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The End of Bilateralism in Europe? An Interest-Based Account of Franco- German Divergence in the Construction of the European Banking Union

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The End of Bilateralism in Europe?:
An Interest-Based Account of Franco-German Divergence
in the Construction of the European Banking Union

A thesis presented by
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List of Acronyms and Abbreviations

BaFin	Federal Financial Supervisory Authority <i>German:</i> Bundesanstalt für Finanzdienstleistungsaufsicht
BdB	Association of German Banks <i>German:</i> Bundesverband deutscher Banken
BVR	National Association of German Cooperative Banks <i>German:</i> Bundesverband der Deutschen Volksbanken und Raiffeisenbanken
DGS(s)	Deposit guarantee scheme(s)
DSGV	German Savings Banks Association <i>German:</i> Deutscher Sparkassen- und Giroverband
EBF	European Banking Federation
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EDRIS	European Deposit Reinsurance Scheme
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
FBF	French Banking Federation <i>French:</i> Fédération bancaire française
IPS(s)	Institutional protection scheme(s)
NPL(s)	Nonperforming loan(s)
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
VÖB	Association of German Public Banks <i>German:</i> Bundesverband Öffentlicher Banken Deutschlands

Chapter I: Introduction

Statement of question and motivation

There are few examples in modern political history which have commanded more attention than Europe's ambitious postwar project to promote an 'ever closer union' between its peoples and member states. And rightfully so—the European project is widely regarded as the farthest-reaching and most successful recent experiment in supranational governance, characterized not only by a high degree of intergovernmental policy coordination, but also and increasingly by the outright transfer of select national competencies to new centers of political authority at the European level. Nowhere has this been more the case than in the economic realm: the founding of the European Coal and Steel Community in 1951 initiated the process of uniting the states of Europe for the purpose of securing a lasting peace, and with the subsequent formation of the European Economic Community, the Single Market, and, finally, a full Economic and Monetary Union with the introduction of the common currency, cooperation has become increasingly all-embracing.

Still, the economic union of Europe remained functionally incomplete as long as no major strides were made toward the coordination of national fiscal policies, the deepening of integration in Europe's capital markets, and—which is the focus of the present account—the creation of a unified framework for bank regulation and supervision. To that end, European heads of state and government made a clear commitment in the summer of 2012 to move systematically toward

the creation of a genuine Banking Union; suggesting a near-complete transfer of banking policy from the national to the supranational level, this pivotal European Council meeting is widely considered to have initiated the most recent ‘grand bargain’ in the history of European integration and one of its most significant steps taken to date. Notwithstanding this ostensible consensus on the necessity of Banking Union, the intensity of the subsequent negotiations reveal that technical details related to its design and implementation are also particularly politically fraught. Indeed, discussions on all three principal components have provoked sharp divisions and in no case has agreement been reached by the anticipated target date. Most recently, progress on a pan-European deposit guarantee scheme has stalled so significantly since it was first proposed in November 2015 that the Banking Union has been effectively rendered incomplete until further notice.¹

Perhaps nowhere have differences of opinion been more visible or pronounced than between France and Germany, which have found themselves at opposite ends of the negotiating table at nearly every turn. France, more than any other member state, has been the main “engine” driving Banking Union forward: at least since the worsening of the banking crisis in 2012, France has acted as the de facto leader of a primarily southern coalition of member states which has favored both a more sweeping transfer of authority and a swifter adoption thereof.² Germany, by contrast, has consistently blocked the transfer of key competencies to the European level, and its generally defensive stance has often

¹ Jan Strupczewski and Francesco Guarascio, "Euro zone without breakthrough on deposit guarantee despite ECB call," *Reuters*, March 12, 2018.

² David Howarth and Lucia Quaglia, "The Political Economy of the Single Supervisory Mechanism: Squaring the ‘Inconsistent Quartet’" (paper presented to the EUSA Biennial Conference, Boston, Massachusetts, March 2015), 16; Rachel A. Epstein and Martin Rhodes, "The Political Dynamics Behind Europe’s New Banking Union," *West European Politics* 39, no. 3 (May 2016): 419.

produced legislative deadlocks and forced compromises at critical junctures.³ What, then, accounts for the apparent incompatibility of French and German policy preferences on the construction of the Banking Union? Specifically, why has the German government generally sought to preserve the autonomy of individual member states to the greatest possible extent, while the French have led the coalition in favor of more radical integration? This is the underlying question which motivates the present analysis.

This divergence is all the more puzzling if one considers the historical importance of the Franco-German partnership to the deepening of Europe's economic and political union over the course of preceding decades.⁴ Indeed, ever since Charles de Gaulle and Konrad Adenauer initiated the postwar reconciliation of their two countries in the 1950s, the bilateral leadership exercised by France and Germany has played a central role in the achievement of several major milestones in the construction of Europe, with other member states often reorienting their positions along the lines of a Franco-German compromise: examples include, famously, the Schuman Plan and the founding of the European Coal and Steel Community in the immediate postwar era; the creation of a European Monetary System in the late 1970s; and, finally, the Maastricht Treaty and the subsequent introduction of a single European currency roughly two decades ago.⁵ In the Banking Union negotiations, Paris and Berlin are again the main players, except that they now find themselves in opposing camps rather than

³ Valentina Pop, "Banking union: The German way or no way," *EUObserver*, December 10, 2012; Francesco Guarascio, "Germany blocks small progress on banking union at EU summit," *Reuters*, December 15, 2016.

⁴ Colette Mazzucelli, *France and Germany at Maastricht: Politics and Negotiations to Create the European Union* (New York: Garland Publishing Inc., 1997); Ulrich Krotz and Joachim Schild, *Shaping Europe: France, Germany, and Embedded Bilateralism from the Elysée Treaty to Twenty-First Century Politics* (Oxford: Oxford University Press, 2012).

⁵ Emmanuel Mourlon-Druol, "Rethinking Franco-German relations: a historical perspective" (Bruegel Policy Contribution 29, Bruegel, November 2017), 4-6.

at the helm of a unified movement.⁶ This observation is consistent with generalized claims that the role of France and Germany as the dual engine of European integration has reached an impasse in recent years, which, given its historical significance, has also inspired an already significant body of literature on the subject.⁷ The present attempt to explain the most recent deviation from this well-established historical pattern thus also addresses the looming threat of an emerging leadership vacuum in Europe and finds significance among the kinds of topics which most preoccupy observers of European relations in the present era.

Banking Union in the era of postcrisis financial reforms

While epistemic observers have long acknowledged the necessity of Banking Union in Europe, banking policy was largely excluded from processes of Europeanization until the recent financial crisis generated a renewed sense of urgency. In theory, the smooth functioning of monetary union ultimately requires the existence of an integrated financial system in which funds are able flow unobstructedly across national borders, that is, by way of financial intermediaries whose cross-border development is not hindered by the distinctiveness of national regulatory jurisdictions.⁸ Thus, the notion of a Banking Union was not particularly novel when it was first agreed in 2012, the topic having been pondered in specialized academic circles at the very conception of European Monetary Union and even broached in the European Commission as early as the

⁶ Joachim Schild, "Germany and France at Cross Purposes: The Case of Banking Union," *Journal of Economic Policy Reform* 21, no. 2 (April 2018).

⁷ Jean Pisani-Ferry, "Only One Bed for Two Dreams: A Critical Retrospective on the Debate over the Economic Governance of the Euro Area," *Journal of Common Market Studies* 44, no. 4 (November 2006); Krotz and Schild, *Shaping Europe*; Schild, "Germany and France at Cross Purposes."

⁸ Yves Mersch, "The single market and banking union" (speech, European Forum Alpbach, Alpbach, August 29, 2013).

1960s.⁹ Still, because the deepening of integration also requires significant and often controversial renunciations of national sovereignty, the Banking Union—like other elements of recent financial reforms—was politically realizable only after the 2008 financial crisis and related challenges of the eurozone, which shifted matters of bank regulation and supervision back to the top of the policymaking agenda.

First, the sovereign debt crisis revealed the urgent need to break self-reinforcing channels of contagion between fragile euro-area banks and their debt-burdened sovereigns, the decoupling of which would be greatly aided if banks were more solidly anchored in Europe rather than in their respective host states. In general, the positive relationship between bank and sovereign credit risk tends to multiply and accelerate the effects of stress in either sector, generating adverse feedback loops which exacerbate the impact of large-scale crises in areas where poorly capitalized banks are also highly exposed to distressed government debt. In Europe, this phenomenon was particularly pronounced among peripheral member states, but led also to spillover effects in those core countries whose banking systems held significant peripheral exposures. As a result, policy interventions intended to address the sovereign-bank nexus moved to the fore among options for postcrisis financial reforms, including the construction of a Banking Union for this particular purpose: if truly European banks were more perfectly diversified across the markets of individual states and enjoyed access to a supranational safety net in the event of financial distress, their solvency would be less closely

⁹ Emmanuel Mourlon-Druol, "Banking Union in Historical Perspective: The Initiative of the European Commission in the 1960s–1970s," *Journal of Common Market Studies* 54, no. 4 (July 2016).

ted to the credit conditions of their host states and systemic risk channels thus also significantly narrowed.¹⁰

Next, persistent divisions in the European banking sector also gravely disrupted the transmission of a single monetary policy at critical junctures, making the construction of the Banking Union ultimately critical to improving the ability of the European Central Bank to manage the effects of system-wide downturns. Like any central bank, the ECB implements monetary policy by encouraging financial institutions within its sphere of influence to adjust lending conditions related to the price and availability of credit. When financial markets are fragmented, these transmission channels do not work as rapidly or effectively, and it becomes more difficult to find the traction necessary to pass interest rate changes on to credit customers. It was once widely believed that market mechanisms could be relied upon to drive financial integration after the launch of the euro and through the accompanying process of regulatory convergence. With the onset of the crisis, however, European credit markets became increasingly fragmented on a variety of measures, and it became clear that the existing level of market integration was largely superficial and broke down quickly in adverse conditions.¹¹ As the principal centers of credit intermediation in the euro area, national banking system—more specifically, their integration into a single Banking Union—thus became key to restoring the effective transmission of

¹⁰ Giovanni Dell'Ariccia et al., "Managing the sovereign-bank nexus" (ECB Working Paper Series No. 2177, European Central Bank, September 2018).

¹¹ David Howarth and Lucia Quaglia, "Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and 'Completing' Economic and Monetary Union," *Journal of Common Market Studies* 51 (September 2013): 104-105.

monetary policy and improving the resilience of the eurozone in the face of future downturns.¹²

Once the experience of the financial and sovereign debt crises had made its necessity more acutely clear, the notion of a Banking Union, more of an academic conceptualization than a concrete policy proposal up to that point, began to gain significant political traction. While a term of art to some extent, Banking Union generally implies the near-complete transfer of responsibility for key instruments of banking policy from the national to the supranational level. Strictly speaking, there had been some policy coordination at the European level even prior to 2008, as, for example, through the Banking and Capital Adequacy Directives of the early 2000s and the transposition into European law of the Basel guidelines for international banking. Still, in the pre-crisis consensus, bank supervision and regulation remained strictly national prerogatives, and there existed significant variation even in those areas where common policies had been suggested. In its postcrisis conception, a fully-fledged Banking Union thus came to be associated with a distinct three-pillar structure, encompassing (1) a unified framework for bank supervision, (2) common management of the restructuring and resolution processes for troubled banks, and (3) a single deposit guarantee fund to protect customer assets against risk of loss in the case of failure. In European legislative parlance, these correspond, respectively, to the existing Single Supervisory and Single Resolution Mechanisms and, thirdly, to a still hypothetical European Deposit Insurance Scheme. Early proposals called for this

¹² Peter Praet, "The importance of a genuine banking union for monetary policy" (speech, EMU Forum 2016, Oesterreichische Nationalbank, Vienna, November 24, 2016).

integrated financial framework to cover all institutions in the European Union, while also allowing for differentiation between euro and non-euro area member states where appropriate.¹³

While political and procedural constraints have required each to be addressed in turn, academic conceptualizations of the Banking Union generally associate all three pillars with strict non-separability, that is, with any reassignments to a higher level of governance ideally proceeding together along a shared timeline. This is driven by practical concerns more than a mere desire for internal consistency. After the entering into force of the SSM, for example, the absence of a unified crisis management framework effectively precluded the single supervisor from delivering unbiased assessments as long as it could not be assured that resolution would proceed in an orderly and predictable manner. Meanwhile, national resolution authorities—and, in the extreme case, national taxpayers—were also loath to bear the costs for what might be considered a supervisory failure at the European level. Even with the introduction of the SRM shortly thereafter, national authorities are today reluctant to disburse resources from national deposit guarantee funds in consequence of European-level decisions which they might themselves vehemently oppose. The resolution of ailing banks, in turn, remains politically more difficult as long as European authorities cannot guarantee that customer deposits will be well-protected.¹⁴ As a result, the effectiveness of the project as a whole generally hinges on the ability of European

¹³ Herman Van Rompuy, *Towards a Genuine Economic and Monetary Union* (Brussels: European Council, June 2012), 4. Today, participation in the Banking Union is considered compulsory for all euro-area member states, while those outside of the currency union are encouraged to take part on a voluntary basis.

¹⁴ Douglas J. Elliott, "Key Issues on European Banking Union: Trade-Offs and Some Recommendations" (Global Economy and Development Working Paper 52, Brookings Institution, November 2012), 14, 44.

policymakers to construct each pillar in a complete and complementary manner, and any legislative deadlocks—such as that on the present construction of EDIS—are from a macroeconomic perspective also eminently consequential.

Outline of content and argument

As a means of understanding Franco-German divergence in the construction of the Banking Union, this thesis proposes an interest-based theory in which national policy preferences are rationally derived from the material interests which predominate in the domestic realm and, in particular, among key stakeholders in the most immediately affected domestic industries. Specifically, French and German policy preferences on each of the three associated pillars are a reasonable reflection of the distinct composition of each state's national banking sector, including the principal aggregations of special banking interests which view the introduction thereof as either favorable or unfavorable to their own economic well-being.

Broadly, the organizational contours of the present thesis are informed both by the natural progression of its leading argument as well as by the distinct three-step approach which has been adopted in the implementation of the Banking Union itself. First, along with a brief survey of the relevant literature, Chapter II introduces the general theoretical and methodological approach which flows through the remainder of the thesis and, in particular, its specific implications in the case at hand. Next, in order to identify the principal aggregations of special interests which are most likely to inform French and German preferences, Chapter

III presents a synthetic overview of the distinct structure and composition of each state's national banking sector as well as some means of comparing these to each other. At the empirical core of the present thesis, the three-pillar architecture of the Banking Union lends itself to conducting three distinct applications of the proposed theoretical framework in the course of Chapters IV through VI: these explore, in turn, the domestic sources of Franco-German disagreement in the construction of the Single Supervisory Mechanism (2012 to 2014), the Single Resolution Mechanism (2013 and 2015), and, finally, in the context of the already proposed but not yet agreed European Deposit Insurance Scheme (2015 to the present). Finally, Chapter VII offers concluding remarks, including an evaluation of the broader implications of this thesis and an assessment of alternative theories which might shed light on any apparent shortcomings.

Chapter II: Theoretical Approach

Review of related literature

At its core, the present investigation into the source of Franco-German disagreement on the construction of the Banking Union is essentially an attempt to better understand the processes of national preference formation which underlie the negotiating behavior of states in a wide range of possible scenarios. Interstate bargaining has been a feature of global politics since the very invention of the modern nation-state, yet there exists relatively little agreement on the mechanisms by which positions are actually formed. While traditional realism views states as unitary actors pursuing independently constructed goals, modern scholarship tends to follow an intergovernmentalist frame, that is, one which derives national preferences from a diverse array of shifting and often antagonistic domestic sources. Within the realm of intergovernmentalist approaches, a wide range of existing strategies can be organized along a spectrum ranging, in their most basic characterizations, from interest- to ideas-oriented explanations. By exploring each of these major schools in turn, the following section situates the key inquiry at the heart of this account within the larger body of literature which has been developed to the same end, with Banking Union representing only one of many conceivable exercises in intergovernmental cooperation both in the European context and otherwise.

Before these basic approaches are introduced over the course of the following paragraphs, it should be noted that studies of European integration have

not always focused on the voluntaristic preferences of participating states as such. Indeed, intergovernmentalism is only one of two main theories which has been applied in the European case, and the launching of the project itself substantially predates most state-based accounts of the related outcomes. The older of these, the so-called neofunctionalist approach, was first elaborated by Ernst Haas in the early stages of integration in the 1950s. As a pluralist theory of international politics, it does not actually assume that member states themselves provide the sole dynamic for further integration, and rather predicts a self-sustaining and ever closer union driven largely by spillovers between policy areas or geographies and from one period to another.¹⁵ In the 1990s, Sandholtz and Sweet proffered the slightly revised supranational governance version, which avoided the apparently deterministic features of neofunctionalism by emphasizing the role of supranational institutions as independent actors driving integration forward.¹⁶ Still, neofunctionalist approaches generally fell out of favor after a series of legislative crises and recurrent political deadlock in the 1960s and 1970s revealed their apparent incompatibility with the reality of European political processes.¹⁷ In response, Stanley Hoffman articulated the first intergovernmentalist counter-theory in the 1960s, and this approach has subsequently fared better in accounting for the observed ebbs and flows of the integration process and the fact that this

¹⁵ Ernst B. Haas, *The Uniting of Europe; Political, Social, and Economic Forces, 1950-1957* (Stanford: Stanford University Press, 1958).

¹⁶ Alec Stone Sweet and Wayne Sandholtz, "European Integration and Supranational Governance," *Journal of European Public Policy* 4, no. 3 (September 1997): 297-317.

¹⁷ Teodor Lucian Moga, "The Contribution of the Neofunctionalist and Intergovernmentalist Theories to the Evolution of the European Integration Process," *Journal of Alternative Perspectives in the Social Sciences* 1, no. 3 (December 2009): 800.

can proceed only as far and as quickly as the preferences of autonomous, self-interested states will allow.¹⁸

Supposing that state preferences are in fact paramount in shaping the outcomes of intergovernmental cooperation, interest-based accounts of their domestic origins expect that national governments seek foremost to maximize the real, material interests of their respective constituencies. In line with Frieden and Rogowski, such approaches are typically rooted in a twofold assumption: while elected officials are principally concerned with their own preservation, their domestic constituents, usually conceived as organized groups, endeavor to protect their own economic interests against changing circumstances in the world economy and in the face of new initiatives for global governance.¹⁹ In the European context, the predominance of interest-based approaches seems to have followed logically from the fact that integration has to date proceeded further in the economic realm than any other. In both a pre- and post-financial crisis environment, Frieden, Walsh, and a wide array of other authors have accounted for cross-national differences in the acceptability of Europe's economic and monetary union by teasing out domestic constellations of 'winners' and 'losers' and the broad political economy characteristics which align domestic interests

¹⁸ Stanley Hoffmann, "European Process at Atlantic Crosspurposes," *Journal of Common Market Studies* 3, no. 2 (February 1965): 85-101; Stanley Hoffmann, "Obstinate or Obsolete? The Fate of the Nation-State and the Case of Western Europe," *Journal of the American Academy of Arts and Sciences* 95, no. 3 (Summer 1966): 862-915. Still, the intergovernmentalism of Hoffmann's early work does not go so far as to explain how the national interests he views as paramount are in fact formed at the domestic level. Moravcsik was among the first scholars to build upon this underdeveloped aspect of Hoffmann's work to formulate the so-called liberal intergovernmentalist framework, based upon a 'liberal' view of domestic politics. Andrew Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach," *Journal of Common Market Studies* 31, no. 4 (December 1993): 473-524.

¹⁹ Jeffrey A. Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45, no. 4 (Autumn 1991): 425-51; Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Political Alignments* (Princeton: Princeton University Press, 1989).

more or less closely with these goals.²⁰ In most cases, their findings are in line with the patterns observed in regional integration more generally, namely that market synthesis is driven forward mostly by multinational firms already engaged in significant cross-border activities and other domestic actors which stand to receive the greatest material benefit from it.

While the literature on Banking Union is still quite underdeveloped when compared with that on European integration more generally, most accounts which do exist follow a similarly interest-based approach. Howarth and Quaglia are the perhaps most prolific scholars within this narrower canon, having published numerous works which explore how specific features of national banking systems—in particular, the reach of internationalization in domestic bank activities—align sectoral interests more or less closely with the objectives of Banking Union and thereby also inform state attitudes toward the related proposals.²¹ Spendzharova reaches a similar conclusion, finding greater support for integration among those member states whose domestic banking sectors are already characterized by high levels of internationalization and foreign ownership.²² In various works on the Banking Union, Epstein and Rhodes highlight the role of multinational bank lobbying groups in driving legislative progress forward, but also incorporate a more neofunctionalist logic whereby the

²⁰ Jeffrey A. Frieden, "The Impact of Goods and Capital Market Integration on European Monetary Politics," *Comparative Political Studies* 29, no. 2 (April 1996): 193-222; James I. Walsh, *European Monetary Integration & Domestic Politics: Britain, France, and Italy* (Boulder, Colorado: Lynne Rienner Publishers, 2000); Leila S. Talani, *Betting for and Against EMU: Who Wins and Loses in Italy and in the UK from the Process of European Monetary Integration* (Abingdon, United Kingdom: Taylor and Francis, 2017).

²¹ David Howarth and Lucia Quaglia, "The Steep Road to European Banking Union: Constructing the Single Resolution Mechanism," *Journal of Common Market Studies* 52, no. S1 (September 2014): 125-40; David Howarth and Lucia Quaglia, *The Political Economy of European Banking Union* (Oxford Scholarship Online: Oxford University Press, 2017); David Howarth and Lucia Quaglia, "Internationalised Banking, Alternative Banks and the Single Supervisory Mechanism," *West European Politics* 39, no. 3 (May 2016): 438-61.

²² Aneta B. Spendzharova, "Banking Union under Construction: The Impact of Foreign Ownership and Domestic Bank Internationalization on European Union Member-states' Regulatory Preferences in Banking Supervision," *Review of International Political Economy* 21, no. 4 (September 2013): 1-31.

exigencies of the postcrisis financial environment allowed European institutions to push for supranational solutions even in the face of fierce opposition from individual member states.²³ In general, however, most existing accounts of the Banking Union are not in-depth country case studies like the present analysis, deriving state preferences from holistic characteristics of national banking systems rather than specific interest group competition within individual sectors.

At the opposite end of the spectrum exist those ideas-based approaches which view national preferences as more or less socially constructed from the culturally-determined ideological lenses—considered path-dependent and value-based—through which states view specific policy issues and the range of appropriate responses. Within this canon, it is possible to assign ideology an absolutely preeminent place in the causal analysis, or to consider ideas-based approaches mainly in conjunction with sectoral and short-term interests when the explanatory power of the latter proves inadequate.²⁴ In the literature on European integration, most such accounts are implicitly or explicitly reminiscent of Sabatier’s advocacy coalition framework, which emphasizes rigidly held normative and ontological beliefs (the “deep core”) that apply across virtually all policy areas in addition to specific causal perceptions of a given issue.²⁵ More recently, Brunnermeier et al. trace common divisions in policies related to the shared currency to a distinction between the rules-based vision of northern

²³ Rachel A. Epstein and Martin Rhodes, "States Ceding Control: Explaining the Shift to Centralized Bank Supervision in the Eurozone," *Journal of Banking Regulation* 17, no. 1-2 (March 2016): 90-103; Rachel A. Epstein and Martin Rhodes, "International in Life, National in Death?: Banking Nationalism on the Road to Banking Union," in *The Political and Economic Dynamics of the Eurozone Crisis*, edited by James A. Caporaso and Martin Rhodes (Oxford Scholarship Online, 2016).

²⁴ Peter Hall, "The Role of Interests, Institutions and Ideas in the Political Economy of Industrialized Nations," in *Comparative Politics: Rationality, Culture and Structure*, edited by Mark Irving Lichbach and Alan S. Zuckerman (Cambridge, United Kingdom: Cambridge University Press, 1997), 184.

²⁵ Paul A. Sabatier, "The Advocacy Coalition Framework: Revisions and Relevance for Europe," *Journal of European Public Policy* 5, no. 1 (March 1998): 98-130.

Europe, which emphasizes rigor and consistency, and the discretionary approach of the south, which more readily recognizes the need for flexibility and adaptation.²⁶ In separate accounts, Quaglia and Donnelly note a similar division between a market-shaping coalition in southern Europe and a rival market-making approach in the north as one of a few explanatory variables for national preferences toward the Banking Union and EU-level financial policies more generally.²⁷ Thus, while ideas-based approaches are generally less well-developed within the field of comparative political economy, they are by no means absent from the literature on European integration or even Banking Union as a more specific area of application.

Situated at some point in between these interest- and ideas-based frameworks is the broad sum of institutions-oriented explanations which has been applied to these and other phenomena in the European Community and elsewhere. In many cases, differences in institutional design—that is, in the basic organizational structures through which both interests and ideas are necessarily filtered—are not necessarily opposed to the former approaches, but can add an additional layer of complexity when it is unclear which from a wide array of disparate and often conflicting forces should prevail. In the European context, the best-known among such approaches is the Varieties of Capitalism typology of Hall and Soskice, which places European member states on a spectrum between two ideal types of advanced capitalist economies based on the ways in which

²⁶ Markus Konrad Brunnermeier, Harold James, and Jean-Pierre Landau, *The Euro and the Battle of Ideas* (Princeton, New Jersey: Princeton University Press, 2016).

²⁷ Lucia Quaglia, "Completing the Single Market in Financial Services: The Politics of Competing Advocacy Coalitions," *Journal of European Public Policy* 17, no. 7 (October 2010): 1007-1023; Shawn Donnelly, "Advocacy Coalitions and the Lack of Deposit Insurance in Banking Union," *Journal of Economic Policy Reform* 21, no. 3 (July 2018): 210-223.

firms are incentivized under different systems of industrial relations.²⁸ Since its invention, this framework has informed a number of accounts which exploit Varieties of Capitalism-based distinctions to explain various aspects of European economic and monetary union.²⁹ Even in the narrow case of Banking Union, Ferber traces Franco-German divergence to a fundamental distinction between bank- and equity-based models of corporate finance which predominate in Germany and France, respectively.³⁰ While such accounts are by no means inconsistent with the present thesis (in fact, they overlap quite significantly), the relationship between banks and firms in the domestic economy is largely excluded from this thesis in favor of a closer analysis of interest group competition within the national banking system itself.

