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BANKING UNION AND THE RISK-CONTROL NEXUS: A GUIDING STAR

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A INTRODUCTION

A rising tide may lift all boats, but, as the European Union (EU) discovered in painful fashion, it may also conceal submerged hazards. A long period of European growth and integration was thrown into reverse in the late 2000s as the Union was buffeted first by the Global Financial Crisis and later by the Eurozone Sovereign Debt Crisis. As the tide drained out, the instability of Europe's financial infrastructure was revealed: a system sufficiently integrated so as to allow the spread of contagion, yet not so integrated as to allow for the effective diversification of risk.

The EU is no stranger to catastrophe. The history of its construction is a story of crisis and repair, as befits a polity born from the ashes of post-war Europe. On this occasion, Europe's response was to call for the integration of the bloc's financial sector into 'a genuine economic and monetary union': a Banking Union.[1] Risk was to be diversified across borders, '[putting] an end to the era of massive bailouts paid by taxpayers and [helping to] restore financial stability'.[2] The nexus between bank and state would be shattered; no bank would be too big to fail. A stronger, more resilient European banking industry would emerge from the devastation of the crisis, capable of financing its own resolutions and providing the real economy with adequate credit without destabilising it.

This article submits that effective application of the new resolution procedures and the introduction of a common deposit insurance scheme – the incomplete elements of Banking Union – can only be achieved by recalibrating the project to take account of the risk-control nexus: risk must be spread equally between the economies of all Member States in return for the centralisation of control at European level. Whether by accident or design, this principle was at the heart of early successes, just as it was absent during reverses and stagnation.

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1 Herman Van Rompuy, (European Council, 2012) EUCO 120/12, 4 <https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf> accessed 24 March 2022.

2 European Commission, 'Updated Version of First Memo Published on 15/04/2014 – Banking Union: Restoring Financial Stability in the Eurozone' (2015) MEMO 14/294.

Returning to the path illuminated by this guiding star will allow for the ultimate realisation of Banking Union.

Section B will explore the weaknesses in European financial infrastructure exposed by the Global Financial Crisis and Sovereign Debt Crisis, with a particular focus on those aspects of the regime to be patched up by common deposit insurance and harmonised resolution procedures. Section C will delineate the architecture of this new regime while introducing the concept of the risk-control nexus. Section D will illustrate that the effective operation and full implementation of Banking Union is undermined where risk and control are allocated inappropriately. Section E details how bilateral relations have come to supervene the Commission as a vehicle for reform and suggests that a renewed focus on the risk-control nexus could pave the way for agreement on resolution and deposit insurance.

B CRISIS

The trouble with European banks began with the Global Financial Crisis. The bursting of a localised bubble in the American housing market spread through the use of derivative instruments, the opacity of which rendered the ultimate magnitude and location of losses uncertain.[3] Uncertainty in the international financial system turned to panic with the collapse of Lehmann Brothers. Inter-bank money markets effectively shut down, causing a crisis of liquidity.[4] A corresponding reduction in lending deepened the contractionary forces dragging the wider economy down. National governments were faced with the unpalatable choice of allowing credit institutions to fail, risking further financial contagion, or injecting public money to save banks deemed 'too big to fail'. While some banks were allowed to go under, such as German lender WestLB, many were not.[5] At the high-water mark of 'too big to fail' thinking in late 2008, the European Council resolved to support major financial institutions with the requisite liquidity and capital to enable them to continue lending.[6]

Those states that opted to assume the liabilities of distressed institutions found their fate inextricably linked to that of their banking industry, giving rise to a 'bank-sovereign nexus'

