Theoretical and Applied Economics
Volume XX (2013), No. 3(580), pp. 103-120

Implications of the single supervisory mechanism on ECB's functions and on credit institutions' activity

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Abstract. *The European Commission's proposal launched on September 12, 2012 for conferring the European Central Bank extended powers in the field of Euro zone banking supervision has become a hotly debated topic across EU member states. Until now, there is still strong resilience of the EU countries outside the single currency area.*

The prospects for its practical implementation raised, however, a series of questions related to its technical feasibility. Our paper intends to shed light on some issues concerning the implications of the single monitoring mechanism on the traditional functions of the ECB, on the coexistence between supranational supervision and the national one, and on various facets of the impact that the new architecture of European banking supervision will have on the business of credit institutions, in terms of performance indicators, efficiency, risk and competition.

Keywords: European surveillance architecture; ECB; banking union; single supervisory mechanism; credit institutions.

JEL Codes: E58, G01.
REL Codes: 11B, 11C.

Introduction

The recent European Commission's proposal for establishing an European banking union is part of the long-term reflections on the prospects for the European Monetary Union and the success of its functioning. This new challenge for all the levels of the European construction is projected to have a significant impact on the functions, responsibilities, powers and mandate of the ECB.

The European banking system, highly fragmented and diversified both from an institutional and balance sheet standpoint, requires a high degree of integration. ECB's statistics highlights the fact that, at the end of February 2012, the Euro area comprised 7,299 monetary financial institutions, of which 6,180 were credit institutions, 1088 were money market funds and 31 were other financial institutions. At the 27 EU member states, the number of monetary financial institutions raised at 9,311, of which 8,039 were represented by credit institutions.

Based on this fact, namely the large number of credit institutions, available now as well as in the early 90s, the Maastricht Treaty has left bank supervisory powers to the national authorities, thus acknowledging the technical and legislative difficulty of implementing a unique surveillance system in Europe.

Recent developments manifested in the banking systems, as a result of the global financial crisis, and the spread of local, national vulnerabilities to the European space, revealed strong interconnections between financial institutions and markets in the Euro area and the impairment of supervisors' ability in solving banking distress.

Therefore, it emerged a main argument in favor of creating the banking union, meaning that national banking problems can be easily managed by a unique European authority namely the European Central Bank. The banking union is an ambitious goal, but it is only a phase in the long-term vision for the economic and fiscal integration in Europe, with the purpose to restore confidence in banks and in the single currency (EC 2012a).

The abandonment of national options in terms of financial policy and banking supervision, and, hence, of national sovereignty in favor of a single European supervisory authority, brought at the core of the speeches the concept of financial trilema. This highlights the impossibility of simultaneous fulfillment of three objectives: financial stability, maintaining national financial policies and financial integration (Constancio, 2012).

A similar approach was developed by Deutsche Bank report (2012), arguing by the concept of impossible trinity that the motivation underlying the creation of the banking union is much deeper, and it lies in the impossibility of synchronizing national surveillance objectives with financial stability and market integration.

The constituents of the banking union are:

a) a Single Supervisory Mechanism, with responsibilities in the field of direct monitoring of banks in the Euro area, impartial and strict application of a common set of prudential regulations,risk control and prevention of crisis events;

b) a common, pan-European system for depositors' protection, which provides the harmonization of protected deposits, faster payments, better funding of deposit guarantee schemes and a mutual borrowing mechanism (EC 2012b);

c) an integrated framework for crisis management in the EU (entitled the European recovery and resolution framework) to establish tools for recovery or controlled banking resolution, in order to prevent crises and to manage them in an early stage (EC 2012b).

In the following, the present paper focuses on the first key constituent, namely the Single Supervisory Mechanism, as the EC's proposal (EC 2012a) statutes that it should become active, operational on January 1, 2013.

According to the text of the proposed regulation (EC 2012a), ECB's duties will be filled with tasks in the field of supervision of credit institutions established in the Euro area countries, regardless of bank size or business model, and of financial conglomerates located in the Euro area. Prudential objectives that can be better managed at the national level will remain in the responsibility of national supervisors (consumer protection, prevention of money laundering etc.).

The proposal provides a gradual implementation: banks that received public support will be monitored by ECB starting on January 1, 2013; systemically important banks starting from July 2013 and since 2014 it will be expanded to all banks in the Euro area.