Proposed theoretical framework

This thesis posits an interest-based theory of national preference formation in which the negotiating behavior of states is understood primarily as a rational pursuit of their material self-interests, not shaped in large part by deeply embedded national ideologies or spillover pressures from interstate cooperation in other areas. Critically, however, these interests are not unitary or predetermined. Rather, in the sense of a two-level game between diplomacy and domestic politics, they result from the mobilization of organized interests in the local

²⁸ Peter A. Hall and David W. Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001).

²⁹ Bob Hancké, Martin Rhodes, and Mark Thatcher, *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (Oxford: Oxford University Press, 2008). Iain Hardie and David Howarth, "A Peculiar Kind of Devastation: German Market-Based Banking," In *Market-Based Banking and the International Financial Crisis*, edited by Iain Hardie and David Howarth (Oxford Scholarship Online: 2013).

³⁰ Tim Ferber, "European banking regulation after the financial crisis: Franco-German conflict of interest during the negotiations on a Single Resolution Fund" (PIPE - Papers on International Political Economy No. 27, Freie Universität Berlin, 2016).

political economy and the natural incentives of policymakers to preserve these to the greatest possible extent.³¹ In the following section, this thesis considers the formation of national policy preferences as a two-step process.

First, in the domestic realm, an anticipated change in policy encourages the formation of organized interests among the most immediately affected groups of domestic stakeholders. In such cases, there must exist a certain degree of “misfit” or “mismatch” between the proposed policy and the existing approach which it threatens to replace.³² The anticipation of significant adaptational pressures, in turn, encourages domestic stakeholders to consider whether they expect the proposed changes to be favorable or unfavorable to their own narrowly construed material interests. The resulting distribution of ‘winners’ and ‘losers’ encourages the formation of issue-specific interest groups, which then lobby for or against broad policy outcomes in line with their anticipated consequences in the local political economy.

This framework does not consider the range of relevant interests to extend beyond the most immediately affected domestic industry. In a given area of policy, industry insiders are typically able to exert far more influence than other kinds of domestic stakeholders, as the former can devote greater resources to lobbying activities and possess superior expertise in the relevant issues (often highly specialized knowledge). Due to the concentrated nature of the benefits (or costs) of the policy in question, they are also better able to sustainably overcome the collective action problems associated with mounting an effective lobbying

³¹ Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-level Games," *International Organization* 42, no. 3 (1988): 427-60.

³² Kevin Featherstone and Claudio M. Radaelli, *The Politics of Europeanization* (Oxford: Oxford University Press, 2003), 60-61.

effort. As a result, non-industry actors are not expected to figure prominently in the formation of national preferences and their omission therefore reasonably justified.

At the intergovernmental level, preference-formulating national governments are rational and self-interested actors which seek foremost to maximize material interests within their respective domains. At a more granular level, this is rooted in the assumption that politicians and policymakers are principally concerned with their own electoral preservation and thus also meaningfully beholden to the interests of their domestic constituencies. Here, dominance is a flexible term requiring closer analysis of the composition of the affected industry and the ways in which industry stakeholders are connected to local political processes. Where national markets are heterogeneous and comprise a wide array of divergent preferences, competition between rival groups can be fierce, and policymakers may be required to balance opposing interests against each other. In general, however, it is assumed that national policymakers are aware of the interests which predominate in the domestic realm and represent these as accurately as possible in the expression of national preferences and the design of final policy outcomes.

Implications in the present case

The following section outlines the implications of the above theoretical framework in the specific case of the European Banking Union. In line with previous assumptions, observers confirm that non-bank actors have not figured prominently in the formation of domestic attitudes toward the related proposals:

notwithstanding its political and economic importance, the Banking Union has far from “mobilized the masses,” and nonfinancial stakeholders have usually been far outnumbered in official consultations and the general public discussion.³³ In the domestic realm, then, the introduction of the Banking Union has far-reaching consequences mostly for individual banks and banking groups in participating member states, which consider these in relation to their own narrowly construed material interests and formulate positions accordingly. Specifically, this thesis identifies three major areas in which the Banking Union is likely to affect domestic banking interests and predicts a distribution of winners and losers in each.

Changes in the competitive landscape: First, the construction of the Banking Union is closely linked to the broader integrative goals of the Single Market program, the appeal of which depends on banks’ expansionary ambitions with respect to Europe as a whole. Broadly, the project’s architects hope that a streamlining of banking policy will allow funds to flow more easily across the continent and thereby also cultivate a more genuinely European market in the provision of banking services; importantly, this is intended not only to equalize the competitive playing field between different kinds of banks in Europe, but also to foster the development of truly European banks with the ability to offer a more diverse range of products and services to a similarly diverse array of international customers.³⁴ Still, not all banks are competitively favored in this respect, with

³³ "Banking Union: Jeroen Dijsselbloem's Springtime," *Agence Europe Daily Bulletin* (blog), March 20, 2014; Myriam van der Stichele, *Financial Regulation in the European Union: Mapping EU Decision Making Structures on Financial Regulation and Supervision* (Amsterdam: Bretton Woods Project, December 2008), 40.

³⁴ Mersch, "The single market and banking union"; Danièle Nouy, "Banking Union - Forging a European banking market" (speech, Frankfurt 120 Round Table, Frankfurt am Main, November 14, 2017).

advantages depending crucially on the reach of their existing operations and ability to leverage market share outside the borders of their home states. In practice, this suggests a clear division between those banks already operating extensive networks of cross-border branches and subsidiaries and those more locally-focused banks which are not active to a meaningful extent outside their respective national markets. The latter, in addition to having no comparable interest in a European market as such, also face competitive pressures from new market entrants and the threat of substitute products offered by these.

Anticipated costs and savings: Second, the Banking Union is also tied to the imposition of new and significant costs, the manageability of which generally depends on the scope of banks' existing operations and the likelihood of savings to be incurred over the longer term. In this respect, each pillar is somewhat distinct and will be examined on a case-by-case basis in subsequent chapters. Broadly, however, the costs associated with Banking Union are both operational (where compliance imposes a significant administrative burden) and pecuniary (where participation requires more substantive contributions or outflows of cash). From the perspective of large banks, fixed costs are marginally smaller relative to their ability to absorb them; in cases where a streamlining of policy reduces the operational burden associated with maintaining extensive cross-border operations, they are also more likely to be offset by savings which can be expected over the longer term. From the perspective of small banks, however, fixed costs cannot be as easily spread across the existing base of production; those not actively engaged in cross-border banking markets also derive no longer-term savings from a

streamlining of policy across national regulatory jurisdictions, and any cost-benefit analysis yields a more unambiguously negative outcome.

Attitudes toward risk-sharing: Finally, the Banking Union is also associated with the imposition of new risk-sharing mechanisms at the European level, the value of which depends crucially on banks' exposures to the kinds of risks these are intended to protect against and combat. Even in national banking markets, institutions are often compelled to contribute to industry-wide insurance pools which produce a stabilizing effect in the system at large. Financial stability, in this context, may be considered along the lines of a tendentially underprovided public good. The shift to a supranational policy regime, then, suggests a widening of the relevant risk pools which is not at all uniformly desirable from the perspective of participating institutions. On the one hand, there are banks which are already well-integrated in European financial markets and accordingly more likely to be affected by—or contribute to—risks emanating from elsewhere in the system (these are considered to pose a higher level of systemic risk); as a result, they look forward to spreading risks across a more widely defined area and reaping the benefits of improved stability in the European financial sector at large. On the other hand, there are banks which are not well-integrated in European financial markets and not likely to be affected by or contribute to risks emanating from elsewhere in the system (these are considered to pose a lower level of systemic risk); as a result, they have little interest in a public good from which they do not derive clear benefits, and are loath to make contributions which

effectively subsidize higher-risk institutions in the same national or supranational markets.

In sum, the introduction of the Banking Union gives rise to clear divergences of interests between domestic stakeholders in the affected member states, in accordance with how the proposed changes affect their material well-being in three areas in particular. In general, the patterns described above suggest the following first-level hypothesis in the formation of domestic attitudes toward the Banking Union:

Hypothesis I: The extent to which individual banks are favorable to the Banking Union will increase with (1) the scale of their existing operations; (2) their expansionary ambitions in cross-border markets; and (3) their level of integration in European financial markets as a whole.

In a policymaking context, then, state preferences related to the design and implementation of Banking Union are expected to closely match dominant interests within each state's domestic banking sector. Because preferences are formulated in response to specific legislative proposals and in many cases also in reaction to the simultaneously expressed preferences of other negotiating partners, the relevant issue areas are more narrowly defined than between major stakeholders in the domestic realm. In the construction of a supranational policy regime, however, preferences relate foremost to the degree of policy autonomy to be transferred from the national to the supranational level (i.e., how to define the balance of power between national and European authorities and, more broadly,

between intergovernmental and supranational models of governance). This suggests the following second-level hypothesis in the formation of national policy preferences toward the Banking Union:

Hypothesis II: The more favorable domestic banks are to the construction of the Banking Union, the more national governments will be amenable to European-level policy centralization in this respect.

Methodology

Case selection: This thesis assesses the validity of this dual-hypothesis framework against qualitative case studies of France and Germany, considering their selection from among 28 European Union member states particularly well-reasoned. First, as will become apparent in chapters to follow, France and Germany present a clear contrast in all of the most pertinent respects, including both in the composition of domestic banking interests as well as in the policy preferences actually expressed at the intergovernmental level. Second, as France and Germany are home to the largest banking sectors in the euro area in terms of assets, their preferences tend to dominate negotiations related to European banking policy and are also better-documented than those of less prominent players.³⁵ Third, given their relatively superior weathering of the financial and sovereign debt crises, it has been suggested that they acted as policy ‘makers’ rather than—like countries of the European periphery—policy ‘takers’ in the realm of postcrisis reforms, with greater autonomy expected from domestic

³⁵ *Report on financial structures: October 2017* (Frankfurt: European Central Bank, October 2017), 24.

economic interests relative to external pressures.³⁶ Finally, as described in the previous chapter, the historical importance of Franco-German cooperation to the deepening of economic and monetary integration in Europe connects this thesis to the large body of international relations literature which focuses on this couple in particular.

Data collection: Organizationally and methodologically, this paper deploys a two-step analysis in each of three separate empirical chapters on the individual pillars of the Banking Union. In each case, a test of Hypothesis I captures bank positions primarily through: policy position papers released by individual banks and their respective lobbying associations; related press coverage; accounts of formal consultation proceedings; and, finally, semi-structured interviews with high-ranking bank officials, lobbyists, and an array of observers with firsthand experience of the bank lobby over the course of their careers. Next, a test of Hypothesis II attempts to reconstruct the development of French and German policy preferences throughout the relevant negotiations at the European level, relying heavily on: a survey of existing press coverage; speeches and other public expressions of preferences by high-ranking government officials; primary sources published by European policymaking institutions, including legislative proposals, meeting minutes, and video recordings; and, finally, a series of semi-structured interviews with officeholders who were either directly involved in or otherwise closely observed the relevant proceedings, including at national ministries of finance, national central banks, and European policymaking institutions. In aggregate, this thesis is based on insights drawn from about fifty

³⁶ Howarth and Quaglia, "Internationalised Banking," 447.

semi-structured interviews conducted by the author both in person and over the phone between March 2018 and February 2019, a comprehensive list of which can be found in the appendix.

Chapter III: Overview of National Banking Sectors

The following chapter provides a synthetic overview of the national banking sectors of both France and Germany. In view of the predictions of Hypothesis I, divisions between banking groups are drawn primarily along economic lines and on the basis of three key areas identified in the previous chapter. In sum, this thesis finds stark contrasts between the French and German banking sectors and the kinds of interests likely to dominate each: while the French market is controlled by a handful of large commercial banks which are all active to varying degrees across borders and systemically well-integrated in Europe as a whole, the vast majority of German banks are small and community-focused, with no aspirations to operate at the European level or increase their level of exposure in cross-border markets. In each case, the following section also identifies mechanisms through which domestic banking interests are likely to coordinate their respective lobbying efforts or exercise more informal influence within the national political system.

Germany

As a point of departure, it is useful to characterize the German banking sector in relation to one of its most distinguishing features, that is, its extremely low level of concentration relative to the European market as a whole. Indeed, Germany tends to score consistently lower on all commonly employed indicators of banking sector concentration than any other member state of the European

Union. By way of illustration, the share of Germany's five largest depository institutions amounts to only about one-third (33 percent) of the total national market for bank assets—about one-half of the E.U. average (60 percent). Cross-country comparisons of another standard indicator, the Herfindahl-Hirschman Index, suggest that Germany's banking sector is the furthest in all of Europe from resembling a monopoly.³⁷ The results of quantitative comparisons are also confirmed by the sheer number of credit institutions currently active in the German market, which comprised over 1,800 individual institutions when the Banking Union first emerged on the policymaking agenda in 2012 and over 1,500 in 2017, according to the most recently available data (see Table 1).³⁸

Table 1: Number of institutions by banking group, 2012-2017

Data source: "The performance of German credit institutions in 2017." Deutsche Bundesbank Monthly Report 29. September 2018.

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Private commercial banks	183	183	183	177	171	172
Big banks	4	4	4	4	4	4
Regional banks and other commercial banks	160	160	160	154	148	149
Branches of foreign banks	19	19	19	19	19	19
Savings banks group	432	426	425	422	412	398
Savings banks	423	417	416	413	403	390
Landesbanken	9	9	9	9	9	8
Cooperative banks	1,101	1,078	1,047	1,021	972	915
Alternative banking total	1,533	1,504	1,472	1,443	1,384	1,313
Other banks	60	61	60	59	56	53
Mortgage banks	17	17	17	16	15	13
Building and loan associations	22	22	21	21	20	20
Banks with special development tasks	21	22	22	22	21	20
All banks	1,776	1,748	1,715	1,679	1,611	1,538

³⁷ The Herfindahl-Hirschman Index computes the size of firms in relation to an industry as a whole and is most commonly cited in characterizing the effects of particular merger and acquisition transactions. "ECB Statistical Data Warehouse," European Central Bank, accessed November 28, 2018. <https://sdw.ecb.europa.eu/>.

³⁸ If smaller savings and cooperative banks were counted as part of their respective networks rather than individually, measures of market concentration in Germany would be more or less in line with those of other European states. Rym Ayadi, Reinhard Schmidt, and Santiago Valverde, *Investigating Diversity in the Banking Sector in Europe: The Performance and Role of Savings Banks* (Brussels: Center for European Policy Studies, 2009), 130.

For the purpose of the present thesis, the fragmented nature of the German banking sector is relevant primarily to the extent that it promotes an unusually high degree of institutional heterogeneity among a diverse array of major and minor players. In the comparative literature of financial systems, this diversity is generally described in terms of a traditional three-pillar structure which formally distinguishes between privately-owned commercial institutions, public-sector savings banks or *Sparkassen*, and member-owned cooperatives, all of which have coexisted in Germany for centuries and continue to compete head-to-head in the same regional and national markets for banking services.³⁹ Importantly, the German banking sector is also truly heterogeneous in the sense that market share is distributed relatively evenly among different kinds of banks (see Table 2). When savings and cooperative banks are considered together, their share of total banking assets is not significantly below that of private commercial institutions, and they also overtake these in some important market segments (e.g., in lending to domestic enterprises). Because this thesis distinguishes between banking groups on the basis of the economic activities in which they are actually engaged, it disregards distinctions in ownership structure except where technically relevant, and instead considers the second and third pillars together as ‘alternative’ banks with the same or similar interests across most aspects of financial regulation.

³⁹ Richard Deeg, *Finance Capitalism Unveiled: Banks and the German Political Economy* (Ann Arbor: University of Michigan Press, 1999), 31-32; Patrick Behr and Reinhard H. Schmidt, "The German Banking System: Characteristics and Challenges" (SAFE White Paper Series No. 32, Goethe University Frankfurt, November 2015), 2-3.

Table 2: Market share (% of total bank assets) by banking group, 2012-2017

Data source: Author's elaboration based on asset data in "The performance of German credit institutions in 2017."

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Private commercial banks	43%	42%	42%	43%	43%	43%
Big banks	34%	32%	31%	32%	31%	29%
Regional banks and other commercial banks	9%	9%	10%	10%	11%	13%
Branches of foreign banks	1%	1%	1%	1%	1%	1%
Savings banks group	26%	27%	27%	26%	25%	26%
Savings banks	11%	13%	13%	13%	14%	14%
Landesbanken	14%	14%	13%	13%	12%	11%
Cooperative banks	8%	9%	9%	9%	10%	11%
Alternative banking total	34%	35%	36%	35%	35%	36%
Other banks	23%	23%	22%	22%	22%	21%
Mortgage banks	6%	6%	5%	4%	3%	3%
Building and loan associations	2%	2%	2%	2%	3%	3%
Banks with special, development, and other central support	15%	15%	15%	15%	16%	15%

Encompassed within the first pillar are institutions which are commercially operated to the benefit of equity shareholders and other private actors, effectively most commonly associated with those ‘big banks’ which have traditionally held the most significant financial power within their respective markets.⁴⁰ Big banks operate at a much larger scale in both national and cross-border markets, reflected both in the operation of variably extensive networks of branches and subsidiaries as well as in the major balance sheet exposures of such banks (e.g., higher shares of assets held outside the home market and liabilities derived from a diverse array of both national and international clients). Usually, these banks are also more exposed to the kinds of structured finance and capital markets products which are generally associated with higher levels of market risk. Given their size, complexity, and interconnectedness in cross-border markets, the systemic relevance of such institutions is generally beyond question: bank-

⁴⁰ Technically, the first pillar also comprises a significant number of smaller and regional institutions which, given that they contribute only a much smaller share of assets to the larger group and are in any case far less visible in debates over national financial regulation, are generally disregarded in the following characterization.

specific distress could potentially trigger a significant disruption to the financial system as a whole and even affect economic activity in real terms.

Strictly speaking, there are only two German banks—Deutsche Bank and Commerzbank—which meet these criteria.⁴¹ Between these, Deutsche Bank is substantially more active in cross-border retail markets, with thousands of branches across Europe and major subsidiaries in Belgium, Italy, Poland, Portugal, and Spain (outside of Germany, Commerzbank’s European retail presence is concentrated mainly in Poland). Both banks are internationalized to varying degrees: outside the borders of its home state, Deutsche Bank held about 32 percent of its assets in the rest of the European Union and 34 percent in the rest of the world by the end of 2012, that is, roughly when first-round debates on the Banking Union reached their height; Commerzbank, while less well-integrated in European markets, scored similarly in its global exposure (17 and 32 percent of total assets, respectively).⁴² Notably, Deutsche Bank has deliberately oriented itself toward higher-risk engagements in the global capital markets, suggesting that high levels of internationalization are not necessarily indicative of a particularly strong retail presence outside of Germany.⁴³ Within Germany, its retail brand has been bolstered by its recent acquisition of Deutsche Postbank AG,

⁴¹ The group of ‘big banks’ is officially designated by the Deutsche Bundesbank and does not depend upon any explicitly defined size threshold or direct comparison between banks. This group has historically also included such major players as Dresdner and HypoVereinsbank, though membership has shifted at various points as a result of (often intra-group) mergers and acquisitions—including, most recently, the takeover and legal merger of Dresdner Bank by Commerzbank in 2009. Today, the formally defined group of big banks technically encompasses four institutions, but these count DB Privat- und Firmenkundenbank AG and Deutsche Bank Aktiengesellschaft as separate entities, and also include the German subsidiary Unicredit Bank AG (that is, what became of Germany’s HypoVereinsbank after it was bought by Italian UniCredit in 2005). Correspondence, Deutsche Bundesbank, January 22, 2019.

⁴² Howarth and Quaglia, "Internationalised Banking," 442.

⁴³ David Howarth, "France and the International Financial Crisis: The Legacy of State-Led Finance," *Governance* 26, no. 3 (July 2013): 377.

which offers a range of simpler, low-cost products for the everyday needs of private customers and small and medium-sized enterprises.

Still, both Deutsche Bank and Commerzbank are rather anomalous when viewed against the landscape of the German banking market as a whole, which is populated by a large number of alternative banks whose activities are by default much more restricted. By definition, alternative banks are bound to socially-oriented business models which emphasize the economic development of their immediate communities through the strategic allocation of credit to private households and small- and medium-sized enterprises.⁴⁴ In Germany, savings and cooperative banks alike are also subject to the so-called regional principle, which explicitly restricts their operations to a narrowly defined geographical area (e.g., a municipality or county).⁴⁵ As a result, such banks tend to have very little or no exposure to markets outside their immediate communities, and do not pose a clear systemic threat to the stability of the European financial system as a whole. From a standpoint of individual bank risk, too, there are several reasons why alternative models might be considered inherently more conservative. The longer time horizon of patient capital and the absence of a clear profit motive are thought to substantially reduce incentives for excessive risk-taking, and most services do not extend far beyond alternative banks' traditional specialization in deposit-taking and lending (overwhelmingly in more stable retail and mortgage markets).⁴⁶ Similarly, institutionalized relationships with their local customer base should

⁴⁴ Olivier Butzbach and Kurt E. Von Mettenheim, "Alternative Banking and Theory," *Accounting, Economics, and Law* 5, no. 2 (2015): 110.

⁴⁵ Behr and Schmidt, "The German Banking System," 11.

⁴⁶ David Llewellyn et al., *Investigating Diversity in the Banking Sector in Europe: Key Developments, Performance and Role of Cooperative Banks* (Brussels: Center for European Policy Studies, 2010), 16; Butzbach and von Mettenheim, "Alternative Banking and Theory," 124.

render alternative banks less vulnerable to the liquidity risk posed by rapid erosions of client confidence, and greater geographical proximity to borrowers allows for more personalized customer screening and monitoring than is possible under the more streamlined operating models of larger banks.⁴⁷

In Germany, alternative banking models are widespread and a favorable regulatory environment has generally allowed them to flourish and prosper. When the Banking Union was first introduced in 2012, the savings and cooperative banking sectors accounted for about 1,500 of the nearly 1,800 institutions in the German banking market—particularly impressive given that alternative banks have been either restructured or completely eliminated elsewhere in Europe over the course of recent decades.⁴⁸ In Germany, by contrast, national regulatory structures have consistently sought to preserve these to the greatest possible extent: until the 2005 intervention of the European Commission deemed this a form of competition-distorting state aid, the debts of public-sector banks were explicitly guaranteed by their respective local and regional governments under the German principle of *Gewährträgerhaftung*, roughly translated as ‘sponsor’s guarantee.’ The phasing out of such guarantees was a clear victory for Germany’s private banks, which objected to the fact that institutions in the savings bank sector consistently obtained perfect or near-perfect ratings from their public

⁴⁷ Alessandro Carretta, Paola Schwizer, and Vittorio Boscia, *Cooperative Banking: Innovations and Developments: Innovations and Developments* (Basingstoke, United Kingdom: Palgrave Macmillan, 2009), 24. Even where large commercial banks operate extensive local branch networks, they tend to centralize most decisions related to the allocation of credit (at Deutsche Bank, since the early 2000s). Interview, Deutsche Bundesbank, October 31, 2018.

⁴⁸ Within the savings and cooperative sectors, such figures encompass a number of regional and central institutions which, despite having traditionally occupied strictly defined supporting roles within their respective groups, are today important providers of financial services in their own right. In the early 2000s, most of these adopted liberalizing growth strategies and became increasingly involved in the kinds of nontraditional financial activities associated with commercial banking. Best-known among these are the *Landesbanken*, which serve as clearing houses for the savings banks in their respective districts and as house banks for their respective states. Richard Deeg and Shawn Donnelly, "Banking Union and the Future of Alternative Banks: Revival, Stagnation or Decline?," *West European Politics* 39, no. 3 (May 2016): 586.

owners and thus also enjoyed more favorable refinancing conditions on Germany's capital markets.⁴⁹ At present, the perhaps most important competitive advantage of Germany's alternative banks are their historically well-established institutional protection schemes, networks of mutual support which allow for system-wide compensation in the case that any member encounters financial difficulties. While the interactions of IPSs with European regulatory frameworks will be explored in greater detail in subsequent chapters, the interventions of the German government have generally allowed these to remain mostly untouched by supranational efforts to promote regulatory harmonization and a more equal competitive playing field in the European market.⁵⁰

The major sectoral divisions in the German banking system also shape the ways in which banks exercise political influence in the formulation of prudential regulation and other important matters. The formal lobbying efforts of all German banks are coordinated by higher-level associations which represent their interests vis-à-vis policymakers and the general public, but membership is strictly defined by a bank's position within the pillar-based system. In the private commercial sector, the Association of German Banks (BdB) encompasses both the big banks and a range of differently sized private institutions; in crafting policy positions, it often balances divergent economic interests and formulates compromises between its larger and smaller members.⁵¹ In the alternative sector, major lobbying associations include the German Savings Banks Association (DSGV), the

⁴⁹ Daniel Seikel, "How the European Commission Deepened Financial Market Integration. The Battle over the Liberalization of Public Banks in Germany," *Journal of European Public Policy* 21, no. 2 (October 2013): 8.

⁵⁰ Alternative banking networks in France, introduced in the following section, have never operated or belonged to an IPS. Currently, IPS are recognized in only 3 countries taking part in the Banking Union (Germany, Austria, and Spain), though Germany's is the largest and most well-known. Correspondence, BNP Paribas, February 1, 2019.

⁵¹ Interviews, Association of German Banks, June 1, 2018; January 9, 2019; January 17, 2019.

Association of German Public Banks (VÖB, which includes regional banks like the Landesbanken), and the National Association of German Cooperative Banks (BVR). Attitudes toward new legislative initiatives are disseminated through the publication of policy position papers and expressed in the context of formal consultations with the European Commission and the European Banking Authority. Representatives at their Brussels locations might also arrange personal meetings at the offices of the European Parliament and host by-invitation events in which formal presentations of policy positions are supplemented by social relationship-building.⁵²

While differences in relative political clout are difficult to claim beyond reasonable doubt, there are at least two reasons one might expect Germany's alternative banks to derive an advantage in cases where their interests are not aligned with those of their large commercial peers. First, in a consideration of bottom-up channels of political influence, savings banks are known to be particularly well-connected in local political communities, a product of their public service obligations and historical origins in the public administration of their respective city or county. As a result, there tends to be significant overlap between politicians elected at the county or municipal level and the supervisory boards of individual Sparkassen, in which the position of chairman is also usually held by the mayor or head of the relevant district authority.⁵³ Most existing accounts focus on the electoral and personal income benefits which politicians

⁵² Interview, European Parliament, December 7, 2018.

