the Draft ECB Framework Regulation, 2014, p. 8

[27] Szombati, 2014

[28] Roubini, 2010, p. 34

iii. In conformity with point (iii) of the first subparagraph of Article 6 (4) and the third subparagraph of the same Article of the SSM Regulation, Article 59 of the Draft ECB Framework Regulation creates a pattern how the significance of cross-border activities can be proved. According to the cited article, a supervised group may be considered significant by the ECB on the basis of its cross-border activities only when the parent undertaking of a supervised group has established subsidiaries, which are themselves credit institutions, in more than one other participating Member State. Such a group may be considered significant, only if the ratio of its cross-border assets to its total assets is above 10 %; or (b) the ratio of its cross-border liabilities to its total liabilities is above 10 %. In the light of this finalised system of provisions on the evaluation of significance based on the cross-border criteria, it can be contended that Stijn Verhelst's opinion is irrational when he says "the legislators have left it to the ECB to provide a precise methodology for this criterion".[29] In fact, it is the ECB's task to provide a precise methodology for each of the criterions, but the cited sentence pretences an impression like it is true only in relation to the cross-border criteria.

iv. According to the fourth subparagraph of Article 6 (4) of the SSM Regulation, those banks for which public financial assistance has been requested or received from the European Financial Stability Facility or the European Stability Mechanism shall not be considered less significant.[30] However, in case of financial assistance received, this criterion is unnecessary, since it is available only for banks with a systemic relevance or with a pose of a serious threat to the financial stability of the Euro-area as a whole or of its Member States. This systemic dimension in question shall be assessed taking into account, primarily, their size, interconnectedness, complexity, and substitutability,[31] so mainly the same assessment shall be taken as it is in relation to point (**i**) regarding the criteria of size.

v. The Single Supervisory Mechanism needs to cover the most significant banks in each participating Member State. Continuing this thought, the fifth subparagraph of Article 6 (4) of the SSM Regulation lays down that the ECB shall carry out the tasks of the SSM, in respect of the 3 (three) most significant banks in each of the participating Member States, disregarding their size, their influence on the national/EU economy, their cross-border activity or the fact that they might require or receive financial assistance from the EFSF or the SRM. The Draft

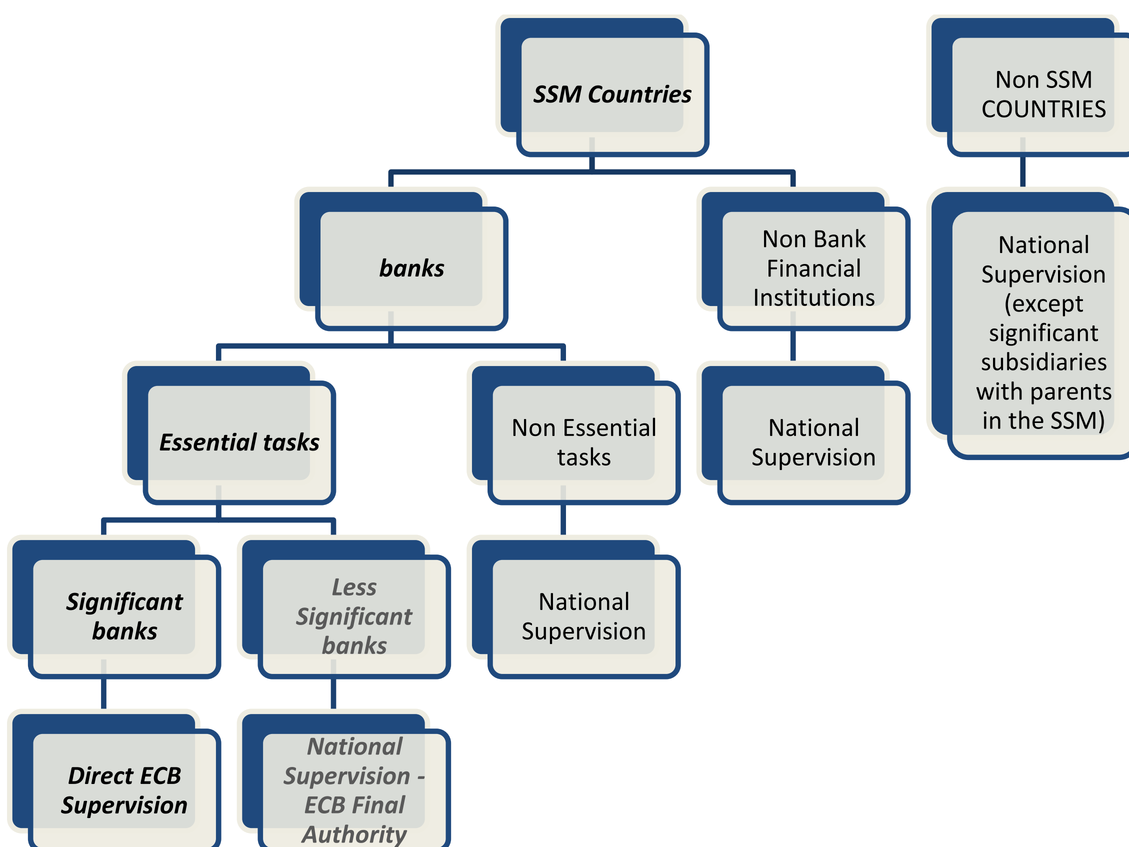
[29] Verhelst, 2013, p. 19

[30] The detailed rules of determining the request or receipt of direct public financial assistance can be found in Article 61 of the Draft ECB Framework Regulation.

[31] Article 3 (2) of the ESM Guideline, 2013

ECB Framework Regulation provides the detailed background and lays down what it means to be 1 (one) of the 3 (three) most significant banks in a participating Member State. Stijn Verhelst is just partly right, when he contends the following: "the value of assets and cross-border activity seem the most relevant criteria"[32] in determining the 3 (three) most significant banks. In fact, Article 65 (2) of the Draft ECB Framework Regulation lays down that the size[33] of the supervised entity and supervised group respectively shall be taken into account in the determination of the 3 (three) most significant banks in each of the participating Member States, and cross-border activity shall not be taken into consideration at all.

The place of the SSM in the EU's financial supervisory landscape[34]



[32] Verhelst, 2013, p. 19
[33] Article 6 (4) i) of Council Regulation (EU) No 1024/2013
[34] Verhelst, 2013, p. 13

V.3. TASKS AND POWERS CONFERRED TO THE ECB

V.3.1. PRUDENTIAL SUPERVISORY TASKS OF THE ECB

As I mentioned in the third subparagraph of the previous chapter and as it can be seen on the figure of the previous page, the Single Supervisory Mechanism comprises provisions only on essential tasks of banks. Article 127(6) TFEU permits the conferral on the ECB of these specific tasks concerning prudential supervision.[35] This particular chapter is devoted only to tasks and powers conferred to the ECB, since according to my assessment − beside the scope − this is the next significant pillar of the SSM Regulation.