It is obvious, therefore, that in front of the new challenges related to the ECB's mandate we will witness a reconfiguration of the European Central Bank's and the national supervisory institutions' tasks.

From this reason, the paper's aim is to identify how the ECB's functions will recalibrate, as a single European banking system supervisor, and to formulate a series of interrogations and answers on the institutional and regulatory framework challenges that both supervisors and credit institutions will be subject to.

In support of our views and arguments we relied upon the opinions of officials of the European banking institutions and researchers from academia, concerned about the new philosophy and practice of banking supervision that the European banking union will generate at a pan-European level.

1. Is ECB entitled to act as sole supervisor for Euro area?

The experience of the recent financial crisis has shown that the national regulations' main focus towards the micro prudential side of banking supervision proved wrong, as it relied on the implicit assumption that monitoring individual financial institutions' soundness and solvency is a sufficient guarantee for the resilience to shocks of the entire financial system. However, prudential supervision ignored the interconnected nature of financial institutions, both at the national and cross-border interbank money market, or the systemic issues. National supervisors' failure resulted in a loss of confidence in the robustness and soundness of national financial systems.

In this context enrolls the Commission's proposal, which provides for the transfer of prudential supervisory powers from the national level to the centralized, supranational level, represented by the ECB. The takeover by the ECB of the Euro zone banking supervisory duties requires a deep rethinking of the pillars of the European construction and is a risk generating process.

As we have noted in a previous paper (Barbu, Vintila, 2006), the European banking regulation and supervision has a strong decentralized nature, that overlaps the unique monetary policy framework in the Euro area, because of two dimensions: *geographic* and *institutional.*

Deutsche Bank (2012) argues that, from an institutional standpoint, the designation of ECB as responsible for supranational supervising is not appropriate (reputational risk is just an example). It states that the European Banking Authority – EBA, the institution that addresses to all EU-27 member countries should possess such powers, but also involving the ECB in the supervisory process. Although supervision and regulation are distinct, interchangeable and complementary activities, the Deutsche Bank report suggests their exercise by a single pan-European authority. In terms of geography, the unique monitoring mechanism should include all the 27 EU countries. Only extended supervision at European level would be effective, in terms of increasingly interconnected banking systems and would ensure a high degree of financial stability.

Pisani-Ferry, Sapir, Veronica and Wolff (2012) adhere to this view, pointing out that the inclusion in the banking union of all 27 EU countries is necessary, first, to maintain financial integration within the European single market. Otherwise, the national supervisory authorities may restrict cross-border operations of banks with headquarters on their territory, to circumvent prudential requirements imposed by the ECB.

Also, the authors mentioned above argue that, given the geographical area of the banking union, it is unlikely that EBA gain competencies in the field of prudential supervision.

EBA's duties, as regulator of the entire EU, aim at strengthening cooperation between supervisory authorities designated by each EU member state and continuing the process of convergence and consolidation of best practices in prudential supervision. Also, EBA drives stress tests for European banks to identify weaknesses in bank capital structure and increase transparency in the European financial system, is involved in creating a single rulebook for financial services in the EU and has a crucial role in the implementation of measures to recapitalize the credit institutions. In the new architecture of banking supervision, the role of EBA will be maintained and it will continue to develop a single rulebook applicable to all the 27 countries.

Thus, across the European banking union, the ECB will have the mandate to cooperate with Euro area national supervisors and EBA.

The creation of the European banking union establishes the premises for allocating new powers to ECB. The main criticism expressed on this issue is that, complementary to responsibilities for banking supervision in the Euro area, the ECB will manage a new bank resolution fund, to support insolvent banks. The ECB will also have the power to establish new arrangements by which to provide better guarantees to depositors and investors, through creating the unified deposit guarantee scheme. The estimated effect of the ECB's overlapping of responsibilities will consist in the increase of powers in influencing national budgetary and fiscal policies (Steinberg, 2012).

2. The lender of last resort role affected ECB's independence?

In response to the financial crisis, central banks have adjusted their operations in various ways: lowering the monetary policy interest rate at a level that would facilitate banks' access to overnight funds; flexible open-market operations, by increasing the maturity and extending the range of securities accepted as collateral in refinancing operations.

Also, central banks have reshaped the monetary policy instruments, adopting unconventional measures (both quantitative and qualitative easing), through which supported credit institutions, by directly purchasing their troubled assets.