[3] The de Larosiere Group, 'Report of the High Level Group on Financial Supervision in the EU' (Brussels, 25 February 2009) <https://ec.europa.eu/economy_finance/publications/pages/publication14527_en.pdf> accessed 24 March 2022.
[4] ibid.
[5] James Wilson, 'Brussels Backs WestLB Break-up Plan' *Financial Times* (Frankfurt, 20 December 2011) <https://www.ft.com/content/03985dda-2afb-11e1-8a38-00144feabdc0> accessed 24 March 2022.
[6] European Council, 'Presidency Conclusions – Brussels, 15 and 16 October 2008' (2008) 14368/08 <https://data.consilium.europa.eu/doc/document/ST-14368-2008-INIT/en/pdf> accessed 24 March 2022.

that operated to the detriment of both.[7] When markets lost confidence in the ability of these nations to meet repayments, a banking crisis developed into a sovereign debt crisis.[8] Discrepancies had developed in the funding of national deposit guarantee schemes, which guarantee the repayment of deposits to customers of participating institutions in the event of bank failure and are funded by the institutions themselves.[9] These discrepancies were cruelly exposed by deposit guarantee scheme arbitrage, with peripheral Member States that operated less well-funded schemes experiencing withdrawals of capital approaching bank run conditions. As governments are the backstop to deposit insurance, the bank-sovereign nexus operated to the disadvantage of both.

Faced with the seismic implications of sovereign default, the European Financial Stability Facility, the European Central Bank (ECB), and the International Monetary Fund elected to bail out the stricken nations, forcing them into economic adjustment programmes that heaped further misery on their hapless citizens.[10] While many factors conspired to bring these nations to ruin, three deserve specific attention: inadequate supervision; chaotic resolutions; and localised risk concentrations, particularly in deposit insurance.

C THE NEW REGIME

As the crisis receded, the Commission began to plot for deeper financial integration through a 'Banking Union' of Eurozone countries (plus Bulgaria and Croatia)[11] that would strengthen the credit sector and restore confidence in the euro.[12] At this stage, Europe's institutions provided all of the initiative for reform. The crux of these reforms was a wholesale transfer of banking policy from the national to the EU level. Supervisory authority was shifted from

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[7] Martin Sandbu, 'Banking Union Will Transform Europe's Politics' *Financial Times* (London, 25 July 2017) <https://www.ft.com/content/984da184-711c-11e7-aca6-c6bd07df1a3c> accessed 24 March 2022.

[8] Fabio Panetta, 'The Impact of Sovereign Credit Risk on Bank Funding Conditions: Report Submitted by a Study Group Established by the Committee on the Global Financial System' (Bank for International Settlements, 2011) CGFS Papers: No 43 <https://www.bis.org/publ/cgfs43.html> accessed 24 March 2022.

[9] The operation of these schemes was mandatory in all EU Member States: Council Directive (EC) 94/19 of 30 May 1994 on Deposit-Guarantee Schemes [1994] OJ L 135/5.

[10] Commission Directorate-General for Economic and Financial Affairs, 'Economic Adjustment Programme for Ireland' (Occassional Papers 76, February 2011) <https://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp76_en.pdf> accessed 24 March 2022.

[11] Decision 2020/1015 of the European Central Bank on the establishment of close cooperation between the European Central Bank and Българска народна банка (Bulgarian National Bank) [2020] OJ L 224 I/1 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020D1015> accessed 24 March 2022; Decision 2020/1016 of the European Central Bank on the establishment of close cooperation between the European Central Bank and Hrvatska Narodna Banka' [2020] OJ L 224 I/4 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020D1016> accessed 24 March 2022.

[12] José Manuel Barroso, 'State of the Union 2012 Address' Speech/12/596 (Plenary Session of the European Parliament, Strasbourg, 12 September 2012) <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_12_596> accessed 24 March 2022.

national competent authorities to the ECB under a new centralised Single Supervisory Mechanism as quid pro quo for access to pan-European crisis funding under the Single Resolution Mechanism. The Bank Recovery and Resolution Directive established new rules designed to make public bailouts less frequent. A European Deposit Insurance Scheme was also proposed (revisited in Section D).

