

ACES POLICY BRIEF

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The Single Supervisory Mechanism for Banking Union Uniformity, Differentiation, and Experimentalism in EU Financial Regulation

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Introduction

How can advances in European integration be reconciled with persistent national diversity? While growing interdependencies within European markets stimulate demands for centralized governance and uniform rules, the latter often clash with the heterogeneity of socio-economic conditions, institutional structures, and policy preferences in an increasingly diverse Union of 27 Member States. One prominent solution to this dilemma is ‘differentiated integration’, in which some Member States forge ahead with new policy initiatives, such as Schengen or the euro, while others ‘opt out’, at least temporarily.¹ But an alternative approach to integrating diversity is ‘experimentalist governance’, in which EU institutions and Member States jointly set and revise common goals and rules, based on recursive learning from comparative review of implementation in different local contexts.²

In no other policy field has European integration advanced more rapidly over the past decade nor has the challenge of reconciling uniform rules with national diversity arisen more sharply than in financial regulation generally and banking supervision in particular. The global crisis of 2007-2009 exposed fundamental flaws in the EU’s networked, multi-level governance architecture for financial regulation, based on collaboration between EU institutions and national supervisors. Foremost among these was the imbalance between the ‘single passport’ for financial institutions and the weakness of European arrangements for supervisory cooperation, information sharing, and crisis management. But the crisis also underscored the risks of regulatory arbitrage arising from the incomplete harmonization of

rules and supervisory practices across EU Member States. In response, the EU created a new system of European Supervisory Authorities (ESAs) to support the development of a ‘single rulebook’ for each field of financial regulation, including banking, while promoting stronger coordination and convergence among National Competent Authorities (NCAs).

More far-reaching still is the Single Supervisory Mechanism (SSM) for European Banking Union, which has been acclaimed as one of the most significant integration steps since the Maastricht Treaty and the introduction of the euro. Established in 2014 as an authoritative supervisor for eurozone banks under the aegis of the European Central Bank (ECB), the SSM is widely considered to mark a decisive step beyond networked agencies towards supranationalization of EU financial regulation. It was intended to break up the ‘cozy relationships’ between banks and national supervisors, which were deemed to have contributed to the global financial crisis, as well as to cut the ‘doom loop’ between banks and sovereigns, which had become a key source of contagion during the euro crisis.

The SSM, accompanied by the creation of a Single Resolution Mechanism (SRM) as part of the broader Banking Union project, may be considered a case of differentiated integration, nested within the Single Market and EU-wide financial regulation. Participation is obligatory for eurozone countries, but other EU Member States may also apply to join under a system of ‘close cooperation’ with the ECB, as Croatia and Bulgaria have already done. Despite opt-outs for non-Banking

1 Frank Schimmelfennig and Thomas Winzen, *Ever Looser Union? Differentiated European Integration* (Oxford: Oxford University Press, 2020).

2 Charles Sabel and Jonathan Zeitlin, ‘Experimentalist Governance’, in David Levi-Faur (ed.), *The Oxford Handbook of Governance* (Oxford: Oxford University Press, 2012), 169-183; Sabel and Zeitlin (eds.), *Experimentalist Governance in the European Union* (Oxford: Oxford University Press, 2010).

Union Member States, which enabled the project to go ahead, the SSM thus faces significant challenges of internal diversity among its 21 participating countries.

To understand how the SSM manages this diversity while at the same time developing an integrated system of harmonized supervision for eurozone banks, this Policy Brief reports the main findings of a detailed study of the evolution and functioning of its organizational practices, decision-making processes, and institutional structures, based on in-depth interviews with European and national officials, together with a wide range of official documents.³ It uses this material to examine the SSM from three distinct perspectives: first as a centralized hierarchy, seeking to impose and enforce uniform rules, standards, and pro-

cedures across the Banking Union; second, as a polyarchic network, seeking to orchestrate intensive cooperation between the ECB and the NCAs; and finally, as an experimentalist organization, seeking to accommodate and learn from diversity by adapting common rules and procedures to the specificities of individual banks, and revising them regularly through peer review of implementation experience at multiple levels. It argues that the most encompassing perspective is that of the SSM as an experimentalist organization, which integrates and recasts key elements of the other two views into a more comprehensive analysis. The Policy Brief concludes by drawing out some key policy insights from the SSM case for the relationship between uniformity, differentiation, and experimentalism in EU regulation more generally.

