The role of the EU institutions in establishing the banking union. Collaborative leadership in the EMU reform process

Bodil Nielsen & Sandrino Smeets

To cite this article: Bodil Nielsen & Sandrino Smeets (2018) The role of the EU institutions in establishing the banking union. Collaborative leadership in the EMU reform process, Journal of European Public Policy, 25:9, 1233-1256, DOI: 10.1080/13501763.2017.1285342

To link to this article: https://doi.org/10.1080/13501763.2017.1285342

© 2017 The Author(s). Published by Informa UK Limited, trading as Taylor & Francis Group

Published online: 03 Feb 2017.

Article views: 1504

Citing articles: 4 View citing articles
The role of the EU institutions in establishing the banking union. Collaborative leadership in the EMU reform process

Bodil Nielsen and Sandrino Smeets

Directorate General Economic Affairs and Competitiveness, Council of the European Union, Brussels, Belgium; Department of Political Science, Aarhus University, Aarhus, Denmark; Institute for Management Research, Radboud University, Nijmegen, the Netherlands

ABSTRACT
This article analyses the role of the EU institutions in guiding the EMU reform process. Many have argued that the institutions have had to adapt to a ‘constraining’ environment in which EU negotiations are highly salient and touch upon ‘core state powers’. To explain how they have been adapting, we provide a detailed process tracing analysis of their role in setting up the banking union. We use insights from principal-agent (PA) theorizing, but extend this framework to account for situations in which there are multiple agents. The analysis shows that in spite of overlapping interests, functional imperatives and a crisis atmosphere, there was nothing inevitable about the banking union. It came about through new patterns of institutional collaboration at different stages and between different levels of decision making. We explore the implications of this type of collaborative leadership at the level of agents, arenas, process and substance.

KEYWORDS Banking union; economic and monetary union; EU institutions; European integration; leadership; principal-agent theory

Introduction
There has been much debate about the role of the EU institutions in managing the euro crisis and EMU reform process. Many have pointed out that the institutions struggled in the early years of the crisis (Bastasin [2012]; Pisani-Ferry [2014]; Wallace [2015]). Scholars generally agree that they had to adapt to a difficult (‘constraining’) environment in which EU negotiations were highly salient in many member states and touched upon ‘core state
powers’ (Bickerton et al. [2015]; Genschel and Jachtenfuchs [2014]; Hooghe and Marks [2009]; Schimmelfennig [2014]).

This article intends to shed light on how the institutions have been adapting. We provide a process tracing analysis of the establishment of the banking union (Beach and Pedersen [2013]: 63–67) and use it to flesh out the institutions’ individual roles and their joint ability to provide leadership. The literature on EMU reform has placed great emphasis on competition between institutions, and on the rivalry between the European Council presidency and Commission in particular (Bauer and Becker [2014]; Chang [2013]; Fabbrini [2013]). Instead, we argue that the banking union revealed the heightened interdependence between the intergovernmental and supranational institutions, which had far-reaching implications for how the process was set up and managed. We contend that new institutional leadership is less about being ‘the engine’ and more about ‘laying out tracks’ (cf. Hodson [2013]).

Some of these implications have already been hinted at in the literature on the banking union. De Rynck (2016) highlights the guiding role of the ECB in getting the project on the agenda. Epstein and Rhodes (2014, 2016) point to the opportunities to engage in ‘venue-shopping’: strategically switching between different levels of decision-making. The analyses of Howarth and Quaglia (2013, 2014) reveal the mix of intergovernmental and supranational elements in the decision-making processes regarding the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). The literature, however, comes to different conclusions about the ability of the institutions to provide leadership in these negotiations. Epstein and Rhodes argue ‘that Europe’s supranational institutions have taken advantage of the crisis to push through reforms that fundamentally contradict the perceived interests of many member states’ (Epstein and Rhodes [2014]: 6). Hennessy, on the other hand, maintains that the EU institutions acted mostly as ‘facilitators’ and that member states determined the design of financial supervision (Hennessy [2014]: 154–155). Donnelly (2014, 2016) even draws a link between the EU’s prevailing intergovernmentalism and the generally disappointing results in terms of providing financial stability.

This article does not discuss all the institutional actions that contributed to the launch of the banking union. Instead, we focus on the key moments at which the negotiations could have stalled or even collapsed. We explain how the institutions were jointly able to keep the process going. In the next section, we present and explain the concept of collaborative leadership, using insights from principal-agent (PA) theory. We explore the implications of collaborative leadership on four dimensions of the decision-making process: agents, arenas, process and substance. The subsequent process tracing analysis fleshes out the interplay and division of labour between the different institutions in detail. In the conclusion, we discuss some of the limits of collaborative leadership, in terms of overall autonomy and individual control.
Analytical framework: Multiple agents in a constraining environment

In classic EU integration theory, institutional leadership is generally equated with supranational entrepreneurship (Haas [1958]; Moravcsik [1999]). The Commission, together with the European Parliament (EP) and European Court of Justice (ECJ), are conceptualized as the ‘engines’ of further EU integration (Pollack [2003]). Leadership thus refers to the ability to drive the machinery forward, with a sense of purpose and towards a relatively clearly defined goal, of the type provided by the (first and second) Delors Commission in the run-up to the Single European Act and the Treaty of Maastricht (Beach [2005]). Over the years, the ‘Delors type of leadership’ might have become a somewhat unfortunate model of a power-hungry Commission ‘hard wired to pursue ever closer union’ (Peterson [2015]: 187–188). In the post-Maastricht era, the possibilities for such entrepreneurship are more limited. As the EU has moved into more sensitive and salient issue-areas, such as fiscal policy or economic governance, its member states have become more wary of transferring competences and the Commission has been less able to fulfil its traditional role.