Article 4 of the SSM Regulation lists the prudential tasks of the ECB, including in particular: authorising and withdrawing authorisation of credit institutions; assessing the implications for the acquisition and disposal of qualifying holdings in credit institutions; ensuring compliance with the EU rules on own funds requirements, securitisation, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on those matters; ensuring compliance with governance arrangements, risk management processes, internal control mechanisms, remuneration policies and practices and effective internal capital adequacy assessment processes; carrying out supervisory reviews, including stress tests, on the basis of which to impose on credit institutions specific requirements; carrying out supervisory tasks in relation to recovery plans, and early intervention where a supervised entity does not meet or is likely to breach the applicable prudential requirements.[36]

In addition to that, point g) of Article 4 (1) and Article 4 (2) of the SSM Regulation confer special tasks to the ECB, in relation to cross-border activity. The above-cited provisions lay down that the ECB shall be competent to carry out participation in supervision in relation to parents not established in one of the participating Member State. For these credit institutions established in a non-participating Member State, which establish a branch or provide cross-border services in a participating Member State, the ECB shall carry out the tasks for which the national competent authorities are responsible. As it can be read from these provisions, the

[35] Ferran, Babis, 2013, p. 6
[36] Darvas, Merler, 2013, p. 5

ECB shall play an important role in the supervision of parent credit institutions, established in a non-participating Member State. This role will comprise all the forms, in which a credit institution is able to expand its operations to the territory of another country. These 3 (three) forms are the following. In case of establishing a subsidiary in an SSM country by a credit institution incorporated in a non-participating Member State, the ECB shall participate in supervision on a consolidated basis. In the second case of establishing a branch in an SSM country by a credit institution incorporated in a non-participating Member State, the ECB shall carry out the tasks for which the national competent authorities are competent. In the third case of providing cross-border services in an SSM country by a credit institution incorporated in a non-participating Member State, the ECB's tasks will be the same as in the second case. Regarding the fact that the ECB shall apply all relevant Union law, and where this Union law is composed of Regulations and where currently those Regulations explicitly grant options for Member States, the ECB shall apply also the national legislation exercising those options,[37] one of the most pivotal challenges will be which the ECB shall face with, if the workforce of the ECB shall have to apply the 28 (twenty-eight) different national legislations in order to fulfil its tasks. It assumes a wide range of professionals going to work for the ECB. This implies a higher level of transition between the European and the national supervision channels.

Although the Single Supervisory Mechanism shall comprise the major tasks of prudential supervision, there are several tasks, which remain under national control even in relation to the Euro-zone countries. These tasks are called non-essential supervisory tasks, such as − inter alia – supervisory steps against money laundering and terrorist financing, consumer protection and supervising cross-border activity of banks incorporated in countries outside the EU. However, in summary, taking into account all the above-mentioned tasks, disregarding their essential or non-essential nature, the essential tasks comprised by the SSM appear to cover the pivotal elements of bank supervision in the EU.[38]

[37] Article 4 (3) of Council Regulation (EU) No 1024/2013
[38] Wymeersch, 2012, p. 6

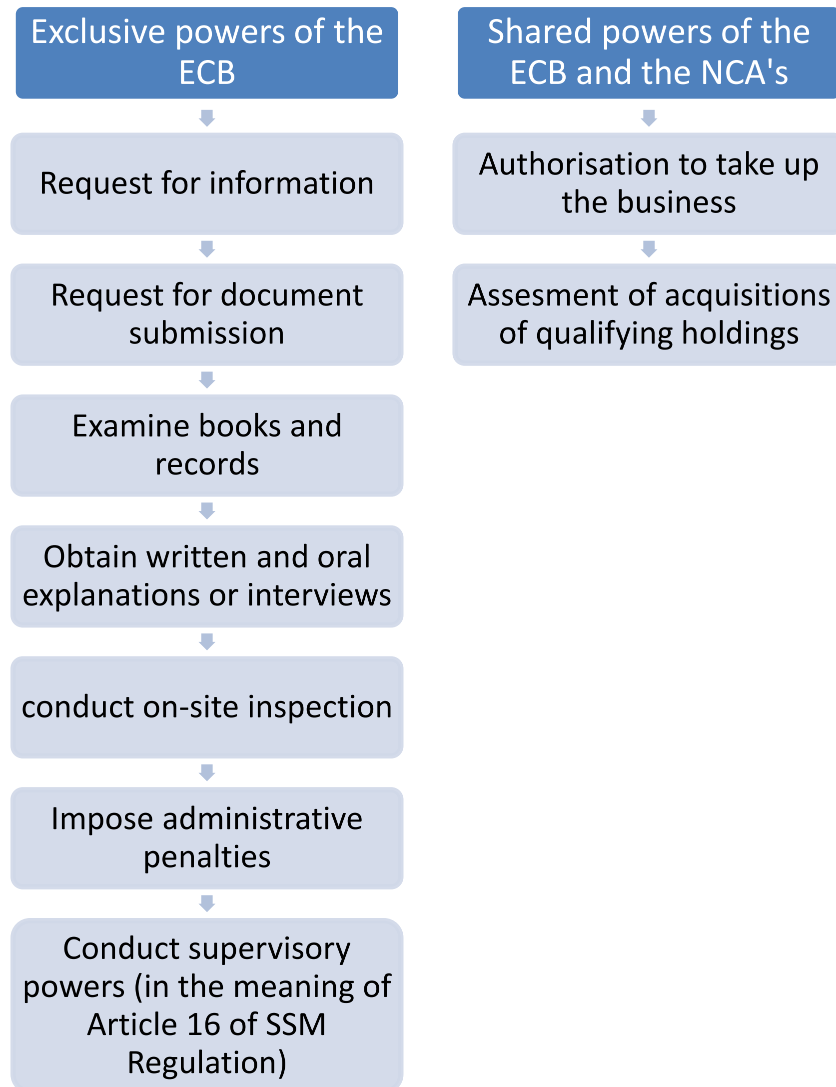
V.3.2. PRUDENTIAL SUPERVISORY POWERS OF THE ECB

Regarding the increased level of cooperation in the field of financial supervision in Europe, the integration view of central banking and bank supervision seems to be the new consensus. Such integration is designed in Article 127 (6) of TFEU, which contemplates that the ECB could take particular powers in the area of banking supervision.[39]

Some of the prudential powers of the ECB relate to all banks, disregarding their significance and are initiated by the national supervisors with the ultimate decision coming from the ECB. The procedures of authorisation and withdrawal of authorisation of banks or the authorisation for the acquisition and disposal of significant holdings do not depend on the significant nature of the credit institutions in question. For all other supervisory activities, the distinction between significant and less significant banks will apply, in the sense that these activities will be directly performed by the ECB in the case of the significant institutions while for the less significant ones, directly by the national supervisors.[40] As regards the powers related to the less significant credit institutions, it is shared between the ECB and the national competent authorities, due to a better allocation of powers and related tasks between the European and the national level. In that sense, it is hard to interpret the Public Consultation[41], when it says: "The ECB has an overall and exclusive competence as regards the granting and withdrawal of authorisations and the assessment of the acquisition of qualifying holdings in relation to all supervised entities".[42] It is not exclusive in the sense, that the national competent authorities are the point of entry for an application in both procedures. They carry out the first assessment of the application based on the conditions laid down under national law. If it considers that the application complies with those conditions, it prepares a draft decision to the ECB. The ECB may agree or object to the positive draft decision of the NCA: it takes a final decision to adopt or to reject the draft decision, i.e. whether to grant the authorisation or not. On the other hand, the NCA has the power to reject the application without the permission of the ECB, in that sense NCA's exercise real power in relation to these 2 (two) particular procedures.

[39] Masciandaro, J. Nieto, 2014, p. 14
[40] Wymeersch, 2012, p. 38
[41] Public Consultation on the ECB Draft Framework Regulation, 2014
[42] ibid., p. 17

Prudential Supervisory Powers of the ECB according to the SSM Regulation in relation to the Euro-zone



V.4. Organizational structure of the SSM

In this chapter a brief review shall be provided on the organizational structure and decision-making bodies of the Single Supervisory Mechanism to reveal how the system operates in the everyday work, how the powers conferred to the ECB can be applied and how the tasks can be performed. Three main decision-making procedures can be separated on the basis that what

kinds of bodies are involved and to what extent. First, there is the general procedure in case of credit institutions of the Euro-zone Member States, whose participation is not based on a close-cooperation mechanism. Second, there is a special procedure in case of authorizing a credit institution to take up the business and for the assessment of acquisitions of qualifying holdings. Third, there is a modified process for countries participating outside the Euro-zone under the mechanism of a close-cooperation. In the following, a summary shall be provided on the former 2 (two), meanwhile the latter shall be examined in the following chapter of The possibility of close cooperation for Member States out of the Euro zone (Chapter VI.).