The ECB's measures to support the Euro area banking system can be classified into two categories: direct purchasing of assets issued by the private sector (the ECB was the only central bank that bought covered bonds, from June 2009 till June 2010, the total value being of 60 billion Euro) and enhanced credit support to Euro area credit institutions, defined as operations that stimulate lending in a more sustained pace, than it could be achieved only by reducing the key interest rate.

The main reproach that is made relates to the quality of collateral and the interest rates charged. Although the lender of last resort role, performed by a central bank, requires the selection of beneficiaries according to the quality of collateral and charging a higher interest rate, however, developments in recent years indicated a collateral widening, by inclusion in its structure of non-investment grade assets and the practice of low interest rates for refinancing operations. In this way, there were violated by the ECB the basic principles of refinancing operations.

ECB's frequent and extensive involvement, in recent years, in buying government bonds generated, on the one hand, the accumulation of significant risks, and, on the other hand, emphasized that this institution has become an important fiscal policy player.

To reduce ECB's involvement in financing budget deficits, in 2010 the European Financial Stability Facility (EFSF) has been created, with the role of ensuring financial stability, by bailing out distressed banks. Providing financial assistance to Euro zone members helps fund their deficits by issuing bonds or other debt instruments in the capital market. EFSF can intervene on primary and secondary bond market to ensure financial stability, acting through five forms of intervention: issue bills and bonds, intervention in the primary market, intervention in the secondary markets, precautionary programs and bank recapitalizations. The HSBC report (2012) claims that these forms of intervention allow the ECB to exert its ability of lender of last resort, but only if the EFSF mechanism is activated by the governments of member countries.

Unlimited ECB intervention in the secondary bonds market may result in serious risks to national budgets. These issues call into question its independence and show the infringement of the fundamental provisions of the Maastricht Treaty that gives ECB no mandate for any direct or indirect financing of member countries governments.

3. Dual supervision (both national and exercised by the ECB) may be conflicting or redundant?

The new European banking supervisory architecture will create similarities with the US banking supervision, which is why we propose a brief foray into the dual banking supervision philosophy of the US banking system, which is considered as one of the most innovative, largely because there are two different regulatory and supervisory structures.

This is reflected by the coexistence of national banks, subordinated to the regulator and supervisor at the federal level (federal agencies), with state banks, which operate under standards and regulations imposed at the state level. This type of dual regulation dates back almost 200 years, having as foundation the legal, constitutional limits on the ability of states to control the entities created by federal authorization.

The benefits of this type of surveillance are highly predicated, highlighting banks' own option related to the supervisory authority. A system in which banks have to choose between several types of supervision leads to lower costs and increases the speed with which new banking products and services are developed and has a greater chance of eliminating outliers.

A study published in 2005 by the American Bankers Association revealed the prevalence of banks under state regulation (70%) compared with those which were under federal jurisdiction. On the size of banks, almost 80% of those which were operating under state jurisdiction were entities of lesser size than national banks, which have developed a business model compatible with this level of supervision.

In recent years, the trend has changed, many banks preferring to enter under regulation at the federal level because of sustainability of this type of surveillance. At a time when the cross-border mergers and acquisitions phenomenon intensifies, cooperation of state bodies with federal agencies is an important factor for bank flexibility and competitiveness. From the cross-examination of financial reports to detection of fraudulent transactions and the establishment of financial holding companies there is a strong collaboration between the two levels of supervision.

In this respect, the Federal Reserve Chairman Alan Greenspan (1995) stated that:"a *single regulator, charged with responsibility for safety and soundness, is likely to have a tendency to suppress risk taking. A system of multiple supervisors and regulators create checks on this propensity*."

Therefore, besides being redundant, supervision on two distinct levels, namely at State and federal level, is the best solution in a banking system that counts, according to the statistics of the Federal Deposit Insurance Corporation (FDIC, 2012), 7,188 banks and 6,961 credit unions (National credit Union Administration, 2012) and this duality enhances stability and financial innovation.

Unlike specific regulatory and supervisory activities in the US, the European Commission's desire is that all credit institutions operating in the single European market apply, without discrimination, a single framework of prudential standards and that prudential monitoring to be conducted by a single authority, the ECB, with the logistical support and expertise of the national central banks of the Euro area member countries.