New intergovernmentalism (NI) highlights some of the post-Maastricht developments, in particular the different patterns of delegation from the member states (principals) to the institutions (agents). NI takes as its point of departure the claim of ‘integration without supranationalization’ (Bickerton et al. [2015]: 706). It argues that the significant extension of the EU’s policy agenda has not been accompanied by a similar transfer of decision-making powers to the central level. Instead, the Community method had to give way to governance by means of intergovernmental coordination, pivoting around the European Council and the Council of Ministers (Fabbrini [2013]: 1005; Mény [2014]: 1340). The increased involvement of the intergovernmental levels is often seen as a challenge to the supranational institutions in particular, and to the functioning of the EU in general (Bauer and Becker [2014]; Chang [2013]; Puetter [2014]). Somewhat overlooked is the potential for inter-institutional collaboration across the divide. In the EMU reform process, this took the shape of high-level political cooperation between the Presidents of the involved institutions – but there was also active cooperation, for instance in the drafting of specific reform measures, at cabinet and services levels.1

To explore the implications of having multiple agents operating in a constraining environment, we use insights from principal-agent (PA) theory. While PA theorizing focuses on the interplay between principals and their agents, the emphasis is generally on the acts of delegation by, and the control mechanism of, the principals (Hawkins et al. [2006]). Agent autonomy or discretion is seen as deliberately granted and conditional (Pollack [2006]:
Agents will attempt to circumvent principal’s controls, but such attempts come down to hiding their actions or withholding information – strategies which presume a certain level of negligence from the side of the principals. We would not expect to find this kind of negligence in the highly salient and politically contested EMU reform process.

PA provides us with relevant conjectures on how agents deal with, or rather make use of, multiple principals. However, it has little to say about the opposite scenario, in which there are multiple agents. Like NI, PA sees principals selecting from a pool of existing agents, or creating new ones, under the assumption that these agents will act as rivals (Hawkins and Jacoby [2006]: 203). Hawkins and Jacoby (2006: 205–212) briefly mention how agents can shape their own mandate by incorporating others (third parties), but they do not explore the implications of such a two-step delegation process. The concept of collaborative leadership serves to flesh out these implications more systematically. We define collaboration as the interplay and/or division of labour between different agents. It can thus refer to two things: either institutions actively working together (interplay), or institutions coordinating their individual actions (division of labour). Such coordination can be informal and might sometimes even be implicit.

We see collaborative leadership as a mechanism that consists of four elements, which refer to four levels of the decision-making process: the main agent(s) involved, the negotiating arena(s), the set-up and organization of the process, and the substance of what is currently being negotiated (see Table 1). This mechanism merely seeks to account for the role of the institutions, not the outcomes of the EMU reform and/or banking union negotiations in full. It thus constitutes a necessary, rather than sufficient, part of any explanation of the establishment of the banking union. Below, we discuss the implications in terms of agent strategies. In the Conclusion, we will discuss the trade-offs, meaning the limitations to this particular type of institutional leadership.

First, in a situation of multiple agents, rather than waiting for and working from formal mandates from their principals, these agents can informally assign themselves and each other to specific, and sometimes unusual, tasks. Because this delegation is informal or even implicit, it does not require ex ante commitment from the principals. On the other hand, it is also more difficult to monitor ex post. There is also one important caveat: principals not only define the scope of agents’ activity ex ante, they can also revoke or amend mandates ex post, or else prevent the exercise of an existing mandate (Pollack [2006]: 179). Agents will not stray too far from current principal preferences to ensure that they will be re-mandated.

Second, in a constraining environment, agents need to prove themselves willing to yield the stage at the moment when progress is no longer possible at their level. Agents will opt for a plethora of different forums and working
In negotiation theory this practice is sometimes referred to as ‘venue-shopping’. On a more general level, it points to a form of ‘joint stewardship’. As our analysis will show, the banking union did not have ‘founding fathers’ but rather a series of temporary caretakers, none of which had the ability to control, let alone steer, all relevant developments. Previous PA analyses have shown that having multiple principals does not necessarily empower agents, as it is often difficult to make use of the divisions between them (Hawkins and Jacoby [2006]: 226). We suggest that having multiple agents might be a more promising way to increase their overall autonomy.

Third, in a situation in which large-scale and explicit Treaty reform is clearly not an option, reforms need to be dealt with in an incremental fashion by means of an open-ended process. There was no Convention-like format for discussing the entire reform package. Nor was there an end-date or final goal in terms of a closing intergovernmental conference (IGC) at which all remaining issues would be dealt with simultaneously (cf. Beach [2005]).

### Table 1. The mechanism of collaborative leadership.

<table>
<thead>
<tr>
<th>Element</th>
<th>Informal delegation</th>
<th>Joint stewardship</th>
<th>Moving the goal posts</th>
<th>Varying levels of specificity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Level:</strong></td>
<td>The agent</td>
<td>The arena</td>
<td>The process</td>
<td>The substance</td>
</tr>
<tr>
<td>Implications: (in terms of agent strategies)</td>
<td>Rather than waiting for clear instructions or a formal mandate, institutions were informally assigning themselves and each other to specific, sometimes unusual, tasks</td>
<td>Institutions opted for different venues and working formats to ensure that the process kept moving. They proved willing to yield the stage when progress was no longer possible at their level.</td>
<td>Institutions were aware, and made use, of the open-ended character of the process, in which steps, sequences and deadlines could sometimes be firm, but at other times were remarkably flexible.</td>
<td>Institutions were aware, and made use, of the rather open mandate, which meant that sometimes a balance was found by going into great detail, sometimes by leaving key questions wide open.</td>
</tr>
<tr>
<td>Trade-offs: (with regard to the ability to provide leadership)</td>
<td>Informal delegation does not require <em>ex ante</em> mandating by the principals, but it does require their continued commitment throughout the process. The institutions need to make sure they are re-mandated.</td>
<td>Joint stewardship might result in an overall gain in agents’ autonomy, but this comes at the expense of individual agents’ ability to control developments.</td>
<td>Flexible steps, sequences and deadlines make it easier for the agents to keep the train moving. On the other hand, it provides principals with the opportunity to let the process run out of steam.</td>
<td>An open mandate provides agents with the opportunity to leave difficult points for later. On the other hand, picking the ‘low-hanging fruit’ first also makes it less likely that these difficult points will eventually be dealt with.</td>
</tr>
</tbody>
</table>
In the EMU reform and the banking union negotiations, steps, sequences and deadlines were sometimes very firm, but at other times remarkably flexible. Agents can make use of this fact by suggesting movement of the goal posts forward and backward on specific issues at specific points in the negotiations. There are several examples of this in our analysis of the banking union.