The Bank Recovery and Resolution Directive establishes a framework to guide competent authorities in their treatment of a failing bank. This was designed to remove Member States' discretion to offer ad hoc rescue packages of the kind that categorised the crisis years. Under this Directive, a bank certified as 'failing or likely to fail' will be wound up under normal national insolvency laws, unless it is determined that the bank provides critical functions essential for economic stability, such that resolution would be in the public interest.[13] In that case, liability for the costs of resolution is shifted away from taxpayers and onto the banking industry to the furthest extent possible.[14] In so far as possible, resolutions should be conducted by the private sector. A new 'bail-in' mechanism allows for indebted banks to continue as a going concern with minimal disruption to ordinary depositors through the write-down of liabilities and/or their conversion to equity.[15] Shareholders and large investors will be exposed to losses first, with deposits under €100,000 protected by the Deposit Guarantee Scheme Directive.[16]

The Single Resolution Mechanism has applied the Bank Recovery and Resolution Directive within the Eurozone since 2016.[17] The mechanism is operated by the Single Resolution Board, which consists of several permanent members and representatives of the relevant national resolution authorities, as well as the ECB. It handles the resolution of credit institutions in participating Member States that have been deemed 'failing or likely to fail' and whose resolution is determined to be in the public interest.[18] Where appropriate, the Single Resolution Board may use the emergency Single Resolution Fund to provide interim aid, such as guarantees or loans, to ensure functions critical to financial stability and the overall economy can continue. This fund is financed by contributions levied from the banking industry itself. It

[13] Council Directive (EU) 2014/59/EU of 15 May 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms [2014] OJ L 173/190.
[14] ibid.
[15] European Commission (n 2).
[16] Council Directive (EU) 2014/49/EU of 16 April 2014 on Deposit Guarantee Schemes [2014] OJ L 173/149.
[17] Council Regulation (EU) 806/2014 of 15 July 2014 Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L 225/1.
[18] ibid.

cannot be used to absorb the losses of an institution or to provide for its recapitalisation.[19] EU leaders struck an agreement on the introduction of a Common Backstop to the Single Resolution Fund late in 2020, doubling its emergency lending capacity and enhancing the credibility of its guarantees.[20]

The only bank resolved under the Single Resolution Mechanism thus far is Spain's Banco Popular, which was declared 'failing or likely to fail' as a result of liquidity issues on 6 June 2017 (revisited in Section D).[21] The Single Resolution Board and Spain's Autoridad de Resolución Ejecutiva (the national competent authority) moved rapidly to formulate a resolution scheme under which the bank's debt was converted to equity and sold to Banco Santander, a national rival, for €1. Customers were unaffected by the takeover, with Banco Popular operating under normal business conditions as a solvent and liquid member of the Santander Group the very next day.[22] No contagion was observed in debt and equities markets.[23] Crucially, taxpayers were not made liable for the bank's failure. The resolution was loudly trumpeted as a vindication of the Banking Union project.[24]

The Single Supervisory Mechanism became operational in 2014 with the passing of the Single Supervisory Mechanism Regulation.[25] In essence, the Single Supervisory Mechanism delegates the supervisory functions of national central banks to the ECB, which will impose a harmonised approach to supervision, unfettered by non-prudential considerations.[26] Specific tasks relating to prudential supervision of credit institutions, such as requiring credit institutions to maintain certain levels of capital or to limit their exposure to individual counterparties, are now vested in the ECB.[27] The most significant banks are supervised directly

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[19] European Commission, 'A Single Resolution Mechanism for the Banking Union – Frequently Asked Questions' (2014) MEMO 14/295 <https://ec.europa.eu/commission/presscorner/detail/en/MEMO_14_295> accessed 24 March 2022.

[20] European Council, 'Statement of the Eurogroup in Inclusive Format on the ESM Reform and the Early Introduction of the Backstop to the Single Resolution Fund' Press Release 839/20 (30 November 2020) <https://www.consilium.europa.eu/en/press/press-releases/2020/11/30/statement-of-the-eurogroup-in-inclusive-format-on-the-esm-reform-and-the-early-introduction-of-the-backstop-to-the-single-resolution-fund/> accessed 24 March 2022.