⁵³ Jonas Markgraf and Nicolas Véron, "Germany's savings banks: uniquely intertwined with local politics," Peterson Institute for International Economics: Realtime Economic Issues Watch (blog), July 18, 2018; Mark Hallerberg and Jonas Markgraf, "The Corporate Governance of Public Banks before and after the Global Financial Crisis," *Global Policy* 9, no. S1 (June 2018): 45. Interviews, various.

themselves derive from associations with local Sparkassen, but it is reasonable to assume that savings banks profit similarly from privileged access to local politicians.⁵⁴ Of course, while local-level politicians are usually less directly involved in policymaking at the European level, the decentralized structure of the German political system and the importance of regional party politics to the federal parliament in Berlin means that local interests still wield substantial influence over the positions adopted at higher levels.⁵⁵

Second, in a top-down interpretation of disparities in political influence, it is also possible that German politicians might actively prioritize the interests of savings and cooperative banks to the extent that their existence is perceived as crucial to the health of the German business landscape and the survival of Germany's bank-based model of corporate finance more generally. While specific objectives vary, the allocation of credit by non-profit institutions is intended to support the economic activities of the large number of small- and medium-sized enterprises—often family-owned and usually unlisted—which form the backbone of the German *Mittelstand*.⁵⁶ Often, local projects may not be considered sufficiently profitable or risk-free to secure funding from commercial banks under favorable terms. The issuing of debt or equity, moreover, may be cost prohibitive and exposes borrowers to volatile repayment cycles due to the generally shorter time horizons of capital market investors.⁵⁷ In such cases, alternative banking models ensure the provision of so-called patient, or long-term, capital to customers who might otherwise find themselves at the margins of commercial

⁵⁴ Jonas Markgraf, "On Board with Banks: Do Banking Connections Help Politicians Win Elections?" (forthcoming).

⁵⁵ Interview, Economic and Financial Committee of the European Union, June 16, 2018.

⁵⁶ Ayadi et al., *Investigating Diversity in the Banking Sector in Europe*, 116-117.

⁵⁷ Deeg and Donnelly, "Banking Union and the Future of Alternative Banks," 588.

lending markets. German politicians, for whom the robustness of the German *Mittelstand* is a particular point of national pride, face clear disincentives to adopt policies which are anathema to the interests of savings and cooperative banks or threaten their ability to remain competitive in the German market.

France

In stark contrast to Germany, France is home to one of the effectively most concentrated banking sectors in Europe, at least within the narrower group of similarly sized member states. Measured in terms of assets, nearly half (45 percent) of the national market is controlled by a group of only five large credit institutions.⁵⁸ While this is partially a function of the relatively low number of individual French banks (around 350 compared with slightly more than 1,500 in Germany), it is also a result of the historical dominance of five banks in particular, including—in order of total assets—BNP Paribas, Crédit Agricole, Société Générale, BPCE (born in the 2009 merger between former giants Groupe Banque Populaire and Groupe Caisse d'Épargne), and Crédit Mutuel.⁵⁹ The first three of these are considered true giants also by European standards, occupying top-ten positions in rankings of the continent's largest banks and figuring prominently within the group of only seven euro-area banks considered systemically important on a global basis (categories in which Germany is usually only represented through Deutsche Bank and not otherwise). In view of this high degree of market concentration, industry observers have variably characterized

⁵⁸ "ECB Statistical Data Warehouse," European Central Bank, accessed November 28, 2018. <https://sdw.ecb.europa.eu/>.

⁵⁹ The French banking sector comprises 347 individual banks, as of most recently available data. "France's banking sector: Facts & Figures," European Banking Federation, accessed January 6, 2019, <https://www.ebf.eu/france/>.

the French banking sector as resembling either an “informal consortium,” “oligopoly,” or even a “cartel-like structure.”⁶⁰

Beyond the general tendency toward consolidation which has marked the development of most modern banking systems around the world, this large-scale orientation is also deeply rooted in the fabric of French society and in the educational background of French industry leaders. The French case is distinctive for the engineering-informed mindset which characterizes the banking profession at the highest levels of leadership, cultivated in large part by trained engineers occupying key executive positions at most top-tier banks. As a result, bank business models tend to be more efficiency-oriented than elsewhere, reflecting a general consensus that the mechanics of banking require economies of scale and that making the necessary investments in best practices (e.g., in the areas of risk management and regulatory compliance) would be impossible at lower levels of production. Because such investments are considered crucial to providing the best selection of services for a wide array of potential banking needs, French technocrats question whether the small-scale orientation of most German banks—in particular, their preservation at the cost of significant adjustments to universal regulatory frameworks—actually constitutes a service or, indeed, a disservice to the German economy more generally.⁶¹

In France, corporate attitudes toward efficiency and scale have also driven a general convergence of business models across once-meaningful commercial

⁶⁰ Interview, Bruegel, November 9, 2018; Cornelia Woll, *The Power of Inaction: Bank Bailouts in Comparison* (Ithaca: Cornell University Press, 2014), 115; Nicolas Jabko and Elsa Massoc, “French Capitalism under Stress: How Nicolas Sarkozy Rescued the Banks,” *Review of International Political Economy* 19, no. 4 (October 2012): 562.

⁶¹ At present, for example, chief executive, financial, and risk officer positions at BNP Paribas are all held by trained engineers. Interview, BNP Paribas, January 4, 2019.

and alternative banking categories (a distinction which the German system, by contrast, strictly preserves). Until approximately twenty years ago, Germany's three pillars could just as well have defined the major sectoral divisions of nearly any other European banking system, but efficiency-oriented reforms and sweeping industry consolidation caused alternative models—at least in their traditional conception—to generally fall out of favor elsewhere in Europe and in most countries even disappear entirely.⁶² In France, this process was particularly radical: in the 1980s and 1990s, most alternative banks were subsumed into large consolidated entities which are at present virtually indistinguishable from the country's commercial banking groups. Savings banks, for example, have effectively ceased to exist autonomously, and, since merging with a leading cooperative group in 2009, now operate as part of the commercial banking network of *Banques Populaires Caisses d'Épargne* (Groupe BPCE). After a series of mergers, once-local cooperative banks like the *Caisses de Crédit Agricole* and the *Caisses de Crédit Mutuel* are now similarly well-integrated within their respective groups, and any legal distinctions which still exist (e.g., in their corporate governance missions) have no practical bearing on the kinds of activities these banks actually pursue. Thus, the transformation of French banking over the course of recent decades has been marked by a gradual but complete abandonment of the alternative banking ethos to the point that, to modern

⁶² Behr and Schmidt, "The German Banking System," 19-21.

observers and in stark contrast to the German archetype, no such category is today even considered to exist.⁶³

Today, the relative homogeneity of the French banking sector is reflected, for example, in the more or less expansionary business strategies which all banks, regardless of legal ownership structure, have assumed with respect to the European market as a whole. Indeed, French banks have long recognized the limitations in the economies of scale to be achieved at the national level alone, especially given that France—at least relative to Germany—is not home to a particularly fast-growing economy or population of potential banking customers. To that end, all have attempted to leverage market share outside the borders of their home state to a greater or lesser extent and usually also consider Europe—more than France—their true home market.⁶⁴ Of the leading commercial banks, BNP Paribas commands the strongest European presence with major retail subsidiaries in Italy, Belgium, and Luxembourg. It is followed by Société Générale, whose intra-European retail activities tend to be concentrated more heavily on the eastern side of the Continent, as through subsidiaries in Romania and the Czech Republic. Even those formerly alternative banks which were founded on principles of proximity to various French localities are today well-represented in the rest of Europe, with Crédit Agricole being perhaps the most noteworthy example, followed by Crédit Mutuel and BPCE to a lesser extent. Crucially, however, any variation between these is of degree rather than of nature,

⁶³ Llewellyn et al., *Investigating Diversity in the Banking Sector in Europe*, 14; Olivier Butzbach, "From Thrifts to Universal Banks: The Sources of Organisational Change in French Savings Banks, 1945–2000," *Business History* 57, no. 8 (May 2015): 1156, 1164; Correspondence, BNP Paribas, February 1, 2019; Interview, Bruegel, November 28, 2018.

⁶⁴ Interview, BNP Paribas, January 4, 2019.

and therefore not necessarily inconsistent with general tendencies toward convergence in the scope and scale of most French banks' operations.⁶⁵

This higher degree of interconnectedness in European financial markets is also reflected in the major balance sheet exposures of most French banks. By the end of 2012, French banking groups held between 10 and 30 percent of their assets in the European Union outside the borders of their home state, and a significant portion in the euro periphery more specifically.⁶⁶ While leading commercial bank BNP Paribas was at this point more exposed than any other, joint liability within consolidated or semi-consolidated 'alternative' groups also created significant exposures for those small banks still advertised as standalone entities at the local level. Such figures were matched in the German market only by Deutsche Bank, Commerzbank, and some of the regional and central institutions within the alternative banking sector; still, because joint liability schemes between savings and cooperative banks did not extend to the centralizing institutions within their respective groups, smaller entities were generally better shielded from external sources of risk than in the French case.⁶⁷ In France, therefore, it is generally more difficult than in Germany to draw distinctions on the basis of systemic risk alone: all French banks, regardless of residual differences in their institutional structures, are relatively well-connected in European financial markets and not obviously more or less likely to be affected by a system-wide financial disturbance.

⁶⁵ Interview, Bruegel, November 28, 2018

⁶⁶ Howarth and Quaglia, "Internationalised Banking," 441-442.

⁶⁷ *Ibid.*, 453, 455-456.

From a standpoint of individual bank risk, too, French banks have almost uniformly departed from the simple deposit-taking and lending activities which continue to constitute the core of most traditional banking models in Germany (with the noteworthy exception of Deutsche Bank). With no important distinctions between banking groups, French models are increasingly characterized by the hybridization of traditional banking services with riskier market instruments for the purpose of funding firms, starkly contrasting with the focus on patient capital which is at the heart of the German approach. For example, deliberately constructed investment banking arms like Crédit Agricole Corporate and Investment Banks (CACIB) and BPCE's Natixis allowed alternative groups in France to become more engaged in the kinds of complex financial transactions (e.g., derivatives trading) which their German counterparts deliberately eschew, at least at the local level. With no major differences on the basis of ownership structure or legal form, the French banking sector was by several measures the most capital markets-oriented in the world just before the financial crisis took hold in 2007, and most banks (with the partial exception of Crédit Mutuel) also suffered significant losses as a result.⁶⁸

Given this general convergence, most formal lobbying now takes place through the jointly coordinated efforts of the French banking industry as a whole, rather than—as in Germany—through the discrete and often oppositionary campaigns of individual pillars. While German banks distribute their lobbying efforts between at least four major associations, the French Banking Federation—

⁶⁸ Interview, University of Campania Luigi Vanvitelli, October 2, 2018; Howarth, "France and the International Financial Crisis," 379; Howarth and Quaglia, "Internationalised banking," 451.

the only such equivalent in France—represents the interests of all banks in the French market on a wide range of issues.⁶⁹ While the formulation of singular policy positions makes bank-specific inputs more difficult to observe, this is not to say that differences do not exist at a more granular level or in the ordering of specific priorities. Still, French banks are usually able to arrive at a consensus relatively quickly, with significantly overlapping interests in most policy areas and years of experience orchestrating joint action through the FBF. In the specific case of the Banking Union, observers also retrospectively confirm that there were no major differences of opinion within the French banking sector itself, which presented a united front not only for the purpose of augmenting its own political voice, but also because this reflected a genuine convergence of interests on the related topics.⁷⁰

In the French case, the formal lobbying efforts of individual banks are likely also supplemented by the existence elite networks of influence which, despite not yet having been particularly well-defined except in a narrow body of literature, are widely recognized to constitute the most important informal links between France's private and public sectors.⁷¹ In France, market power tends to be concentrated in the hands of a small business elite which also enjoys close ties to the upper echelons of the civil service through personal relationships derived from overlapping educational and professional trajectories. This is deeply entrenched in the fabric of French society and, in particular, in the selective and

⁶⁹ As in Germany, French banks are also subsumed under pan-European lobbying associations (e.g., the EBF).

⁷⁰ Interviews, French Banking Federation, January 16, 2019; BNP Paribas, January 4, 2019.

⁷¹ Mairi Maclean, Charles Harvey, and Jon Press, "Elites, Ownership and the Internationalisation of French Business," *Modern & Contemporary France* 9, no. 3 (August 2001): 313-25; Luc Rouban, "L'inspection Générale Des Finances, 1958-2008: Pantouflage Et Renouveau Des Stratégies Élitaires," *Sociologies Pratiques* 21, no. 2 (November 2010): 19-34.

prestigious *Grandes Écoles*, the most successful graduates of which often spend between five and ten years in the public administration before rotating into top-level executive positions in some of France's largest private-sector corporations.⁷² This phenomenon is more pronounced in the banking industry than any other, where elite networks also interact with an extensive historical record of state-led interventions.⁷³ While the extent of such networks is difficult to measure empirically, the fact that the senior management of most leading French banks consists in large part of former Ministry of Finance officials or members of the financial inspectorate might be taken as general evidence.⁷⁴

Still, in the context of the present analysis, the effects of bank-state ties are difficult to predict. At the most basic level, interpersonal relationships and private exchanges might serve as an auxiliary channel through which individual banks increase their political leverage with respect to the policy decisions which affect them, thereby supplementing efforts the formal lobbying efforts of the French Banking Federation and individual banks. Given the highly centralized nature of the French polity, however, it has also been suggested that official policy positions more often reflect a conflation of private- and public-sector interests, especially as conceived by the French elite.⁷⁵ Where such interests are directly at odds with one another, the vesting of significant independent authority in central political figures also renders these better able to impose state-determined policy priorities on the private sector, rather than being subject to manipulation in the

⁷² Interviews, Société Générale, January 8, 2019; Economic and Financial Committee, November 14, 2018.

⁷³ Howarth, "France and the International Financial Crisis," 389.

⁷⁴ In the French banking sector, such examples abound: current chairman of BNP Paribas Jean Lemierre was formerly the director of the French Treasury; Xavier Muska, in the senior management of Crédit Agricole, was also former Treasury director and economic policy advisor under president Nicolas Sarkozy; and others. Interview, Economic and Financial Committee, November 14, 2018.

⁷⁵ Interviews, various; Howarth and Quaglia, "The Political Economy of the Single Supervisory Mechanism," 16.

opposing direction. For the purposes of the analysis to follow, however, this is considered to be an exception reserved for more acute situations of political crisis rather than the rule.⁷⁶

Comparative analysis

In sum, the French and German banking sectors are dominated by starkly contrasting patterns of domestic banking interests, at least as characterized—along the lines of Hypothesis I—by the scope of their existing operations, the reach of their expansionary ambitions in the rest of Europe, and their level of integration in the European financial market as a whole. While share of the German banking market is distributed more or less evenly between alternative and commercial banking groups, Germany is home to only two major banks with a significant European presence. As a result, German preferences on the Banking Union are reasonably expected to reflect the greater prevalence of small, locally-focused institutions, the activities of which do not extend beyond the borders of a single jurisdiction and which would have correspondingly little to gain from the standardization of banking policy at the European level. The French banking sector, by contrast, has been consolidated to such an extent over the course of preceding decades that is today dominated by no more than five leading banking groups, all of which have a significant and growing footprint in the European banking market and corresponding exposures on bank balance sheets. French preferences on Banking Union, then, will be informed by a significantly more homogeneous constellation of domestic banking interests, all of which are more

⁷⁶ Interviews, French Treasury, January 11, 2019; Bruegel, November 28, 2018.

or less uniformly inclined toward the benefits of policy centralization at the European level and the creation of a more integrated European banking market.

Chapter IV: The Single Supervisory Mechanism

Once policymakers had agreed in principle on the need for a more integrated European banking system, they decided to move first on the creation of a common framework for bank supervision, which was clearly set out at a European Council meeting in late June 2012.⁷⁷ In general terms, supervision is intended to ensure the sound functioning of banks' day-to-day operations by ensuring compliance with the relevant rules and regulations (microprudential supervision), as well as to promote the stability of financial systems as a whole by detecting risks at an appropriately early stage (macroprudential supervision). To this end, supervisors apply a wide variety of tools, including regular on-site examinations, periodic stress tests, and other means of data collection and monitoring. In the European context, the actual formulation of prudential regulation is considered a legislatively separate issue (governed by the Single Rulebook), with supervision referring more immediately to the ways in which these rules are applied and adjusted to the unique features of each state's national banking system. Still, because regulations can be only as effective as their implementation, rigorous supervision is generally considered equally critical.

Despite some previous efforts to harmonize standards across Europe, bank supervision had been an explicitly national competency prior to the entering into force of the Single Supervisory Mechanism in 2014, often carried out by a national central bank, a dedicated national agency, or a combination of the two.⁷⁸

⁷⁷ *Statement of the Euro Summit* (Brussels: European Council, 2012), 1.

⁷⁸ Efforts to harmonize bank supervisory practices included a Memorandum of Understanding adopted in June 2008 to facilitate cooperation between bank supervisory authorities, national central banks, and national ministries of finance across the EU. While MoUs were not legally binding, voluntary cooperation was supported by European structures

Still, as the onset of the financial crisis in 2008 made acutely clear, the largely microprudential focus of precrisis supervisory practices had failed to keep pace with new sources of systemic risk arising from the increasing interconnectedness of financial institutions in both national and cross-border markets.⁷⁹ Observers also expressed concern that supervisory forbearance may have led national authorities to turn a blind eye toward rapidly accumulating problems in their respective sectors, or at least to understate their scale to investors and fellow euro-area member states.⁸⁰ Thus, early advocates of the SSM not only hoped to ensure that prudential rules would be uniformly applied and equally credible throughout the European banking sector; crucially, the construction of a single supervisor was also intended to secure key informational advantages in the case of systemically relevant cross-border banks and to overcome the persistent home biases of national authorities, which had in some cases allowed banks to exploit regulatory loopholes or permitted an otherwise suboptimal implementation of rules at the domestic level.

Part I: The domestic political economy of a common supervisory regime

Even while most day-to-day operational assignments would continue to be carried out at the national level, the introduction of a single European supervisor had far-reaching implications in the domestic banking sectors of affected member

including the Banking Supervision Committee (BSC) of the European System of Central Banks, the Committee of European Banking Supervisors (CEBS), and colleges of national supervisory authorities which coordinated the cross-border supervision of banks with subsidiaries or significant branches in other euro area countries.

Van der Stichele, *Financial Regulation in the European Union*, 29-30; Zdenek Kudrna, "Cross-Border Resolution of Failed Banks in the European Union after the Crisis: Business as Usual," *Journal of Common Market Studies* 50, no. 2 (March 2012): 287.

⁷⁹ Teodora Cristina Barbu and Iustina Alina Boitan, "Implications of the Single Supervisory Mechanism on ECB's Functions and on Credit Institutions' Activity," *Theoretical and Applied Economics* 20, no. 3 (March 2013): 105-106.

⁸⁰ Stijn Verhelst, "Assessing the Single Supervisory Mechanism: Passing the Point of No Return for Europe's Banking Union" (Egmont Paper 58, Royal Institute for International Relations, June 2013), 12.

states. In line with the expectations of Hypothesis I, this shift was most objectionable from the perspective of those small, locally-focused institutions of the kind which were prevalent in Germany, which feared the destruction of long-established and comfortable relationships with national supervisors and the imposition of new—and, in their view, unjustified—administrative costs. By contrast, large cross-border banks in both Germany and France looked forward to a streamlining of supervision across the various national markets in which they were active, and generally considered this to outweigh the short-term inconvenience of the transition itself.⁸¹ The following section traces the formation of these domestic attitudes in the period preceding the introduction of the SSM and, in particular, the ways in which these arose from the distribution of winners and losers in three major areas of anticipated economic effects.

Changes in the competitive landscape: First, centralized supervision was expected to produce a significant pro-competitive effect and some industrial restructuring in a newly defragmented European banking market. As emphasized by the Banking Union’s architects, the creation of a more robust market for bank mergers and acquisitions was not only an inevitable consequence of policy centralization, but also one of its explicitly stated objectives. Prior to the implementation of the SSM, a lack of comparability between national approaches to supervision made it far more difficult to assess the quality of other banks’ assets, especially in areas where levels of nonperforming loans were still high and

⁸¹ Some observers recall that when French policymakers first began to endorse the notion of a Banking Union, the French banking sector was actually somewhat reluctant, but aligned itself rather quickly once the substantive negotiations on the SSM got underway. This apparent reversal of preferences seems most plausibly interpreted as natural resistance to changes in the status quo: French banks, like their German counterparts, enjoyed comfortable relationships with their national supervisors and were loath to forfeit these in favor of a still only vaguely defined supranational regime. Still, once it became clear that the introduction of centralized supervision would be inevitable, French banks shifted their focus to the ways in which the design of the Banking Union might serve their interests in the longer run. Interviews, various.

their true value nearly impossible to estimate. As a result, uncertainty surrounding the economic value of potential investments or partnerships (compounded with existing cultural and linguistic differences) rendered cross-border M&A a particularly precarious kind of transaction.⁸² In this sense, policymakers considered the imposition of a single supervisor a critical means of reinvigorating M&A activity in the euro area—on the decline in both frequency and value since at least 2000—and key to forging a better integrated and more competitive European banking market more generally.⁸³

Still, the extent to which individual banks would be able to take advantage of a prospectively enlarged market for mergers and acquisitions depended crucially on the scope of their existing operations and the existence of any legal or statutory restrictions on these. Those banks which already operated extensive networks of branches and subsidiaries—notably, large commercial banks in both Germany and France—tended to have pre-existing ties to markets outside the borders of their home state and greater internal resources devoted to the exploration of new opportunities. As a result, they generally looked forward to the removal of obstacles to cross-border M&A and expected the introduction of a single supervisor to improve their competitive position in a newly defined European market. Even cooperative banking brands in France, where principles of regional demarcation had long been abandoned, were increasingly well-known in the rest of Europe and coordinated their lobbying activities accordingly.

⁸² European Central Bank, *ECB Annual Report on Supervisory Activities 2017*, March 15, 2018, 13-15.

⁸³ Mersch, "The single market and banking union." In retrospect, uncertainties surrounding the completion of the Banking Union through its third and final pillar appear to have prevented the SSM from accomplishing its objectives in this area. Ignazio Angeloni, "The Single Supervisory Mechanism: Were Expectations Fulfilled?" (speech, 5th Conference on the Banking Union, Goethe University, Frankfurt, 22 November 2018).

By contrast, truly local banks had comparatively little to gain from the consolidation of European banking markets under a single supervisor. Those small French banks still advertised as an individual entities at the local level expressed some reluctance to direct supervision by a European-level authority, but their interests were generally overwhelmed by the strong support of their mother institutions from which they had comparatively little autonomy.⁸⁴ In Germany, however, continued adherence to the regional principle meant that the addressable markets of savings and cooperative banks were by default much more restricted. What is more, the continued legal separation of public and private banks effectively prevented most mergers or acquisitions from crossing the lines between banking groups; to the extent that consolidation had taken place within existing segments, it was more often a direct response to financial stress rather than a proactively identified new business venture.⁸⁵ Thus, the natural limitations of their business models meant that Germany's alternative banks would derive little advantage from operating in the Single Market, especially insofar as this threatened to expose them to new competitive pressures emanating from elsewhere in Europe. Unlike their semi-consolidated counterparts in France, Germany's small banks were not similarly beholden to the often opposing interests of their central institutions: in the case of the savings banks, the Landesbanken's poor weathering of the financial crisis and subsequent Brussels-imposed restructuring had forced them to pare down ambitious plans for

⁸⁴ Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 14, 28.

⁸⁵ There have been isolated cases of consolidation across banking groups, as with some Landesbanken acquiring private banks. "Germany: Technical Note on Banking Sector Structure" (IMF Country Report No. 11/370. International Monetary Fund, Monetary and Capital Markets Department, July 2011), 7.

international expansion and significantly weakened their political position on these matters.⁸⁶

Germany's small banks also expected a further competitive disadvantage from the introduction of a single supervisor, that is, one which related not to the expansion of the Single Market as such, but rather to the assumed lesser familiarity of a European supervisor with the idiosyncrasies of alternative business models. Existing supervisory structures in Germany were particularly accommodating of institutional distinctiveness: in a clear deviation from those corporate governance standards which were increasingly well-established in banking systems around the world, German authorities did not actually subject savings and cooperative banks to external audits by independent public officials, but rather vested significant self-regulating authority in the decentralized auditing institutions—or *Prüfungsverbände*—such banks were allowed to maintain as part of their respective regional associations. In this context, it has been suggested that Germany's alternative banks benefited from a certain degree of supervisory capture, whereby the local agents most immediately responsible for their supervision also identified strongly with their assigned sector and were thus rather favorably inclined toward institutions they were supposed to monitor independently.⁸⁷

A European supervisor, by contrast, would almost certainly have been less familiar with these German institutions, which were increasingly anomalous and

⁸⁶ James Wilson, "Banker praises Landesbanken reforms," *Financial Times*, September 9, 2012.

⁸⁷ Other observers argue that this phenomenon did not in fact result in undue leniency. Because work in the *Prüfungsverbände* was a common path to promotion within the boards of the banks' respective associations, alternative bank supervisors had clear "skin in the game" and were thus in many ways even more scrupulous than supervisors in either the BaFin or the Deutsche Bundesbank. Interview, Deutsche Bundesbank, November 29, 2018.

even peculiar given the general liberalization of alternative banking elsewhere in Europe. From the perspective of many European officials, the privileges they seemed to enjoy in their home market were at times suspicion-arousing and even outright worrisome.⁸⁸ Thus, while their major rivals generally looked forward to the elimination of local biases under the new supervisory regime, Germany's alternative banks consistently complained that any European supervisor would be "too remote" from their businesses to offer fair supervision and accordingly unacceptable.⁸⁹

Anticipated costs and savings: Next, the imposition of a single supervisor was also impossible to consider in isolation from the significant operational burden associated with such a transition. Under national systems of supervision, banks were required to prepare prudential financial reports and forward these for examination by the relevant authorities. If similar reports were prepared for the exclusive use of a European supervisor and applied a uniform set of standards (in the sense of the Single Rulebook) to a wide variety of participating institutions, it was not only likely that the level of detail and frequency required would increase, but also that the requirements themselves would be substantively different and probably more rigorous. The preparation of such documentation—not to mention the imposition of new supervisory fees—would inevitably require additional staff and increase human resource costs across each individual institution.