Fourth, the open-ended character of the process also has implications for the substance of what was being negotiated at a specific point in time. There may have been the image of a complete EMU or full-fledged banking union somewhere on the horizon, but that did not mean that all these substantive elements had to be dealt with to the same level of specificity. There was the opportunity to ‘pick and choose’ which issues to deal with now, and which issues to agree to in principle while leaving the details for later. Again, agents can make use of this fact when formulating agendas and proposals for discussion at a specific meeting. As will become clear from our analysis, in agreeing on the substantive elements of the banking union, sometimes a balance was found by going into very great detail, at other times by leaving key questions wide open.

**Empirical analysis: A triple jump in reverse**

The banking union is generally considered to be one of the most significant developments in European integration since the Maastricht Treaty. Table 2 provides an overview of its main elements. The single supervisory mechanism (SSM), the single resolution mechanism (SRM), the single resolution fund (SRF) and a significant part of the single rulebook were all negotiated between June 2012 and April 2014.

We identify three phases: June to December 2012, January to June 2013, and July 2013 to April 2014. Setting up the banking union was like doing a triple jump in reverse. After the *jump* of the SSM, there followed a more classic but no less important legislative *step*, with the completion of the single rulebook, which included the Capital Requirements Directive (the CRD 4), the Directive on Bank Recovery and Resolution (the BRRD) and the Directive on Deposit Guarantee Schemes, the (DGS), accompanied by an initial agreement on ESM-related elements. This then enabled the final *hop* of the SRM, with an initially tiny SRF, limited bridge financing and no real backstop.

The three ‘moves’ required different patterns of institutional collaboration. For the jump, the interplay between the European Council presidency and the ECB was crucial for getting (and keeping) a banking union on the agenda, and the interplay between the Commission and the Council was crucial for procuring the SSM. For the step, the division of labour between the legislators (the Ecofin Council and the EP) and the Eurogroup was crucial. This is because the
Table 2. Overview of (decision making on) the main elements of the banking union.

<table>
<thead>
<tr>
<th>Element</th>
<th>Proposed</th>
<th>Council negotiations</th>
<th>Council agreement</th>
<th>Trilogue/other negotiations</th>
<th>Final agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>May 2011</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRR</td>
<td></td>
<td></td>
<td>(largely)</td>
<td></td>
<td>March 2013</td>
</tr>
<tr>
<td>BRRD</td>
<td></td>
<td>6 June 2012</td>
<td>January to June 2013</td>
<td>27 June 2013</td>
<td>September to December 2013</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(largely)</td>
<td></td>
<td>December 2013</td>
</tr>
<tr>
<td>Single Supervisory Mechanism</td>
<td>SSM</td>
<td>12 September 2012</td>
<td>September to December 2012</td>
<td>12 December 2012</td>
<td>January to April 2013</td>
</tr>
<tr>
<td>Single Resolution Mechanism</td>
<td>SRM</td>
<td>10 July 2013</td>
<td>September to December 2013</td>
<td>18 December 2013</td>
<td>February to March 2014</td>
</tr>
<tr>
<td>Single Resolution Fund</td>
<td>SRF</td>
<td>18 December 2013</td>
<td>January to March 2014</td>
<td>21 May 2014 signature</td>
<td>Ratification by participating Member States</td>
</tr>
<tr>
<td>Direct Recapitalisation</td>
<td>ESM</td>
<td>29 June 2012 European Council</td>
<td>20 June 2013 Main features</td>
<td>20 June 2013 Main features</td>
<td>Approval by Member States according to national procedures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>to ESM</td>
<td></td>
<td></td>
<td>June 2014 Political under-standing; December 2015 by ESM Board</td>
</tr>
</tbody>
</table>

Note: The table provides a summary of the timeline for the decision making process on the main elements of the banking union. The timeline includes proposed dates, council negotations, council agreements, trilogue/other negotiations, and final agreements.
BRRD pivoted around the bail-in principle, meant to shift the burden for saving banks from taxpayers to share- and bondholders. While the Ecofin was negotiating bail-in, the Eurogroup hammered out the rules for direct recapitalization of banks by the ESM. On both elements, a provisional agreement was reached in June 2013. These two agreements paved the way for the hop, in which again other actors took centre stage. The European Council President and the ECB played a minor role on the SRM, and the role of the Commission was also more limited. Instead, the interplay between the rotating Council presidency, the Council Secretariat and the Eurogroup was crucial in procuring a deal, first in the Council and then with the EP.

The jump (launching the SSM and banking union)

Informal delegation was crucial from the very beginning of the process. Many have pointed to the importance of the European Council and Euro Area Summit of June 2012 (De Rynck [2016]; Glöckler et al. [2016]; Howarth and Quaglia [2013]; Schäfer [2016]). Yet it would be difficult to argue that this is where a banking union as such was put on the agenda.