[21] Camille de Rede, 'The Single Resolution Board Adopts Resolution Decision for Banco Popular' (Brussels, 7 June 2017) <https://www.srb.europa.eu/en/node/315> accessed 24 March 2022.

[22] ibid.

[23] Alessia Giustiniano, 'How Banco Popular Failed' *Financial Times* (London, 4 July 2017) <https://www.ft.com/video/4b79ca83-9e35-483a-b2d6-357268a886be> accessed 24 March 2022.

[24] FT View, 'Banco Popular Process is a Model for Failing Banks' *Financial Times* (London, 08 June 2017) <https://www.ft.com/content/99a2e27c-4c48-11e7-919a-1e14ce4af89b> accessed 24 March 2022.

[25] Council Regulation (EC) 1024/2013 of 15 October 2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions [2013] OJ L 287/63.

[26] ibid recital 12.

[27] ibid recital 23.

by the ECB, with the remainder subject to the supervision of their national central banks.[28] The operation of this mechanism could be observed in the ECB's direction that Irish banks reduce the level of non-performing loans on their balance sheets in 2018, which was deemed a risk to financial stability.[29]

When assessed as a constituent pillar of Banking Union, the true value of the Single Supervisory Mechanism becomes apparent. Supervisory harmonisation under this mechanism enables an historic mutualisation of risk under the Single Resolution Fund and European Deposit Insurance Scheme (considered further in Section D). Healthy credit institutions contributing to the resolution of a distressed bank can be satisfied that it was subject to equivalent rules and supervision, while national governments can cede supervisory power without remaining liable for bank failure.[30] The bank-sovereign nexus is weakened, as trigger-happy governments will no longer be so free to inject taxpayer money into struggling credit institutions. The elegance of this arrangement sidesteps the spectre of moral hazard: the fear that an entity will behave without regard to risk because it will not suffer any consequences. This is the central compromise of Banking Union: risk diversification in exchange for the centralisation of control at a European level.

D FALLING SHORT

Conceptual elegance aside, the real-world application of Banking Union has been somewhat short of inspiring. Away from the offices of the Commission, national governments have demonstrated a stubborn tendency to resist the new diktats of non-intervention. Meanwhile, disagreement over the appropriate allocation of risk and control have frustrated efforts to implement the final pillar of Banking Union, the European Deposit Insurance Scheme.

The Italian government has proven singularly determined to resist the bail-in requirements under Bank Recovery and Resolution Directive, instead preferring to rely on a series of legal fudges to inject taxpayer money into struggling banks. This was particularly clear in the

[28] The ECB directly supervises 115 of the most significant banks in the eurozone, with inclusion depending on size, economic importance, cross-border activities, and previous applications for aid from the European Stability Mechanism/European Financial Stability Facility. A bank is also significant if it is one of the three most significant established banks in a country. All Irish banks are supervised directly by the ECB because of their economic importance to the country: European Central Bank, 'What Makes a Bank Significant?' (2022) <https://www.bankingsupervision.europa.eu/banking/list/criteria/html/index.en.html> accessed 24 March 2022.
[29] Arthur Beesley, 'Ireland's Banking Sector Steps Up Drive to Sell Soured Loans' *Financial Times* (Dublin, 22 August 2018) <https://www.ft.com/content/1899a8f4-a512-11e8-8ecf-a7ae1beff35b> accessed 24 March 2022.
[30] Aneta Spendzharova, 'Is More "Brussels" the Solution? New European Union Member States' Preferences About the European Financial Architecture' (2012) 50(2) Journal of Common Market Studies 315.