V.4.1. GENERAL PROCEDURE

As it can be seen in the figure below, the general decision-making process of the SSM is a linear mechanism separated into a level performing examination of the supervised entities, another level for decision-making and a third one for administrative revision of the decisions.

On the first level there are the Joint Supervisory Teams (JST) facing with significant workload, in particular their tasks include performing the supervisory review and evaluation process for the significant supervised entity or group that it supervises and proposing to the Supervisory Board a supervisory examination program in relation to the supervised entity.[43] A joint supervisory team shall be established for the supervision of each significant supervised entity or group in each participating Member State. Each Joint Supervisory Team shall be composed of members from the ECB and the national competent authorities as well, with a JST coordinator in charge designated by the ECB.[44]

On the next level, we can find the Supervisory Board, which undertakes the planning and execution of the tasks conferred to the ECB. In this process, the Governing Council is the only entity, which has the power to oppose the Supervisory Board's decisions, however in fact it is unlikely to happen so frequently.[45] Draft decisions of the Supervisory Board will be deemed

[43] Article 3 (2) of Draft SSM Framework Regulation, 2014
[44] Ibid, Article 3 (1)
[45] Verhelst, 2013, p. 21

adopted unless the Governing Council objects in a short period.[46] Although the Supervisory Board is not a decision-making body de iure, it will play such a role de facto.[47]

Finally, Article 24 of the SSM Regulation creates the possibility of internal administrative review of the decisions made by the Governing Council.

General decision-making process of the SSM

V.4.2. Special procedure

In case of authorization, the withdrawal of authorization and the assessment of acquisition of qualifying holdings, the SSM Regulation[48] and regarding the detailed procedural provisions the Draft SSM Framework Regulation[49] provide different rules in comparison with the general procedure. As regards these 2 (two) issues, there shall be a wider cooperation between the ECB and the national competent authorities. Here the legal background delegates more power to national level, as the tasks of assessment of the authorization and the preparation of a draft decision is appended to the NCAs. In the second stage, the NCAs propose the draft decision to the ECB. At the final stage the ECB shall decide on granting or rejecting the authorization. This kind of division of labor is highly necessary, since for instance in case of authorization of new banks, there is no basis to evaluate whether the new entity shall be significant or not, so the final decision is made by the ECB, disregarding the further significant or less significant nature of the new entity.[50]

[46] Enoch, Everaert, Tressel and Zhou , 2013, p. 210
[47] Verhelst, 2013, p. 22
[48] Article (14) and (15) of Council Regulation (EU) No 1024/2013
[49] Article (73) - (87) of Draft SSM Framework Regulation
[50] Questions & answers for the public consultation on the Draft ECB SSM Framework Regulation, p. 4

V.4.3. ACCOUNTABILITY

Regarding individual decisions, accountability is performed by the possibility of turning to the Board of Review. This is an internal remedy to avoid illegality for the parties, since it can be initiated against Governing Council decisions by private and legal persons, also including the supervised credit institutions.

As regards the overall operation of the SSM, there are significant checks and balances in the system, thus the ECB's independence can remain remarkable, the ECB has become one of the most independent central banks in the world.[51] The strength of this independence is coming from the stringent system of bodies accounting the ECB. The ECB is accountable for the submission of an annual report on the tasks carried out to the European Parliament, to the Council, to the Commission and to the Euro group.[52] Furthermore, the ECB is subject to internal and external audits by the European Union Court of Auditors.[53] Finally, at the end of the day the ECB decisions − as any other legal act within the territory of the EU – are subject to the review procedure of the European Court of Justice, with the words of Masciandaro and J. Nieto: "the ECB as bank supervisor is accountable ex post to the Court of Justice of the European Union for the legality of its actions".[54]

As regards this list of examiner bodies, it is evident that the accountability is strict and valid towards the institutions of the EU, but they are much less effective in direct relation to the Member States. Although the SSM Regulation encompasses provisions on the control license of the national parliaments,[55] these mechanisms are enervate since, they consist only options for the ECB on which the ECB can motivate its decision to cooperate with the national parliaments and submit them the annual report or answer their reasoned observations or may accept the invitation of a national parliament. There is no binding effect in these acts, it is absolutely based on the ECB's willingness whether they cooperate or not. On the other hand,

[51] Chalmers, Davies and Monti, 2010, p. 732
[52] Article 20 (2) of Council Regulation (EU) No 1024/2013
[53] Enoch, Everaert; Tressel and Zhou , 2013, p. 210
[54] Masciandaro, J. Nieto, 2014, p. 22
[55] Article 21 of Council Regulation (EU) No 1024/2013

although there is no legal binding effect in the acts of Member States in this relation, it is hard to imagine that the ECB would refuse the invitation of a national parliament, without losing face, without losing from its high-rated reputation.

VI. THE POSSIBILITY OF A CLOSE COOPERATION FOR MEMBER STATES OUT OF THE EURO ZONE

Since the SSM Regulation delegates all the supreme powers of decision-making to the Governing Council, consist of Chairs of the national banks of Member States within the Euro-zone, the current legal framework does not offer the possibility that the decisions of the ECB Governing Council are directly applicable and binding in Member States outside the Euro-zone. This situation is perfectly articulated by Verhelst[56] as follows: "In a nutshell, the Treaty stipulates that non-euro zone countries are not allowed to vote in the final decision-making body of the ECB, nor are non-euro zone countries bound by decisions made by the ECB.".

On the other hand, there is a huge need for supervisory unification, for instance because of the internationally over-connected structure of credit institutions within the union. To avoid fragmentation and the further splitting of the union to core Member States and peripheral Member States, the decision-makers had to come up with a solution, which grants − at least the possibility – for Member States outside the Euro-zone to join the system. However, it cannot be more than a dispositive rule, a voluntary feasibility, as regards the composition of the supreme decision-making body of the SSM. Hence, on the decision of the Member State concerned, to join the system within the framework of a close-cooperation agreement, it has to undertake that it abides itself to the ECB's guidelines and requests and to provide all relevant information the ECB may require and has harmonised relevant national legislation.[57]

As regards the comparison between the status of SSM Member States within the Euro-zone, and Member States outside the Euro-zone signing a close cooperation agreement, 2 (two)

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[56] Verhelst, 2013, p. 25

[57] Article 7 (2) of Council Regulation (EU) No 1024/2013

main differences can be observed. First, the opposition between the practices of direct and indirect supervision of the ECB regarding significant supervised entities has to be mentioned. Second, the different complication rate between SSM Member States within the Euro-zone, and Member States outside the Euro-zone signing a close cooperation agreement has to be emphasized.

Regarding the first criteria, in the system of close cooperation, the national competent authorities should take the measures required by the ECB. An ECB decision can manifest only in the form of requests. These requests do not have a direct binding effect within the national legislations, so they have to be transplanted to the decisions of the national competent authorities. If the ECB had to address a decision to a supervised entity or supervised group, the ECB would, instead of addressing a decision to a supervised entity or supervised group, issue instructions to the NCA in close cooperation and that NCA would address a decision to a supervised entity or supervised group in accordance with such instructions.[58] In other words, if the ECB considers that a measure should be adopted by the NCA in relation to a significant supervised entity or group, it shall address to that NCA: a general or specific instruction, a request or a guideline requiring the issuance of a supervisory decision in relation to that significant supervised entity or significant supervised group in the participating Member State. In respect of a less significant supervised entity or less significant supervised group, specific instruction cannot be addressed.[59] To be able to meet the criteria, one pre-requisite for the signing of the close cooperation agreement is the passing of the Capital Requirements Regulation and its complement the fourth Capital Requirements Directive. This is necessary so that the SSM can implement a harmonized supervisory rulebook based on the Basel III accord instead of the currently in place and different national regulations.[60]

If a NCA does not transplant any particular request of the ECB into a formal decision of the NCA, the ECB does not have any tool to enforce the request, except to force the Member State concerned to leave the close-cooperation status, so the SSM as well. On the other hand, the NCA should be cautious, since in the system of close cooperation, it shall be liable for any

[58] Article 111 (3) of Draft SSM Framework Regulation, 2014
[59] Ibid, Article 108 (2)
[60] Darvas, Wolff, 2013, p. 4

damage resulting from its failure to apply any ECB measure, instruction, request or guideline in a timely manner.[61] So basically, the main difference is laying on the possibility of the ECB to issue direct decisions towards the supervised credit institutions. Within the Euro-zone the ECB has direct supervisory power, outside indirect, via national supervisory authorities.