The meeting of the Heads of State and Government of the Euro Area had primarily dealt with the Spanish banking crisis. For many member states, recapitalization of the distressed Spanish banking sector by the ESM had been the main issue on the agenda. Initially there was talk of a limited, temporary mechanism, but Chancellor Merkel seemed to favour a permanent structure before the ESM could be brought into play. The meeting therefore invited the Commission to present proposals for a single supervisory mechanism and the Council to consider these proposals by the end of 2012. It is doubtful whether the participants were aware that they were launching a ‘banking union’ with this action. In these early stages, the concept was still unclear. The more reluctant member states, for instance the Netherlands, equated it with common supervision.

At the European Council the following day, President van Rompuy presented a first draft of the four presidents’ ideas for deepening the economic and monetary union (EMU). Furthermore, ECB president Draghi used his speech to convince the Heads of State and Government of the dire need to break the vicious circle between banks and sovereigns. While ‘various opinions were expressed’ about the draft report, the conclusions mentioned remarkably little about the first building block: an integrated financial framework or ‘banking union’. Nevertheless, the European Council invited its President to develop a specific and time-bound road map for the initiatives in the report, including concrete proposals on preserving the unity and integrity of the Single Market in financial services and which will take account of the Euro Area statement and,
inter alia, of the intention of the Commission to bring forward proposals under Article 127.¹⁰

Such internal deadlines are typically flexible, and in this particular case it was unclear what stage of the decision making process needed to be reached by December.¹¹ More significant was the external deadline provided by the EP elections of May 2014 and the corresponding change of the Commission later that year. This combination of deadlines ruled out certain options, notably Treaty change. For the SSM in particular, the use of Article 127 entailed that supervision would be given to the ECB. There was no legal basis to do otherwise. This helped to speed up the process. Within the ECB, a workgroup on supervision had been set up and intensive cooperation with the Commission was established at all levels.¹² Rather than providing its opinion on the Commission proposals, the institutions were jointly drafting the texts. As people directly involved note:

The ECB already had a clear view on what a banking union would look like. It had developed the concept in house. They could thus provide the outline and the main elements: supervision and resolution.¹³

This collaboration ensured that the two SSM proposals could be presented a few months after the June European Council. The proposals were accompanied by ‘a roadmap towards a banking union’ which merely confirmed the elements mentioned in the Four Presidents’ Report.¹⁴ The roadmap was never part of the Council discussions. Instead of clinging to the vision of a complete banking union, the institutions decided to move the goal posts closer. This they did by dropping the common deposit guarantee scheme. In their interim report of October 2012 the four presidents admitted that ‘sharing banking sector risks without more effective fiscal discipline could otherwise lead to adverse incentives for sovereigns’.¹⁵ It was partly due to the difficult trilogues on the deposit guarantee scheme (DGS) directive, where even an update of an existing directive, based on national schemes but with more ambitious funding limits, had proven difficult to agree upon.

At this point everything thus depended on securing the first step: meeting the deadline on the SSM. As the institutions moved from agenda management to process management, the European Council and ECB stepped back while the rotating presidency and Council Secretariat started looking for a feasible working format. The first thing to be decided was how the two Commission proposals would be handled. Different decision-making rules applied. On the (main) SSM regulation, which would concern the Euro Area Member States, the EP only needed to be consulted. The accompanying regulation on amending the EBA, however, fell under ordinary legislative procedure, and was an issue for the EU as a whole. However, on substance the two proposals were inextricably linked. For the Non-Euro Member States, especially the UK, it was essential that the EBA rules be adapted to ensure that the
new supervisory behemoth would not unilaterally control decision making in the EBA. They wanted to use the unanimity requirement for the SSM Regulation to ensure that de facto unanimity would also be required for the EBA Regulation. For this reason, and in order to get the EP to adopt a constructive attitude, the decision was taken to treat the two proposals as a package, while never agreeing to any legal link.

The SSM was discussed for the first time at the informal Ecofin in Nicosia on 15 September. At first, the Cypriot presidency was not particularly eager to take on such an enormous, not to mention politically sensitive, dossier. However, a great deal of pressure from the Commission resulted in the Presidency announcing that it would push for a deal before Christmas. The next question was which working configuration would handle the proposals. One obvious candidate was the financial services working group. But this group fell under the full interpretation regime, which made the meetings rather long and inefficient. It also meant that these meetings needed to be planned many weeks in advance. Another candidate would have been the financial service attaches, who were also dealing with the CRD4/CRR and BRRD, but this working party was already overburdened with the single rule-book legislation. Thus, in order to facilitate the work the Coreper decided to set up an ad hoc working party, consisting of (high-level) representatives, primary financial directors from the capitals. For the institutions this was also an attempt to change the dynamics, under the belief that financial directors would be less inclined to engage in detailed discussions of the technicalities, but rather focus on the key political issues:

For attaches, it is easier to maintain that they do not have a mandate and therefore cannot proceed any further or make concessions. This will generally be accepted. Whereas with financial directors, the idea is: you are here to take decisions. This can be used to put pressure on member states.16

Such venue-shopping contributes to, but is seldom sufficient for, reaching an agreement. With a flexible working format and knowing the final deadline, the Presidency and the Council Secretariat could start planning backwards. There would be seven working party meetings in a period of two months. Nevertheless, there were a number of open issues in December, and an extra Ecofin meeting turned out to be necessary. In spite of institutional efforts to explain otherwise, quite a few member states were still not convinced that the ECB could or should take over supervision of all banks. A compromise was reached with a system of combined direct and indirect supervision. The hesitant member states could maintain that they would remain in control over their smaller banks, while the more ambitious member states could point out that the ECB would in principle be able to oversee any bank in the Eurozone. After providing the necessary side payment to the
UK in the form of double majority voting in the EBA, a deal was reached in the early hours of 13 December 2012.