Notably, however, such costs were fixed rather than variable, and their expected manageability thus contingent on a bank's ability to spread them more

⁸⁸ James Wilson, Gerrit Wiesmann, and Alex Barker, "Germany's small banks fight union plans," *Financial Times*, December 2, 2012.

⁸⁹ James Wilson, "German division over euro bank regulation," *Financial Times*, September 4, 2012.

or less widely across the scope of its existing operations. From the perspective of larger institutions, the burden—while still bothersome—could be distributed among a large staff already dedicated to similar matters and financed through a larger pool of existing resources. This was true of large commercial banks and of those cooperative banking networks in France which, due to their consolidated nature, already operated sizeable economies of scale in matters such as these. From the perspective of Germany’s small banks, however, such an operational burden was likely to be substantial and—because these were independently managed despite forming part of their respective national associations—impossible to spread across a similarly large base of operations.⁹⁰

From the perspective of large cross-border institutions, the outcome of a preliminary cost-benefit analysis was even more favorable to the extent that new administrative costs would be fully or partially offset by the long-term savings afforded by the streamlining of supervision across national borders. Prior to the introduction of the SSM, the maintenance of extensive cross-border networks had been significantly complicated by the distinctiveness of national approaches to supervision and differential treatment effects across the European market. As a result, cross-border banks generally favored the reduction in long-term operating costs associated with such a transition, while local banks (given the geographically restricted nature of their operations) anticipated no comparable

⁹⁰ Federal Financial Supervisory Authority, *BaFin Annual Report 2014*, 116. In the past, the Europeanization of regulation had in some instances created divergences between alternative banks and their respective associations due to the ability of the latter to provide economies of scale in systems designed for the sector as a whole. In the transposition of the Basel guidelines into European law, for example, both the DSGV and the BVR favored the implementation of new risk assessment models which they would be able to control, though these changes were clearly unfavorable from the perspective of individual institutions. Interview, Deutsche Bundesbank, November 29, 2018.

benefits.⁹¹

A note on systemic risk: Unlike other policy instruments encompassed within the Banking Union, supervision does not require explicit risk-pooling between individual institutions; this is not to say, however, that risk considerations did not figure prominently in the formation of domestic attitudes toward the SSM and, in particular, toward the significant operational burden it supposed. Germany's small alternative banks, in particular, insisted that this charge was not commensurate with the risk they actually posed and therefore incompatible with principles of proportionality which were at the time already well-established in the realm of financial sector regulation. In general, the notion of proportional treatment suggests that policy inventions most immediately intended to address systemically relevant institutions should not be inadvertently extended to others which do not pose a similar threat.⁹² As summarized by one savings bank executive, "you don't impose the safety rules you'd need for a 2,000-passenger cruise ship on a yacht taking five people up the coast."⁹³ As the negotiations proceeded, such arguments formed the basis upon which the more generalized opposition of savings and cooperative banks gave way to more narrowly formulated demands for their own exclusion: in accordance with their understanding of proportionality, European supervision should apply to only those systemically relevant institutions whose size, complexity, and interconnectedness in European financial markets warranted it.⁹⁴

⁹¹ Interviews, various.

⁹² *Core Principles for Effective Supervision* (Basel, Switzerland: Basel Committee on Banking Supervision, 2012), 29.

⁹³ Georg Fahrenschon, head of the DSGV, quoted in Wilson et al., "Germany's small banks fight union plans."

⁹⁴ *Gemeinsames Positionspapier zu einem einheitlichen Aufsichtsmechanismus für Kreditinstitute im Sinne der Gipfelerklärung der Mitglieder des Euro-Währungsgebiets vom 29. Juni 2012* (Berlin: BVR/VÖB/DSGV, 2012), 1-2.

It is important to note, however, that this insistence upon proportionality was not taken for granted or even readily accepted outside the alternative banking sector.⁹⁵ Indeed, their rivals begrudged the fact that such institutions could reap the benefits of forming part of a unified group while still denying their systemic relevance where convenient.⁹⁶ As observers pointed out, mutual guarantee schemes effectively unified alternative banking groups from a systemic risk perspective, with an exogenous shock, for example, to the German economy as a whole potentially having devastating system-wide effects.⁹⁷ A parallel is often drawn with savings and loan crisis in the United States, when a series of failed mortgage deals and a sudden rise in interest rates combined to produce widespread failures across thrift financial institutions in the 1980s.⁹⁸ More recently, many of the Sparkassen's ill-fated counterparts in Spain fell victim to a sector-wide collapse following the breakdown of the Spanish mortgage market in late 2007 and under the additional weight of the global financial crisis which followed closely behind.⁹⁹ Even within the German savings bank group there were glaring exceptions to the general pattern of stability: while almost all local banks emerged from the crisis unscathed, the Landesbanken fared disastrously and in many cases also pushed losses onto their affiliated Sparkassen. Thus, the

⁹⁵ Nicolas Véron, "Europe takes an important step towards a European banking union" (CEPR Policy Portal, VoxEU, December 19, 2012). Consolidated and semi-consolidated alternative banking groups in France did not claim to be similarly nonsystemic, as joint liability schemes provided a direct link between smaller banks and the internationalized activities of their mother institutions. Germany was the only member state at the time in which joint liability schemes covered only local banks and not the Landesbanken or other attached entities. Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 28.

⁹⁶ Wilson et al., "Germany's small banks fight union plans."

⁹⁷ Because savings banks' long-term assets consist overwhelmingly of mortgages and other products which guarantee the borrower a locked-in rate, interest rate hikes can have a more significant effect on the Sparkassen than on the more diversified portfolios of large commercial banks. Stephen Kahl et al., "How Germany's Little Savings Banks Threaten Big Financial Woes," *Bloomberg Businessweek*, October 5, 2018.

⁹⁸ Gabriele Steinhilber and Laura Stevens, "German Savings Banks Flex Political Muscle," *The New York Times*, November 10, 2013.

⁹⁹ Luis Garicano, "Five lessons from the Spanish cajas debacle for a new euro-wide supervisor" (CEPR Policy Portal, VoxEU, October 16, 2012).

historical frequency with which banking crises have originated in institutions of precisely the same size and scope cast doubt upon their ability to maintain their near-perfect historical record into the indefinite future. As a result, large banks in France and Germany alike generally advocated for the new supervisory framework to incorporate all euro-area banks in a uniform manner, without any size-based or other kind of threshold for inclusion.¹⁰⁰

In sum: Banks are far from indifferent to the kind of supervisory regime in which they are encompassed, and the anticipated impact of the single supervisory mechanism gave rise to clearly identifiable patterns of special interests along the lines of Hypothesis I. From the perspective of large, systemically relevant institutions in both Germany and France, the introduction of a European supervisor would provide new competitive opportunities in an enlarged Single Market and streamline the costs associated with maintaining extensive cross-border operations; notwithstanding some inconvenience-driven reluctance in the early stages of the negotiations, their lobbying activities were on the whole rather positively inclined toward the establishment of the SSM and their own inclusion within it.¹⁰¹ Due to the consolidated nature of cooperative banking networks in France, their interests tended to align closely with those of their commercially-operated peers and they coordinated their lobbying activities accordingly.¹⁰² The opposition of Germany's small alternative banks, however, was unambiguous:

¹⁰⁰ Interviews, various. FBF, "The FBF favours a single supervision mechanism for European banks," press release, September 12, 2012.

¹⁰¹ Ibid.; BdB, "Bankenverband zur europäischen Bankenaufsicht," press release, May 8, 2013.

¹⁰² Crédit Mutuel, BPCE, and Crédit Agricole expressed some concerns about their inclusion under the direct supervision of a European-level authority, but this ambivalence was never expressed as outright opposition and they joined France's commercial banks in coordinating their lobbying activities through the FBF. Imen Hazgui, "Union bancaire: Crédit Agricole signale plusieurs inquiétudes autour de la supervision unique de la BCE," *EasyBourse*, May 14, 2014; Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 14-15.

loath to forfeit the favorable arrangements they enjoyed under the existing system and with no obvious advantages to be gained from the unification of European banking markets, they resisted the transfer of supervisory authority to the European level and, as the introduction of the SSM became increasingly certain, also issued specific demands for their own exclusion.

Part II: The formation of national policy preferences on the SSM

In line with Hypothesis II, Part II of this chapter demonstrates that domestic banking interests meaningfully shaped Franco-German negotiating behavior in the legislation of the SSM at the European level. In the negotiations on the SSM, the most relevant points of disagreement were those which related directly to the issue of scope: it was not immediately clear whether European supervision should extend to all banks in the euro area and, in the case that it did not, how to define the threshold which would trigger it.¹⁰³ On this matter, French policymakers took into account the apparent consensus within their national banking sector and called for the scope of direct supervision to extend to all euro-area banks, regardless of size or significance. The German government, by contrast, was significantly constrained by the vehement opposition of its alternative banking sector and accordingly willing to cede supervisory authority only on the most systemically relevant cross-border banks within its borders. The following section traces the development of these basic policy preferences and their derivation from the aforementioned constellations of domestic banking

¹⁰³ Other points of disagreement were more technical than substantive in nature and did not do not explicitly concern the division of supervisory responsibilities between the national and the European level. These included the place of non-euro area member states in the new supervisory architecture, the selection the ECB as leading prudential supervisor, the formulation of an appropriate legal basis, and the agreement upon a suitable timeline for implementation.

interests from the time the SSM was first proposed to when it officially became operational in November 2014.

In September 2012, the European Commission adopted a package of legislative proposals which served as a crucial first step toward the construction of a single supervisory mechanism at the European level, calls for which had become increasingly frequent over the summer of the same year and also followed directly from existing disagreement between France and Germany on a related matter.¹⁰⁴ Most significant among these was a proposal for a Council regulation conferring specific prudential supervisory tasks on the European Central Bank, which would serve as the central institution at the heart of the new supervisory framework.¹⁰⁵ As such, the ECB would be empowered to ensure compliance with existing regulatory standards, detect risks threatening the health of the financial sector at large, and to carry out, in cooperation with national resolution authorities, preemptive interventions when banks find themselves in breach of important requirements. Notably, the proposal omitted key operational details concerning, for example, the precise relationship between the ECB and national supervisory authorities as well as the division of responsibility between the ECB and the EBA (European Banking Authority).¹⁰⁶ On the scope of the ECB's supervisory activities, the proposal generally foresaw the inclusion of all credit

¹⁰⁴ From an agenda-setting perspective, calls for joint supervision were closely linked to a Franco-German dispute regarding the appropriate means of addressing the rapidly deteriorating banking crisis in Spain and the urgent need to provide some kind of financial assistance to Spanish banks. A coalition of national governments, including France, was strongly in favor of recapitalizing struggling banks directly via the newly created European Stability Mechanism, bypassing the more indirect route which would channel such assistance via the Spanish treasury. Germany, however, opposed any such action without prior agreement on the establishment of a central supervisory authority to ensure that risk among those banks receiving capital injections would be adequately controlled. "Germany, Finland, Netherlands begin to unravel EU banking union plans," *Euractiv* with *Reuters*, September 26, 2012.

¹⁰⁵ *Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank Concerning Polices Relating to the Prudential Supervision of Credit Institutions*, COM (2012) 511 final (September 12, 2012).

¹⁰⁶ Howarth and Quaglia, "Banking Union as Holy Grail," 110.

institutions in the euro area regardless of business model or size, with the ECB also acting as host supervisor for those non-euro area banks which operated branches or offered cross-border services in participating member states.

At this point, early divisions between member states became readily apparent, including the beginnings of a significant Franco-German rift which would carry through the remainder of the negotiations. A meeting of EU finance ministers in Cyprus provided a convenient forum for discussion of the Commission proposal, which had been adopted only a few days prior. While German policymakers were in favor of granting the ECB some prudential responsibility for the monitoring of large cross-border institutions, they objected to the broad scope foreseen by the Commission. In doing so, however, they also clashed directly with their French counterparts, who pressed for the rapid introduction of the new supervisory authority and for this to encompass all roughly 6,000 euro-area banks without discrimination and in a roughly equal manner.¹⁰⁷ These preferences continued to define the basic line of division between the French and German governments over the course of the following months, becoming increasingly well-defined at a European Council meeting in mid-October and as reaching agreement on the matter became progressively more urgent ahead of a tentatively agreed December deadline. At the October summit, European heads of state and government agreed to continue work on the single

¹⁰⁷ Alex Barker, "EU ministers at odds over banking union," *Financial Times*, September 15, 2012.

supervisory mechanism as a matter of priority and reemphasized an end-of-year timeline for agreement.¹⁰⁸

Ahead of the next-scheduled European Council meeting in mid-December 2012, German finance minister Wolfgang Schäuble warned that German support for centralized supervision would remain elusive as long as its scope continued to be so broadly defined. “It would be very difficult to get an approval from [the] German parliament if you would leave the supervision for all the German banks,” he is quoted to have told fellow ministers.¹⁰⁹ Schäuble and other German officials bolstered their case for exclusions by calling into question the institutional capacity of the ECB or any other European institution to manage the supervision of roughly 6,000 banks in the diverse markets of the euro area, with an official emphasis placed on logistical challenges related to staffing, language barriers, and travel costs.¹¹⁰ That this would significantly undermine the project’s ability to perform efficiently was, in his view, simple “common sense.”¹¹¹ To many observers, however, logistical concerns were little more than a “red herring” intended to distract from the true basis of the German position, that is, to ensure that significant supervisory authority would be retained at the national level and that the burden of compliance would be minimal for the vast majority of German banks.¹¹²

More specifically, the exemptions demanded by the German government were in line with the preferred outcomes of various domestic banking groups,

¹⁰⁸ European Council, "Council Conclusions of 18/19 October 2012," communication from the General Secretariat to the Delegations, October 19, 2012.

¹⁰⁹ Alex Barker and Peter Spiegel, "Schäuble puts brake on bank union plan," *Financial Times*, December 4, 2012; Benjamin Fox, "Franco-German rift derails banking union deal," *EUObserver*, December 5, 2012.

¹¹⁰ Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 6.

¹¹¹ Wilson, "German division over euro bank regulation."

¹¹² "Banking Disunion," *Financial Times*, December 5, 2012.

focusing on those small local and regional institutions which, as described in the previous section, were most vigorously opposed. On large cross-border banks, by contrast, Germany ceded direct supervisory authority with little hesitation.¹¹³ In theory, there were a number of ways in which a precise threshold could be defined, including by bank size (assets or by assets as a percentage of national GDP), by cross-border activities (foreign-held assets as a percentage of total bank assets), or some combination of the two. Germany repeatedly insisted that only those banks with more than 5 percent of total assets engaged in cross-border transactions—in Germany’s case, only Deutsche Bank and Commerzbank—should be subject to direct ECB supervision, as this would also leave a large number of savings and cooperative banks mostly unaffected.¹¹⁴

The French government expressed strong support for the SSM to assume the broadest possible scope, covering all of the nearly 6,000 banks in the euro area as the Commission also envisioned in its September proposal.¹¹⁵ To overcome the logistical issues related to granting a single institution such expansive coverage, the French preferred a licensing system that would permit national supervisory authorities to act on behalf of the ECB, but never advocated the exclusion of any banks in particular.¹¹⁶ French finance minister Pierre Moscovici explicitly warned against the kind of dual system favored by his German counterpart, insisting that any limitation on the scope of centralized supervision would undermine the credibility of the new mechanism and call into question the entire rationale behind

¹¹³ Epstein and Rhodes, "The Political Dynamics Behind Europe’s New Banking Union," 423.

¹¹⁴ Howarth and Quaglia, "The Political Economy of the Single Supervisory Mechanism," 12; Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 5, 12.

¹¹⁵ Fox, "Franco-German rift derails banking union deal."

¹¹⁶ Howarth and Quaglia, "The Political Economy of the Single Supervisory Mechanism," 15; Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 5, 5.

the Banking Union.¹¹⁷ From a strictly economic perspective at least this position seemed well-reasoned. As the case of the Spanish cajas seemed to confirm, major difficulties arise even in small and mid-sized financial institutions and such banks are often key to anticipating systemic problems before they become visible on a large scale. What is more, the ECB would also be ill-equipped to act as effective lender of last resort for the euro area with only limited information about certain banks and if early intervention could be obstructed by the delaying tendencies of national authorities.¹¹⁸ Even once it became clear that some kind of threshold for inclusion would indeed be adopted, French policymakers still insisted that the ECB should be able to assume supervisory authority also for non-significant banks in cases where this was deemed necessary.¹¹⁹

French policymakers, along with the French Banking Federation and a number of individual French banks, also expressed fairness concerns over the potential for unequal treatment under a dual system of supervision, particularly of those national banking sectors—like the French—which were more heavily dominated by the kinds of large cross-border banks whose systemic relevance was generally beyond question. Given the high degree of concentration in the French banking market and the size of those five institutions which dominated it, it was highly likely that all of these would be included under the direct supervisory authority of the ECB even if any exclusions were allowed. As a result, the French government repeatedly raised the point that under the German proposal or a similar compromise, a much larger portion of French bank assets would be

¹¹⁷ John O'Donnell and Robin Emmott, "Franco-German rift threatens EU banking union," *Reuters*, December 4, 2012.

¹¹⁸ Thorsten Beck, "Banking union for Europe - risks and challenges" (CEPR Policy Portal, VoxEU, October 16, 2012).

¹¹⁹ David Schäfer, "Explaining the Creation of the EU Banking Union: The stability culture, the vicious circle, and the limits of power and interests" (Doctoral thesis draft, London School of Economics and Political Science, 2015), 11.

subject to direct ECB supervision than would be the case in other large European banking markets, particularly in Germany.¹²⁰

After months of direct and indirect clashes between the French and German governments, agreement was finally reached at a December 2012 meeting of the Economic and Financial Affairs Council. At this point, the European Council officially adopted two complementary regulations for the establishment of the SSM, one conferring specific prudential supervisory tasks on the ECB and another modifying an existing regulation to better define the interactions of the EBA with the new supervisory framework.¹²¹ While familiar patterns of Franco-German co-leadership were clearly absent from legislative proposals produced in the early stages of the policymaking process, national leaders insisted that a series of bilateral consultations were crucial to “bring [their] views into line” and thus contributed to consensus-building in the critical phase.¹²² Nonetheless, the terms of the agreement were ultimately brokered by the Cypriot Council presidency rather than by the two great powers which had been more often at the forefront of European lawmaking.¹²³

While the compromise—as adopted by the Council of the European Union in October 2013—granted the ECB formal responsibility for all institutions in the euro area and for the overall effective functioning of the program as a whole, it also distinguished between those banks deemed significant by a set of predetermined criteria, which the ECB would supervise directly, and those

¹²⁰ Howarth and Quaglia, "Internationalised Banking," 447.

¹²¹ Council of the EU, "Council approves single supervisory mechanism for banking," press release, October 15, 2013.

¹²² French finance minister Pierre Moscovici quoted in Schild, "Germany and France at Cross Purposes," 111.

¹²³ Ibid.

deemed insignificant, which it would supervise only indirectly.¹²⁴ As banks' systemic importance often becomes clear only in the wake of a financial collapse, no single feature or characteristic has thus far been identified as a perfect standalone predictor; indeed, this problem has been the subject of a critical debate in financial regulation more generally since the 2008 financial crisis and as part of the subsequent effort to improve supervisory and regulatory standards across the globe. Still, the formula devised in the context of the SSM highlights two factors in particular, with significant banks generally considered to be those with assets exceeding €30 billion (alternatively, 20% of the host country's GDP) or those with a demonstrated history of financial weakness (i.e., any which had at some point requested or received public financial assistance via the ESM or ESFS).¹²⁵ With regard to those less significant institutions not included within its direct remit, the ECB would still adopt a central oversight function, issuing guidelines or general recommendations to competent national authorities, requesting that these disclose certain kinds of financial information, and, in extraordinary circumstances, also assuming a direct supervisory role if this was considered necessary. Even direct supervision was to be carried out in close cooperation with lower-level officials through so-called joint supervisory teams (JSTs), which would consist of staff from both the ECB and national supervisory authorities, including those of member states in which banks operated subsidiaries or significant cross-border branches.

¹²⁴ Council Regulation (EU) No 1024/2013 of 15 October 2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions, 2013 O.J. (L287).

¹²⁵ In addition to these first two criteria, Article 6 also defines as significant those credit institutions which belong to one of the three most significant credit institutions within a particular member state and those which the relevant national authority, with confirmation from the ECB, considers generally significant within the national economy.

Because the agreed threshold mostly sheltered Germany's small alternative banks from direct supervision by the ECB, it was at least to some extent compatible with the German policy priorities and with patterns of special interests within the German banking sector itself. Indeed, the very adoption of such a two-tiered system was intended foremost as a means of preserving the institutional peculiarities of the German banking sector and its large numbers of savings and cooperative banks in particular. Notwithstanding this apparent success, the savings banks continued to insist that even the €30 billion threshold was too high to spare enough banks from the significant effort required to accommodate the transition.¹²⁶ German policymakers, apparently aware of the interests of important domestic constituents, advocated for the threshold to be raised to €50 billion.¹²⁷ Still, since its entering into force, direct ECB supervision under the SSM has in practice been much more heavily skewed toward commercial than alternative banking, with the former consistently accounting for the vast majority of significant institutions in the German market.¹²⁸ Moreover, because alternative banking groups comprise a much larger number of individual banks, those significant institutions which they do contribute represent only a small portion of the sector total and, importantly, also include those effectively more commercialized institutions (e.g., public-sector Landesbanken) of which the German government rather willingly ceded direct control.

The institutional design of SSM was also not wholly incompatible with the French vision, at least insofar as it decisively rejected the notion that any euro-

¹²⁶ Georg Fahrenschon, "Union bancaire: La position des caisses d'épargne allemandes," *Regards Sur L'économie Allemande*, no. 109 (July 2013): 9.

¹²⁷ Epstein and Rhodes, "International in Life, National in Death?," 18.

¹²⁸ *BaFin Annual Report 2014*, 84.

area banks could be shielded entirely from supervisory interference at the European level. On this matter, intergovernmental agreement on the necessity of Banking Union forced Germany into a kind of “rhetorical trap,” a position from which it could not help but concede greater authority than it had initially considered acceptable.¹²⁹ As a result, the indirect authority of the ECB over all euro-area banks and its power to assume a vastly expanded role in extraordinary circumstances preserved French interests even within a dual system of supervision. Still, the legitimacy of fairness concerns expressed throughout the related negotiations seems to be retrospectively confirmed by the outcome of supervision under the agreed threshold: as identified in an ECB decision in early 2014, the list of significant institutions to fall under the direct supervision of the SSM accounted for nearly 90 percent of French bank assets compared with about 70 percent in Germany and less than half in some other member states.¹³⁰ More recently, France was home to 321 of the euro area’s significant institutions in 2017, accounting for about three-fourths (76%) of the total number of credit institutions in France, while Germany was home to only 63. Analogously, of the roughly 3,000 less significant institutions in the SSM, 103 are located in France and 1,455 in Germany.¹³¹

In sum: The preferences expressed by the French and German governments on the scope of direct supervision under the SSM closely matched the expectations of Hypothesis II, that is, they generally reflected the composition of each state’s national banking sector and the distribution of small and large

¹²⁹ Schäfer, “Explaining the Creation of the EU Banking Union,” 11.

¹³⁰ Decision of the European Central Bank of 4 February 2014 identifying the credit institutions that are subject to the comprehensive assessment (ECB/2014/3), 2014 O.J. (L69/107); Howarth and Quaglia, “Internationalised Banking,” 444.

¹³¹ Author’s calculations based on data from BaFin and ACPR (Banque de France).

banking interests within its borders. German policymakers sought foremost to shelter savings and cooperative banks from the effects of centralized supervision, offering to relinquish direct supervisory authority only over those large commercial banks which were themselves also less opposed. In this sense, German preferences seemed to prioritize smaller banks' demands for their own exclusion over the fairness objections of their larger peers, who remained wary of demands for proportional treatment and suspected that savings and cooperative banks were not in fact as systemically irrelevant as they often claimed. French preferences for an all-encompassing scope bespoke similar concerns over the distributive effects of proportional treatment and closely reflected the attitudes of most domestic banks: the French banking sector—while recognizing the inconvenience of the transition itself—was far more positively oriented toward the introduction of a European supervisor and also more unified in this respect. As a result, it is clear that Franco-German divergence in the construction of the SSM was not isolated or arbitrary; rather, it was a rationally derived and arguably predictable outcome between member states representing vastly distinct sets of domestic interests in a particularly contentious area of policy.

In the end, the Single Supervisory Mechanism officially entered into force in November of 2014 and thus became the first of three pillars to be established on the 'long journey' toward Banking Union. At this point, the ECB assumed formal supervisory authority over 128 significant institutions in the euro area as well as indirect monitoring authority over several thousand less significant institutions. Still, the compromise forged on the scope of direct supervision under

the SSM is not inconsequential from a macroeconomic perspective and, as will become clear in subsequent chapters, also figures prominently in shaping Franco-German disagreement on the construction of the remaining pillars. Indeed, as long as the supervision of several thousand euro-area banks remains effectively in the hands of national supervisors, other institutions are wary of moving forward with some of the more politically contentious elements of the Banking Union, including those risk-sharing mechanisms which are particularly crucial to strengthening the resilience of the eurozone against the effects of future crises. Thus, while policymakers viewed agreement on common supervision as more attainable in the near term both politically and procedurally, rendering this palatable to all member states—and, in particular, to the diverse array of banking interests encompassed within them—also required key sacrifices which, in turn, created inadvertent obstacles to future legislative progress and the completion of the Banking Union through the construction of its final pillar.