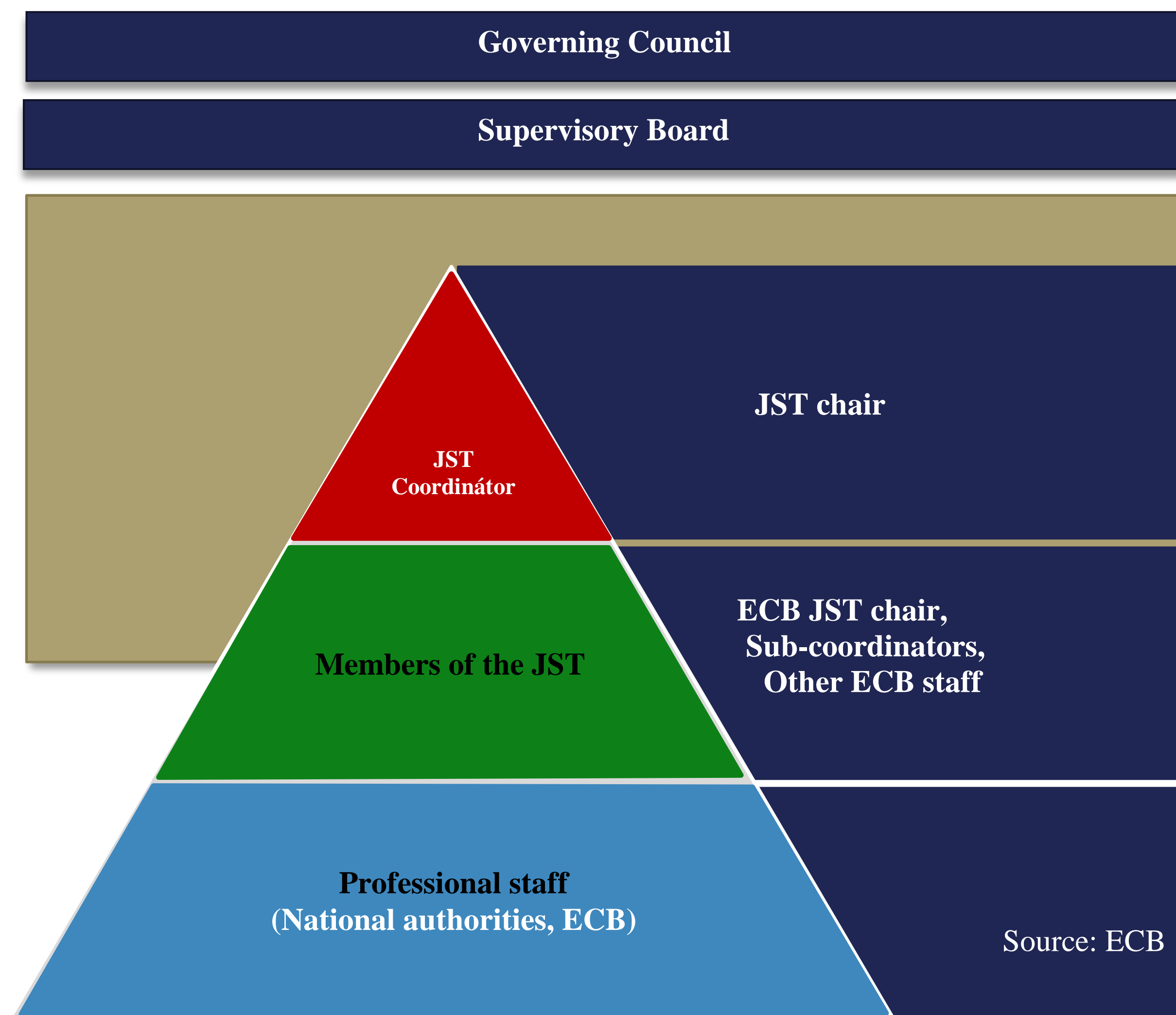
Second, non-euro area Member States in close cooperation who disagree with a draft decision of the Supervisory Board only have a right to send their reasoned disagreement in order not to be bound by the pertinent decision if the Governing Council does not confirm the non-euro area Member State‘s objection. If the Governing Council does not change its contested decision, the only remaining resort lies in the immediate termination of the close cooperation on the affected Member State‘s request.[62] However, there are no widespread means in the hands of the NCA's in case of disagreement, the last resort, namely quitting from the system is quite simple to achieve. So in case of disagreement, the participating Member State can decide to temporarily or permanently leave the SSM as it can suspend or terminate its membership. Nevertheless this option is absolutely closed for Member States, inside the Euro-zone.

The ECB will exercise supervision on these banking groups on the same terms as applicable in the euro-area jurisdictions. Whether the ECB will be competent, or the national supervisor in that state depends on the quantitative and other criteria, whereby the consolidated data at the level of the parent will determine whether ECB or national supervision will apply, whether the credit institution concerned is evaluated as significant or less significant. In case of inward investment by a significant group, the ECB will be in fully charge of the parent company and of the branches, services and subsidiaries wherever located in the SSM area, being all participating states. A comparable national regime will be applicable to the less significant groups, where the supervision will be exercised by the national supervisors, of the home state for the parent and its branches and its service provision, and of the host state for the subsidiaries.[63] In other terms, according to Article 116 (1) of the Draft SSM Framework Regulation, an NCA in close cooperation shall adopt decisions in respect of significant

[61] Article 108 (6) of Draft SSM Framework Regulation, 2014
[62] Tröger, 2013, p. 33
[63] Wymeersch, 2012, p. 34

supervised entities and significant supervised groups in its Member State only on the ECB's instructions. The NCA in close cooperation may also request instructions from the ECB.

The coordination of credit institutions under direct ECB supervision



VII. ADVANTAGES AND DISADVANTAGES OF A CLOSE COOPERATION

VII.1. GENERAL ASSESSMENT OF PROS AND CONS

As regards the general assessment on whether a non-euro zone Member State should join the SSM or not, a number of issues have to be considered. For a better understanding, the list of these issues is provided below in the structure of separating between general approaches valid for each Member State and Member State-specific approaches, valid only in relation to Hungary. In this chapter, I take into account the general approaches that each non-euro zone Member State has to take into consideration.

According to the creators of the Single Supervisory Mechanism, the system shall provide harmony, effectiveness and strong accountability all across the participating Member States.[64] Harmonised legislation is coming into fruition, not only in relation to the Euro-zone Member States, but among countries out of the zone. However, joining to the SSM could mean a significant indicator in this process, which gives a framework and guarantee further integration as well. Fostering effective governance by the SSM is a just theoretical effect of the system so far, since it shall be the question of time whether the different levels of the SSM's decision-making structure will be able to provide the system with effectiveness. As regards accountability, the SSM has exceptionally stringent system of checks and balances towards diverse EU institutions. For a non-euro zone Member State the real question is whether it would be worth to give up significant parts of the national accountability system and shift them to EU level or not. For instance, in case of the UK, they decided not to cede any elements of the sovereignty of its financial supervision, since the enormous impact of the UK financial sector in relation to the whole economy.