On 14 December, the European Council dared to look ahead to the entire banking union package. While welcoming the agreement on the SSM, the Heads of State and Government immediately urged for work to continue on the other elements of the banking union. We contend that it was only at this point that the banking union was formally put on the agenda. Paragraph 11 marked out the trajectory:

The Commission will submit in the course of 2013 a proposal for a single resolution mechanism for Member States participating in the SSM, to be examined by the co-legislators as a matter of priority with the intention of adopting it during the current parliamentary cycle.\(^\text{17}\)

The steps as such were of course not new, but the endorsement was nevertheless important. This was because up until this point, progress beyond single supervision was not guaranteed. There might have been sound academic arguments for why a system of European-level supervision and national-level resolution would never work. But similar arguments had not been sufficient for keeping the common DGS on the agenda. From an institutional perspective, at least as significant as the substantive results was the general agreement on the process. Collaboration between the Commission, the Council and the EP had resulted in an ad hoc working format that could be replicated in the SRM negotiations.\(^\text{18}\) Meanwhile, the EP had managed to be placed on an equal level with the Council. In the ensuing trilogue, the EP lived up to its promise of being constructive, focussing on the accountability and transparency of the new structures.

**The step (Single rulebook and ESM involvement)**

The varying flexibility of the steps, sequences and deadlines that had been crucial for procuring the SSM was also used in the second phase. What had long been treated as a single market issue, namely common rules for financial services, now became part of the debate about the banking union and therefore subject to the same deadline. This mattered less for the CRD4 and CRR trilogues, which were close to being agreed.\(^\text{19}\) It did matter, however, for the BRRD and DGS. Grouping these legislative proposals under ‘the single rulebook’ was not just about framing. The dossiers were politically linked by the argument that a banking union could not function without a single set of rules.

A central element of the BRRD was the bail-in of share- and bondholders. The bail-in principle would become a game changer. This was because it managed to combine the protection of depositors (as foreseen in the DGS) with the orderly resolution of banks, while shifting the burden from taxpayers
to the banks’ creditors and bondholders. It thus offered comfort to those who had initially perceived a banking union, and a common resolution mechanism in particular, as an indirect system of transfers (from Northern European sovereigns to Southern European banks). Some member states (Germany, Finland and the Netherlands) were anything but enthusiastic about involving the ESM in the banking union. However, for other member states (Portugal, Ireland and Spain), access to ESM support was crucial. From an institutional perspective, the second stage was therefore about ensuring progress on two formally unrelated but politically linked tracks: the Eurogroup negotiations on direct recapitalization and the Ecofin negotiations on the BRRD and DGS.

The role of the ESM in the banking union had already been briefly discussed in the first phase. Even before this debate had started, it was clear that direct recapitalization would not come in time to be available for Spain. Already in July 2012, the country had settled for ‘indirect recapitalization’ of the banking sector via the sovereign.20 ESM involvement also featured in the debate about ‘legacy assets’. The three finance ministers of Germany, Finland and the Netherlands had voiced their concerns in this regard through a joint statement:

The ESM can take direct responsibility for problems that occur under the new supervision, but legacy assets should be the responsibility of national authorities.21

This particular issue was addressed in the SSM general approach, as agreed in December 2012, where the ECB was invited to perform balance sheet assessments (consisting of asset quality reviews and stress tests) of the banks. While the ECB framed it as ‘a clean sheets moment’, hesitant member states could refer to this as an ‘entry test’.22 Actually excluding a bank from participating in the SSM would be difficult, because initially the plan was for all European banks to fall under ECB supervision.

While this dealt with problems of the past, it did not solve the matter of future ESM involvement. The ESM-related elements of the banking union were dealt with by the Taskforce on Coordinated Action (TFCA), which reported to the Euro Working Group (EWG) and the Eurogroup. This was an informal, intergovernmental venue, in which the Commission and ECB were present only as observers.23 It was thus up to the Eurogroup president to maintain the momentum. Initially, this proved to be very difficult. Once the immediate crisis matters had been addressed, the overall rationale of the debate changed. The focus shifted from recapitalization to resolution and from bail-out to bail-in.24 ESM involvement would only come at the very end of a well-defined and uniform process for dealing with troubled banks. The core features of this process were fleshed out in the BRRD.

With this, we move from the first to the second track. After years of preparations, the Commission’s proposal on the BRRD had been presented in June...
2012. It covered a broad range of preparatory and preventive measures, covering early intervention as well as actual resolution. In terms of process management, these negotiations were mostly legislative business as usual. Most relevant for our analysis are the substantive choices that were made. When drafting the mammoth proposal, the Commission clearly made use of varying levels of specificity. What would turn out to be one of the key issues for debate, the 8% bail-in, was not even specified in the proposal. It came out of a compromise in Ecofin. Some member states would have preferred a lower number, but at the same time they were forced to admit that it was very difficult to calculate the exact percentage that would be needed for future resolutions. The high percentage constituted a compromise for allowing some flexibility and possible exemptions from bail-in. With regard to this flexibility, the negotiating parties again decided not to try to flesh out all possible scenarios, but rather agree on the principle.

A matter that was discussed in great detail was the exact order in which shareholders and creditors would be called upon to bear losses to finance a restoration or resolution. The reason for this high level of specificity was the banking crisis in Cyprus in March 2013. As part of the initial deal for Cyprus, depositors with deposits below 100,000 euro would have been forced to take losses via a special tax being levied on all deposits. New Eurogroup president Dijsselbloem hinted that this might be the new line to follow in all future banking crises. This conflicted with what was being negotiated under the BRRD and DGS. In an affair that became known as ‘Template-gate’, media sources marked this as ‘a watershed in how the EU deals with failing banks’.