The SSM as a Centralized Hierarchy

The SSM was explicitly designed as a more centralized and hierarchical institution than the ESAs. The ECB has final authority to grant and withdraw banking licenses within the SSM, and is directly responsible for supervising the largest and most systematically important eurozone banks. It can also take over supervision of less significant institutions (LSIs) from NCAs where it deems this necessary to ‘ensure consistent application of high supervisory standards’. The SSM is committed to ‘intrusive, hands-on’ supervision of significant credit institutions (SIs), through Joint Supervisory Teams (JSTs) of ECB and national officials, supported by on-site inspection missions and central benchmarking. The SSM has created a large body of detailed and prescriptive internal manuals, operational guides, and guidance

documents to promote harmonization and convergence of supervisory approaches across participating units. It has likewise sought to develop ‘joint supervisory standards’ to steer and harmonize national supervision of LSIs. Such supervisory convergence is considered crucial to advance the SSM’s mission and strategic aims of ‘contributing to the safety and soundness of credit institutions and the stability of the financial system’ while ‘promoting European financial integration’, by reducing opportunities for regulatory arbitrage, removing national barriers to cross-border operations, and ensuring a level playing field for all eurozone banks.

3 Jonathan Zeitlin, “Uniformity, Differentiation, and Experimentalism in EU Financial Regulation: The Single Supervisory Mechanism in Action”, *ACES SSRN Research Paper* 2021-4 (May 31, 2021). Available at SSRN: <https://ssrn.com/abstract=3857077>. Sources for all quotations and references in the text can be found in this paper.

The SSM as a Polyarchic Network

Alongside these centralized hierarchical features, however, the SSM also displays significant heterarchical features that support an alternative view of eurozone banking supervision as a polyarchic network. Thus, all major decisions of the SSM must be approved by its Supervisory Board, where NCA representatives account for 21 of 27 votes. Hence all important SSM initiatives and policies are developed through joint working groups, task forces, and drafting teams convened by ECB divisional networks, but often led by NCA officials. The ECB has never exercised its powers to take over supervision of LSIs from national authorities, and prefers co-development of Joint Supervisory Standards

to the imposition of binding instruments, which are slow and difficult to change. The ECB does not directly employ or control the large numbers of NCA staff involved in off- and on-site supervision through the JSTs and inspection missions. NCAs themselves retain an independent voice on EU banking regulation through their dominant position in the European Banking Authority (EBA), with double majority voting arrangements to safeguard the interests of non-Banking Union member states. The institutional design of the SSM can thus be said to encourage a cooperative rather than a hierarchical approach by the ECB to joint supervision with the NCAs.

The SSM as an Experimentalist Organization

The SSM clearly diverges in a number of significant respects from the classic experimentalist architecture identified in previous studies of EU governance (represented graphically in the Annex). Rather than setting open-ended framework goals and giving national or sub-national actors substantial autonomy to pursue them in ways adapted to their own local circumstances, the SSM has developed increasingly detailed and prescriptive rules and methods, which banking supervisors are expected to apply as consistently as possible across credit institutions and jurisdictions. But within these limits, studying the SSM 'in action' reveals the centrality to its organization of experimentalist practices of learning from diversity, peer review, and continuous revision based on local implementation experience. Adoption of these experimentalist practices flows directly from the SSM's deliberate efforts to adapt its rules, methods, and procedures to banks' diverse business models on

the one hand, and constantly to update them in response to uncertain and rapidly changing markets and technologies on the other.