The next significant incentive could be the evolutional nature of the SSM, since it is just one stage in the evolution of the banking union. The previous step was the creation of a Single Rulebook, which contains the substantive provisions of financial supervision in the form of

[64] Enoch, Everaert; Tressel and Zhou , 2013, p. 227

CRR[65] and CRDIV.[66] As regards the SSM, the ECB shall exercise the powers conferred to it by the SSM Regulation from the 4th of November 2014. The next step shall be the introduction of the Single Resolution Mechanism, which will be able to offer a European-level solution for bank resolutions. The final stage would be a European common deposit guarantee system.[67] The most attractive element of the banking union is definitely the common deposit guarantee system, which could act as a powerful European umbrella in case of some non-euro zone Member States' financial and sovereign debt crisis.

As regards the competitive disadvantage of non-participating Member States, a number of arguments need to be considered carefully. First, delaying a decision on joining the SSM increases the uncertainty for the concerned credit institutions. This uncertainty is able to justify delays of operational and investment decisions of the credit institutions concerned, so is able to increase the uncertainty and cause competitive disadvantage. Moreover, there is also a competitive disadvantage of credit institutions which are not owned by a parent credit institution headquartered in an SSM country.[68] This risk is articulated by Darvas and Wolff, in their preparatory work prepared for a hearing at the Danish parliament: "When a Member State stays outside of the SSM, then domestically owned banks and those banks that do not have a parent bank in a SSM participating member state may face a competitive disadvantage. If supervision by the ECB will be regarded as an important safeguard in the assessment of the soundness of banks, then staying out may imply higher financing costs: both the cost of wholesale funding may be relatively higher and the depositors may also require a higher interest rate."[69]

The participating non-euro zone Member States can face also with the advantage of accession to all the relevant information they acquire on formal and informal channels of cooperation with the ECB inside the inner procedures of the SSM. It shall mean a significant benefit, especially in the supervision of the cross-border activity of European-wide banking groups.

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[65] Regulation (EU) No 575/2013
[66] Directive 2013/36/EU
[67] Szombati, 2014
[68] Darvas, Wolff, 2013, p. 12
[69] ibid, p. 14-15

Another, non-negligible factor of participation is the possibility of contribution to the shaping of the practical operation of the SSM. The Governing Council as well as the Supervisory Board will have to set the rules of the practical operation of the SSM. This will be done at an early phase and will likely shape in a fundamental way the effectiveness and inclusiveness of the new mechanism. While according to the regulation, non-euro members most likely can join formally only after the system has been set up, a clear and early signal to join the SSM is likely to increase the voice of non-euro Member States in shaping the modalities. At the same time, however, the modalities have to be in line with the draft technical standards, guidelines, and recommendations prepared by the EBA. This argument therefore calls for an early indication of the intention to join.[70]

Due to the ECB's lack of powers in relation to non-euro zone Member States, the possible signing of a close cooperation agreement and the legal relationship behind it provide easy escape routes for the close co-operators in case of changing their minds. If a significant disagreement gives the reason to do so, the agreement can be terminated quite easily. Both the ECB and the non-euro zone SSM Member State can decide on such termination. In case of a possible termination by the ECB, there are 2 (two) options available. First, the ECB issues a warning to a Member State stating that it does not respect one of the three conditions laid down in the SSM Regulation.[71] The cited article of the regulation contends that close cooperation between the ECB and the national competent authority of a participating Member State whose currency is not the euro shall be established, if the Member State concerned undertakes that its national competent authority will abide by any formal opinion issued by the ECB. It also has to undertake that it will provide all relevant information necessary for a comprehensive assessment of credit institutions supervised by the ECB, and finally the Member State concerned also has to undertake to enter into the close cooperation relationship in relation to all credit institutions established in that certain Member State. If the country does not take sufficient action after such a warning, the ECB can end the close cooperation agreement. In the second option, the Governing Council objects to a decision by the Supervisory Board. Since the non-euro zone country does not have any representatives in the Governing Council, it can then notify the Governing Council that it objects to the decision. If

[70] Darvas, Wolff, 2013, p. 15
[71] Article 7 (2) of Council Regulation (EU) No 1024/2013

the Governing Council nonetheless sticks to its decision, the non-euro zone country can choose not to apply the supervisory decision. This is the situation when the Governing Council could decide on the suspension or termination of the close cooperation agreement. Terminating the close cooperation agreement is easier for the non-euro zone country even more than it is for the ECB. A non-euro zone participating Member State can end the agreement whenever it disagrees with a draft decision of the Supervisory Board. Furthermore, if a country has been part of the SSM for more than 3 years, it can even choose to end the close cooperation agreement without any specific formal reason. The feedback loop, however, is that if a Member State has terminated the close cooperation relationship, it cannot enter again into it for a period of 3 (three) years. On the other hand, using these provisions could even cause non-easy effects as well. First, these provisions could delay a Member States' entry into the Eurozone, as the Eurozone would surely not accept a country to enter the Monetary Union without being part of the SSM.[72] Second, although these provisions on the easy secession of the SSM may not place any serious legal pressure on the Member State concerned, they can result in hard political and economic difficulties. A Member State in the situation concerned may face political distrust and may leave a message to the markets saying it does not pursue to have a European-wide transparent supervisory system with strong checks and balances, but wants to stay in the dark.

VII.2. Advantages of a close cooperation specifically in relation to Hungary

As it was mentioned in the previous chapter, beside the general approaches valid for each Member State, there are country-specific conditions likely in relation to each Member State, hence Hungary is no exception. In the following, the list of country-specific advantages related to Hungary will be provided in prioritization.

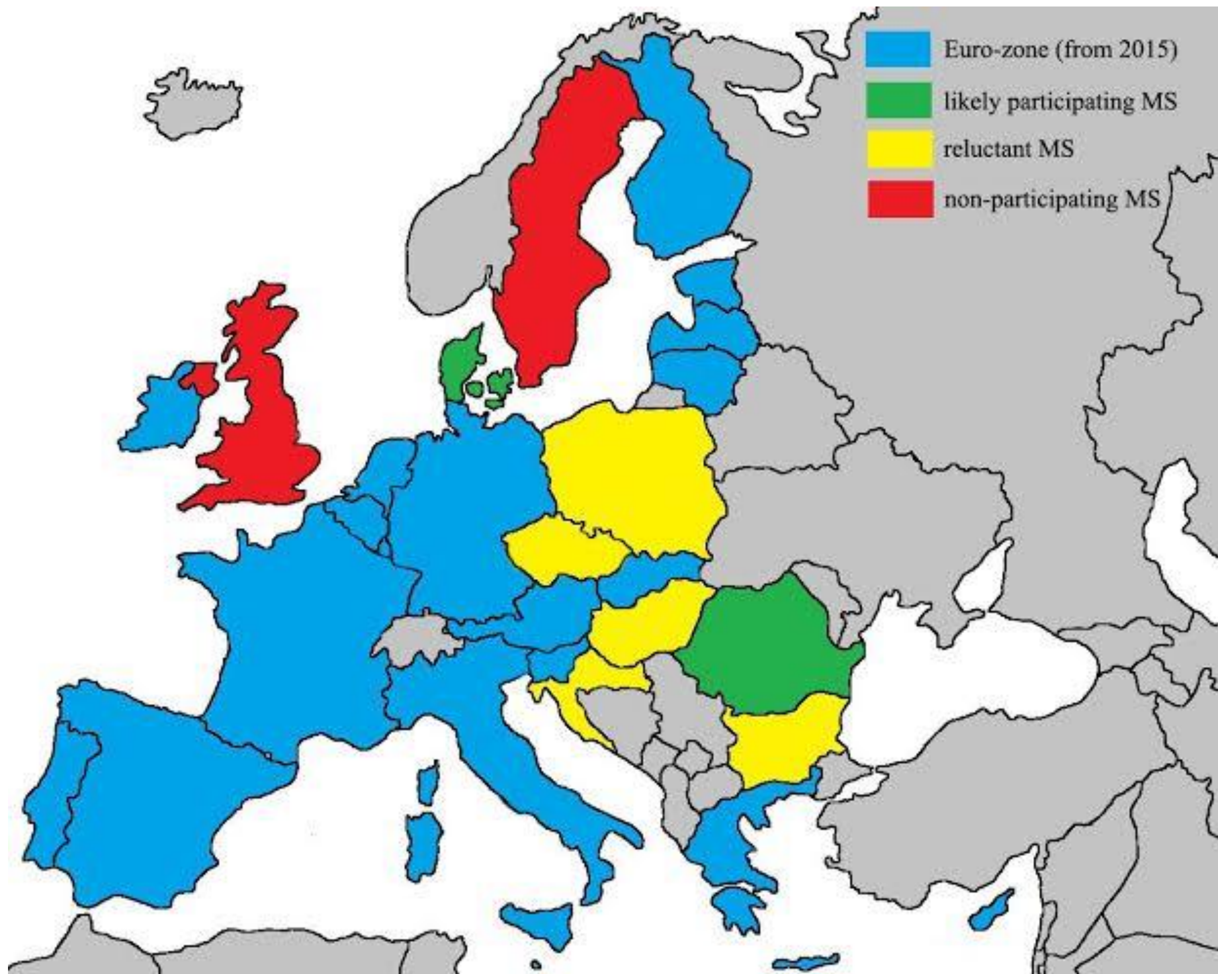
According to my assessment most importantly, with an immediate declaration of the will of participation, Hungary has an unrepeatable chance to declare its commitment to the EU