4. Is it appropriate the sharing of supervisory powers between the ECB and national authorities?

Centralization of authority at the ECB level should not be confused with operational centralization (Pisani-Ferry, Sapir, Veron, Wolff, 2012). The EC Directive proposal explicitly depicts the possibility of delegating certain tasks and operations to national supervisors.

Currently, EU national authorities base their activity on the Core Principles for Effective Supervision issued by the Basel Committee on Banking Supervision. With the implementation of the single monitoring mechanism, each national supervisory authority will have to conform and comply with regulatory and supervisory requirements set by the ECB, which will eliminate the disparities in the legislation of Euro area countries. All banks operating in the Euro area will be subject to the same prudential requirements, and hence, references to the legislation in the country of origin (home country) versus the host country will simply disappear.

Attributions assigned by the EC proposal to national authorities are: assessing compliance with national legal framework for the authorization/ withdrawal of a bank license and proposing a decision that can be enforced only by the ECB; conducting on-site inspections, in compliance with regulations issued by the ECB and its warning of any vulnerability identified; making recommendations to the ECB on the validation of internal risk models of banks; the application of sanctions is shared between the ECB and national authorities.

In our opinion, national supervisors will hold the role of an interface between credit institutions and the ECB, a beneficial situation because it allows ECB to draw on their expertise in monitoring resident credit institutions. Also, the ECB can reduce its operational costs because, although supervision at this level is feasible for large banks, with systemically important cross-border activity, there is the risk of being time consuming and requires significant financial and human resources, if it will be extended to the thousands of small and medium-sized banks in the Euro area.

In this context, Deutsche Bank (2012) show that establishing a monitoring mechanism on two distinctive levels, in which ECB monitors only systemic banks and national authorities supervise the remaining banks, is not indicated as small local or regional banks may be too at the origin of systemic crises.

Pisani-Ferry and Wolff (2012) advocate the delegation of supervision powers forsmall/medium sized banks to national authorities, while the ECB has legal responsibility for prudential monitoring of all banks in the Euro area, citing that, at the end of 2010, the largest 200 banks in the Euro area accounted for over 95% of banking assets.

However, in the process of defining the legal framework under which the single supervisory mechanism will work, it is required the clear delineation of the ECB's supervisory duties from those of national authorities, not to affect the balance of power between them. Thus, Gourisse (2012) draws particular attention to the ECB's role of providing or withdrawing the bank authorization, of driving directly on-site inspections or imposing administrative sanctions up to 10% of banks' annual turnover.

Therefore, the coexistence of the two levels of supervision, in a decentralized framework, in which national authorities have powers specifically set forth and defined, and the ECB benefits from decision-making, facilitate the exercise by the ECB of the single supervisor role.

5. What would be the impact of integrated supervision on systemically important banks?

Establishment of unique, supranational surveillance can help to tackle the issue of systemic financial institutions, in terms of balance sheet size, complexity or business connections with other financial markets ("too big to fail", "too complex to fail" or "too interconnected to fail").

Centralized supervision is more objective and less biased than the national one. Also, it will contribute to limiting the moral hazard induced by local supervision.

A study published by Demirguc-Kunt and Huizinga (2012) introduces a distinction in awarding the quality of being systemically important financial institution (SIFI). The activity of a bank can be characterized by its absolute value (the value of balance sheet and off balance sheet aggregate assets) and its systemic value (the ratio of bank debt to the country's GDP). This ratio indicates the maximum value of saving costs to be borne by the country of origin of the bank, if the bank becomes insolvent and its assets are totally damaged.

In the above mentioned context, Rohtsalu (2012) argues that, by creating the banking union, systemic size banks included in the category of being "too big to save" because the home country is not able to save them will become, by relation to Euro zone GDP, "too big to fail", i.e. banks with large absolute value. This will change the public perception and will improve their position on financial markets.

The impact of systemic financial institutions operating across borders and become bankrupt/insolvent can be better managed by the ECB than by the national supervisory authorities. In this respect, some authors (Pisani-Ferry, Sapir, Veron, Wolff, 2012) point the informational advantages enjoyed by European authorities, at the expense of national ones.

The unification of supervision could prove beneficial because, currently, banking systems are characterized by a high share of foreign capital, which means that the parent bank operations are subject to regulation and supervision in the home country, while banks in the host country, at which they hold the majority ownership, are subject to other prudential norms.