Thus, despite the SSM's emphasis on regulatory harmonization and supervisory convergence, it does not seek to homogenize banks' business models or impose a one-size-fits-all approach to their supervision. Instead, it seeks to accommodate banking diversity across the eurozone by tailoring common rules and methods to firms' specificities, 'balancing uniform supervisory anchor points with constrained supervisory judgment', while combining the 'deep specific knowledge of national supervisors with the broad-ranging experience of the ECB'. To achieve these objectives, the design of the SSM's supervisory model was itself the outcome of joint deliberation and comparison of national practices by mixed ECB-NCA teams. The development of the JSTs has similarly involved an

intensive process of cross-fertilization and mutual learning among supervisors from different national systems. To foster this multi-perspectival approach to bank supervision, the SSM systematically combines multiple forms of comparison both nationally and cross-nationally through ongoing peer review and benchmarking within and between JSTs, onsite inspectors, and ECB divisional networks.

From the outset, the SSM has sought to engage in ‘forward-looking’ supervision, aimed at identifying emerging prudential risks and threats to financial stability, rather than ‘looking backward towards audited accounts’. Its manuals, guides, and guid-

ance documents are therefore regarded as ‘living documents’, subject to continuous review and improvements’ in light of implementation experience and new developments. Frontline supervisors can and regularly do propose revisions to rules, procedures, and methodologies based on problems and possibilities revealed by local application. The recent reorganization of ECB Banking Supervision, designed to enhance collaboration and break down emerging silos between frontline supervision and horizontal benchmarking and methods services can itself be seen as a higher-level instance of such experimentalist recursive revision.

Conclusions

This Policy Brief has examined the SSM from three distinct perspectives: as a centralized hierarchy, a polyarchic network, and an experimentalist organization. Each of these views highlights important characteristics of the SSM, which need to be incorporated into any comprehensive analysis. But each successive perspective also illuminates critical features obscured by its predecessor. The most encompassing perspective, however, is that of the SSM as an experimentalist organization, which integrates and recasts elements of the other two views into a more complete and dynamic analysis of its evolving architecture and practical operations.

The SSM, as we have seen, was designed as a more centralized institution than the ESAs, while the ECB has officially been given far-reaching hierarchical authority over eurozone banks and NCAs. But as a deeper investigation of the SSM’s governance structure reveals, all major policies and decisions must effectively be agreed by the NCAs, while the supervision of individual banks depends in large measure on tasks carried out by national officials over whom the ECB has no direct hierarchical con-

trol. Even the most eye-catching powers granted to the ECB, such as the right to take over direct supervision of LSIs or to issue binding instructions to NCAs turn out on closer inspection to operate more as a form of experimentalist ‘penalty default’, a last-resort mechanism for inducing reluctant parties to collaborate in joint activities by threatening to impose consequences undesirable for both sides, than as an effective instrument of hierarchical control.

The SSM’s polyarchic governance structure and institutional design mean that the ECB and the NCAs are ineluctably ‘condemned to cooperate’ with one another, a shared fate embodied in the dense web of expert networks, working groups, and drafting teams established to co-develop policies, procedures, and methodologies, as well as in the JSTs and on-site inspection missions themselves. But the ECB and the NCAs created these elaborate joint structures for feeding local supervisory knowledge into the development and application of common methods and procedures not merely because they felt obliged to do so polit-

ically, but also because they considered them functionally essential for tackling the diversity of business models and national conditions across the Banking Union, while adapting to rapid changes in financial markets, technologies, and lending practices. To support a forward-looking approach to supervision under conditions of high uncertainty, the SSM has accordingly instituted a remarkable array of experimentalist processes for recursive revision of policies, methodologies, and procedures through continuous peer review and benchmarking of implementation at multiple levels. Six years after its formation, the SSM has applied these same experimentalist principles of recursive review and revision to its own organizational structure, in order to deepen collaboration between the JSTs, the NCAs, and the ECB's horizontal services, while enhancing its capacities to tailor supervision to banks' individual business models.