Chapter V: The Single Resolution Mechanism

With the new supervisory regime more or less firmly in place by late 2013, European lawmakers shifted their focus to the Banking Union's second pillar, that is, a single resolution framework for winding down those ailing banks whose failure would have severely negative consequences in the financial system at large. Failure, in general terms, refers to the closing of a bank in the case that it becomes insolvent or otherwise too illiquid to meet the sum of its outstanding obligations to depositors and other creditors. Especially in the case of systemically relevant cross-border banks, however, liquidation through conventional insolvency procedures is usually inappropriate given the vital role they occupy in the larger economy and the existence of significant interdependencies with other institutions across the financial system. Resolution, then, allows competent authorities to intervene—through an orderly restructuring process carried out at an appropriately early stage—and ensure the continuity of a bank's critical operations without undue disruption. In this sense, the existence of a well-functioning mechanism for resolution is a crucial means of mitigating the undesirable effects of bank failures when doing so is considered necessary to safeguard the general public interest, protect taxpayer resources, and ensure general financial stability.¹³²

In the pre-SRM era, crisis management and resolution were left largely to the discretion of individual member states, and the possibility of introducing a

¹³² *Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EEC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM (2012) 280 final (June 6, 2012), 4.*

common European framework entered mainstream policy discussions only after the financial crisis made its necessity more acutely clear. To be sure, there had been some previous efforts to facilitate cross-border cooperation in cases where resolution necessarily involved multiple sets of national authorities, but this was always voluntary and never required explicit cost-sharing between states.¹³³ As shown through various high-profile bank failures in the course of the crisis, however, national approaches often relied on ad hoc solutions and were to the discontent of national taxpayers also usually insufficient to shield governments against having to conduct large-scale public bailouts. In order to ensure swifter and more impartial decision-making in cross-border cases and separate banks' financial health from the solvency of their host governments, postcrisis proposals for a single resolution mechanism suggested that going forward, major decisions should be taken at the European rather than at the national level (by a single resolution authority), with the costs thereof also more evenly distributed across national borders (via a single fiscal backstop).¹³⁴

Part I: The domestic political economy of a common resolution regime

Still, the shift to a European resolution framework was not uncontentious from the perspectives of the affected stakeholders, and created significant divergences of interests in line with Hypothesis I. Large cross-border banks in France and Germany eagerly anticipated the streamlining their operations across different regulatory jurisdictions, and weighed the pro-competitive effects of an

¹³³ Kudrna, "Cross-Border Resolution of Failed Banks," 286-287.

¹³⁴ Van Rompuy, *Towards a Genuine Economic and Monetary Union*, 5.

integrated banking market positively against the imposition of new and significant costs. Given their systemic importance, such banks also had an immediate interest in the stabilizing effects of a credible resolution regime and looked forward to spreading the costs thereof more widely across Europe. By contrast, small community-focused banks of the kind which were prevalent in Germany attached no value to the creation of a European market in which they could not participate, and were loath to contribute to any risk-sharing arrangement from which they would not directly benefit. The following section explores these basic lines of division in greater detail and the ways in which they arose in three key areas of anticipated economic outcomes.

Changes in the competitive landscape: As in the case of the SSM, the competitive implications of the SRM were derived primarily from the expectation that the Europeanization of banking policy was key to promoting the Single Market agenda in the realm of banking services more generally. In the pre-SRM era, European banking operations were necessarily segregated—or ringfenced—along the geographical borders of individual member states. Absent a credible mechanism to manage the resolution of cross-border banks, authorities in different regulatory jurisdictions could not be assured that corrective action (carried out by home-country authorities at the level of the parent institution) would not be unnecessarily delayed or proceed in a manner that would be otherwise harmful to their interests. Seeking above all minimize the losses accruing to stakeholders within their respective jurisdictions, they faced clear incentives to impose stricter regulatory standards—including additional capital

requirements and restrictions on the intragroup movement of liquidity—on cross-border banking operations within their borders. As a result, most observers expected the impartiality of decision-making under a European-level authority to remove or at least drastically reduce territorial biases in prudential regulation and thereby facilitate the freer flow of capital and liquidity across a more integrated financial market. While the linkages between ringfencing and resolution were not legislatively enshrined and often not even made explicit in the public discussion, these issues were usually considered in close relation to one another and figured prominently in the formation of domestic attitudes toward related proposals.¹³⁵

Of course, not all euro-area banks were equally well positioned to take advantage of a newly enlarged European banking market, which tended to favor those large cross-border banks already operating extensive intra-European retail networks at the time the SRM was proposed. This included most of the principal banking groups in France, all of which operated internationally at some scale and objected to the fact that the existing regulatory environment effectively prevented them from reallocating resources among their affiliates (e.g., redirecting deposits from areas of excess liquidity to finance loan demand elsewhere).¹³⁶ Given that the internationalization of German banks was at the time far less retail-focused (and indeed, has been historically almost exclusively concentrated in the areas of corporate lending and investment banking), the geographical ringfencing of foreign retail outposts might have been marginally less salient.¹³⁷ Notwithstanding any bank-specific variation, however, all banks with meaningful cross-border

¹³⁵ Interviews, various.

¹³⁶ Interviews, BNP Paribas, January 4, 2019; Société Générale, January 8, 2019; FBF, January 16, 2019.

¹³⁷ Howarth, "France and the International Financial Crisis," 377-379.

activities in the rest of Europe (in Germany, Deutsche Bank and Commerzbank) considered securing the free and efficient movement of liquidity to be a crucial policy priority and were principally supportive of the SRM for this particular purpose.¹³⁸

In Germany, however, there were also large numbers of alternative banks which had no expansionary ambitions whatsoever and nothing comparable to gain from market-unifying policies. In contrast to the cross-border entities of large banking groups, their day-to-day operations were not similarly burdened by existing restrictions on the intragroup movement of liquidity. Germany's savings and cooperative banks were not even required to hold additional capital against interbank borrowing and lending, transactions which were generally considered risk-free: local savings banks, for example, operated with substantial surpluses of deposits over their outstanding loan portfolios, but regularly transferred excess liquidity to their regional institutions, which obtained only one-third of their funding from customer deposits.¹³⁹ As in earlier rounds of negotiations, therefore, alternative banks continued to insist that domestic authorities better understood the unique characteristics of their respective ways of doing business, and that transferring these to a distant European body would be therefore “unacceptable.”¹⁴⁰

¹³⁸ Interview, Association of German Banks, January 9, 2019; BdB, "Bankenverband: Bankenunion zügig vorantreiben – die Euro-Zone stärken," press release, October 13, 2013; EBF, "SRM agreement is essential to Banking Union, say banks," press release, December 19, 2013; BdB, "Bankenverband begrüßt Einigung zur Bankenabwicklung," press release, March 20, 2014; FBF, "The FBF favours a single supervision mechanism."

¹³⁹ Wilson et al., "Germany's small banks fight union plans"; "Germany: Technical Note on Systemic Liquidity and Bank Funding" (IMF Country Report No. 16/195, International Monetary Fund, Monetary and Capital Markets Department, June 2016.), 12-13.

¹⁴⁰ Howarth and Quaglia, "The Steep Road to European Banking Union," 132.

Anticipated costs and savings: Domestic attitudes toward the SRM were also shaped by pecuniary considerations of the associated costs. Unlike supervision, resolution is a rather infrequent—and, for most banks, unlikely—occurrence, not associated with a significant operational or administrative burden.¹⁴¹ Still, when these do materialize, the costs of resolving a failing bank are usually substantial, involving at least that sum of money required to return it from a position of insolvency to the point where its assets are again equal to its total liabilities, or sufficient to meet all outstanding financial obligations as they fall due.¹⁴² In the postcrisis era, attitudes toward resolution converged on the principle that the costs of future failures should be shifted more explicitly onto private sector participants and institutions within the banking industry itself, thereby removing pressure from national taxpayers to bear these costs ex-post. In practice, this was generally understood to require the ex-ante collection of contributions from healthy banks—in effect, financial sector taxation—to either feed into the general revenues of the state or into a specially designated resolution fund, calibrated to cover a significant portion of any costs that might materialize in the course of future crises.¹⁴³ As a result, individual banks viewed the desirability of the new resolution regime as highly contingent upon their ability to minimize the size of any contributions they would be expected to make.

¹⁴¹ This is not to say that there were no administrative costs associated with the transition to a new resolution regime. Under the SRM, participating banks were charged new administrative fees from the year 2015 onward. Lucia Orszaghova and Martina Miskova, "Financial Contributions and Bank Fees in the Banking Union" (MPRA Paper No. 64643, Munich Personal RePEc Archive, January 2015), 14-15. Still, this burden was far less significant when compared with the contributions banks were required to make to the SRF itself. Interview, BNP Paribas, January 4, 2019.

¹⁴² Marianna Blix Grimaldi et al., "Estimating the Size and Incidence of Bank Resolution Costs for Selected Banks in OECD Countries," *OECD Journal: Financial Market Trends* 2016, no. 1 (March 2017): 5.

¹⁴³ Stijn Claessens, Michael Keen, and Ceyla Pazarbasioglu, *Financial Sector Taxation: The IMF's Report to the G-20 and Background Material* (Washington, D.C.: International Monetary Fund, September 2010).

German banks were aware that new levies would be substantially and unequivocally larger than those already being collected for the same purpose at the national level, but not all banks expected to be equally worse off under the new regime. In Germany, levies collected as of 2011 were channeled directly into a national resolution fund, which, in the four years of its existence, collected about €500 and €600 million annually (see Table 3). The SRF, once fully funded, would actually be smaller in size (€55 billion versus €70 billion), but significantly higher contributions would be required to render this—as intended—fully operational by 2023.¹⁴⁴ Still, national arrangements had been particularly favorable to the interests of smaller savings and cooperative banks, cost advantages which such institutions reasonably feared to lose in the transition to the SRM. Under the German system, many had made only minimal contributions of less than €1,000 (around 43% of institutions), and some were exempted from any obligation to pay levies at all (around 38% of institutions, including most cooperative banks and between 80 and 100 Sparkassen).¹⁴⁵ While the details of the new calculation methodology remained still uncertain, attitudes in the postcrisis environment were generally less favorable to such exemptions: even small banks were considered to derive substantial benefits from the stability of larger, more systemically relevant institutions operating in the same markets and were expected to contribute accordingly.¹⁴⁶ As a result, alternative banks’

¹⁴⁴ There was no predetermined deadline by which the German fund was to reach its target size, and the collection process could feasibly have been spread across multiple decades. Interview, Association of German Banks, January 17, 2019; "Banken feilschen um Beitrag für EU-Abwicklungsfonds," *Reuters*, March 21, 2014.

¹⁴⁵ Correspondence, Association of German Banks, January 30, 2019; "Banken feilschen um Beitrag für EU-Abwicklungsfonds."

¹⁴⁶ "The long road to more financial stability in Germany and Europe" (Annual Economic Report 2014/15, German Council of Economic Experts, 2015), 21; Peter Spiegel, Alex Barker, and Alice Ross, "EU leans on big banks to finance bailout fund," *Financial Times*, October 21, 2014.

lobbying efforts with respect to the SRF tended, variably, to center on: (1) insistence that the German fund was already sufficient and should not be replaced at all;¹⁴⁷ (2) demands for their own exclusion;¹⁴⁸ or (3), once it became clear that they would indeed be required to participate, for the calculation of individual contributions to reflect principles of proportionality and keep the size of their particular burden to a minimum.¹⁴⁹

Table 3: Bank contributions to German resolution fund, 2011-2014

Data source: Author's elaboration based on data obtained from correspondence with Association of German Banks

<u>Year</u>	<u>Banking group</u>	<u>Number of banks</u>	<u>% of institutions</u>	<u>Levies (€ million)</u>	<u>% of levies</u>
2011	Large and regional institutions	186	10%	260.2	44%
	Savings banks	429	23%	27.8	5%
	Central institutions of savings banks	9	0%	223.6	38%
	Cooperative banks	1141	61%	8.8	1%
	Central institutions of cooperative ba	2	0%	19	3%
	Other credit institutions	116	6%	52.2	9%
	Total	1883		591.6	
2012	Large and regional institutions	187	10%	404.4	58%
	Savings banks	423	23%	19.5	3%
	Central institutions of savings banks	9	0%	181.9	26%
	Cooperative banks	1124	60%	6.4	1%
	Central institutions of cooperative ba	2	0%	11.6	2%
	Other credit institutions	113	6%	70.4	10%
	Total	1858		694.2	
2013	Large and regional institutions	184	10%	231	44%
	Savings banks	422	23%	16	3%
	Central institutions of savings banks	9	0%	204.6	39%
	Cooperative banks	1104	60%	5.9	1%
	Central institutions of cooperative ba	2	0%	11.7	2%
	Other credit institutions	111	6%	52.2	10%
	Total	1832		521.4	
2014	Large and regional institutions	183	10%	260	50%
	Savings banks	417	23%	14.1	3%
	Central institutions of savings banks	9	0%	173.8	34%
	Cooperative banks	1080	60%	10.4	2%
	Central institutions of cooperative ba	2	0%	4.8	1%
	Other credit institutions	110	6%	53	10%
	Total	1801		516.1	

Given that a European resolution fund would be mobilized primarily for large, systemically important banks, institutions of this size could not make a

¹⁴⁷ *Gemeinsames Positionspapier zu einem einheitlichen Aufsichtsmechanismus*, 3.

¹⁴⁸ *Positionspapier Zum Vorschlag Für Eine Verordnung Zur Festlegung Einheitlicher Vorschriften Und Eines Einheitlichen Verfahrens Für Die Abwicklung von Kreditinstituten Und Bestimmten Wertpapierfirmen Im Rahmen Eines Einheitlichen Abwicklungsmechanismus Und Eines Einheitlichen Bankenabwicklungsfonds* (Berlin: BVR/VÖB/DSGV, 2013), 5; Fahrenschon, "Union bancaire," 12-13.

¹⁴⁹ BVR, "EU-Abwicklungsfonds ante portas," *BVR - Finanzpolitik aktuell*, March 2014; *Erklärung der Genossenschaftsbanken und Sparkassen zur Europawahl: Stabilität sichern, Subsidiarität stärken – für die Schaffung einer mittelständischen Bankenpolitik in Europa* (Berlin: BVR/DSGV, March 24, 2014).

similar case for exclusions or exemptions, but nonetheless opposed being made to shoulder the entire burden. In the German case, national resolution arrangements already drew particularly heavily from the largest banks in the system, with 1% of banks contributing 87% of the entire domestic fund.¹⁵⁰ To avoid the replication of a similar funding structure at the European level, Germany's large banks resisted any scheme which would penalize them disproportionately or doubly (i.e., on the basis of both size and risk) and advocated against exemptions for smaller banks that would have allowed existing distortions to persist.¹⁵¹ French banks, in a similar vein, worried that the new funding mechanism would draw disproportionately from among their ranks. Indeed, early proposals for the SRF foresaw French banks contributing as much as €17 billion over an eight-year period, or over €2 billion annually, while existing financial sector taxation—in effect in France as of 2011—had collected only between €500 million and €800 million each year.¹⁵² As a result, French banks uniformly insisted that the new calculation methodology should take into account their relatively low risk profiles more than their size, and not punish these for their own largeness. Thus, while increased costs did not dissuade large banks from their more principled support, they still resisted any funding structure which incorporated proportionality to a

¹⁵⁰ Correspondence, Association of German Banks, January 30, 2019.

¹⁵¹ *Comments on the Proposal for a Regulation 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 Bank Resolution Fund and Amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council* (Berlin: BdB, September 27, 2013), 3-4; BdB, "Bankenverband begrüßt Einigung"; Howarth and Quaglia, "The Steep Road to European Banking Union," 133-134.

¹⁵² Spiegel et al., "EU leans on big banks." In contrast to Germany, revenues from national bank levies in France were introduced directly into the general state budget rather than into a specially designated resolution fund. Orszaghova and Miskova, "Financial Contributions and Bank Fees," 18.

high degree and burdened them disproportionately or unreasonably relative to their smaller counterparts.¹⁵³

Attitudes toward risk-sharing: The introduction of the SRM reflected a broad consensus to promote financial stability by distributing the costs and risks of bank resolution more widely across the European market. Thus, like any burden-sharing agreement, it was politically contentious not only for the cost of participation as such, but also for the high probability of ex-post resource redistribution between different kinds of banks.¹⁵⁴ Bank failures, after all, occur with only limited frequency, and resolution—in contrast with standard insolvency proceedings—tends to be reserved for those kinds of systemically important institutions whose continued existence is associated with a substantial public interest. As a result, it was highly likely that a substantial portion of contributing institutions would never require recourse to a resolution fund at all, and—even more objectionable—that their contributions could be interpreted as effective transfers to higher-risk institutions operating in the same markets. Such redistributive effects would in theory also be further exacerbated by the perverse moral-hazard incentives generated by any kind of external guarantee once in place.¹⁵⁵ Thus, a widening the resolution risk pool was not at all uniformly desirable from the perspective of all participating banks: while systemically

¹⁵³ CEO of BNP Paribas Jean-Laurent Bonnafé quoted in "Banques françaises et allemandes contribueront à même hauteur au niveau européen," *Le Monde*, November 4, 2014; French Banking Federation, "Banking union: a major step towards a stable European banking system," press release, December 19, 2013; "Contributions to SRF - Opposing Camps Clash," *Agence Europe Daily Bulletin* (blog), December 4, 2014.

¹⁵⁴ In theory, ex-ante collection is intended to overcome precisely those political considerations which make most risk- or burden-sharing agreements difficult to implement. In the ex-ante case, banks contribute behind a veil of ignorance with regard to their own future needs, and the resolution regime can technically account for any preexisting differences by charging premiums in accordance with individualized risk assessments. In reality, however, the proper pricing of such premiums is also politically charged and highly difficult to agree upon.

¹⁵⁵ It is standard economic theory that when decision-makers are better protected from the direct consequences of their actions, they are incentivized to undertake more risk than would otherwise be desirable.

important institutions looked forward to the stabilizing effects of spreading losses more widely across the European market, others were loath to subsidize these while deriving no comparable benefit for themselves.

Small alternative institutions in Germany were particularly vocal in their opposition to the risk-sharing implications of the SRM, especially given the extent to which they were already well-insulated from the resolution risk of their more systemically relevant peers. Considering the low systemic relevance of individual savings and cooperative banks, resolution authorities would be hard-pressed to argue that their continued viability was associated with a substantial public interest, at least in the case that financial distress did not extend to the entire group. Thus, as is true of small and mid-sized institutions more generally, they would not even in death be appropriate candidates for resolution and never require recourse to any fund set up for this purpose. Idiosyncratically, the continued viability of Germany's alternative banks was also already protected by institutional protection schemes within their respective groups, which made risk-sharing with non-IPS institutions even more objectionable than for other kinds of small banks in the rest of Europe: in the case that an individual savings or cooperative bank encountered financial difficulties, it could receive funds from its respective national association or otherwise simply be merged or taken over by members of its own group, effectively a private bailout with no large-scale repercussions. Because their activities were not yet meaningfully internationalized except at the level of their central institutions, they were also less likely to benefit from the stabilizing effects of a more credible resolution framework in the euro

area as a whole. As a result, their lobbying efforts tended to reflect grave concerns over the possibility for resource redistribution under the SRM, and they were vigorously opposed to participating in any resolution risk-sharing arrangement which, from their perspective, offered no obvious benefits.¹⁵⁶

From the perspective of systemically relevant institutions, risk-sharing in this respect was naturally less objectionable, especially to the extent that it would allow them to spread the costs of future resolutions more widely across the whole of Europe. While no institution with high level of confidence in its own operations would willingly self-identify as a likely candidate for failure and, by extension, possible resolution, banks with cross-border exposures had a more immediate interest in the health of the eurozone in the wake of the financial and sovereign debt crises and were more willing to assume substantial costs in the construction of a Banking Union for this particular purpose. As a result, it made less sense for them to issue strong objections to the risk-sharing implications thereof, and, against smaller banks' demands for exclusion, they rather looked forward to the possibility of spreading the associated costs across a larger number of small and mid-sized institutions.¹⁵⁷ While they remained wary of the possibility of intra-European capital transfers (insisting, for example, on comprehensive asset quality reviews and other risk-reducing measures to be introduced in advance of any common fund), the rhetoric of their lobbyists reflected a greater sense of European solidarity and was usually aligned with that of the Banking Union's

¹⁵⁶"Auch kleinere Banken sollen zahlen," *Handelsblatt*, October 21, 2014; "Banken feilschen um Beitrag für EU-Abwicklungsfonds"; *Erklärung der Genossenschaftsbanken und Sparkassen zur Europawahl*.

¹⁵⁷ Interviews, various. BdB, "Bankenverband zur Bankenabwicklung," press release, November 8, 2013.

architects in emphasizing the need for risk-sharing as a means to accomplish specific macroeconomic goals.¹⁵⁸

In sum: The economic impact of a European resolution regime created a clear distribution of winners and losers in the domestic banking sectors of participating states. In line with the predictions of Hypothesis I, systemically important cross-border banks looked forward to overcoming the existing fragmentation of European banking markets and spreading the risks of resolution more widely across Europe—even at a substantially higher cost. As a result, the French banking sector quickly coordinated its lobbying activities in favor, and was also joined by those large commercial banks in Germany with a similar set of policy priorities. German alternative banks, however, were loath to be incorporated into a costly risk-sharing arrangement from which they derived no obvious benefit: without meaningful cross-border activities or corresponding exposures on their balance sheets, they had no clear interest in the financial health of the euro area as a whole or in the fungibility of liquidity between the countries within it.

Part II: The formation of national policy preferences on the SRM

Relative to Part I of this chapter, the following section is more immediately concerned with the actual construction of the SRM at the intergovernmental level, which provoked sharp disagreements in two areas in particular. First, national policy preferences diverged with respect to the degree of decision-making authority—that is, on the initiation of resolution procedures—to

¹⁵⁸ *Comments on the Proposal for...a Single Resolution Mechanism*; Speyer and Böttcher, *EU Banking Union*, 2-3.

be transferred from the national to the supranational level. Most notably, this incorporated questions related both to the scope of the SRM (the number and kinds of credit institutions to be included within its remit) as well as to its institutional design (how this would define the balance of power between national and European-level resolution authorities). Second, national governments also diverged with respect to the financing of the new resolution regime and, in particular, the extent to which this should draw upon common funding. Along this dimension, preferences related both to the extent of mutualization between national resolution funds (whether and how quickly national resources should be turned over to a common pool at the European level) and to the methodology to be used in the calculation of individual bank contributions (the ways in which this pecuniary burden should be distributed between differently sized institutions and those which assumed different levels of systemic risk).

In line with the expectations of Hypothesis II, the following section demonstrates that domestic banking interests closely informed state preferences in each of the aforementioned issue areas. Given the high proportion of large, systemically relevant institutions in the French banking sector, national policymakers favored both a higher degree of discretion at the level of the supranational authority (crucial to remove remaining incentives for geographical ringfencing and other burdensome regulatory safeguards) as well as a financing mechanism which would spread the costs of resolution more widely across the European banking sector (and not draw disproportionately from a handful of large institutions). Beholden to the high proportion of small, not systemically relevant

institutions whose interests were actively hostile to the creation of a European regime, German preferences sought to preserve the discretion of national resolution authorities and resisted any financing mechanism which would impose a significant burden on these or similarly-sized institutions. To clarify the above linkages, the following section presents a chronological account of Franco-German negotiating behavior throughout the legislation of the SRM between 2013 and 2015, highlighting the ways in which national preferences developed in response to specific legislative proposals and in relation to the major economic interests emanating from within the French and German banking sectors at the same time.

Despite increasingly frequent calls for a single resolution mechanism over the course of the preceding year, it had become clear by the early months of 2013 that the interests of member states—including France and Germany in particular—were not at all aligned on the matter. At this point, German finance minister Wolfgang Schäuble did not even consider the creation of a single resolution authority obviously legitimate, insisting that a network of national authorities would be sufficient and also legally more appropriate in the near to medium term.¹⁵⁹ In general, German officials dismissed the project as “premature” and “unwise.” The French, by contrast, were clear in their preference for swifter and more meaningful action: “we want a full banking union and we want it fast,” Schäuble’s counterpart Pierre Moscovici is reported to have said in late April. In view of the preexisting agreement on the SSM and considering all

¹⁵⁹ Schäuble and other German officials insisted that the creation of a single resolution authority required a more appropriate legal basis than Article 114 of the Treaty of the Functioning of the European Union, which most other member states (including France) and the European Commission considered sufficient. Wolfgang Schäuble, “Banking union must be built on firm foundations,” *Financial Times*, May 12, 2013.

three pillars necessary complements to one another, French officials likened the current impasse to “wading across a river and stopping halfway.”¹⁶⁰ A bilateral declaration published in May allowed France and Germany to define some way of aligning their competing positions, but this broadly contoured vision did not go very far in settling any of the new resolution regime’s more controversial aspects or bridging disagreements on specific issues.¹⁶¹

Tentative solutions shifted into focus with the publication of the European Commission’s first formal legislative proposal in the summer of the same year.¹⁶² On the scope of the new mechanism, the Commission generally foresaw the inclusion of all credit institutions in participating member states and made no distinction between those considered significant or less significant under the SSM. While resolutions would be carried out by a newly constructed single resolution board (comprising representatives from participating national authorities, the SSM, and the European Commission), the Commission also bestowed upon itself the final decision-making authority with respect to the initiation of such procedures, which the board (and, by extension, the national authorities encompassed within it) would only be able to recommend. Finally, with respect to the financing of the new regime, the Commission also provided for the creation of a €55 billion private backstop or single resolution fund, financed through the ex-ante contributions of participating banks (for which it did not yet venture a clear calculation methodology) and built up through the gradual pooling

¹⁶⁰ Alex Barker and Peter Ehrlich, "EU split over plans for bank resolution," *Financial Times*, April 29, 2013.

¹⁶¹ Présidence de la République Service de Presse, "France and Germany—Together for a stronger Europe of Stability and Growth," press release, May 29, 2013, 5.

¹⁶² *Proposal for a Regulation of the European Parliament and of the Council 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 Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council*, COM (2013) 520 final (July 10, 2013).

of national funds over a ten-year period. While these points did not represent a significant departure from general principles laid out in earlier declarations, new details allowed member states to focus their positions in more narrowly defined issue areas and moved France and Germany once again to opposite ends of the negotiating table.

German policymakers viewed the Commission as having gone too far in the centralization of decision-making authority at the European level. With the interests of savings and cooperative banks in mind, the German government sought a reduction in the scope of the new mechanism which would allow national authorities to assume a leading role in the resolution of all but the most systemically important cross-border banks in a given member state (similar to the compromise already adopted in the context of the SSM).¹⁶³ Even with regard to its more systemically relevant institutions, Germany objected to the notion that the European Commission should be allowed the final decision on the initiation of resolution procedures, favoring instead a network solution whereby any such decisions would be taken by an association of national authorities at least in the foreseeable future.¹⁶⁴ On this matter, it is possible that German policymakers were reacting at least partially to vehement opposition from within the alternative banking sector, a representative of which had even gone so far as to liken the Commission proposal to the enabling acts which had been used to bestow nearly unchecked power upon the Nazis in the 1930s.¹⁶⁵ At a later point, Germany conceded on the centralization of decision-making authority in a European-level

¹⁶³ "Single Resolution - Discussions at Standstill," *Agence Europe Daily Bulletin* (blog), November 18, 2013.