The initial deal for Cyprus was quickly revised, and it did not come to affect the BRRD negotiations directly. However, it did help those who argued for bringing the implementation date forward (from 2018 to 2016). More significantly, the Cyprus crisis helped the Eurogroup president in selling the banking union to the more hesitant member states, not least his own:

Before Cyprus, progress was slow specifically on issues such as the public backstop, which countries like Germany considered to be a transfer. After Cyprus, the debate was about what can we do privately and what do we still need to do publicly. Now, there was something in it also for Germany, Finland and the Netherlands.

Securing the BRRD agreement in the Council (June 2013) was still no walk in the park. The Ecofin meeting of 21 June 2013 needed to be ‘extended’ to 26 June, rather than ‘reconvened’, in order to avoid crossing any deadlines. There were long and difficult negotiations about the funding, the flexibility and the starting date. In the end the Council agreed on a bail-in with mandatory exceptions, flexible exceptions and prohibitive rules for the intervention of
The resolution financing arrangement that each Member State would be required to set up to manage a bank resolution.

The Cyprus crisis also created some new momentum on the ESM track. The TFCA, EWG and Eurogroup managed to arrive at a provisional agreement on the main features of the operational framework for direct recapitalization. Given the link to the BRRD, it was proposed that the operational framework be finalized as soon as the BRRD and DGS proposals had been finalized with the European Parliament. Meanwhile, the possibilities for accessing ESM funds also featured in the debate about backstops. While the ECB was preparing for the comprehensive assessments of the banks that would come under its supervision, Germany, the Netherlands and Finland continued to insist that member states must provide national solutions to problems which had occurred while banks were under national supervision. This is reflected in the June 2013 European Council Conclusions:

In this context [the comprehensive assessment], Member States taking part in the SSM will make all appropriate arrangements, including the establishment of national backstops, ahead of the completion of this exercise.

The appropriate ‘pecking order’ (first private sources, then national and euro area/EU instruments) would eventually be laid down in the November 2013 Ecofin conclusions. Moving the goal posts characterized the debate about ESM involvement. It would take until June 2014 for the Eurogroup to reach a political understanding on direct recapitalization. It was still presented as ‘another important pillar of the banking union’. But the member states had set prohibitive criteria, making it unlikely that the instrument would ever be used.

The Lithuanian presidency was subsequently able to finish the trilogues on the BRRD and DGS in time (December 2013), even though it had little to offer to the EP on its main concern, which was the establishment of EU-level funding. Opinions differ on how well the BRRD succeeded in harmonizing recovery and resolution schemes. Critics argue that the directive, like the CRD4 and CRR, is full of national exemptions and that some countries took a long time to implement it. Nevertheless, institutional collaboration had played a crucial role in anchoring the bail-in principle on a national level, as well as in the mind-sets of those who would soon be dealing with it on a European level.

The hop (the SRM, SRF and backstop)

As the debate on the SRM was about to begin, a number of institutions stepped back. First, there was less involvement from the European Council level. At the European Council level, substantive comments were replaced by procedural statements, the most important of which was the invitation
to the Commission to present the SRM.\textsuperscript{35} European Council President Van Rompuy made it perfectly clear that he had no intention of involving the Heads of State and Government in the debate (Ludlow [2013a, 2013b]). Even more than had been the case with the SSM, it was up to the legislators to find the agreement. Second, there was less intensive cooperation between the ECB and the Commission on the SRM proposal.\textsuperscript{36} In contrast to the SSM, the ECB would be just another party providing its opinion on the Commission’s proposal and participating in the meetings.

These meetings got off to a flying start, working from the same \textit{ad hoc} working party format and consisting to a large extent of the same people. The Lithuanian presidency, assisted by the Council Secretariat, chaired about a dozen meetings. An early obstacle in the negotiations was to find agreement on how to calculate the bank contributions to the SRF. This was a tricky issue since the contribution of an individual bank could change according to whether its contribution was calculated on a national or Euro Area-wide basis. The Commission therefore proposed to deal with the question by delegated act, hoping that it would not become an issue during the negotiation.\textsuperscript{37} Member states can, and some in fact did, object to the suggestion to put this matter under delegated act, but it soon became clear that it would be impossible to settle before the December deadline. Thus the Commission approach was no longer challenged.

Another issue that would prove impossible to settle before Christmas was the common backstop, an issue that fell well outside the legislative scope. The Eurogroup came up with another creative solution, which is reflected in a statement that became part of the Ecofin conclusions on 18/19 December 2013:

\begin{quote}
During the initial build-up phase of the fund, bridge financing will be available from national sources, backed by bank levies, or from the European Stability Mechanism, in accordance with existing procedures ... During this transitional phase, a common backstop will be developed, which would become fully operational at the latest after 10 years.\textsuperscript{38}
\end{quote}

Deadlock on a backstop was avoided by agreeing that this was an issue that really only needed to be dealt with once the SRF was fully operational (expected in 2024). This immediately created the new problem of what would happen if a bank failed in the intervening period. But the chairs of the EWG and Eurogroup presumed that agreeing on temporary bridge financing would be easier than on a permanent backstop. The former might then be used as a template for the latter. Nevertheless, the negotiations on both would be postponed until after the agreement on the constitutive elements of the banking union.\textsuperscript{39}

By moving the goal posts (on the backstop and bank contributions) and opting for a low level of specificity (on the bridge financing), the institutions
were able to keep the process going. However, the main obstacle still loomed: German opposition to the use of Article 114 of the Treaty of the Functioning of the European Union (TFEU) as a legal basis for establishing the SRM. The article is about approximation provisions to improve the functioning of the internal market. There were doubts as to whether it provided a sufficient basis for creating a new body (the SRB) and for providing the funding (through the SRF). In the beginning of December, little progress had been made on this matter.