6. In what way will be affected the current activity of credit institutions?

ECB's duties in matter of monetary policy and maintaining financial stability in the Euro area will correlate with the sole prudential supervision role. ECB shall be entitled to verify the business model adopted by credit institutions, to assess the extent to which capital requirements are adequate to the risk profile, to critically analyze the results of stress tests conducted by the respective banks, the risk management procedures and internal control, in order to identify in an early stage the potential vulnerabilities that may affect the viability and resistance to shocks of the credit institutions' business.

In this sense, Bernanke (2010) is in favor of investing supervisory authorities with the power to limit financial institutions' engagement in risky activities.

Concrete ways in which the single supervisory authority will intervene to correct the deficiencies found still remain ambiguous: what action will the ECB adopt if the recommendations made by it to credit institutions won't be implemented? Will be imposed limits or thresholds on lending growth or performance indicators?

In light of prudential financial reporting that credit institutions have to periodically prepare and send to the national supervisory authority, it is possible that the type of information required, the level of detail and frequency multiply as a result of requests for reports which will be made exclusively for the use of the ECB. The volume of work necessary for preparation of additional documentation will require additional staff, thus increasing the human resource costs. Financial reporting activities will be even more complex in the case of Euro area banks that decide to conduct business through branches in a non-participating country at the banking union, which will be triple monitored (by the host country supervisory authority, the ECB and the supervisory authority of the country of origin) or in the case of non-participating banks that operate through branches in the Euro area (will be subject to supervision by the ECB, in addition to the monitoring of the national authority in the home country).

Also, banks will pay the fees charged by the ECB in order to cover its expenses incurred in carrying out tasks within the scope of integrated surveillance. The amount of the fees will be proportional with the bank systemic importance and risk profile.

7. What effects will have the unique supervision on credit institutions' performance and risk indicators?

The relationship between the particularities of supervisory activity and risk, performance and financial soundness bank indicators has been the subject of a series of empirical studies over the last decade. Largely, the studies circumscribed to these topics positioned in the center of the analyses and correlations the official power of banking supervisors. The empirical results are relevant and can be used as a benchmark by ECB, in the concrete exercise of the Euro zone single supervisor role. Also, in the context of the desired banking union, criticism on the risks of aggregating excessive powers by the ECB become more pronounced, so it is necessary to make a foray into approaches on this topic.

Economic literature argues that there are several channels through which the features of surveillance activity can influence banking performance.

Barth, Caprio and Levine (2004) showed that a supervisory activity which promotes better information transparency induces the development of the banking system, reflected by the increase in the share of private credit to GDP, and strengthens the efficiency of the intermediation activity, due to lower net interest margins.

A similar position is adopted in the study of Demirguc-Kunt, Laeven, Levine (2004), revealing the erosion of profitability ratios and increase of financial intermediation costs, as a result of the adoption of rigid regulations that restrict banking activity and impose barriers to financial market access.

The first comprehensive study that explored the empirical relationship between banks' financial soundness indicators and characteristics of banking supervision was conducted by Davis and Obasi (2009). The analysis included 914 largest banks, by total asset value, from a sample of 64 countries, for a period during 1995-2003. The results illustrated the positive linkage between exercising supervision by the central bank and financial health indicators: increasing the share of liquid assets in total assets, improving ROA profitability and increasing the share of loans in total assets. These results are maintained also in the event that supervision is centralized within a single entity or shared among several entities. High expertise and number of the surveillance staff correlates with a decrease in the share of loans in total assets, and hence reductions of credit risk exposure, while reducing banks' liquidity and profitability levels. The effect on leverage ratio is zero, regardless of the variables used as a proxy for surveillance features.

The same authors highlight three aspects of the supervisory authority power: the extent to which it acts promptly by taking corrective action when it finds an impairment of various components in the banking business, holding the right of discretionary intervention when it notices violations of banking regulations and the supervisory authority's power of decision occurs without the agreement of other state authorities.

The extent to which regulation and banking supervision stimulates or conversely, restricts the operational efficiency of banking activity was investigated by Pasiouras, Tanna and Zopounidis (2009). They quantified efficiency through the stochastic frontier approach, by using 2,853 observations with data for the 615-listed commercial banks in 74 countries, over the period 2000-2004. The conclusion of the analysis is that banking regulations increase market discipline, while the strengthening of surveillance powers increases both banks' cost efficiency and profit efficiency.

Another study is that of Barth, Lin, Ma, Seade and Song (2010), performed on a sample of 4,050 banks from 72 countries, for the period 1999-2007.