¹⁶⁴ "Commission banking union plans met with scepticism," *Open Europe Blog* (blog), July 11, 2013; Peter Spiegel, "ECB on collision course with Germany on banking union," *Financial Times*, November 8, 2013.

¹⁶⁵ Chris Bryant, "German banker likens Brussels bank powers to Nazi 'enabling acts'," *Financial Times*, July 11, 2013.

institution, but preferred a choice of the European Council, where voting structures operated under principles of unanimity and would thus better preserve national autonomy by permitting member state governments a veto right with respect to resolution decisions.¹⁶⁶

German policymakers were also evidently concerned that the financing of the new regime might draw heavily from the pooled resources of participating member states. Suspecting that the SRF might become another “de facto bailout mechanism,” German policymakers were initially hostile to any European-level mutualization and would have preferred a loosely held network of national resolution funds at least until the necessary treaty changes could be effected.¹⁶⁷ Once the introduction of the SRF was largely beyond question, Germany still preferred a relatively lengthy ten-year transition period for doing so and clashed with other negotiators who suggested that this timeline could be shortened.¹⁶⁸ Throughout the remainder of the negotiations, the German position reflected a general aversion to sharing the costs of future resolutions with other member states and sought to ensure that these would remain anchored at the national level for as long as possible.

In all of the above, German policymakers were directly at odds with their French counterparts, who were far more amenable to the consolidation of

¹⁶⁶ Alex Barker, Peter Spiegel, and Stefan Wagstyl, "Berlin gives ground in banking union debate," *Financial Times*, December 6, 2013.

¹⁶⁷ Epstein and Rhodes, "International in Life, National in Death?," 21; "Safety Net Question to be Dealt with Separately," *Agence Europe Daily Bulletin* (blog), December 5, 2013.

¹⁶⁸ Rebecca Christie and Rainer Buergin, "Schäuble at Odds With ECB on Pooling Bank-Failure Fund," *Bloomberg*, January 28, 2014.

authority at the European level.¹⁶⁹ With regard to the scope of the SRM, France charged that exemptions amounted to a “de facto abandoning of the very idea of Banking Union,” and insisted, alongside the Commission, that all banks should be incorporated on an equal and largely undifferentiated basis.¹⁷⁰ On this matter, French policymakers apparently shared the prevailing view within their domestic banking sector institutions that German demands for proportional treatment made little economic sense (a closely-linked network of many small institutions was not inherently more stable or less crisis-prone), and would only create a disproportionate burden for those larger banks which could realistically never be considered for these.¹⁷¹ Reflecting the strong private-sector interest in the elimination of geographical ringfencing, French policymakers endorsed the choice of the European Commission to serve as the ultimate authority on the initiation of resolution procedures: given that the Commission was at the time associated with the highest degree of independent governance, it also offered the greatest possibility for ensuring impartiality in resolution cases which spanned multiple member states.¹⁷²

French attitudes were also decidedly more European on the financing of the new regime, unsurprising given the dominance of large, systemically relevant institutions which were eager to spread the costs of future resolutions more widely across the European banking sector. In this respect, a mere network of national

¹⁶⁹ In this respect, the French position was also generally more in line with the European consensus; Germany, in contrast, was isolated in many of its key positions. "Germany Isolated on Two Key Aspects of Bank Resolution Scheme," *Agence Europe Daily Bulletin* (blog), November 7, 2013.

¹⁷⁰ "Ministers to Discuss Ireland and Banks," *Agence Europe Daily Bulletin* (blog), November 13, 2013; "Rapport d'information déposé par la Commission des Affaires Européennes sur les progrès de l'union bancaire et de l'intégration économique au sein de l'Union économique et monétaire," Assemblée Nationale, December 18, 2013; "Texte Adopté No. 284: Résolution Européenne," Assemblée Nationale, January 30, 2014.

¹⁷¹ Interviews, BNP Paribas, January 4, 2019; French Treasury, February 5, 2019.

¹⁷² Stefan Wagstyl, "Germany's SPD hints at greater solidarity with troubled EU states," *Financial Times*, December 12, 2013; Interview, French Treasury, February 5, 2019.

resolution funds—as advocated by Germany—was considered entirely insufficient, and French policymakers were consistently in favor of assuming mutual responsibility at the European level.¹⁷³ On the building up of the SRF, they hoped that national resolution funds could be pooled more rapidly—for example, within five years—than under the ten-year timeline favored by the Germans and also foreseen in the Commission proposal from July.¹⁷⁴ In the French view, even the compromise which was ultimately adopted, which provided for the gradual mutualization of national compartments over an eight-year period, “considerably reduce[d] the principle of solidarity at the heart of the SRM.”¹⁷⁵

As long as Franco-German disagreement continued to preclude actual legislative progress, it quickly became clear that the single resolution mechanism would not in fact be operational by the end of 2013, as many had initially hoped. Still, after remaining locked in a monthslong standoff over much of the year, both states began to exhibit a greater willingness toward compromise which would bring European policymakers significantly closer to reaching a final agreement. In most cases, shifting policy positions arose from a need to bridge the gap between the German government and the European consensus. Ahead of a key European Council summit in late October, the German government indicated its willingness to adopt a more “constructive” stance and also endorsed a commitment to reach agreement on the matter by the end of the year.¹⁷⁶ In advance of another such summit in mid-December, it even expressed readiness to accept the European

¹⁷³ "Rapport d'information"; "Texte Adopté No. 284."

¹⁷⁴ Benoît Cœuré quoted in "Lautenschläger Wants Brief Bank Resolution Transition Period," *Agence Europe Daily Bulletin* (blog), February 4, 2014.

¹⁷⁵ Rapporteur in the French Senate François Marc quoted in Schild, "Germany and France at Cross Purposes," 109.

¹⁷⁶ Valentina Pop, "Germany budging on banking union," *EUObserver*, October 23, 2013; European Council, "Council Conclusions of 24/25 October 2013," communication from the General Secretariat to the Delegations, October 25, 2013.

Commission as the final decision-making body and thereby conceded a far more significant centralization of authority that it had initially deemed acceptable.¹⁷⁷ The French government, too, was forced to assume some flexibility with respect to a potential compromise on the scope of the SRM, which would likely reflect German demands for the resolution of small banks to remain a national prerogative.¹⁷⁸ In facilitating the following agreement, therefore, Franco-German compromise was absolutely crucial.

After a series of bilateral talks between France and Germany, the Council of Ministers reached an agreement on a draft regulation of the SRM in mid-December 2013.¹⁷⁹ With regard to the scope of the new mechanism, the Council conceded to German demands by allowing national governments to retain responsibility for the resolution of most banks within their borders, that is, all those without cross-border operations and not under the direct supervision of the SSM. In practice, this effectively ensured that the resolution of savings and cooperative banks would almost never be carried out at the European level.¹⁸⁰ Still, the difficulty of compromise also ensured that decision-making would be highly—and, in the view of most observers, unnecessarily—complex: the final authority for the initiation of resolution procedures would be vested not in the European Commission, but in a single resolution board comprising both a permanent group of supranational actors as well as representatives from the

¹⁷⁷ Barker et al., "Berlin gives ground in banking union debate."

¹⁷⁸ Pop, "Germany budging on banking union."

¹⁷⁹ Council of the European Union, "Council agrees general approach on Single Resolution Mechanism," press release, December 18, 2013.

¹⁸⁰ The resolution of even less significant institutions would be carried out by the single resolution authority in all cases where these required recourse to the SRF. Given the existence of well-funded IPSs among savings and cooperative banks in Germany, this was unlikely to affect them and the German government issued no objection. Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 6, 19.

national resolution authorities of each member state. The weak involvement of the European Council, which would be permitted to object or call for changes within twenty-four hours of the adoption of board decisions, reflected German insistence on the retention of some sort of national veto. Finally, like the prior proposal, the agreement also provided for the stepwise introduction of a single resolution fund over the course of a ten-year transitional period. For the time being, this effectively ensured that all resolution costs would be borne first by the national compartments of individual member states, with others contributing only a progressively increasing share as mutualization proceeds.

Still, because the regulation remained subject to adoption in the European Parliament and Council, the final design of the SRM was not actually agreed until March 2014 and deviated in several ways from the earlier draft.¹⁸¹ The Parliament, in particular, applied substantial pressure to the concessions previously made to Germany.¹⁸² To the satisfaction of their French counterparts, German policymakers ultimately conceded on a speedier mutualization of the SRF—to proceed over the course of eight rather than ten years—which would allow for a larger portion of common funding to become available at an earlier stage.¹⁸³ The French, alongside other advocates of a stronger resolution authority, also won a minor concession in that the role of the Commission in the SRB would

¹⁸¹ Regulation (EU) No 806/2014 of the European Parliament and of the Council 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 O.J. (L225/1).

¹⁸² "EP Sends Bank Resolution Question Back to Ministers," *Agence Europe Daily Bulletin* (blog), December 17, 2013; December 19, 2013; James Fontanella-Khan, "European Parliament challenges plan for €55bn bank rescue fund," *Financial Times*, January 16, 2014.

¹⁸³ At a more granular level, Germany and the European Parliament also clashed with respect to whether mutualization should proceed faster or just as fast as banks actually pay into the SRF. The European Parliament hoped that mutualization could proceed over a three-year period, with banks having ten years to pay in. Germany wanted the two processes to run at the same rate (but ideally slowly). Rebecca Christie and Maud van Gaal, "EU Mulls Faster Pooling of Euro Bank-Failure Fund Money," *Bloomberg*, January 27, 2014; "Schäuble: 'We are ready to speed up EU bank rescue fund,'" *Euractiv* with *Reuters*, February 19, 2014.

marginally increase, though the compromise was again highly complex and far from the efficient framework they had initially envisioned.¹⁸⁴ Still, member states considered these modifications ultimately agreeable and the regulation was thus officially enshrined into European law by July.

Notwithstanding this milestone consensus, one key issue remained still undiscussed: indeed, the calculation of individual bank contributions to the SRF was not addressed in earnest until after the design of the SRM was firmly in place, and continued to occupy policymakers' attention throughout the remainder of 2014. Given that their national banking sectors—the largest in the euro area—would likely contribute the bulk of the financing, disagreements between France and Germany were again particularly pronounced. The German position was predictably influenced by the cost concerns of small alternative banks, which had consistently advocated if not to be exempted entirely at least to be relieved from having to give as much as their larger, more systemically relevant peers. As a result, German policymakers called for the new calculation methodology to respect principles of proportionality and take into account a wide array of criteria (including size, systemic relevance, and individual bank risk) to distinguish between different kinds of institutions.¹⁸⁵ In response to such demands, French policymakers gave voice to the concerns of individual French banks that the introduction of proportional treatment—given the fixed target size of the SRF—would only increase the share to be contributed by larger and more obviously

¹⁸⁴ Howarth and Quaglia, *The Political Economy of European Banking Union*, 15.

¹⁸⁵ *Shaping Germany's Future: Coalition treaty between CDU/CSU and SPD* (Berlin: Non-official translation by Konrad Adenauer Stiftung, February 2014), 61.

systemically relevant institutions.¹⁸⁶ As a result, French preferences emphasized from an early point that domestic banks should not be unduly penalized for high levels of industry consolidation and that the calculation of contributions should take risk into account more than size (thereby also directly at odds with the size-based methodology advocated by the Germans).¹⁸⁷

A compromise tabled by the European Commission in October reflected the need to find some sort of middle ground between these divergent positions.¹⁸⁸ In a concession to the German government, the proposal included several provisions for the special treatment of small- and mid-sized institutions, including a lump-sum regime under which certain banks (those with contribution-relevant liabilities of less than €300 million and total assets of less than €1 billion) would only pay a fixed annual amount of as little as €1,000, and also recognized IPSs as a risk-mitigating factor which would reduce their contributions to the SRF.¹⁸⁹ Still, Germany's savings and cooperative banks continued to insist on raising the threshold for inclusion (from €300 million to €500 million in contribution-relevant liabilities and from €1 billion to €3 billion in total assets) so that it might cover an even larger number of institutions—demands which German finance minister Wolfgang Schäuble also endorsed at the European level.¹⁹⁰ To appease French concerns, the proposal also provided for a transitional mechanism to ensure that member states with particularly concentrated banking sectors would

¹⁸⁶ FBF quoted in "Lobby Groups Pleased with Bank Resolution Deal," *Agence Europe Daily Bulletin* (blog), March 24, 2014; "Resolution Fund - Avoiding Distortions on Single Market," *Agence Europe Daily Bulletin* (blog), October 15, 2014.

¹⁸⁷ "Ministers to Discuss Stability and Growth Pact," *Agence Europe Daily Bulletin* (blog), June 18, 2014;

¹⁸⁸ Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements, 2015 O.J. (L11/44).

¹⁸⁹ Spiegel et al., "EU leans on big banks."

¹⁹⁰ "Auch kleinere Banken sollen zahlen"; "Banken feilschen um Beitrag für EU-Abwicklungsfonds." Indeed, under the calculation methodology proposed in October, only more than a quarter of Germany's Sparkassen would be classified as 'small' and pay the lump sum of as little as 1000 euros toward the fund. Spiegel et al., "EU leans on big banks."

not bear an unreasonably high burden when the new rules entered into force.¹⁹¹ Still, such provisions were clearly insufficient to appease the concerns of the euro-area's largest banks, which were expected to account for around 90 percent of common funding while representing about 85 percent of the euro area's total banking assets.¹⁹² Given the French banking sector's relatively high degree of industry consolidation, this effectively implied that French institutions would contribute about €17 billion to the fund over an eight-year period (the highest national contribution, or 30 percent of the total fund), with German institutions contributing about €2 billion less. Considering their relatively low risk profiles, French banks considered this result "exorbitant" and entirely unjustified.¹⁹³

Given the intensity of intergovernmental disagreements and the inherent complexity of the matter at hand, policymakers did not reach agreement on a final calculation methodology until the very end of 2014.¹⁹⁴ Basic principles remained largely unchanged from the previous proposal: individual bank contributions would be calculated on the basis of size and then risk-adjusted, and provisions for the special treatment of small and mid-sized institutions were not modified in a meaningful way. More notably, French policymakers' concerns about the fairness of the new regime were ultimately resolved through an informal agreement that the French and German banking sectors would each bear an equal-sized burden in the financing of the SRF, that is, each contribute about €15 or €16 billion over the

¹⁹¹ "Methodology for Contributions to Resolution Funds Announced," *Agence Europe Daily Bulletin* (blog), October 21, 2014. German policymakers strongly opposed the introduction of any such transitional mechanism. "Germany Opposes Transitional SRF Contributions Mechanism," *Agence Europe Daily Bulletin* (blog), November 7, 2014.

¹⁹² *Europe: Building a Banking Union* (Austin, Texas: Stratfor Assessments, October 29, 2014). Small banks, by contrast, which accounted for 1 percent of banking assets, would contribute only 0.3 percent, and mid-sized institutions (14 percent of assets) only 9.7 percent. Spiegel et al., "EU leans on big banks."

¹⁹³ *Ibid.*; "French, German resolution fund bill to be 15 billion euros per country," *Reuters*, November 4, 2014.

¹⁹⁴ European Commission, "EU Banking Union Fit for Service," press release, December 19, 2014.

envisioned eight-year period.¹⁹⁵ Corrections to the earlier calculation methodology would trim up to €2 billion off of French banks' total contributions and were effectively reverse-engineered to lead to this result.¹⁹⁶ Still, it is important to note that the contributions of French and German banks have in fact diverged significantly since this agreement and the entering into force of the SRM shortly thereafter, a result which has given rise to some lingering resentment on the part of French banks and—as relates to the following chapter—clear reluctance to enter into similar kinds of cost-sharing arrangements in the future.¹⁹⁷

In sum: In constructing the SRM, observable disagreements between France and Germany were largely the result of policy preferences which sought to preserve the dominant interests of each state's national banking sector. While German policymakers never rejected the idea of the SRM in principle, they did go to great lengths to ensure that its domestic impact would be minimal. To that end, they favored the retention of significant decision-making authority at the national level and sought to avoid any financing mechanism which would have required small banks to enter costly and unfavorable risk-sharing agreements with larger institutions. The French view, by contrast, clearly reflected the dominance of large, systemically relevant institutions in the French banking sector; as a result, policymakers were substantially more generous with respect to both the transfer

¹⁹⁵ "French, German resolution fund bill to be 15 billion euros per country"; "Banques françaises et allemandes contribueront à même hauteur au niveau européen."

¹⁹⁶ Interviews, French Treasury, January 11, 2019; February 5, 2019.

¹⁹⁷ Delphine Cuny, "Fonds de résolution unique : les banques (françaises surtout) passent à la caisse," *La Tribune*, July 25, 2018. Divergences in contributions may be the result of a number of simultaneously occurring phenomena, including more dynamic growth in the French deposit base and the fact that the funding mechanism itself also provided for assets to be measured against an increasingly European rather than national frame of reference. Similar trends have been observed within the German banking sector between different kinds of credit institutions, with the contributions of large and regional banks accelerating particularly rapidly between the years 2015 and 2018. Observers also note that while the relevant regulations were at the time deemed to be sufficiently precise, the way in which the SRB has refined the calculation methodology in the past few years has been opaque and difficult for banks to reproduce. Interviews, various.

of decision-making authority and the assumption of mutual responsibility in the financing of future resolutions. In line with the expectations of Hypothesis II, then, the extent to which individual member states were prepared to support policy centralization at the European level depended crucially on the composition of their domestic banking sectors and the distribution of large and small banks within their borders.

In a practical sense, however, the accommodation of member states with differently structured banking sectors implied that the new regime was necessarily less effective than it otherwise might have been when it officially entered into operation at the start of 2016. While the introduction of a European resolution framework was intended to ensure that related decisions would be met in a quicker, more efficient, and nationally impartial manner, decision-making processes in the SRB—due in large part to German resistance—are today so excessively complex that rapid action is nearly impossible.¹⁹⁸ Similarly, a central aim of creating a common resolution fund was to spread the costs of future resolutions more widely across the European banking sector and ensure that national taxpayers would not be made to foot the bill when private resources proved insufficient; in practice, however, a general lack of cross-border solidarity in the construction of the SRF guaranteed that this would occur only after an appropriately lengthy transition period, with costs borne mostly at the national level for several years to come. In retrospect, then, the balancing of opposing interests among different kinds of euro-area banks effectively prevented the SRM from realizing the full purposes of Banking Union as initially envisaged and thus

¹⁹⁸ Interview, BNP Paribas, January 4, 2019; "Rapport d'information".

also had farther-reaching implications for the stability of the project going forward.

Chapter VI: The European Deposit Insurance Scheme

With agreement reached on both the Single Supervisory and Single Resolution Mechanisms by the spring of 2014, there remains today only one pillar—a centrally managed and commonly funded system for the guarantee of bank deposits—to be constructed for the technical completion of Europe’s Banking Union. In general terms, a well-functioning mechanism for deposit insurance, which guarantees customer deposits in the event of bank failure, not only protects the unsophisticated depositor for his own sake, but also serves the public interest more generally by reducing the likelihood that random fluctuations in public confidence might prompt self-fulfilling bank runs and, in the most destructive scenarios, system-wide panics.¹⁹⁹ In most cases, deposit insurance funds are financed through the mandatory contributions of participating banks, collected ex-ante by a government agency (or a private entity with government backing) and then disbursed as needed to recoup losses in both resolution and ordinary liquidation cases. Over the past decade, deposit guarantees have expanded both in prevalence and generosity of coverage in most countries affected by the 2008 financial crisis and have thus become increasingly critical financial safety nets in most modern banking systems around the world.²⁰⁰

To date, no real legislative progress has been made toward the transfer of deposit insurance from the national to the European level, though the architects of the Banking Union consider this an integral component of the three-pillar agenda

¹⁹⁹ Douglas W. Diamond and Philip H. Dybvig, “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy* 91, no. 3 (1983): 401-19.

²⁰⁰ Asli Demirgüç-Kunt, Edward Kane, and Luc Laeven, “Deposit Insurance Debates” (IMF Working Paper WP/14/118, International Monetary Fund Research Department, July 2014).

for postcrisis financial reforms. Despite increasingly rigorous harmonization over the course of preceding decades, deposit insurance remains today an exclusively national competency, with persistent variation in quality and design across individual member states. As widespread bank failures in the recent financial crisis made clear, however, national deposit guarantee schemes are in many cases still insufficiently funded to protect deposits up to the level technically guaranteed under the European standard, and even the more credible among them remain vulnerable to exhaustion in the case of large local shocks.²⁰¹

Importantly, the credibility of national DGSs depends not only on the sum of paid-in resources, but also on the health of governments' public finances which serve as a backstop in the case of shortfalls. As a result, the trust of European consumers in their respective national banking systems remains highly dependent on the fiscal position of their home states, which, in turn, has exacerbated deposit flight in times of crisis and distorted the competitive playing field between banks operating in the supposed Single Market.²⁰² In this respect, the present harmonization approach is clearly insufficient as long as national DGSs continue to function independently; rather, in the completion of the Banking Union and the realization of its intended macroeconomic purposes, a fully mutualized European deposit insurance scheme is technically still outstanding.

²⁰¹ A 1994 directive required every member state to operate at least one DGS covering at least €20,000 per depositor, which represented the first legal step toward a common standard for deposit insurance in Europe. The experience of the financial and sovereign debt crises precipitated further convergence. Unilateral commitments on the part of individual states to protect deposits up to an increased coverage limit were reinforced by a joint response in 2009, when a new directive increased the coverage level first to €50,000 euros and then to €100,000 euros and also shortened the maximum payout period to 20 working days. Most recently, the passage of Directive 2014/49/EU in 2014 has required all banks in the EU in to participate in an officially recognized DGS.

²⁰² Guntram B. Wolff, "European Parliament Testimony on EDIS" (speech, European Parliament ECON Committee Public Hearing of 23 May, Brussels, May 23, 2016); "European Union: Publication of Financial Sector Assessment Program Documentation—Technical Note on Deposit Insurance" (IMF Country Report No. 13/66, International Monetary Fund, Monetary and Capital Markets Department, March 2013), 7.

Part I: The domestic political economy of a common deposit insurance regime

As with previously constructed pillars of the Banking Union, the transition to a supranational deposit insurance regime is likely to have a substantial impact on the interests of participating banks. In contrast with patterns identified in preceding chapters, however, bank attitudes are not wholly in line with the predictions of Hypothesis I: at present, a wide array of domestic stakeholders in both Germany and France views the introduction of a European deposit insurance scheme as almost uniformly unfavorable, their lobbying efforts thus more closely aligned than at any earlier point in the Banking Union negotiations. Once again, Germany's alternative banks express the most vehement opposition, fearing the loss of competitively advantageous institutional protection schemes and the imposition of costly risk-sharing arrangements at the European level. More surprising given their generally consistent support in other areas, large commercial banks—while not opposed to European deposit insurance as a theoretical policy construct—also consistently resist its implementation in the present context. Notwithstanding this clear deviation from the basic lines of division identified in preceding chapters, the following section demonstrates that domestic opposition to EDIS is in fact rationally derived from a more uniform distribution of 'losers' in France and Germany alike and in the same three areas which have shaped bank attitudes toward other pillars as well.

Changes in the competitive landscape: In the European case and in general, developments in the realm of deposit insurance regulation have far-reaching implications for the dynamics of competition in the banking industry.

Indeed, banks compete quite fiercely with one another on the deposit-taking side of their balance sheets, and doing so effectively requires them to impart a strong sense of security with respect to their ability to safeguard customer assets. In this context, participation in a sufficiently generous, well-funded, and otherwise credible arrangement for deposit protection is a critical marketing tool for building trust in a particular brand and for capturing market share from other institutions also vying for preferential access to the same set of customers. In a departure from the basic lines of division identified in preceding chapters, then, the competitive (dis-)advantages of the Banking Union's third pillar relate not to the expansion of European banking markets as such; rather, at least in the German case, where deposit guarantees are still demarcated along the sectoral lines of the three-pillar system, domestic banking interests consider how a prospective equalization of the playing field is likely to affect their ability to attract deposits relative to both national and international competitors, and shape their attitudes toward EDIS accordingly.²⁰³

From the perspective of Germany's alternative banks, EDIS is undesirable to the extent that it threatens the competitive advantages afforded by long-standing arrangements for institutional protection. Rather than offering an explicit guarantee for a capped level of customer deposits, IPSs effectively protect the continued viability of all member institutions, including all associated liabilities,

²⁰³ Since the 2014 adoption of more rigorous standards for European DGS harmonization and their transposition into German law the following year, all German banks are required to participate in a recognized statutory DGS which complies with those statutory requirements (including a €100,000 coverage level) laid out in the directive. Beyond this minimum, however, there are several additional mechanisms of deposit insurance in Germany and it is in these that the most significant sectoral distinctions are preserved. In France, reflecting a general absence of institutional accommodations for significant heterogeneity, all banking groups are currently encompassed within a single DGS, the *Fonds de Garantie des Dépôts et de Résolution*, or FGDR. Given that both the FGDR and EDIS would offer insurance up to the same coverage threshold (€100,000), French banks generally do not expect the shift to significantly alter their ability to attract depositors or the dynamics of competition within the French banking market more generally. Interviews, various.

through an implicit mutualization across the entire group.²⁰⁴ These have both historically and in the present shaped the competitive landscape of the German banking sector as a whole. Indeed, the cooperative banks' invention of the first IPS in the early 1930s was most immediately a marketing tool intended to restore depositor confidence amidst the economic turmoil of the Great Depression.²⁰⁵ Even today, the generous protections of their privately-owned peers (described in greater detail in the subsequent paragraph) cannot reasonably match the trust afforded by the blanket guarantees of entire institutions.²⁰⁶ While the introduction of EDIS would not prohibit the operation of IPSs per se, representatives of the alternative banking sector insist that the "unsustainable double burden" of maintaining existing arrangements while also paying into a European fund would render their continued existence "impossible."²⁰⁷ In their view, EDIS would not only erode depositor confidence by enforcing a lower level of explicit protection, but in doing so would also threaten to abolish a hallmark of alternative banking which is "of existential importance for trust in the common brand" and without which their very ability to remain competitive in the German market would be compromised.²⁰⁸

The competitive implications of EDIS also explain why Germany's private banks have been only relatively more favorable and advocate its introduction only under a specified set of conditions. In theory, an equalized

²⁰⁴ Still, the financing offered through IPS is not unlimited or unconditional. Many observers point out that a sector-wide collapse could quickly overwhelm existing resources for mutual support. Interviews, various.