At this key moment, joint stewardship failed, as institutional strategies were out of sync, at least at the political level. The Commission, on the one hand, was not willing to seriously consider an alternative legal base. Instead of preparing for eventualities, they maintained that Article 114 was the only option. The Commission appeared to be mimicking its approach on the SSM, with Commissioner Barnier trusting that he would again be able to procure concessions from the German finance minister Schäuble. The Lithuanian presidency, on the other hand, had the feeling that Germany would not budge on this issue. Moreover, they were aware of their own limitations. Being effective as a chair depends on more than being transparent, well-organized and able to meet deadlines:

One needs to be strong enough to say ‘no’ to the big guys. To be able to do this, one needs sufficient backing from the political level. Lower-level process management can be undone if ministers are overwhelmed by the likes of Sapin or Schäuble.40

The latter invited the Lithuanian presidency, the Commission and some key delegations to private meetings in Berlin. The idea of splitting off the process of the SRF from the SRM was discussed here. The former would be negotiated through an intergovernmental agreement (IGA). The Commission and EP objected heavily to this ‘re-intergovernmentalization’ of the decision-making process. The EP stated that it would continue to treat the SRM and SRF as a package. Meanwhile, the outgoing Lithuanian presidency proceeded with laying out the groundwork for the IGA. At the regular Ecofin meeting on 10 December there was broad support for splitting off the SRF from the main Regulation. This resulted in a hectic redrafting of the relevant text in the period between the two Councils. Going into the extraordinary Ecofin of 18 December 2013, the Chair and the Secretariat knew that they had the basis for a deal.

In hammering out the details, the Council would again make use of varying levels of specificity. The key open issue was the governance of the single resolution board (SRB). But participants were well aware that this would be one of the main issues for debate in the SRM trilogue. Any Council agreement would therefore not be definitive, as EP representatives were already criticizing the complex solution reflected in the general approach.41 To make the mutual
fund easier to swallow, the Netherlands had suggested creating national com-
partments. The mutualization of these compartments over time could then be
decided as part of the IGA. The Council Secretariat would specify the modal-
ities of the intergovernmental conference.

Yet another type of institutional collaboration proved necessary to secure
the final deal. The IGC had to be set up in less than two days. The incoming
Greek presidency had not planned to present a chair. Given the link with the
negotiations in the Eurogroup on the backstop/bridge financing, the Sec-
retariat suggested that the meetings be chaired by the chair of the EWG,
Thomas Wieser. To pre-empt tough trilogues, they also suggested including
the EP, formally only as observers, but with the right to actively participate
in the discussions. This constituted a modest step towards a Convention-
like format, but it worked remarkably well: the EP representatives participated
constructively and the member states proved themselves remarkably open to
dealing with the thorny issues, in spite of their presence.

Sequencing was again key to success. The EP wanted to be able to take the
results of the IGA into account when dealing with the SRM. The terms of refer-
ence, as agreed by the ECOFIN Council, stated that the results of the confer-
ence would be presented at the beginning of March 2014. Work therefore
needed to be swift. The IGC managed to reach a provisional agreement on
the (mutualization of the) national compartments before the deciding trilogue
with the EP on 18/19 March 2014. The Eurogroup president then took it upon
himself to close the deal. Dijsselbloem effectively merged the intergovern-
mental and Community processes, and personally worked on hammering
out a deal on the decision-making structures within the SRB in an all-night tri-
logue meeting between the Council, Commission and Parliament. The
member states agreed to introduce a greater degree of mutualization and
to shorten the mutualization period in the IGA by two years. The EP was
forced to acknowledge the legal limitations stemming from the fact that
the SRB was an agency, while the final resolution decision needed to be
taken by an institution. The compromise was an intricate power-sharing
arrangement between the Council and the Commission.

**Conclusion**

This article analysed the role of the EU institutions in setting up the banking
union and the opportunities for providing leadership during that process. We
sought to determine how, rather than how much, the institutions mattered.
After reading the analysis, some might wonder to what extent this process
was ever really institution-led. We have argued that this represents a new
type of institutional leadership, tailored to the constraining environment in
which the negotiations took place. In the analysis, we fleshed out the
characteristics of this collaborative leadership on four levels. We now discuss some of its limitations.

As our analysis of the initial phase has shown, the mandate to launch a banking union was effectively created by the agents themselves, in particular the ECB and Commission. The trade-off is that these agents needed to keep their principals committed. The European Council’s endorsement in particular was crucial:

Our job was to keep the leaders committed to the project; so with each summit we made sure that there were conclusions about the banking union in which we noted the progress made and set new deadlines. These deadlines were certainly not always respected. But they helped to keep the pressure on the ministers.\textsuperscript{44}

Participants characterize the establishment of the banking union as ‘a marathon dressed up as a sprint’.\textsuperscript{45} In reality it looked more like a relay race. For a period of almost two years, representatives felt as if they were working in a pressure cooker, and no one, neither from a member state nor from an institution, would dare to be the one to wreck the process.