From the perspective of banking regulations, restricting banking activities negatively influences the efficiency (calculated with a non-parametric method), while increasing capital requirements has a marginal, but positive effect on efficiency. From a supervisory perspective, a supervisor with a high degree of independence and increased power is positively correlated with banking activity efficiency. The authors have quantified the banking supervisor power index, based on 14 variables that reflect the exercise of supervisory authority, which has been further correlated with the efficiency indicators. The result indicated that the increased power of the supervisory authority improves corporate governance and banking efficiency, but only where the authority shows a high degree of independence from political factor.

A recent research (Chortareas, Girardone, Ventouri, 2012), performed on a sample of 22 EU countries in the period 2000-2008, aimed to show whether the banking supervisory and regulatory authorities' interventions significantly affect operational efficiency and performance of banks. Empirical evidence suggested that the increased power of the banking supervisory authority can improve credit institutions' efficiency, but also it can be a signal for interventionist attitude or obstruction of banking activity, which compresses the efficiency level.

8. How will influence the competitive environment the way in which credit institutions operate?

From the perspective of competition among banks, establishing the single monitoring mechanism will generate distortions of competitive banking environment, as some prudential regulations of the countries not included in the mechanism may be more or less restrictive than the ECB's ones. There is the risk that banks resident in non-participating countries to the European banking union avoid opening subsidiaries or the taking over, through mergers and acquisitions, of banks operating in countries participating to the union, in order to evade the prohibitive legislation imposed on by the ECB.

In some studies (Pisani-Ferry, Sapir, Veron, Wolff, 2012) it is shown that any partial banking union involves a risk of regulations arbitrage and, thus, competitive distortions. In addition, it is drawn attention to the risk of undermining the business of small, local banks, operating in non-Euro zone countries, with weak economic fundamentals, in favor of banks monitored by ECB.

In other words, it is possible that the retail and corporate banking market of the non-Euro zone banks be affected, as banks that fall under the single supervision mechanism will benefit from better public perception regarding the financial health and risk-taking. We can assist to the cross border migration of customers towards supranational supervised banks, the selection criteria being represented, ultimately, by the differentiated interest rates charged. Thus, some small banks, non-included in the single mechanism, will have to redefine business strategies, including through mergers or acquisitions procedures, or to cease doing banking business.

These perspectives for the European retail and corporate banking market overlap on the existing legislative context. According to McKinsey report (2012), the European retail banking is going through an important period of pressure on ROE, largely due to Basel 3 requirements, as well as other initiatives impacting on the level of capital and own funds. For systemically important banks in the Euro area, the ROE level fell by between 0.4% and 1.2% in the period 2010 to mid 2012, which means a significant impact of regulations on banking performance. As a result, banks are concerned about new strategies, including the repricing of the mix of products and services granted, so as to increase efficiency.

Deutsche Bank (2012) adds that not including the most important financial center in Europe, which is England, in the unique monitoring mechanism will enhance the potential manifestation of competitive distortions.

The impact of credit institutions' single supervision on ratings is perceived by Standard & Poor's study (2012) to be positive, to the extent that it will help reduce/eliminate existing disparities in national legislations dedicated to banking regulation and supervision. Uniformization of supervisory framework in the Euro area will help improve the scores calculated for the component called *institutional framework of the banking system*. As a result, ratings of banks located in countries that will join the banking union will be better than those of banks outside the union, which will create distortions of competition. These can occur both by difficulties in attracting/keeping the existing portfolio of clients, and by decreasing the attractiveness of issuing shares or bonds.

Statements that refer to effects induced by the single supervisory mechanism to the banking competition emphasize that, to be effective and equitable, it must be transparent, have a broad scope of coverage of financial institutions and be neutral for banking competition (to ensure a level-playing field) (Constancio, 2012, Deutsche Bank, 2012).

In this respect, Noyer (2009) pointed out that, during the process of reforming the regulations related to the financial sector, it should be considered the financial industry's optimal degree of diversity and to subordinate it to maintaining financial stability. In other words, it has to be found a balance between fostering competition and financial innovation, on the one hand, versus standardization and harmonization of European regulations, on the other hand.