²⁰⁵ Interview, Deutsche Bundesbank, May 30, 2018.

²⁰⁶ IPSs are described as the "biggest competitive advantage" of the savings and cooperative banks in Germany's domestic market. Stefan Kaiser, "Kampf um die deutschen Spargroschen," *Spiegel Online*, September 13, 2012. Markus Frühauf, "Ab 100.000 Euro geht es ums Vertrauen," *Frankfurter Allgemeine*, September 8, 2018.

²⁰⁷ *Credible, sustainable deposit protection* (Berlin: BVR/DSGV, January 2016).

²⁰⁸ Hans-Günter Henneke, "Erprobte und stabile Strukturen der Sparkassen erhalten," *Börsen-Zeitung*, June 15, 2018; *Comments on the European Commission proposal for a regulation establishing a European Deposit Insurance Scheme* (Berlin: Die Deutsche Kreditwirtschaft, January 2016).

playing field in the national market for deposits is desirable to the extent that it would obviate the need for unnecessarily costly voluntary guarantees. Indeed, it was in direct response to the IPSs of their alternative peers that Germany's private banks were compelled to adopt far more generous arrangements for deposit protection than are common in other member states: in addition to the statutory DGS required under European law, they also operate a voluntary scheme which secures all covered deposits up to a ceiling of 20 percent of a bank's liable capital, thereby guaranteeing full compensation at least in effect if not in theory.²⁰⁹ Still, because voluntary schemes also constitute a competitive distortion at the level of the European market, it is possible that a hypothetical EDIS might be accompanied by the introduction of a maximum level of deposit protection which would leave their fate—like that of institutional protection—rather uncertain. As a result, Germany's private banks are loath to forfeit what is considered a “gold standard” in the European market as a whole, fearing that the introduction of EDIS would produce a significant disruption among German retail customers who are accustomed to a much higher level of explicit protection.²¹⁰ Across Germany, then, banks formulate the nature of their opposition to EDIS in line with its anticipated consequences in the competitive banking landscape, which—though objectionable to varying degrees—are not clearly favorable to the interests of any domestic stakeholders.

Anticipated costs and savings: In general, the costs most immediately associated with any kind of explicit deposit guarantee arrangement are those

²⁰⁹ Interviews, Association of German Banks, June 1, 2018; January 9, 2019; Deutsche Bundesbank, May 30, 2018.

²¹⁰ Interview, Association of German Banks, January 9, 2019; *Stellungnahme zum Verordnungsvorschlag der Europäischen Kommission im Hinblick auf die Schaffung eines europäischen Einlagensicherungssystems* (Berlin: Die Deutsche Kreditwirtschaft, January 2016), 2.

which arise in the context of financing—and, as needed, replenishing—an ex-ante fund which is large enough to guarantee all insured deposits up to a specified coverage limit. As in the case of the SRF, then, the desirability of EDIS is closely linked to expectations regarding the specific contributions banks would be required to make and, in particular, whether these would be greater or lesser than the present cost of deposit insurance under the applicable national framework. On this matter, it should be noted that the most comprehensive legislative proposal to date makes an explicit commitment to cost-neutrality, that is, EDIS would at least in theory not collect additional contributions beyond those already required to fund national DGSs to the level stipulated in the most recent European directive.²¹¹ Still, the proposal contains no specific provisions for the calculation methodology to be used and this reassurance is generally not taken at face value in either member state under consideration.²¹²

Germany's alternative banks have adopted the most unambiguous position in this respect. Since failing to secure their exemption from the most recent round of European regulatory harmonization, alternative banks have been required—in addition to maintaining traditional arrangements for institutional protection—to finance statutory deposit guarantee funds which provide for the reimbursement of insured deposits up to an individual coverage limit of €100,000.²¹³ Still, given the generally faultless historical record of their IPSs (there has been no single incident

²¹¹ *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme*, COM (2015) 586 final (November 11, 2015), 46; "EU deposit guarantee scheme will not raise banks' costs - Commission," *Reuters*, November 11, 2015.

²¹² Interviews, various.

²¹³ Prior to the 2015 transposition into German law of the most recent DGS directive, the implicit guarantees afforded by well-functioning IPSs exempted Germany's savings and cooperative banks from having to set up statutory DGSs as were required of other kinds of banks. As a result, they had also been vehemently opposed to earlier rounds of regulatory harmonization in this respect. Interview, Deutsche Bundesbank, May 30, 2018.

of depositor compensation in the history of their operation), these funds, once outfitted with adequate financial reserves, tend not to need to be replenished.²¹⁴ Because statutory funds are partitioned along the sectoral lines of Germany's three-pillar system, participating institutions can also be assured that they will not be drained by insolvencies outside their respective groups. An EDIS, however, could be drawn upon to finance the reimbursement of depositors anywhere across the euro area; as a result, it would have to be restocked much more frequently and thus imposes additional costs regardless of how individual contributions are calculated.²¹⁵ European policymakers have offered generalized reassurances that the costs to Germany's savings and cooperative banks will not be increased as a result, but such promises have not been explicitly reflected in official proposals and are in any case nonbinding.²¹⁶ As a result, Germany's alternative banks continue to assume that EDIS would substantially increase the costs of deposit insurance relative to existing arrangements and issue objections on precisely these grounds.

While commercial banks in both Germany and France recognize the possibility that EDIS could impose new and additional costs, French banks are at present significantly more assured in this respect. Germany's commercial banks remain wary of any funding structure which—like that of the SRF—might be more heavily weighted toward the contributions of large institutions, but generally associate the financing of EDIS with too much uncertainty to be able to formulate

²¹⁴ Interview, Economic and Financial Committee, June 16, 2018. The DGS of the private commercial banks, by contrast, is drawn upon 1-2 times a year. Interview, Association of German Banks, January 9, 2019.

²¹⁵ *Credible, sustainable deposit protection*, 6.

²¹⁶ Birgit Marschall and Christopher Ziedler, "EU will deutsche Sparer zur Kasse bitten - Union empört," *RPOonline*, November 26, 2015. Still, the funding path for participating national DGSs set out in Article 41j of the most recent legislative proposal, COM (2015) 586 final, includes no specific provisions for banks with IPSs.

a more concrete position at this point.²¹⁷ French banks, however, have been on the whole much more expressly displeased with the inequitable distribution of costs under the SRF, and are accordingly hesitant to enter any European arrangement for deposit insurance which might produce similar discrepancies.²¹⁸

Unlike their German counterparts, French banks can also formalize these expectations on the basis of a key technical distinction between the expected financial strength of EDIS and that of the existing French DGS. Under European standards, France and other member states with particularly concentrated banking sectors have been permitted to reduce the target level of their national DGSs from 0.8% to no lower than 0.5% of covered deposits (an indirect means of compensating these for having to bear a larger burden in the financing of the SRF). Legislative proposals for EDIS, however, provide for no similar kinds of exemptions, and its introduction would thus require significant additional contributions from the French banking sector relative to current arrangements and relative to the contributions of member states like Germany, where 0.8% of covered deposits has already been the default for a number of years.²¹⁹

For French banks, the substantive costs of deposit insurance are also increasingly less likely to be offset by operational savings resulting from a streamlining of operations across the European banking market. In theory, the absence of European deposit insurance—like that of a European resolution mechanism in the previous chapter—is closely linked to the persistence of

²¹⁷ Interview, Association of German Banks, January 9, 2019.

²¹⁸ Interview, BNP Paribas, January 4, 2019.

²¹⁹ Interview, French Treasury, January 11, 2019. The possibility for a reduced target level for the national DGS was agreed in direct response to the calculation of individual bank contributions to the SRF. "Council Reaches Broad Agreement on SRF Contributions," *Agence Europe Daily Bulletin* (blog), December 9, 2014.

geographical ringfencing and related barriers to the cross-border provision of banking services: fearing that national DGSs might foot the bill for the failures of international bank affiliates operating within their borders, domestic regulatory authorities continue to maintain strict operational divisions between these and their foreign-headquartered parents.²²⁰ The elimination of geographical ringfencing tends to be more highly prioritized by the principal banking groups in France, which are more internationally ambitious than their German counterparts and usually more interested in European solutions. Still, over the past few years and in the context of the most recent banking package, it has become increasingly clear that the adoption of greater flexibility in this regard will continue to be blocked by smaller ‘host’ states in which foreign branches and subsidiaries comprise a large share of the domestic market.²²¹ As a result, the operational gains that might be associated with further progress on EDIS actually remain distant and uncertain, thereby also substantially reducing the incentives of French banks to make a “bet for the future” in lending their support to the relevant proposals.²²²

²²⁰ It is useful to distinguish between legally independent subsidiaries and integrated branch networks: unlike branches, the standalone subsidiaries of cross-border banking groups are usually subject to local deposit arrangements and are thus also more frequent targets of geographical ringfencing by host country authorities. Eugenio Cerutti et al., "Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks" (IMF Working Paper WP/10/247, International Monetary Fund, European Department and Monetary and Capital Markets Department, November 2010), 7.

²²¹ At present, capital and liquidity waivers may be applied only to subsidiaries within a particular member state—i.e., not on a cross-border basis—which are also overseen by the same supervisor. Following the introduction of the SSM in 2014, the European Commission suggested that the improved quality of cross-border group supervision should allow for similar flexibility among subsidiaries active in other member states of the Banking Union. Still, as agreed by the Parliament and Council in December 2018, the most recent banking package excludes any such waivers—a disappointing result from the perspective of those French authorities which had considered this an important step in the creation of a genuinely European banking market. At this point, it remains unclear at what point in the future, if at all, cross-border waivers might indeed be introduced. Interviews, various. See also European Parliament, "Banking package: Parliament and Council reach an agreement," press release, December 4, 2018.

²²² Interview, BNP Paribas, January 4, 2019. These developments also align with general observations of French banks apparently backpedalling on their earlier support for EDIS and thereby aligning themselves also more closely with the German position. Ruth Berschens, "French Banks May Block E.U. Deposit Insurance," *Handelsblatt*, June 6, 2016.

Attitudes toward risk-sharing: At its core, any interbank arrangement for deposit insurance represents an effort to spread risks—in this case, the risks of failure and the associated costs for a particular class of affected stakeholder—across a more broadly defined area or set of institutions. As a result, deposit insurance is also inextricable from the political dynamics of risk-sharing as a more general phenomenon, including the possibility for a significant reallocation of material resources from more to less financially sound institutions. In contrast to resolution and the risk-sharing implications of the SRF, however, size and systemic relevance alone do not make certain banks clearly more or less appropriate candidates for depositor reimbursement in the case of failure: if implemented, a European deposit insurance fund could technically be mobilized for banks in both resolution and ordinary liquidation proceedings (though presumably more frequently in the latter case).²²³ As a result, the obvious beneficiaries of deposit insurance are generally even more difficult to identify in advance with a high degree of accuracy, and the risk-sharing aspects of EDIS therefore also particularly controversial.

Those banks which have been among the most vocal with respect to the risk-sharing implications of EDIS are Germany's alternative banks. In contrast to the negotiations on the SRF, however, small and medium-sized banks can make only a much weaker case for exemptions from EDIS on the basis of size or systemic relevance alone. Instead, alternative banks have focused the basis of their opposition on the existence of well-funded IPSs within their respective

²²³ As described in the previous chapter, systemically important banks are usually more appropriate candidates for resolution than for ordinary liquidation procedures in the case of a potential insolvency. Given the credit hierarchy (the extensive waterfall of bail-in) agreed in the context of the Bank Recovery and Resolution Directive, it is unlikely that unsophisticated depositors would be affected in such a case. Interviews, various.

groups; by allowing for preventive action before any mechanism for depositor reimbursement would even be triggered, they effectively eliminate any possibility of requiring recourse to EDIS at any point in the future. Accordingly, alternative banks object to imposition of cross-border liability obligations that would allow resources collected in institutional protection and statutory deposit guarantee funds to sponsor the risks assumed by other institutions and compensate for underfunded (and often still ex-post funded) DGSs in other member states.²²⁴

Of particular concern are the large stocks of nonperforming loans concentrated in the banking sectors of the European periphery, which increase the default risk of individual banks and thereby also their likelihood of requiring recourse to future financial assistance. Germany's alternative banks have extremely low levels of nonperforming loans in both the German and broader European context.²²⁵ As a result, they generally insist that any reallocations of risk should be preceded (or indeed, substituted) by a thoroughgoing effort to reduce risks across the European banking sector as a whole (e.g., by discharging existing stocks of NPLs and by ensuring the consistent implementation of existing DGS directives across all member states).²²⁶

At present, cross-border banks in both Germany and France are not significantly less opposed to the risk-sharing implications of EDIS than their smaller, more insulated peers—an apparent departure from the solidarity

²²⁴ Cathrin Schaer, "German banks oppose an EU-wide deposit insurance," *Handelsblatt*, January 15, 2018; BVR/DSGV, "BVR und DSGV gegen Vergemeinschaftung der Einlagensicherung: Keine weitergehende Transferunion zugunsten unterfinanzierter Sicherungssysteme in der EU," press release, January 1, 2016.

²²⁵ Levels of nonperforming loans are less than 2 percent among German Sparkassen, while the German average is about 5 percent. Markus Hank, "Die Bedeutung eines europäischen Einlagensicherungssystems (EDIS) für die Finanzmarktstabilität der Eurozone" (Master thesis, Hochschule für Öffentliche Verwaltung und Finanzen Ludwigsburg, 2015), 67.

²²⁶ *Monetary Union: Providing the right impetus for stability* (Berlin: DSGV, June 2017), 4-5; Helmut Schleweis, "Echte Sicherheit braucht Eigenverantwortung," *Börsen-Zeitung*, June 15, 2018.

expressed in the context of the SRF, but one which follows in a logical manner from the distinct set of circumstances in which the new pillar has been proposed. Since the construction of the SRM, cross-border banks have significantly reduced their exposures to the European periphery and are increasingly less willing to assume a significant burden in the protection thereof. Second, in both France and Germany, where deposit guarantees are already prefunded to the required level (and beyond), all banks are generally unwilling to subsidize persistent shortcomings in the DGSs of other member states, many of which still rely on ex-post funding mechanisms and fail to comply with other minimum standards set by the European Commission. Finally, for French banks in particular, objections are linked to lingering concerns related to the unequal treatment of institutions under existing pillars of the Banking Union, as reflected, for example, in the thousands of less significant institutions and non-CRD entities which remain under the effective control of national supervisory authorities and which the SSM can only monitor to a limited extent. Because the SRM was intended more immediately for those significant institutions already included within the direct supervisory remit of the ECB, such distinctions were then far less problematic than in the current context.²²⁷

In sum: In Germany and France alike, major banking interests remain strongly opposed to the introduction of a European deposit insurance scheme, at least in any existing legislative conception thereof. On this matter, the opposition of Germany's alternative banks is just as pronounced as in the context of previous pillars and rests on similar objections. With competitively advantageous

²²⁷ Interviews, various.

arrangements for institutional protection already in place, such banks are unwilling to contribute to a supranational safety net to which they never expect to require recourse. In contrast to patterns established in previous chapters, however, commercial banks in both Germany and France are only relatively more amenable. As a result, the current example is not entirely compatible with the expectations of Hypothesis I, which predicts greater support for market-unifying policies among those banks which are already meaningfully Europeanized in their relevant operations and exposures. Still, large bank attitudes are not necessarily incompatible with a rational consideration of their economic interests in the current environment: with European solidarity increasingly less likely to be rewarded by easier expansion into cross-border markets, the value of costly risk-sharing agreements—especially where the scope of existing risks is still unknown and remains effectively outside the reach of European supervisory authorities—is not readily apparent.

Part II: The formation of national policy preferences on EDIS

In accordance with the dual hypothesis framework which forms the basis of the present analysis, national policy preferences should closely match the domestic banking interests identified in Part I of this chapter. As this pillar of Banking Union remains as yet unconstructed, disagreements among member states are still rather fundamental: in the negotiations which have taken place to date, differences center largely on whether and to what extent a European deposit insurance scheme should mutualize national DGSs across borders, as well as on

the existence of significant preconditions for doing so. On these issues, the predictions of Hypothesis II are corroborated in the German case more than the French. With preferences more or less uniform across the German banking sector, German policymakers have pursued an even harder line of opposition to EDIS than to previously agreed pillars of the Banking Union. Despite the generally muted interest of French banks, however, French policymakers have not deviated from the complete support they offered in earlier rounds of negotiations, even as the incentives to bear the associated costs become progressively less compelling. The following section characterizes these principal negotiating positions—of course, subject to change as negotiations on EDIS proceed over the course of coming years—within an approximate time frame from 2012 to the end of 2018, finding the proposed theoretical framework to be only an incomplete predictor of national preferences on this particular aspect of Banking Union.

Initial reactions to European deposit insurance were first elicited from individual member states in September 2012, at which point it also became clear that despite generalized opposition across the French and German banking sectors alike, official policy preferences would continue to diverge along the same basic lines identified in previous rounds of negotiations. At this stage, the Commission had prepared a draft proposal for the establishment of a new agency, the European Deposit Insurance and Resolution Authority, which would transfer both resolution and deposit insurance decisively to the European level. The French indicated a strong interest in implementing both pillars as soon as practically feasible and preferably within the year 2012, such that the achievement of a fully-fledged

Banking Union would not be stalled further.²²⁸ On these points, the enthusiasm of French policymakers was obviously inconsistent with preferences emanating from within the banking sector itself, but also representative of pro-European attitudes they would carry through the remainder of the EDIS negotiations to date. The EDIRA proposition, however, was met with fierce opposition from no member state more than Germany. Germany's veto, in turn, reflected both the categorical opposition of its alternative banks as well as the more circumstantial opposition of its large commercial banks, which were not opposed to such a construct in principle but preferred a later timeline for its implementation. In the first of many accommodations to German resistance, senior policymakers decided to remove the section in question and mostly relegated the issue of deposit guarantees to a brief section on next steps.²²⁹

Between the years 2012 and 2015, a pattern of unified German opposition precluded further legislative progress on EDIS. In response to early objections, the Four Presidents' Report issued in December 2012 effectively avoided the issue altogether, and the mutualization of deposit insurance disappeared from the policymaking agenda for the time being.²³⁰ German resistance also led to the removal of mandatory lending from the Commission's 2010 proposal for a recast Deposit Guarantee Schemes Directive (Article 10), such that the amended version adopted in 2014 provided for this option only on a voluntary basis and under a

²²⁸ Pierre Moscovici, "Pierre Moscovici's speech at Bruegel Annual Meeting" (speech, Bruegel Annual Meeting 2012, Brussels, November 9, 2012).

²²⁹ Alex Barker, "Brussels shelved bank deposit scheme," *Financial Times*, September 13, 2012.

²³⁰ Howarth and Quaglia, *The Political Economy of European Banking Union*, Chapter 7, 3. The Four Presidents' Report issued in December 2012 emphasizes a need for further harmonization of national DGSs but does not foresee any particular strategy for their transfer to the European level. Van Rompuy et al., *Towards a Genuine Economic and Monetary Union* (Brussels: European Council, December 5, 2012), 8.

narrow set of conditions.²³¹ In the German view, even mandatory lending constituted a step too far in the direction of mutualization: national DGSs, after all, continued to vary widely in their capacity—some had only just been set up and did not comply even with minimum standards—and therefore also in their ability to lend.²³² Such concessions were to the particular discontent of France, which continued to emphasize the need for no less than a genuinely supranational system, that is, one which would not only facilitate the movement of liquidity between national DGSs, but also pursue a genuine pooling of resources through the creation of a single fund.²³³ Given the intensity of the German opposition, however, French policymakers were forced to limit their aspirations to amendments of existing DGS directives, which introduced more rigorous standards for harmonization in national frameworks but did not go further in the direction of a genuine EDIS.²³⁴

The issue of EDIS appeared to reemerge with the publication of the Commission's first formal legislative proposal in November 2015, which provided a detailed outline for a possible implementation.²³⁵ Specifically, the introduction of EDIS was foreseen to proceed stepwise in three distinct stages: first, during a three-year reinsurance phase, a European deposit guarantee fund would only provide a capped level of financial assistance—a portion of which

²³¹ Schild, "Germany and France at Cross Purposes," 109-110; See Article 12, "Borrowing between DGSs," in Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, 2014 O.J. (L173/149). German savings banks also explicitly rejected cross-border lending between national DGSs and advocated instead for a last-resort borrowing mechanism to exist only at the national level. *The ESBG's updated position on the Review of the Deposit Guarantee Schemes (DGS) Directive* (Brussels: European Savings and Retail Banking Group, September 20, 2013), 3.

²³² Patricia Wruuck and Jan Schildbach, *Deposit insurance in the Banking Union: Options for the third pillar* (Frankfurt: Deutsche Bank Research, 2015), 3.

²³³ "Rapport d'information"; "Texte Adopté No. 284."

²³⁴ Schild, "Germany and France at Cross Purposes," 109. See, for example, Directive 2014/49/EU.

²³⁵ Commission Proposal COM (2015) 586 final.

would take the form of a loan to be repaid—in the case that national DGSs and all other available means (e.g., raising short-term ex-post contributions from within national banking sectors) were exhausted; in a subsequent phase of co-insurance, foreseen to last four years, the European fund would cover a progressively increasing share (from 20% to 80% between the first and final years) of the liquidity needs and losses of participating national DGSs, which would be entitled to such payouts irrespective of their ability to fund these independently; finally, in the full insurance steady state, envisaged at the time to be operational by 2024, participating DGSs would be 100% mutualized with no limit to the amount of funding extracted from the common pool.²³⁶ Thus, this implementation schedule reflected at least some acceptance of the principle that losses should, at least in the near- to medium-term, continue to be borne at the national level, with common funding being made only progressively more available over an extended timeline.

The sharpening of proposals over the course of 2015 allowed member states to formulate their respective stances—including, perhaps most visibly, the nature and extent of the German resistance—somewhat more precisely. At this stage, German preferences became more constructive in the sense that opposition was no longer presented as categorical, but rather as attached to specific preconditions related to reducing risks in the European banking sector and strengthening those components of Banking Union which were already in place. In the near term, then, policymakers should focus their attention on verifying the

²³⁶ German banks fear competitive distortions arising from provisions for loss coverage in addition to liquidity coverage. In this case, depositors have no remaining incentives to evaluate the fitness of credit institutions and choose from among these only in terms of the interest rates they offer. Interview, Association of German Banks, January 22, 2019.

functionality of the Single Supervisory Mechanism and ensuring the consistent implementation of the existing DGS Directive across all member states.²³⁷ Given persistent deficiencies in these areas, to suggest the further mutualization of bank risks through a European deposit insurance or even reinsurance scheme was at this point unacceptable. In this sense, German policymakers did not bar the possibility of further discussions on EDIS, but also made clear that these could take place only at an indefinite and certainly distant point in the future.²³⁸

To the extent that the introduction of extensive preconditions would postpone further progress on EDIS, German policymakers appeared mindful of opposition from within the German banking sector and willing to prioritize domestic interests over external pressures for more rapid legislative action. At this point, the various associations of German banks were united in their explicit rejection of the Commission proposal for the reasons outlined in Part I.²³⁹ Still, to express obvious opposition to the completion of the Banking Union remained politically unfeasible in an integrationist Europe, and German policymakers thus had to find some means of adapting more absolute opposition to the exigencies of cooperation in intergovernmental fora. European policymakers were aware of the constraints the German government faced in the domestic realm and made efforts to accommodate these wherever possible. For example, to appease fears that institutional protection schemes might be made to subsidize the activities of

²³⁷ The Commission included a communication alongside its November proposal reiterating the need for further risk-reducing measures, but these were dismissed by the German government as insufficiently concrete. Volker Kauder, Gerda Hasselfeldt, and Thomas Oppermann, "Antrag der Fraktionen der CDU/CSU und SPD Zu den Überlegungen der Europäischen Kommission zur Schaffung einer Europäischen Einlagensicherung," Deutscher Bundestag Drucksache 18/6548, November 3, 2015, 2.

²³⁸ Werner Mussler, "Schäuble bremst EU-Einlagensicherung," *Frankfurter Allgemeine*, June 17, 2016. Political discussions were further delayed by German demands for a full consultation-based impact assessment and insistence that any EDIS proposal was still technically contingent upon an amendment of its legal basis. Jim Brunson, "Germany warns on eurozone bank deposit plan," *Financial Times*, December 8, 2015.

²³⁹ *Comments on ...a European Deposit Insurance Scheme*.

higher-risk institutions, Commission President Jean-Claude Juncker had even suggested that Germany's alternative banks could be excluded from participation; other officials, however, considered exemptions highly objectionable and they were not actually reflected in the later proposal.²⁴⁰ As the negotiations proceeded, the German government continued to emphasize the need to respect strict proportionality and to avoid creating "unequal conditions" that might threaten the distinctive structure of its banking system in particular.²⁴¹

On all of the above points, the German position was clearly hostile to that of France, which remained unwaveringly committed to the introduction of a fully-fledged EDIS at the earliest possible juncture. Indeed, French officials accepted the Commission's November proposal without reservation and expressed concerns that the imposition of extensive preconditions would only produce unnecessary delays. While French minister of finance Michel Sapin did not deny the need to reduce risks in the European banking sector, he did not share the German view that this should precede further progress on risk-sharing or be allowed to stand in the way of the completion of the Banking Union through its third and final pillar. On this matter, the French aligned themselves more closely with the legislative approach adopted by the European Commission, which foresaw risk-reducing measures occurring together with the introduction of EDIS along a shared timeline.²⁴²

²⁴⁰ Arno Schuetze and David Goodman, "EU proposes savings bank exemption from deposit guarantee scheme," *Reuters*, October 15, 2015; "Euro zone bank watchdog raises doubts on deposit guarantee exemptions," *Reuters*, November 4, 2015.