treatment of two Veneto based institutions, Banca Popolare di Vicenza and Veneto Banca, certified by the ECB as 'failing or likely to fail' just weeks after the resolution of Banco Popular.[31] The Single Resolution Board determined that resolution was not in the public interest, as the banks did not provide critical functions and their failure was not expected to have a significant adverse impact on financial stability.[32] Their liquidation was thus remitted back to the national authorities, who promptly activated a public interest clause to assume bad debts worth €17 billion. The best portions of both banks were sectioned off and sold to a well-capitalised national bank, Intesa Sanpaolo.[33] Deemed so insignificant as not to warrant rescue by the Single Resolution Board, these banks survived because of their particular importance to the Veneto region,[34] as well as the unusually high level of ownership of bank bonds among Italian retail investors.[35] The architects of Banking Union set out to end 'too big to fail'; they did not reckon with the pernicious effect of 'too small to fail'.[36]

Italy exhibited a similar attitude in its dealings with Banca Monte Paschi di Siena, the world's oldest bank, which was subject to a precautionary recapitalisation in 2017.[37] Precautionary recapitalisation is an extraordinary procedure that allows for a partial state bailout, without full bail-in, where a bank has been shown to be solvent but ill-prepared for adverse conditions.[38] The fruits of this €5.4 billion expenditure proved rotten; the government failed to divest itself of its shares in the bank ahead of the EU imposed deadline at the end of 2021.[39] The courted

[31] European Central Bank, 'ECB Deemed Veneto Banca and Banca Popolare di Vicenza Failing or Likely to Fail' (23 June 2017) <https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html> accessed 24 March 2022.

[32] Sergio Dos Santos Bernardo E Amaro, 'The SRB Will Not Take Resolution Action in Relation to Banca Popolare di Vicenza and Veneto Banca' *Single Resolution Board* (23 June 2017) <https://www.srb.europa.eu/en/node/341> accessed 24 March 2022.

[33] FT Reporters, 'Why Italy's €17bn Bank Rescue Deal is Making Waves across Europe' *Financial Times* (London, 26 June 2017) <https://www.ft.com/content/03a1c7d0-5a61-11e7-b553-e2df1b0c3220> accessed 24 March 2022.

[34] Lucrezia Reichlin, 'The European Banking Union Falls Short in Italy' *Financial Times* (London, 27 June 2017) <https://www.ft.com/content/3b8bc570-5a7e-11e7-b553-e2df1b0c3220> accessed 24 March 2022.

[35] Italian retail investors owned approximately one-third of the €600 billion bank bonds in issuance in in 2016; International Monetary Fund, 'IMF Executive Board Concludes 2016 Article IV Consultation with Italy' IMF Country Report No 16/329 (July, 2016) <https://www.imf.org/external/pubs/ft/scr/2016/cr16222.pdf> accessed 24 March 2022.

[36] Angelo Messore, 'How State Aid Survived the Italian Banking Crisis' (*Lexology,* 20 September 2017) <https://www.lexology.com/library/detail.aspx?g=18229e16-c0b0-4523-96f1-18ff2f6069ab> accessed 24 March 2022.

[37] Alex Barker and Rachel Sanderson, 'Brussels and Rome Seal Rescue Deal for Monte dei Paschi' *Financial Times* (Brussels, Milan, 1 June 2017) <https://www.ft.com/content/3c6e3cb8-46ae-11e7-8519-9f94ee97d996> accessed 24 March 2022.

[38] European Central Bank, 'What is a Precautionary Recapitalisation and How Does it Work?' (27 December 20 16) <https://www.bankingsupervision.europa.eu/about/ssmexplained/html/precautionary_recapitalisation.en.html> accessed 24 March 2022.