Conclusions

European Commission's proposal to create a European banking union that comprises the Euro area member countries translates into abandoning the national options in matters of financial regulations and banking supervision, and therefore a voluntary renunciation to the attribute of national sovereignty, in favor of a single European authority. This paper, with an unconventional structure, based on the formulation of interrogations and their punctual argumentation, proposed to investigate the implications of the banking union's first pillar, namely the unique monitoring mechanism, on the traditional functions of the ECB, on the feasibility of the coexistence between supranational supervision and the national one, and on various facets of the impact that the new architecture of European banking supervision will have on the business of credit institutions, in terms of performance indicators, efficiency, risk and competition.

Table 1

Synthesis of interrogations made

Interrogations formulated by the authors	Arguments brought byoficial institutions and researchers	Authors' opinions
Is ECB entitled to act as sole supervisor for Euro area?	▪ From a geographical standpoint, the single supervisory mechanism should include all the 27 EU countries (Deutsche Bank, 2012,Pisani-Ferry, Sapir, Véron, and Wolff, 2012). ▪ From an institutional standpoint, the designation of ECB as responsible for supranational supervising is not appropriate (Deutsche Bank, 2012). ▪ Increased ECB's powers in influencing national budgetary and fiscal policies (Steinberg, 2012).	▪ National supervisors' failure in managing banking distress events ▪ Deep rethinking of the pillars of the European construction ▪ The interconnected and cross-border nature of banking activity justifies concerns for a single supervisor ▪ Banking regulation and supervision responsibilities should be taken by a single pan-European authority (Barbu, Vintila, 2006).
Did the lender of last resort role affected ECB's independence?	▪ The Maastricht Treaty gives ECB no mandate for any direct or indirect financing of member countries government debt ▪ To reduce ECB's involvement in financing budget deficits, in 2010 has been created the European Financial Stability Facility (EFSF)	▪ ECB supported the Euro area banking system by reshaping the monetary policy instruments and by modifying the size and structure of its own balance sheet. ▪ ECB's direct purchasing of assets issued by the private sector. ▪ the criteria for cuantifying ECB's independence have to be rethought according to the new context generated by the financial crisis.
Dual supervision (national and exercised by the ECB) may be conflicting or redundant?	▪ The experience of the dual banking supervision in the US banking system has revealed the successfullcoexistence of banks supervised federally with bankswhich operate under standards and regulations imposed at the state level (American Bankers Association, 2005).	▪ Besides being redundant, supervision on two distinct levels, namely centralised at European level with delegation of specific tasks to national level, is the best solution in a banking system that counts thousands of banks.

Interrogations formulated by the authors	Arguments brought byoficial institutions and researchers	Authors' opinions
	▪ A system that comprises multiple supervisors won't have the tendency to suppres risk taking or financial innovation (Greenspan, 1995).	▪ ECB tends to become an institution with powers similar to that of Federal Reserve.
Is it appropriate the sharing of supervisory powers between the ECB and national authorities?	▪ Centralization of authority at the ECB level should not be confused with operational centralization (Pisani-Ferry, Sapir, Véron, Wolff, 2012). ▪ a monitoring mechanism on two distinctive levels, in which ECB monitors only systemic banks and national authorities supervise the remaining banks, is not indicated as small, local banks may be too at the origin of systemic crises (Deutsche Bank, 2012). ▪ The delegation of supervision powers forsmall/medium sized banks to national authorities, while the ECB has legal responsibility for prudential monitoring of all banks in the Euro area (Pisani-Ferry, Wolff, 2012). ▪ The clear delineation of the ECB's supervisory duties from those of national authorities, not to affect the balance of power between them (Gourisse, 2012).	▪ National supervisory authorities apply the regulatory requirements issued by ECB. ▪ Banks operating in Euro zone will apply the same prudential requirements, hence references to the legislation in the country of origin (home country) versus the host country will simply disappear. ▪ National supervisors will hold the role of an interface between credit institutions and the ECB. ▪ Reduction of ECB's operational costs with human and financial resources.
What would be the impact of integrated supervision on systemically important banks?	▪ Banks included in the category “too big to save” will become “too big to fail” (Rohtsalu, 2012). ▪ Systemic financial institutions operating across borders and become bankrupt/insolvent can be better managed by the ECB, because of informational advantages (Pisani-Ferry, Sapir, Véron, Wolff, 2012).	▪ Centralized supervision is more objective and less biased than the national one. ▪ It will contribute to limiting the moral hazard induced by local supervision. ▪ The high share of foreign capital in national banking systems is another argument in favor of unifying supervision.
In what way will be affected the current activity of credit institutions?	▪ Bernanke (2010) is in favor of investing supervisory authorities with the power to limit financial institutions' engagement in risky activities.	▪ ECB shall be entitled to verify the banks' business model, to assess the capital adequacy to the risk profile, to analyze the results of stress tests, the risk management procedures and internal control. ▪ Ambiguity surrounds the concrete ways the single supervisory authority will intervene to correct the deficiencies ▪ Enhancement of the level of detail and frequency ofprudential financial reporting send to ECB, thus increased costs with human ressources. ▪ Fees requested by ECB will add to banks' current operational expenses.