The second trade-off concerns the limited ability of individual agents to steer, let alone control, developments. The banking union represents an acknowledgement of new realities in EU decision making. This was not leadership through intergovernmental coordination, fitting with the conjectures of new intergovernmentalism. The substantive role of the European Council and its president was limited. Its high-level guidance did not lead to detailed instructions. This was also not leadership through supranational entrepreneurship. The entrepreneurial role of the Commission and ECB on the SSM could not be replicated on the SRM. Commissioner Barnier was dominant at specific stages of the legislative processes, but he did not guide the overall project. The Commission needed to channel ideas through the European Council, where the Commission was represented by its President. Both European Council President Van Rompuy and Commission President Barroso in turn needed to rely on Draghi’s plenary interventions to keep the Heads committed. Meanwhile, the EWG and Eurogroup were crucial for procuring the necessary (albeit it so far limited) ESM involvement. The intergovernmental and supranational agents did not compete with, but rather needed, one another to make their interventions work, not just once but continuously throughout the process.

The third trade-off is related to the first. It is relatively easy to organize open-ended discussions, but it is more difficult to maintain their pace. In establishing the banking union, external events like crises or elections ensured a continued sense of urgency. What can happen when the pressure is taken off became apparent with the relaunch of the banking union project, as part of the June 2015 Five Presidents report. While the agents were still
eager to continue with the work, the principals did not seem to share their sense of urgency anymore.

The fourth trade-off stems from the ability ‘to pick and choose’ which issues to deal with in detail. The obvious downside to postponing the more difficult points is that becomes less likely that they will eventually be dealt with. In a traditional IGC, deals on difficult issues, in this case a public backstop or a common resolution fund, would typically be reached through issue-linkages or as part of package deals (Beach [2005]). There were attempts to create such linkages in the banking union, for instance between the SSM and direct recapitalization (Glöckler et al. [2016]). But the two issues could be decoupled just as easily, and on the former a faster and more far-reaching deal was reached. In the banking union process, there are continuing doubts as to whether the ‘high-hanging fruit’ (the common DGS or EDIS in particular) will eventually be picked. Some feel that the current arrangements fall short in breaking the vicious circle between banks and sovereigns - which was the motivation for launching the project in the first place (Schäfer [2016]).

As stated above, the conditions for acquiring access to direct recapitalization are highly stringent, the SRF will be tiny in its first few years and the agreement on bridge financing essentially comes down to member states guaranteeing to back up their own national compartments.

These limitations should be kept in mind when attempting to draw lessons from the case of the banking union: First, the process was exceptional in many ways, and there is no guarantee that the mechanism of collaborative leadership would operate in the same way under ‘normal’ circumstances or under pressure of a different kind. Second, there was nothing inevitable about the banking union. Notwithstanding functional imperatives, overlapping interests and a crisis atmosphere, it was a long way to travel from an initially auxiliary supervisory mechanism to a single resolution fund. Nor did the institutions succeed in making it inevitable. What they did was to make a banking union feasible. Even near the end of 2013, there were doubts that the finish line would be reached; but at least the institutions had ensured that a way to get there had been clearly marked out.

Notes

1. Author’s interviews, European Council President’s cabinet, Commission cabinet and services, 18-3, 14-7, 27-8-2015.
12. Author’s interviews, ECB and Commission services, 4-9-2015, 6-1-2016.
13. Author’s interview, European Council president cabinet, 14-7-2015.
16. Author’s interview, member state representative, 7-1-2016.
18. And later again for the Proposal for a European Deposit Insurance Scheme (EDIS).
19. The Council had already reached an agreement on CRD4 and CRR under the 2012 Danish presidency; the trilogues with the EP would be dealt with by the 2012 Cyprus and the 2013 Irish presidencies.
22. Author’s interviews, ECB and member states representatives, 6-1, 7-1-2016.
23. From the Commission’s side, the negotiations were covered by DG ECFIN, while the banking union was dealt with primarily by DG MARKT (now DG FISMA).
24. Author’s interview, ECB and EWG, 6-1-2016, 28-1-2016.
26. ‘Cyprus rescue signals new line on bailouts’ Financial Times 25-3-2013.
27. Author’s interviews, member state representatives, 28-8-2015.


32. Statement by the President of the Eurogroup. ESM direct recapitalisation instrument, 10-6-2014.

33. The ESM can recapitalize banks directly only if private investors have been bailed-in, in accordance with the BRRD. In addition, the national resolution funds or, from 2016 onwards, the Single Resolution Fund must contribute. The bank must be ‘systemically relevant’ and the requesting ESM Member unable to provide financial assistance without very serious effects on its own fiscal sustainability.

34. Author’s interviews, member state representatives and MEP, 9-2-2016, 16-2-2016.


36. Author’s interviews, ECB and Commission cabinet, 6-1-, 7-1-2016.


40. Author’s interview, member state representative, 7-1-2016.

41. MEP Sven Giegold came up with a poster entitled ‘SRM – Council Mechanism – over the weekend Seriously?’ which set the tone for (the media debate surrounding) the trilogue: http://www.sven-giegold.de/2014/banking-rescue-for-beginners/.

42. The final Ecofin ended in the early hours of Thursday 19 December 2013, while the institutions effectively closed for Christmas on Friday 20 December.

44. Author’s interview, European Council presidency level, 14-7-2015.
45. Author’s interview, Commission services and cabinet level, 4-9-2015, 6-1-2016.
46. In the subsequent migration crisis, we might have been witnessing the opposite response, in which institutional competition trumped cooperation, while member states opted for purely national solutions.

Acknowledgement

We would like to thank Lucia Quaglia, the editors and anonymous reviewers for their valuable comments and suggestions.

Disclosure statement

No potential conflict of interest was reported by the authors.

Funding

This work is part of the research project, Building a New Europe, supported by the Danish Council for Independent Research under Grant DFF-4003-00199.

Notes on contributors

Bodil Nielsen is Head of Unit, Directorate General Economic Affairs and Competitiveness, General Secretariat of the Council of the European Union.

Sandrino Smeets is Assistant Professor, Department of Political Science, Aarhus University and the Institute for Management Research, Radboud University.

References