[39] Davide Ghiglione, 'Italy, Unicredit Talks Over Sale of Monte dei Paschi Collapse' *Financial Times* (Milan, 24 October 2021) <https://www.ft.com/content/5446c2f2-4fed-4894-bf7f-7b1b884e9607> accessed 24 March 2022.

private buyer, UniCredit, appears to be holding out for the state to assume Monte Paschi's bad debts in exchange for its takeover of the healthy components of the bank, in line with the precedent set in the resolution of the Veneto banks.[40]

Outraged German commentators regarded Banking Union as having been discredited by this saga, and labelled the sorry affair 'a grave mistake'.[41] Their faith in the promises of peripheral Member States to embrace reform of their financial sectors was shaken, setting back efforts to complete financial integration and introduce a European Deposit Insurance Scheme.[42] The resolve of the Single Resolution Board and of the Commission to stand up to national governments and implement bail-in was called into question. The successful resolution of Banco Popular was no salve to the complaints of detractors; the presence of a willing and suitably well capitalised private buyer obviated the need for any contentious decisions regarding commitments made to senior bondholders and large depositors.[43]

The continued absence of a European Deposit Insurance Scheme – a mooted pan-European deposit guarantee scheme – represents another Banking Union failure. While the 2014 Deposit Guarantee Scheme Directive mandated a higher minimum threshold of deposit protection up to €100,000, the degree to which these schemes are funded continues to vary between Member States.[44] Recall that Section B outlined how these variances contributed to the toxic bank-sovereign nexus that dragged the economies of certain Member States into meltdown. Banks in peripheral Member States were effectively penalised for the delinquency of their colleagues, preventing them from competing on a level playing field.

The European Deposit Insurance Scheme, the third pillar of Banking Union, was designed to turn the page on this issue definitively. First proposed in 2010, and again in 2015, the Commission proved unable to calibrate a European Deposit Insurance Scheme in such a manner as to vanquish the spectre of moral hazard. Core Member States, particularly Germany,

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[40] Rachel Sanderson, 'No More Time for Extend and Pretend on Monte Paschi' *Bloomberg* (New York, 2 November 2021) <https://www.bloomberg.com/opinion/articles/2021-11-02/for-mario-draghi-and-europe-no-more-time-for-extend-and-pretend-on-monte-paschi> accessed 24 March 2022.

[41] Jim Brunsden, 'Berlin Leads Backlash against Italian Bank Rescue' *Financial Times* (Brussels, 26 June 2017) <https://www.ft.com/content/71ece778-5a53-11e7-9bc8-8055f264aa8b> accessed 24 March 2022.

[42] ibid.

[43] Reichlin (n 34).

[44] Deposit-Guarantee Schemes Directive (n 16); The Cypriot Σύστημα Εγγύησης των Καταθέσεων και Εξυγίανσης Πιστωτικών και Άλλων Ιδρυμάτων has the means to cover 0.29% of covered deposits, significantly below its target of 0.8%. By way of contrast, the corresponding figure Finland's Talletussuojarahasto was 0.87% in 2020, above its target of 0.8%; see European Banking Authority, 'Deposit Guarantee Schemes Data' <https://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/deposit-guarantee-schemes-data#collapse16-1> accessed 24 March 2022.

opposed a pan-European deposit guarantee scheme on the grounds of excessive risk taking and profligacy in those Member States likely to avail of a European Deposit Insurance Scheme.[45] Against intractable national opposition, Eurocrats had no answers. A decade born in the shadow of financial meltdown limped to a close without having implemented the reforms that might prevent the same.

E A PATH FORWARD

An article written in early 2017 labelled the looming confrontation between Italy and the EU as a 'make-or-break moment' for Banking Union.[46] The contemplated public bailouts of Italy's banks came to pass. Banking Union bent before it broke. While the strict application of 'bail-in' demanded by critics would have yielded a certain satisfaction, a more pragmatic view recognises that such a course of action would not have been to the advantage of financial convergence. In a region already prone to Euroscepticism, would providing a genuine example of European arbitrariness and inflexibility really have contributed to long-term integration?[47] Italy's actions should be understood in the context of a Banking Union that was not delivering on its central compromise with national governments. Control was exercised at the local level, in contravention of the spirit of the Bank Recovery and Resolution Directive, because risk was concentrated at the local level. The solution to inconsistent application of the rulebook is not less Banking Union, but more.