[72] Verhelst, 2013, p. 26-27

integration, more specifically to the Single Supervisory Mechanism and to the ECB as well. The ECB's broad analytical possibilities and its independent experts have the chance to observe the national financial system more objectively, without any form of outer influence, which can help both the structural and the cyclical risks to be recognized in time. This can be considered as a significant merit by the analysts and the investors as well. The positive expectations and the favourable mood of the investors about the banking union likely can affect the domestic banks' external source supply situation. In addition, because of the high reputation of the ECB, the cost of funding may decrease and credit rating agencies are likely to assign a lower probability of sovereign debt crises, meanwhile improving the Member State's credit assessment. Based on the above-mentioned facts and according to market players, investors and credit rating agencies, it can be concluded that the highest added-value of the SSM is its reputation, specifically coming from its unified methodology fortified by the stringent system of checks and balances, which is able to guarantee the avoidance of outer influences. As regards the decision on the participation in the SSM by Hungary, it can be contended that the professional reputation of the National Bank of Hungary is lower than the ECB's. According to my assessment, this economic effect is more significant than any other legal one.

The second supporting reason is that since the participation is expected to inflict positive reactions from the market due to the above-mentioned fact that the ECB's reputation is far stronger than the reputation of the national competent authorities, so if the majority of the Member States are joining, it shall be a concrete competitive disadvantage for those Member States who stay out, and a concrete funding disadvantage for those credit institutions who operate in those Member States. This progress makes the competitive disadvantage the second most significant economic effect of non-participation. However, according to the information available now, in May, 2014 the majority of non-euro zone Member States have already decided not to join, or reluctant to provide a unequivocal response. The following figure is able to express the uncertainty of the situation.

The relationship between the banking union and the Member States[73]



The third supporting reason is coming from the evolutionary nature of the banking union, more specifically from the next stage of that, namely the creation of the Single Resolution Mechanism. In December 2012 the European Council Conclusions stated that "the European Commission will submit in the course of 2013 a proposal for a single resolution mechanism for Member States participating in the SSM, to be examined by the co-legislators as a matter

[73] Szombati, 2014

of priority with the intention of adopting it during the current parliamentary cycle”.[74] From another aspect, the interaction between global financial stability, cross-border banking and preserving a national resolution authority is the crucial problem. The relationship between these 3 (three) legal institutions is referred to as financial trilemma.[75] The elements of the financial trilemma are hard to be combined, bank resolution is not well defined at a cross-border level. The trilemma is even more pressing when banks have a larger international exposure and when they are operating in a monetary union. If credit institutions will be supervised under the umbrella of a Single Supervisory Mechanism, a Single Resolution Mechanism is the appropriate next step. Such a mechanism ensures that when a credit institution fails under the SSM, the failure can be resolved in an appropriate manner.[76] This is underlined by a review of major cross-border bank failures, which revealed that national resolution powers are often inadequate, leading to costly, inefficient and national interventions were proved ineffective sometimes. So the adoption of the SRM could prove to be a major step forward in this respect.[77] In this regard, the SRM shall likely be a significant guarantee tool, especially in case of relative small and vulnerable economies, such as Hungary. It is a major reason to participate in the SSM, so in the whole progress of banking union as well, if Hungary shall have access to the 55 (fifty-five) billion Euros of resolution fund, which shall be available to all participating Member States in case of preventing the next crisis. In prevention, there is no need to use this protective umbrella perforce. There are some cases, in which the mere existence of the Single Resolution System is enough to avoid the escalation of an upcoming crisis. It can happen that without the realized financial aid of this system the mere existence of participation is able to suggest trust to the markets, so creates the possibility of recovery.

The fourth supporting reason is the effect of personal presence. By joining the first round of admission, Hungary would have its greatest chance to earn influence. In that case, Hungarian experts and managers may have the chance to be admitted to the ECB in an appropriate number, so they would have the ability to represent broadly the special Hungarian aspects and

[74] Véron, Wolff, 2013, p. 11
[75] Hakkarainen, 2013, p. 1
[76] Article 6 of 2013/0253 (COD) Proposal
[77] Eijffinger, 2013, P. 47

the special knowledge needed for the supervision of the domestic credit institutions.[78] On the other hand, as a result of this possibility, Hungary would have the chance to get closer to the mainstream of European integration, and especially to the new methods of financial supervision and crisis management.

VII.3. RISKS OF A CLOSE COOPERATION SPECIFICALLY IN RELATION TO HUNGARY

The possibility of the participation in the Single Supervisory Mechanism has several benefits in relation to the participating Member States however, almost each advantage has 2 (two) faces, and during a comprehensive assessment the negative sides can be discovered as well. In the following, I try to summarize these "negative sides" of participation and compare them with the advantages they offer in the same time. Regarding the conclusion, the official opinion of the National Bank of Hungary and my own assessment will be relied on.

On one hand, the immediate admission has several benefits, as it could be seen in the previous chapter. On the other hand, it contains some risks as well. The risks of immediate accession can be summarized by the unproven structural framework of the SSM and the untested mechanisms, in particular the opacity of annual decision-making in relation to bank groups (capital, liquidity) and the lack of exercise in handling crisis situations. This could lead to significant gaps in monitoring and early intervention or to the enforcement of weaknesses. In the EU context, bank regulation is viewed as harmonized and decentralised supervision has been seen as the main problem. Paradoxically, the SSM potentially entails the opposite risk, i.e. having a centralised supervisory mechanism, which relies on a partially harmonized rulebook. This risk is highlighted because recent experience has shown that the adoption of the single rulebook is far from straightforward, and its 'single' element has been pushed down significantly in the various stages of negotiations in order to accommodate preferences of the Member States.[79] By the time being, the result of the comprehensive assessment and stress test are not foreseeable. It can eventuate in serious market uncertainty, if results reveal that possibly several significant credit institution shall need capital increase at the same time. Such a situation may imply an exaggerated investor conduct, resulting in the increase of market

[78] Article 31 of Council Regulation (EU) No 1024/2013
[79] Ferran and Babis, 2013, p. 29-30

risk. For this reason, it is essential to operate the supervisory mechanisms for domestic credit institutions in a well-functioning manner, in particular as regards the cooperation between the micro-prudential and macro-prudential branches of the national bank.[80] According to the assessment of the National Bank of Hungary, this aim could be achieved more likely within the framework of the national system, which is − in comparison with the Single Supervisory Mechanism – a more tested pattern. It is, because – regarding the deficiencies of the former supervisory structure – in October 2013 there was a political will melting the National Financial Supervisory Authority into the national bank and creating a new provisional background. Thus, the creation of this new system could be fully subject to the forthcoming European financial rule, and in particular to the legal framework of the banking union.