Interrogations formulated by the authors	Arguments brought byoficial institutions and researchers	Authors' opinions
What effects will have the unique supervision on credit institutions' performance and risk indicators?	▪ A transparent supervisory activity strengthens the efficiency of the intermediation activity (Barth, Caprio, Levine, 2004). ▪ Rigid regulations erode profitability indicators and increase the financial intermediation costs(Demirgüç-Kunt, Laeven, Levine, 2004). ▪ Davis and Obasi (2009) depict the positive linkbetween banks' financial soundness indicators and characteristics of banking supervision. ▪ A highly independent supervisory authority, with increased powers, is positively correlated with bank efficiency(Pasiouras, Tanna, Zopounidis, 2009, Barth, Lin, Ma, Seade, Song, 2010,Chortareas, Girardone, Ventouri, 2012).	▪ The empirical results reported by economic literature can be used as a benchmark by ECB, in the concrete exercise of the Euro zone single supervisor role.
How will influence the competitive environment the way in which credit institutions operate?	▪ Any partial banking union involves a risk of regulations arbitrage and, thus, competitive distortions (Pisani-Ferry, Sapir, Véron, Wolff, 2012). ▪ Not including England in the unique monitoring mechanism will enhance the potential manifestation of competitive distortions (Deutsche Bank, 2012). ▪ Ratings of banks located in countries that will join the banking union will be better than those of banks outside the union, which will create distortions of competition (Standard & Poors, 2012).	▪ Banks resident in non-participating countries to the European banking union avoid opening subsidiaries or the taking over, through mergers and acquisitions, of banks operating in countries participating to the union, in order to evade the prohibitive legislation imposed on by the ECB. ▪ Cross border migration of customers towards supranational supervised banks. ▪ Some small banks, non-included in the single mechanism, will have to redefine business strategies, including through mergers or acquisitions procedures, or to cease doing banking business. ▪ The European retail banking will be exposed to increased pressures on ROE, due to Basel 3 requirements and renunciation at bank recapitalization through state support.

Empirical evidence we have summarized does not clearly, unambiguously indicate a significant positive impact of initiatives to reform the banking supervisory framework in recent years at both the European and international level. However, there are clearly expressed several highlights that should be taken into account in the implementation by the ECB of the single oversight mechanism.

Since the ECB's role as lender of last resort and financier of budget deficits questioned the independence of this institution, it is necessary to redefine the criteria for assessing the independence of central banks in exceptional circumstances, such as the financial crises. Also, we report the many technical deficiencies that will result from the correlation of ECB's duties as unique supervisor to those of EBA as sole regulator and the national authorities.

The advantages of the unique surveillance mechanism will consist in unifying the supervisory framework, with direct and immediate effects on the monitoring of systemically important financial institutions, but relying on the expertise and contribution of each national authority in their monitoring approach.

From the perspective of the supervised credit institutions, they will have to face additional costs generated by the new prudential financial reporting requirements, the fees charged by the ECB and additional human resource. The increase in credit institutions' operating expenses will have a direct impact on profitability indicators, to the extent that banks will bear all of these costs. If they choose to further transfer all or part of these costs to customers, by incorporating them in the final cost of financial products and services offered, it is possible that we assist at the erosion of their client portfolio, through customers' migration to banks subject to single supervision, that offer the best remuneration for deposits and lowest credit costs.

All these can be offset by the beneficial effects enhanced by the single surveillance of the Euro area geographical space: effects on operational efficiency and financial stability.

Relative to the impact on bank competition, we subscribe to the viewpoints that signal the potential for competitive distortions between banks included under the dome of unique supervision and the non-participating ones. It is therefore possible to assist at a comprehensive process of mergers and acquisitions involving small and medium sized banks, which will lead to a reconfiguration of the banking systems' institutional capacity.

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