A revolutionary proposal by then German finance minister Olaf Scholz in late 2019 offered just such a solution. This diluted 'reinsurance' scheme would see depleted national schemes able to borrow from a European Deposit Insurance Scheme under the authorisation of the Single Resolution Board.[48] Any costs exceeding a certain threshold would have to be met by the Member State.[49] This concession in risk-diversification was linked to a control element:

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[45] Commission, 'Proposal for a Directive on Deposit Guarantee Schemes' COM (2010) 0368 final; Commission, 'Proposal for a Regulation of the European Council and of the Council amending Regulation (EU) 806/2014 in Order to Establish a European Deposit Insurance Scheme' COM (2015) 0586 final; Jim Brunsden, 'Germany Warnson Eurozone Bank Deposit Plan' *Financial Times* (Brussels, 8 December 2015) <https://www.ft.com/content/76a651b8-9db8-11e5-b45d-4812f209f861> accessed 24 March 2022.
[46] Alex Barker, 'A Make-Or-Break Moment for Europe's Rules on Bank Crises' *Financial Times* (London, 11 January 2017) <https://www.ft.com/content/dc16c063-ab4a-302f-ba65-1426e357c59f> accessed 24 March 2022.
[47] The anti-euro Northern League was victorious in the 2015 Veneto regional election, see James Politi, 'Matteo Renzi Suffers Set Back in Italy's Regional Elections' *Financial Times* (Rome, 1 June 2015) <https://www.ft.com/content/26c65c08-0824-11e5-85de-00144feabdc0> accessed 24 March 2022.
[48] Olaf Scholz, 'Germany Will Consider EU-wide Bank Deposit Reinsurance' *Financial Times* (London, 5 November 2019) <https://www.ft.com/content/82624c98-ff14-11e9-a530-16c6c29e70ca> accessed 24 March 2022.
[49] ibid.

the harmonisation of insolvency procedures and the reduction of risk. The latter was to be achieved by increasing the risk-weighting of debt issued by one's own sovereign, which traditional accounting frameworks recognise as zero-risk.[50] These are sensible measures. Negative interest rates and tight controls on dividend payments have incentivised banks to purchase sovereign bonds.[51] Given the known proclivity of domestic institutions to exhibit a 'home bias' for the debt of their sovereign, such excess liquidity could result in risk concentrations giving rise to a fresh bank-sovereign doom-loop.[52]

These proposals were well received by commentators, but were rejected by Italy, which demanded either a 'eurobond' or some other alternative safe asset for its banks to hold.[53] Failure to reach an agreement on this occasion should not obscure the significance of this proposal. First, the ideological barrier to common deposit insurance was removed; second, national governments wrested the mantle of reform from Europe's institutions to become the primary actors shaping Banking Union. The path towards full implementation of Banking Union is now clear; all that is required is one last surge from Member States.

F CONCLUSION

Though Scholz's proposal was rejected in 2019, recent events have paved the way for a settlement. The Recovery and Resilience Facility allows for debt financed spending on a European level to the tune of €390 billion in grants to support recovery from the Covid-19 pandemic and aid climate transition.[54] This fund shattered an ideological glass-ceiling, paving the way for further financial integration. Bonds issued under this facility could break the deadlock on common deposit insurance by serving as an alternative safe asset for banks seeking to invest their reserves.[55]

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[50] ibid.

[51] Martin Arnold, 'Italian and French Banks Revive "Doom Loop" Fears with Bond Buying' *Financial Times* (Frankfurt, 6 April 2021) <https://www.ft.com/content/fde7833a-8283-45b8-97ae-9104e1c974cd> accessed 24 March 2022.

[52] European Central Bank, 'Home Bias in Bank Sovereign Bond Purchases and the Bank-Sovereign Nexus' (2016) Working Paper 1977 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1977.en.pdf> accessed 24 March 2022.