In relation to Hungary, the biggest attraction could be the Single Resolution Mechanism, with its fund of 55 billion Euros, paid in by all the European banks no later than 2024. The ECOFIN Council reached an agreement on the Single Resolution Mechanism, the second leg of a banking union, at a meeting on 18th of December 2013. This provides a base to start negotiations on the SRM with the European Parliament. The Council expects the proposal to be adopted before the European elections in May 2014.[81] However, the SRM itself cannot justify the positive decision on participation. As community resources for crisis management not yet available, so in extreme cases it may be found that the costs of a banking crisis shall be paid by domestic taxpayers, as it would happen without joining the banking union, but with a decision only much later born on European level. Moreover, in extreme cases, it is also conceivable that in case of the resolution of a significant European bank; even the national contribution to the SRM has to be used for finance the resolution of that significant bank concerned.[82]

Regarding the professional reputation of the ECB, it is highly incontestable that the MNB's professional reputation is far behind the ECB's, but here it is also worthwhile to point out that there shall be very strong fire walls – sometimes referred to as Chinese wall − between the ECB's branch, responsible for monetary policy and the branch responsible for supervision and

[80] Szombati, 2014
[81] http://www.bbj.hu/economy/eu-closer-to-banking-union;-hungary-on-the-fence_74634 (Date of access: 25.05.2014)
[82] Szombati, 2014

organization, which precludes any form of interaction in theory. If it comes to fruition, then the supervisory branch of the ECB will have to build up its own creditability, which has to be − at least partly − independent from the reputation of the ECB responsible for monetary issues. In this regard, the SSM has to build up its own creditability. In building up its own creditability, currently the most important step is the Asset Quality Review and the stress test. As the results of these are expected only at the end of 2014, until this deadline it will not be revealed whether banks with inappropriate assets fail or not. Since in many Member States the national resolution mechanisms will be operational only in 2015 and state intervention on capital increase is profoundly restricted by competition rules, it is unpredictable whether the ECB would change its mind and prescribe lower capital requirements to avoid the possibility of bank bailouts. Thus, the MNB's supervisorial credibility is being put to the same test. To pass the test, the MNB has already tried to meet 2 (two) requirements. First, an arrangement has been settled that the MNB shall use the asset quality review and the stress test based on ECB methodology including the participation of an external consultant in relation to the OTP Group, the only Hungarian-owned bank, which would be considered as a significant one according to the SSM Regulation. Second, the MNB has access to all the relevant information related to the foreign-owned subsidiaries operating in Hungary, so in the possession of those it has the ability to make responsible decisions.[83] In that sense, there is no need to shift under the umbrella of the Single Supervisory Mechanism.

Some say that the trust of the markets can be earned easier if there are external control mechanisms in the system of financial supervision, hence the mere existence of a participation decision can calm down the investors' nervousness. For this reason, the mere participation in the SSM has the heritage of better economic outlooks. However, according to the opinion of the MNB, it is not true by all means. Since the ESRB has the possibility to issue recommendations if not adequately treated systemic risk is detected in Hungary, external control already exists.[84] Nevertheless, this control exercised by the ESRB is far less powerful than the outer control mechanisms, provided by the SSM.

[83] Szombati, 2014
[84] Ibid.

The essential task of the ESRB is to supervise the financial system in order to detect potential risks that can affect the financial system and the real economy. When such a risk is detected, the ESRB – as it was mentioned above − can emit only warnings and recommendations to the Member States and other EU bodies. The ESRB, however, does not have the competence to make decisions that are binding on others, as the Member States and EU bodies are not obliged to act upon the warnings and recommendations issued by the ESRB. In its present configuration, the ESRB is a rather bloated body. In an EU with 28 (twenty-eight) Member States, the ESRB has members of which 38 (thirty-eight) have voting rights. Voting members comprise representatives of all Member States, the President and Vice-president of the ECB and other representatives of EU bodies. Most decisions in the ESRB are made by simple majority. A 2/3rds majority is needed only when a recommendation or warning is to be made public.[85] Thus, the ESRB is unable to fulfil the role of an effective external control entity of the MNB, at least because of 2 (two) simple reasons. First, its recommendations are not binding. Second, since it has a bloated structure, it is likely not capable to respond in real emergencies in time, due to its overcomplicated voting mechanism.

VII.4. FORESIGHT OF THE EFFECTS OF PROS AND CONS

According to my assessment the effects of the decision on participation can be categorized through 2 (two) approaches. First, the pros and cons can be summarized from the aspect of the credit institutions, second from the aspect of the Member States. No matter which approach will be chosen, both of them have equal gravity. As regards credit institutions, it will be emphasized in the following, that the vast majority of Hungarian credit institutions are not interested in the government decision on participation, simply because they are not significant enough. To use oversimplification, the question of participation is about the right of supervision over the sole significant Hungarian-owned credit institution, the OTP Group. As regards the state level, the context is more complex, but a prudent summary is provided in chapter VII.4.2.

[85] Verhelst, 2013, p. 36

VII.4.1. Credit institution approach

According to Article 4 (1) g) of the SSM Regulation, the ECB's tasks shall include carrying out the supervision on a consolidating basis over credit institutions` parents established in one of the participating Member States. Although in principle it would mean that the ECB has all those supervisory powers that it possesses in relation to subsidiaries established in participating Member States, in reality the consolidated supervision is limited to the specific tasks enumerated in Article 112 (1) a) − c) of the CRD IV,[86] mainly restricted to planning and coordination activities. Moreover, it does not affect the direct supervision by the national supervisory authority over subsidiaries established in a non-participating Member State. Since − as I mentioned above – these tasks conferred to the ECB by the SSM Regulation are mainly coordinative and design in nature, even though they are not exercised by the ECB without assistance, but together with the national competent authorities according to Article 9 (1) of the Draft SSM Framework Regulation. According to the cited article, When the ECB is the consolidating supervisor, it shall chair the college established pursuant to Article 116 of the CRD IV.[87] The national competent authority where the parent, subsidiaries and significant branches within the meaning of Article 51 of the CRD IV,[88] if any, are established, shall have the right to participate in the college as observers. If there is no college established pursuant to Article 116 of the CRD IV,[89] and a significant supervised entity has branches in non-participating Member States that are considered as significant in accordance with Article 51(1) of the CRD IV,[90] the ECB shall establish a college of supervisors with the competent authorities of the host Member States.[91] Because the above mentioned mechanism, Wymeersch – at least in relation to subsidiaries out of the SSM[92] − miscalculates himself, when he writes the following: "With respect to subsidiaries of significant banking groups that qualify for the SSM regime, these will be directly supervised by the ECB, and hence included

[86] Directive 2013/36/EU
[87] ibid.
[88] ibid.
[89] ibid.
[90] ibid.
[91] Keranis, 2014
[92] Szombati, 2014: According to the semi-official communication betwwen the ECB and the MNB, as regards subsidiaries out of the SSM, but with parents inside, it is not decided yet whether these subsidiaries shall be under direct or limited ECB supervision.

in the overall supervision of the banking group, and this irrespective of their individual quantitative importance. The calculation takes place on a consolidated basis".[93]

By and large, the significant supervisory tasks and powers over the Hungarian subsidiaries of parent credit institutions established in the Euro-zone remains with the National Bank of Hungary as the national competent authority, in case of standing out of a close cooperation agreement.

According to the above mentioned assessment, the debate on whether − as a non-euro zone Member State − Hungary should join the SSM through the possibility of a close cooperation or should not, is important from 2 (two) aspects.