A crucial feature of the SSM, which may at first glance to conflict with this experimentalist perspective, is its commitment to the development of uniform rules, methods, and procedures that supervisors are expected to apply as consistently as possible. Such uniformity and consistency, its leaders firmly believe, are crucial to advance the SSM's overarching goals of financial stability and market integration. As we have seen, however,

the SSM does not seek to impose a 'one-size-fits-all' approach on eurozone banks, but rather to calibrate supervision ever more finely to the latter's diverse business models and risk profiles, treating similar institutions similarly and different institutions differently, irrespective of national origin. The development of its supervisory model, along with its core methodologies and procedures, was itself the result of an intensive process of comparison and 'learning from difference' by mixed teams of ECB and national officials. The outputs of these methodologies and procedures, including banks' annual supervisory review and evaluation assessments, are subject to peer review and comparative benchmarking at multiple levels, aimed at clarifying reasons for disagreement, and identifying blind spots and possibilities for improvement, which should be addressed in subsequent iterations. In this process, frontline supervisors regularly challenge their applicability in particular cases, and feed in proposals for changes through joint ECB-NCA networks. The SSM's rules, methodologies, and procedures, together with its broader policies and organization, are thus regularly updated and revised on the basis of learning from comparative review of implementation experience in different local contexts, as in the classic experimentalist governance architecture.

Key Policy Insights

Key Policy Insight # 1

Diachronic Experimentalism as a Condition for Uniform Regulation in the EU

The major difference between the SSM and the classic experimentalist governance architecture is its distinctive combination of synchronic uniformity with diachronic revisability, whereby rules and

procedures are progressively specified, narrowing discretion for lower-level actors at any given moment, but remain fully contestable in light of local application, and subject to recursive revision in light of comparative implementation review. In this respect, the SSM represents an advanced case of a broader trend which can also be observed in other sectors such as chemicals and electricity

regulation,⁴ towards the emergence of simplified experimentalist governance architectures based on a single set of harmonized but provisional rules, revisable through ongoing monitoring and review of local implementation. *The case of the SSM supports the view that under conditions of high interdependence coupled with high uncertainty, uniform rules and practices can be accepted as effective and legitimate by Member States, provided that they are applied in contextually sensitive ways and revised regularly on the basis of local implementation experience, through deliberative procedures in which frontline officials themselves participate. In this sense, the case of the SSM further suggests that far from uniformity and experimentalism being antithetical to one another, diachronic experimentalism may actually be a necessary condition for synchronic uniformity of regulation within a diverse polity like the EU.*

Key Policy Insight #2

Experimentalist Governance and Differentiated Integration as Asymmetrical Complements

The Banking Union is obviously a case of differentiated integration, whose creation would not have been possible without the exclusion of non-euro Member States, especially the UK. But if differentiated integration allowed the Banking Union to move forward initially, it does nothing to address the very substantial challenges of integrating diversity among its members, for which the SSM's experimentalist organization and practices are instead essential. The EBA, whose own peer review and supervisory convergence activities are also conducted on experimentalist lines, likewise provides a vital framework for learning from difference among NCAs across the Banking Union divide in drafting, overseeing, and revising the EU's Single

Rulebook. *The case of EU banking regulation thus suggests that experimentalist governance and differentiated integration may be complementary, but asymmetrically so, in that the latter depends on the former to accommodate diversity within and across separate groups of Member States, but not vice versa.*

Annex:

The Classic Experimentalist Governance Architecture in the EU

Source: Jonathan Zeitlin (ed.), *Extending Experimentalist Governance? The European Union and Transnational Regulation* (Oxford: Oxford University Press, 2015), 2.



⁴ Jonathan Zeitlin, "EU Experimentalist Governance in Times of Crisis", *West European Politics* 39(5): 1073-1094; Bernardo Rangoni, "Electricity Regulation in the European Union: Uniform, Differentiated or Experimentalist?" Amsterdam Centre for European Studies (ACES) SSRN Research Paper No.2020/07. Available at SSRN: <https://ssrn.com/abstract=3617959>.