[53] Rebecca Christie, 'Scholz's Improved Plan to Complete the Banking Union' *Bruegel Institute* (Brussels, 8 November 2019) <https://www.bruegel.org/2019/11/scholzs-improved-plan-to-complete-the-banking-union/> accessed 24 March 2022; Martin Sandbu, 'Italy Emerges as Biggest Obstacle to Eurozone Banking Union' *Financial Times* (London, 13 January 2020) <https://www.ft.com/content/b9dea3b6-3384-11ea-a329-0bcf87a328f2> accessed 24 March 2022.

[54] Editorial, 'A Chance to Press on with EU Banking Union' *Financial Times* (London, 2 December 2020) <https://www.ft.com/content/8f91f48f-ce5d-48d5-998d-b8d714dbdab7> accessed 24 March 2022.

[55] Martin Arnold, 'EU Recovery Fund Deal Revives Hopes for Eurozone Banking Union' *Financial Times* (Frankfurt, 24 July 2020) <https://www.ft.com/content/ba437551-d19c-4557-8920-2187549a615e> accessed 24 March 2022.

The realities of a shifting world order have prompted a renewed emphasis on the strategic autonomy of Europe, which demands that the bloc protect and disseminate its standards while ensuring that it is a capable guarantor of its own stability.[56] The EU is determined to strengthen its financial sector following Brexit, with European Commissioner for Financial Stability, Financial Services and the Capital Markets Union, Mairead McGuinness, speaking in terms of 'vulnerability' and of the EU's being 'captured' by a system it does not regulate or supervise.[57] Also of significance was Olaf Scholz's ascendance to the German Chancellery in late 2021. The new coalition's agreement for government contains a commitment to implement a European reinsurance scheme in line with his earlier proposals.[58] While this proposal may not diversify risk to the same extent as a full pan-European deposit insurance scheme, it would amount to a tangible achievement. Politics is, after all, the art of the possible. The fact that Banking Union is ultimately a political struggle, not a sandbox-like exercise in constructing a perfect financial architecture, was lost on the Commission; as the project began to tread on more contentious areas, a national backlash was inevitable. Settlements reached in the current phase of bilateral reform will ultimately be founded on the consent of constituent states, promising a more stable and effective Banking Union.

From conception to (partial) realisation, the life of Banking Union has been one of complexity and frustration. Belying this complexity, the project can ultimately be reduced to one central compromise: diversify risk away from individual Member States in exchange for governments relinquishing the levers of control over credit institutions. Whether by accident or design, the initial drive for Banking Union managed to strike an appropriate balance between these two considerations in implementing the Single Supervisory Mechanism and Single Resolution Mechanism. Failure to introduce common deposit insurance and other risk diversification policies prompted failure of the control element in Italy's application of the Bank Recovery and Resolution Directive. In turn, failure to link proposals for common deposit insurance to a satisfactory control element resulted in their defeat. Scholz's scheme marks a return to the risk-

[56] European Council, 'Strategic Autonomy for Europe - The Aim of Our Generation' (28 September 2020) <https://www.consilium.europa.eu/en/press/press-releases/2020/09/28/l-autonomie-strategique-europeenne-est-l-objectif-de-notre-generation-discours-du-president-charles-michel-au-groupe-de-reflexion-bruegel/> accessed 24 March 2022.
[57] Sam Fleming and Jim Brunsden, 'EU Cannot Be "Captured" by City of London, Warns Financial Services Chief' *Financial Times* (Brussels, 16 December 2020) <https://www.ft.com/content/5b706fd6-48b5-4b0f-8503-9c7423a93072> accessed 24 March 2022.
[58] Bündnis für Freiheit, Gereichtigkeit, Nachhaltigkeit, *Mehr Fortschritt Wagen* (Koalitionsvertrag 2021-2025) 168 <https://www.spd.de/fileadmin/Dokumente/Koalitionsvertrag/Koalitionsvertrag_2021-2025.pdf> accessed 24 March 2022.

control principle. The ultimate realisation of Banking Union is within reach. The guiding star illuminates the way.