First, on the basis of the criteria regarding the 3 (three) most significant banks in each of the participating Member States[94] in case of participation via close cooperation, the 3 (three) most significant banks would go under direct ECB supervision. For the time being, it cannot be ascertained with certainty which credit institutions would be described as the 3 (three) most significant ones on the basis of the "principle of the 3 (three) most significant banks". However, those can only be Hungarian-owned credit institutions, since from a legal perspective the ECB supervises bank groups together on a consolidated basis.[95] On the other hand, in the official communication between the ECB and National Bank of Hungary, the ECB referred to the fact that it might supervise the significant subsidiaries directly, which could mean an exchange in the order of the 3 (three) most significant.[96]

Second, the question of participation is decisive regarding the form of supervision in relation to the foreign-owned credit institutions with parents established in the Euro-zone. According to the above mentioned information, in case of Hungary's staying out from the SSM, the central supervision of the ECB shall be realized on a consolidated basis. However, the

[93] Wymeersch, 2012, p. 33
[94] Article 6 (4) 5) of Council Regulation (EU) No 1024/2013
[95] Thus, it is likely that the 3 most significant Hungarian-owned bank could be the OTP Group, the FHB Bank and the Takarékbank according to market data avaliable in 2014.
[96] In that case, the 3 most significant bank in Hungary – with direct ECB supervision – could be: OTP Group, K&H bank, Erstebank.

consolidated supervision is limited to the specific tasks, mainly restricted to planning and coordination activities and it will not affect the direct supervision by the national supervisory authority over subsidiaries established in a non-participating Member State. In case of participation, the ECB could have more significant tasks and powers in relation with credit institution concerned.[97]

VII.4.2. MEMBER STATE APPROACH

In the EU accession-treaty, Hungary undertook that − after the fulfilment of the Maastricht criteria – it shall introduce the Euro as its official currency. This step will include automatically the accession to the banking union as well, as the basic purpose of the banking union is to strengthen the monetary and the fiscal union. Thus, in theory Hungary is able to apply for participation to the banking union at any time between the launch of the SSM (November 2014) and the domestic introduction of the Euro.[98] By the time being, the Hungarian government has not made available any information on its opinion related to the likeliness participation to the SSM. However, the National Bank of Hungary shall emit a document in which it advises to the government not to join immediately the Single Supervisory Mechanism, so the banking union. The MNB will advise to wait and see whether the newly introduced SSM will be able to meet the high expectations.[99] Regarding the current close cooperation between the MNB and the newly re-elected government, it is highly unlikely that the government will refuse the opinion of the MNB and will decide to participate though. Even though, Hungary will likely keep the strategy of waiting-out, the alteration of some certain circumstances in the future will be able to change this opinion. The most significant of these circumstances are provided below.

First, as regards the map on page 35, within the EU, but out of the Euro-zone, there are only 2 (two) Member States − Denmark and Romania – who likely want to participate. For different reasons, but the UK and Sweden clearly proclaimed their will to stay out the SSM. The rest of the Member States are reluctant, and it can be assumed, most of them will not join the system

[97] Keranis, 2014
[98] Szombati, 2014
[99] http://www.bbj.hu/economy/eu-closer-to-banking-union;-hungary-on-the-fence_74634 (Date of access: 25.05.2014)

from the beginning. If the reluctant 5 (five) Member States (4 (four) out of Hungary) decide to join though, the market pressure, the need to avoid competitive disadvantage on the level of the Member States can prompt Hungary towards accession as well. Because of geo-political connexion, conduct of Poland is particularly important in relation to Hungary.[100]

Second, if the participating Member States of the SSM and the ECB unilaterally take actions in each case, and this consensus marginalizes the opinion and lobby power of all other Member States outside the SSM, and makes it impossible to represent an opinion different from the ECB's, in that case, a reconsideration of the national approach will be needed on participation. Such circumstances can profoundly alter the current decision of the MNB on participation.[101]

Third, as it was mentioned above staying out can cause a competitive disadvantage not only for Member States, but for supervised credit institutions as well. If the financing conditions will drastically become different for credit institutions inside and outside the banking union, then the institutional pressure may force the Hungarian government to rethink its decision. The same is the case, if the domestic credit institutions experience serious competitive disadvantage in relation to other interbank transactions, meanwhile their costs regarding supervision are roughly the same, compared to their competitors established in a participating Member State.

VIII. CONCLUDING REMARKS

By agreeing on a Single Supervisory Mechanism, the EU took one of its boldest decisions since the Euro was firstly introduced on 1st of January 2002, since the SSM presents a satisfactory first step towards the Banking Union. Another positive element of the agreement is the large role that is offered to non-euro zone Member States in the SSM, within the scope

[100] http://www.bbj.hu/economy/eu-closer-to-banking-union;-hungary-on-the-fence_74634 (Date of access: 25.05.2014)
[101] Szombati, 2014

of what is legally feasible.[102] In that sense, it is even more significant step than the introduction of the Euro, since with the SSM, the financial supervisory integration has the chance to cover immediately each Member State of the European Union, but the monetary union can have the same effect only at the end of a long road, which is – in its entirety – forgotten at the moment.

Regarding the negative side of the framework, a bigger problem is the fact that the membership of non-euro zone countries remains rather noncommittal. At any given point, such countries will be able to leave the SSM.[103] Continuing this thought, but approaching from a Member State aspect, the decision on whether Hungary wants to participate in the SSM or not, is basically a political resolution, less a legal one. I would not say that it is only a symbolic step from a legal perspective, but I do say the main significance of the immediate participation would rather have been a political gesture, than an irrevocable commitment towards the legal framework of the European-level financial supervision. Regarding the procedural structure of a close cooperation possibility, and the fact that even without participating as a close co-operator, Hungary needs to negotiate on a particular kind of cooperation with the ECB,[104] the decision on accession becomes legally less significant. No matter Hungary's accession decision, subsidiaries of Euro-zone parent credit institutions, operating in Hungary shall be supervised by the ECB somehow. In case of a close cooperation, it shall happen with the ultimate power of the ECB, based on the procedural rules of the SSM Framework Regulation. In case of non-participation, the ECB shall exert consolidated supervision over the subsidiaries of Euro-zone parent credit institutions, operating in Hungary, with a higher level of autonomy for the national competent authority. According to the above mentioned thoughts, there is 1 (one) significant issue remaining dependent on the participation decision. It is nothing other than the direct supervision of the one and only Hungarian-owned credit institution, which – according to its size and assets – shall be described as significant in the methodology of the ECB: the OTP Group.

[102] Verhelst, 2013, p. 51

[103] ibid, p. 51

[104] Article 3 (6) of Council Regulation (EU) No 1024/2013: "The ECB and the competent authorities of non-participating Member States shall conclude a memorandum of understanding describing in general terms how they will cooperate with one another in the performance of their supervisory tasks under Union law in relation to the financial institutions referred to in Article 2. The memorandum shall be reviewed on a regular basis."

In that regard, the significance of the decision on participation is much less in relation to Hungary, than in relation to other Member States, with more important financial sector, such as the UK. The above-mentioned statement seems to be true particularly with the anytime future possibility of participation available to Hungary.

However, as regards the political sphere, Hungary’s likely staying out of the first round of accession to the SSM can be described as a next sign of its special way, and its non-commitment towards the possibly deepening European integration.

As regards the whole overview of the Single Supervisory Mechanism, according to my opinion the real substantive issue is whether the advantages of SSM such as unification can rise above the risks such as endless bureaucracy and difficulties in cooperation. If the operation of the SSM is able to confute the negative sounds envisioning slower decision-making processes within the ECB than on national level, and establish an effective mechanism, it will be the only appropriate answer to those Member States who decided not to participate in the first round of accession. In case of a well-functioning, effective SSM, Member States such as Hungary will definitely reconsider their opinion. However, to do so, the SSM has to prove its viability.

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