²⁴¹ "Antrag der Fraktionen der CDU/CSU und SPD zu dem Vorschlag für eine Verordnung des Europäischen Parlaments und des Rates zur Änderung der Verordnung (EU) Nr. 806/2014 im Hinblick auf die Schaffung eines europäischen Einlagenversicherungssystems," *Deutscher Bundestag Drucksache 18/7644*, February 23, 2016, 2-3.

²⁴² Heller and Strupczewski, "UPDATE 1-EU, Germany head for clash over deposit insurance plan"; Schild, "Germany and France at cross purposes," 110, 112.

In this respect, the urgency with which French policymakers approached the completion of the Banking Union stood in clear and deliberate opposition to the stated interests of domestic banks. Indeed, the French banking sector expressed a uniform preference that movement toward European deposit insurance should not proceed any further than the reinsurance stage, that is, a system in which national compartments are left mostly to their own devices and a limited pool of common funding is available only as a last resort—in European legislative parlance, a European Deposit Reinsurance Scheme, or EDRIS. Reflecting concerns which were shared across the French and German banking sectors alike, the introduction of even a reinsurance scheme should be preceded by extensive risk-reducing measures, including a comprehensive asset quality review of all euro-area banks and not only those significant institutions already subject to the direct supervision of the SSM.²⁴³ On the topic of EDIS, therefore, the interests of the French banking sector appeared to be in practice actually more closely aligned with the official preferences of the German government than those of its own representatives.

While the French have not wavered in their commitment to the Banking Union's final pillar, attempts to mollify the German opposition in the years since the original Commission proposal have rendered the introduction of EDIS an increasingly distant and now entirely uncertain possibility. By mid-2016, European policymakers conceded that all political discussions of EDIS would be subordinated to further progress in the realm of risk reduction and a simultaneous scaling back of commitments to mutualization. With their French counterparts

²⁴³ Interview, French Treasury, January 11, 2019; French Banking Federation, January 16, 2019.

growing increasingly frustrated at the slow pace of progress, German officials still did not view subsequent improvements as sufficient to warrant any imminent action. After nearly two years of mostly fruitless talks, the Commission even published a watered-down revision of its earlier submission in October of 2017, but this was met with outright rejection across the landscape of German banks and from the German government itself.²⁴⁴ The election of the new German leadership, firmly in place by March of 2018, engendered some hopes for a softening of the national position, but these, too, were soon dashed as staunch opposition continued to preclude agreement over the course of the year.²⁴⁵ In the present state of affairs, all substantive decisions on EDIS have been effectively postponed to an unspecified point in the future, and a vague agreement to set up a high-level expert group suggests that any meaningful confrontations will be put off for some time further.²⁴⁶

In sum: Notwithstanding their still uncertain outcome, intergovernmental negotiations on European deposit insurance have challenged the theoretical conception of national policy preferences as a two-step process. Indeed, empirical observations of French and German negotiating behavior yield mixed results. In the German case, linkages between national policymakers and their most relevant domestic constituents are clear: German banks are generally united in their

²⁴⁴ In particular, the new approach foresaw a far more gradual introduction of EDIS than the original proposal and did not even make clear that a steady state of full mutualization would be the desired result. Instead, it concretely identified as future policy options only the reinsurance phase (which, in contrast to the original proposal, would require all financial assistance to be repaid and all costs therefore to be borne ultimately at the national level) and the coinsurance phase (which would not automatically enter into force after a period of three years, but would also be contingent on compliance with certain preconditions, including a reduction in the stocks of nonperforming loans on bank balance sheets).

European Commission, "Communication on completing the Banking Union." communication, October 11, 2017; *Stellungnahme zum Kommunikationspapier der EU- Kommission zur Vervollständigung der Bankenunion vom 11.10.2017 / Ausführungen der Kommission zu EDIS* (Berlin: Die Deutsche Kreditwirtschaft, October 11, 2017).

²⁴⁵ Jorge Valero, "Germany poses 'real problem' when protecting bank savers with European guarantee, says official," *Euractiv*, July 10, 2018.

²⁴⁶ Jim Brunson and Mehreen Khan, "Eurozone reform deal: what was agreed and what was put on hold," *Financial Times*, December 4, 2018

rejection of any EDIS proposal presented to date, and German policy preferences have therefore also revolved around all but complete opposition. The French case, by contrast, constitutes an unusual departure from both the predictions made at the outset of this analysis and the general patterns observed in the course of preceding chapters: while the position of the French banking sector has vacillated between ambivalence and outright disinclination, French policymakers have not wavered in their support for the swiftest possible implementation of a fully-fledged EDIS and the rapid completion of the Banking Union as a whole.²⁴⁷ In this sense, French negotiating behavior in the context of this final pillar represents the most significant instance in the entire set of Banking Union negotiations in which the proposed theoretical framework has failed to predict the policy preferences adopted by individual member states. Possible reasons for this discrepancy as well as a more generalized assessment of potential shortcomings are explored in the following chapter.

Regardless of their source, Franco-German divergences in the case of EDIS are also as such eminently consequential, at least to the extent that they pose a seemingly insurmountable obstacle to the realization of further legislative progress. Much to the dismay of the project's innovators and to the puzzlement of a growing collection of scholars and observers, it is at this point highly unlikely that the final pillar of Banking Union will be completed anytime in the near future

²⁴⁷ This is not to say that the French have wholly ignored the interests of domestic banks. French policymakers have noted the lesser likelihood that their banks would be required to draw upon EDIS funds and have asked that this also be reflected in a reduction of individual bank contributions. In acquiescing to German demands for risk reduction, they have borne in mind the potential for unequal treatment among systemically large cross-border banks, and insisted that any risk-reducing measures therefore be applied uniformly to all institutions which are regulated and supervised in the same fashion (not as a function of bank size). "Meeting of the Expert Group on Banking, Payments and Insurance held on 6 November 2015 discussing banking," meeting minutes, European Commission, November 6, 2015.

or indeed, at all.²⁴⁸ While it is not the purpose of this thesis to account for legislative outcomes, generalized observations related to the depth of Franco-German disagreement—on EDIS, preferences appear more diametrically opposed than ever before—likely figure into explanations for why compromise has proven so distinctly elusive. With stalemate apparently the new status quo, the integration of Europe’s disparate national banking systems remains necessarily incomplete and its broader economic objectives therefore also unfulfilled: as long as deposit insurance is collected and disbursed at the national level, persistent variation precludes any possibility of leveling the competitive playing field within the envisioned Single Market; similarly, as long as bank funding conditions are not wholly decoupled from governments’ ability to underwrite national DGSs, the sovereign-bank nexus which so gravely exacerbated the effects of the financial crisis also inevitably persists. While some argue that harmonization—at least at a sufficiently rigorous level—serves a very similar purpose, this is clearly not the intention of the Banking Union’s architects and can from a macroeconomic perspective only ever be considered second-best.

²⁴⁸ See, for example, Mark Cassell and Anna Hutcheson, "The Politics of Banking Union in the EU: Regulators, Resolution and Deposit Insurance" (paper prepared for the Financial Crisis in Comparative Perspective Panel at the 2016 Annual Meeting of the Western Political Science Association, San Diego, California, March 2016); Annika Stahlhut, "Chances for Pan-European Deposit Insurance" (Bachelor thesis, University of Twente, 2012).

Chapter VII: Conclusion

Assessment of results

The preceding analysis applies an interest-based theory of national policy preference formation to Franco-German divergence in the construction of the European Banking Union. In line with existing approaches in the political economy literature of European integration, the proposed theory expects the behavior of states to reflect an objective consideration of the material interests which predominate in the domestic realm and to remain largely impervious to external pressures arising from the act of collaboration itself. In application, the dual hypothesis framework outlined in Chapter II predicts state support for the Banking Union to be determined largely by the configuration of domestic banking interests and, in particular, driven forward by those banks which are already more Europeanized in their existing operations and level of integration in the European financial market as a whole. As a result, an assessment of domestic banking interests should be sufficient to both predict and retrospectively explain the preferences ascribed to individual member states on the consolidation of banking policy in intergovernmental fora and, to the extent that these exist, major points of disagreement between them.

In retrospect, the proposed hypotheses have fared rather well in clarifying most of the observed divisions between France and Germany. First, in the context of the Single Supervisory Mechanism, special interest patterns explain German preferences for a more narrowly defined scope and French preferences for the

opposite: while small banks of the kind which were numerous in Germany sought to avoid the significant—and, in their view, unreasonable—administrative burden of such a transition, large banks in the French market looked forward to streamlining their cross-border operations in a newly enlarged Single Market for European banking. On the Single Resolution Mechanism, Germany sought to limit the extent of risk-sharing and resisted the transfer of significant decision-making authority to the European level, with France expressing more generous preferences in both respects: at the same time, German banking interests were less exposed to systemic risk and favored the preservation of idiosyncratic national structures, while systemically relevant French banks were more interested in the reduction of cross-border capital and liquidity barriers which was expected to follow. In the context of the still unconstructed European Deposit Insurance Scheme, however, domestic banking interests explain national policy preferences only to a partial extent: while banks in both member states remain reluctant to varying degrees, only German policymakers have adopted this opposition in practice.

In sum, then, there has been only one major instance over the entire set of Banking Union negotiations in which the proposed theoretical framework has proved to be an insufficient predictor of Franco-German divergence and policy positions adopted at the intergovernmental level. As outlined in the preceding chapter, French eagerness to press ahead with the introduction of a European deposit insurance scheme was and continues to be manifestly at odds with the interests of leading stakeholders in the domestic realm, who align themselves

more closely with their German counterparts in resisting immediate progress toward mutualization in this respect. What, then, accounts for the apparent limitations of an interest-based approach in the case of the final pillar, when its explanatory power has generally been upheld in all other areas of the related negotiations? This thesis recognizes two possible explanations.

First, there may be a fundamental distinction between deposit insurance (or the related negotiations) and other policy instruments encompassed within the Banking Union. This possibility is also supported in principle by the growing body of scholarly literature which questions the impossibility of reaching agreement on this matter when all three pillars are technically interdependent and emerged on the policymaking agenda at around the same time. In this line of reasoning, the disconnect between French policymakers and their domestic constituents might have emerged just as the prospect of reaching any kind of agreement became increasingly distant and even outright improbable. At present, the project's champions generally consider the extremely narrow set of conditions under which the German government will even entertain the possibility of EDIS to be so restrictive that it has rendered the entire debate effectively surreal.²⁴⁹ The perception that no version of EDIS will ever be palatable, in turn, may severely distort both the expression of interests within the French banking sector itself as well as the formulation of policy preferences at the intergovernmental level: as long as Germany continues to pursue a hard line of opposition to all related proposals, the positions adopted by other member states are effectively

²⁴⁹ Interview, BNP Paribas, January 4, 2019.

meaningless (i.e., the French can be as generous as they wish with none of the associated consequences).

Second, it is also possible that this disconnect is the result of an actual omission within the theoretical framework itself, that is, of some core piece of the preference formation process which has not been taken into account. While this thesis explores relevant features of business-government relations in the context of Chapter III, it does not formally distinguish between the political systems of the member states in question and assumes that domestic banking interests exert political influence through similar channels and largely to the same degree. In retrospect, this assumption may be ill-founded in relation to Germany and France, which are home to highly distinct sets of political-institutional arrangements which also mirror the patterns of relative (de-)centralization which characterize their respective national banking systems. In Germany, a decentralized federal state with important veto points at the level of the individual *Länder*, it is easier for lower-level interests to exert political influence even in those areas of policy which are ultimately decided at the supranational level. In France, by contrast, structures of political decision-making are highly centralized and even technocratic, with more political autonomy concentrated, for example, in the position of the French president than analogously in the German chancellor. As a result, French authorities are freer to subordinate insular private-sector interests to the realization of broadly construed policy objectives—in the case of EDIS, the completion of Banking Union and the anticipated economic benefits to the

European Community as a whole.²⁵⁰ Accordingly, an interest-based theory of national preference formation seems to wield more predictive power in federally structured states which facilitate the exertion of political influence at low levels, but encounters limitations in centralized polities where policymakers are less beholden to domestic interests.

Discussion of alternative theories

A complementary theory—one which is not incompatible with an interest-based approach but adopts a distinct focal point in the domestic realm—emphasizes not the identity or interests of domestic actors as such, but rather the distinctive institutional arrangements in which they have been contained to this point. In this view, state preferences overlap with those of their domestic constituents not in a causal manner, but rather as the result of a common interest in preserving the momentum of the existing status quo.²⁵¹ The present account considers the relevance of institutional arrangements to be subsumed in the interests of domestic stakeholders themselves, which figure actively rather than passively in the formation of national preferences at the intergovernmental level.²⁵² Still, the existence of a partial status quo bias is useful in explaining initial reluctance even among those domestic stakeholders which were ultimately favorable: in the case of the SSM, for example, French banks were instinctively

²⁵⁰ Interviews, various.

²⁵¹ This approach is reminiscent of accounts which explicitly link member state preferences for EDIS and European-level DGS harmonization to those DGS arrangements which already exist at the national level. See, for example, David Howarth and Lucia Quaglia, "The Difficult Construction of a European Deposit Insurance Scheme: A Step Too Far in Banking Union?," *Journal of Economic Policy Reform* 21, no. 3 (July 2018): 190-209.

²⁵² Throughout the Banking Union negotiations, domestic institutions also acted as special interests in their own right. In the transition to the SSM, for example, national supervisory bodies (e.g., the BaFin or Deutsche Bundesbank) were particularly reluctant to lend their support to legislative proposals which would have considerably reduced their importance in the German banking market. Interview, Deutsche Bundesbank, November 29, 2018.

loath to surrender comfortable relationships with national supervisors and became explicitly supportive only after the new regime was relatively better established. In general, such biases clarify why even those banks whose interests were objectively more closely aligned with the purposes of Banking Union were often only relatively more amenable (indeed, it is for this reason that this thesis tends to frame the interests of domestic stakeholders in terms of degree rather than as absolute preferences).²⁵³

A more direct challenge to an interest-based account of Franco-German divergence is one which emphasizes the culturally-determined ideological lenses through which states in the north and south of Europe approach particular policy problems and the range of appropriate responses. Applied to the case of Banking Union, a rules-based philosophy emphasizing rigor and consistency provides additional context for Germany's basic aversion to risk-sharing whatever the conditions. Similarly, a discretion-based worldview which allows for greater flexibility explains why the French are generally more amenable to the needs and wants of peripheral Europe and their resistance to risk-sharing therefore only circumstantial (based on a specific set of circumstances).²⁵⁴ Still, any account which does not consider those special interests contained in their respective banking sectors encounters limitations at the more granular level: in this case, it would appear arbitrary, for example, that Germany insisted on a particular threshold for triggering direct supervision by the SSM (to maximize exemptions among its domestic banks), or that France requested a reduction in contributions

²⁵³ Cassell and Hutcherson note the possible role of prospect theory in shaping winning and losing attitudes toward the Banking Union. Since losses loom larger than gains, domestic actors which perceive themselves as losing from a given policy change exhibit a stronger reaction. Cassell and Hutcherson, "The Politics of Banking Union in the EU," 5-6.

²⁵⁴ Brunnermeier et al., *The Euro and the Battle of Ideas*. Interview, Economic and Financial Committee, June 16, 2018.

to EDIS for member states with highly concentrated banking sectors (to ensure that banks would not be doubly penalized in the funding of this and the SRF). Thus, attempts to explain complete sets of policy positions require at least some consideration of the material interests at stake, though a parallel evaluation of relevant ideological predispositions renders an interest-based analysis more exhaustive.

Finally, a third theory which competes with the premise of the present analysis is one which favors a game-theoretic account of state behavior in instances of intergovernmental cooperation. Such models recognize that national preferences are not formulated in a domestic vacuum, but reflect a strategic awareness of the state's own bargaining power and dynamic expectations related to the negotiating behavior of other actors. As a result, states are incentivized to adopt positions which are deliberately extreme but are expected to move the terms of compromise closer to the policy outcome they genuinely prefer, that is, their true ideal point.²⁵⁵ Still, the existence of such strategic considerations undermines the conclusions of the present analysis only to the extent that the initial negotiating positions of states are also distant from the preferred outcomes of their domestic banking sectors, under the assumption that these continue to dictate the true—though perhaps unexpressed—ideal points of their respective national governments. This is recognized to have occurred only once in the negotiations on Banking Union, that is, when French policymakers offered far more generous support for the introduction of EDIS than a strict consideration of domestic

²⁵⁵ Jeffrey Frieden and Stefanie Walter, "Analyzing Inter-state Negotiations in the Eurozone Crisis and beyond," *European Union Politics* 20, no. 1 (March 2019): 134-51.

interests should have allowed. Otherwise, even the very hard lines of opposition adopted by Germany clearly reflected the interests at least certain groups of domestic stakeholders and were therefore also plausibly representative of true ideal points.

Possible expansions

To expand the scope of the present analysis, a future replication or extension could widen the array of country case studies and determine the extent to which similar constellations of domestic interests also produce an alignment of preferences along previously identified axes of Franco-German disagreement. For example, among the 28 member states with a stake in the related negotiations, there are several which are home to more decentralized banking systems—most notably, Austria and Italy—and could be considered against the German example, though idiosyncratic features (e.g., institutional protection) are also likely to render the latter case somewhat unique. The French archetype, in turn, could be further developed through parallel analyses of other states (e.g., the Netherlands, home to ING and Rabobank) which exhibit lower levels of institutional diversity and tend to be dominated by handfuls of large, multinational banking groups. Still, as outlined in Chapter I, the focus of this thesis is deliberately narrow and encompasses only those leading member states which exert the greatest influence in the design of final policy outcomes. Thus, while an expansion would certainly be a worthy pursuit, arbitrary increases in the number of countries under consideration would not necessarily elevate the broader significance of the

investigation as such.

Within a fixed number of country cases, it would also be appropriate to look beyond the most obviously affected stakeholders and consider a wider array of potentially relevant domestic interests. For example, a future extension might consider not only those domestic banking groups whose lobbying efforts are likely more consequential, but also those domestic affiliates of foreign-headquartered banks which are technically counted in the same sector and industry (but largely omitted from the preceding analysis). To the extent that geographical ringfencing remains issue-linked with several components of the Banking Union, such an expansion would be particularly useful in the case of ‘host’ member states (not Germany or France) in which foreign-headquartered banks actually comprise a majority of domestic institutions.

Even more broadly, there are certain issue areas in which it might be advisable to consider also a generally defined public interest shaping national preferences toward the relevant legislation. In practice, the public tends to be most visibly invested in matters related to cross-border risk-sharing, with German taxpayers usually demonstrating a particular sensitivity. While most risk-sharing mechanisms in the Banking Union are fundamentally private in nature, that is, involving resources collected from within the banking sector itself, even private arrangements are either explicitly or implicitly backed by public guarantees and by extension also taxpayer resources. Most such issues (e.g., the use of ESM funds to backstop the SRF in the case of future shortfalls) are not central to the design of the pillars themselves and therefore largely omitted from preceding

analyses, though a conceivably more complete approach would take these—and others on which the public might have had a more direct stake than previously assumed—into account.

Still, it is important to note that the present thesis effectively demonstrates that a wide array of outcomes in an eminently consequential area of policy can be both predicted and explained without any consideration of the relevant public interests. More broadly, then, the design of financial regulation seems to depend almost exclusively on the interests of its direct subjects, with little to no active participation from outside the financial sector itself. In the case of the Banking Union, however, efforts to accommodate the narrowly construed interests of participating banks have also undermined the effectiveness of the project in critical respects. In this sense, nonparticipation from the European public or other kinds of domestic business interests is clearly incompatible with their assumed stake in the financial health of the euro area as a whole and the future of European integration as a political and economic project.

Broader implications

In general terms, the success of an interest-based framework in explaining Franco-German divergence in the construction of a Banking Union challenges a number of common assumptions related to the fate of the European project over the course of coming years and decades. In particular, it suggests that the European Community can no longer rely unequivocally on the leadership of only two member states to drive forward history-making decisions in the realm of

political and economic integration. Indeed, from the postwar reconciliation between the two nations in the early 1950s, most community-building milestones of European history are owed to Franco-German bilateralism and the weight of their co-leadership at critical junctures. In the present state of affairs, however, the stalled state of the Banking Union—which remains still unconstructed nearly seven years after first emerging on the policymaking agenda, its fate at the time of writing largely unknown—is due in large part to failures of France and Germany to reach agreement among themselves and thus suggests a fundamental and even permanent shift in the commonly assumed dynamics of European integration. As long as both states remain beholden—albeit to varying degrees—to the interests of domestic stakeholders who refuse further legislative progress and preclude consensus-building at the intergovernmental level, the fast pace which has characterized the construction of Europe over the course of preceding decades appears bound to slow.

Insurmountable political impediments to the completion of Banking Union also suggest the growing inability of another commonly assumed driver of European integration to push past persistent countervailing interests at the domestic level of individual member states. Indeed, the neofunctionalist school suggests that even in the absence of Franco-German leadership, the ever closer union of Europe should be driven forward as a largely self-sustaining process due to the existence of significant spillover effects and the agency of European institutions. Integration, in this view, subordinates national interests to the exigencies of Union and proceeds irrespective of the adoption of explicitly pro-

European attitudes by member states themselves. Progress on the Banking Union, however, bodes rather pessimistically for the possibility that such models will be able to set the pace of integration going forward: not only have the negotiations extended far past any of the initially envisioned deadlines for implementation, but the scope of what has been constructed thus far has also been severely reduced by the objections of member states despite Commission efforts to the contrary. Thus, it appears that future advances in the realm of European integration will be defined neither by an extension of traditional patterns of bilateral leadership nor by those automated processes which are assumed to spur integration even in the face of isolated resistance. Rather, in line with the interest-based framework which forms the basis of the present analysis, progress will hinge on the extent to which new projects are made palatable to a wide range of domestic stakeholders and ensure the preservation of their interests even through the extension of European interference into new areas of policy.

In this sense, the experience of constructing the Banking Union also mirrors that of other epochal projects which aim to enhance the overall wellbeing of broadly defined communities by shifting to an increasingly supranational framework for defining the barriers of economic activity, especially as these relate to the circulation of both physical and human capital within ever-widening global markets. While intergovernmental cooperation to these ends promises to unlock new frontiers of economic prosperity, such undertakings invariably create both winners and losers within the realm of affected stakeholders. In the case of the Banking Union, this dichotomy is observed firsthand between those small banks

which cannot realistically consider Europe their actual or potential home market, and larger competitors which look forward to expanding the scope of their operations and achieving new economies of scale at the European level. In line with the preceding analysis, most of the albeit limited progress toward the completion of this project has been determined by the ability of policymakers to accommodate the needs of heterogeneous national industries. As a result, the realization of its associated economic gains—including not only the efficiency of truly European banks operating within a veritable Single Market, but also the stability of a monetary union in which the common currency does not circulate in a fragmented and accordingly dysfunctional financial system—also hinges upon the extent to which these can be made attractive to firms of variable sizes and with different sets of policy priorities. If the lessons of this experience are not heeded by the architects of new market-expanding projects in Europe and across the world, roadblocks created by the mobilization of counter-interests in the domestic realm might make it increasingly difficult for communities at large to reap similar benefits.

Final summary

In sum, this thesis assesses the usefulness of an interest-based theory of national preference formation as a means of understanding Franco-German divergence in the construction of the Banking Union and on each of its three requisite pillars. Indeed, the bilateral leadership which has characterized most milestone achievements in the history of European integration has been notably

absent from all related negotiations to date: on the Banking Union, France and Germany have generally found themselves at opposite ends of the negotiating table, their preferences more or less diametrically opposed on all of the associated issues. The empirical case studies conducted in the course of preceding chapters, however, suggest that French and German preferences are in fact rationally derived from the distinct compositions of their national banking sectors and the patterns of economic interests which result from these. In future, then, the fate of the European project seems to hinge on the degree to which new forms of ever closer integration can be made palatable to a diverse array of domestic stakeholders in participating member states. No matter how strong the apparent economic imperatives, national policymakers—especially in those states where political authority is more diffuse—remain beholden to the interests of their domestic constituents, with further integration proceeding only as far as their interests will allow.

Appendix: Author's Interviews

This thesis is based on original research drawn from the following conversations and semi-structured interviews, listed in the order in which they were conducted. In most cases, interviews were conducted in confidentiality and the names of interviewees withheld by mutual agreement. Additional information may be available upon request.

<i>Affiliation</i>	<i>Date</i>
EMU Choices Project	March 13, 2018
Financial Conduct Authority	March 27, 2018
London School of Economics	April 30, 2018
London School of Economics	May 2, 2018
University of Twente	May 17, 2018
Bruegel Think Tank	May 22, 2018
Hertie School in Berlin	May 23, 2018
Deutsche Bank Research	May 30, 2018
Deutsche Bundesbank, Markets	May 30, 2018
Deutsche Bundesbank, Financial Reporting	May 30, 2018
Association of German Banks, Brussels	June 1, 2018
Hertie School of Governance	June 7, 2018
Hertie School of Governance	June 8, 2018
Economic and Financial Committee of the EU	June 16, 2018
European Central Bank	September 12, 2018
London School of Economics	September 13, 2018
Deutsche Bundesbank, Executive Board	September 13, 2018
University of Campania Luigi Vanvitelli	October 2, 2018
Deutsche Bundesbank, Executive Board	October 31, 2018
German Ministry of Finance, Europe Division	November 8, 2018
Bruegel Think Tank	November 9, 2018

University of Bologna	November 11, 2018
Former president, EU Financial Committee	November 14, 2018
University of Luxembourg	November 21, 2018
Bruegel Think Tank	November 28, 2018
Deutsche Bundesbank, Executive Board	November 29, 2018
Bruegel Think Tank	December 6, 2018
European Parliament, Office of Sven Giegold	December 7, 2018
European Commission, Financial Committee	December 21, 2018
Toulouse School of Economics	December 28, 2018
BNP Paribas, Prudential Affairs	January 4, 2019
French Treasury, Banking Regulation	January 11, 2019
French Treasury, Banking Regulation	January 11, 2019
BNP Paribas, Prudential Affairs	February 1, 2019
Société Générale	January 8, 2019
Association of German Banks, Brussels	January 9, 2019
(Formerly) Banque de France	January 11, 2019
French Banking Federation	January 16, 2019
Association of German Banks, Berlin	January 17, 2019
Association of German Banks, Berlin	January 22, 2019
BNP Paribas, Banking Economics	February 1, 2019
French Treasury, European Policy and Strategy	February 5, 2019

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