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Opportunities and Risks of the European Banking Union

Abstract

The European Banking Union tries to resolve the conflict between financial market stability and the taxpayers' burden for bank bailouts. Moreover, the Banking Union seeks for reducing the interdependence of banks and sovereigns in the Eurozone. The Banking Union represents an important instrument in achieving those objectives. However, the expectation that it will never take again tax money for bank bailouts is not realistically founded. In particular, European resolution and deposit insurance fund are inadequately funded. A decisive factor for the success of the Union is the ongoing process of the bank balance auditing (Asset Quality Review). Instead of national backstops, we propose a sector-specific fund (sectoral backstop) to be financed by the pan-European banking sector.

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Opportunities and Risks of the European Banking Union

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Summary

The European Banking Union is intended to resolve the conflict between financial market stability and the taxpayers' burden for bank bail-outs. Moreover the Banking Union seeks for reducing the interdependence of banks and states in the Eurozone. With respect to those goals, the Banking Union represents an important instrument pointing into the right direction. However, the expectation that taxpayers' money will never again be required for bank rescues cannot be fulfilled. The European resolution and deposit guarantee schemes in particular are inadequately funded. A decisive factor for the success of the banking union is the on-going process of Asset Quality Review. Instead of national back-up mechanisms (backstops), the authors propose a special sectoral fund (sectoral backstop) to be financed by the pan-European banking sector.

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1. Why have a European Banking Union?

The European Banking Union is intended to be an important instrument in enabling banks in distress to be resolved or restructured, without endangering financial market stability or burdening the tax-payer. In addition, it is intended to reduce the interdependence of banks and states that arose as a result of the bank rescue operations following the financial crisis of 2007-2009. The financial market crisis that originated in the US mortgage market had led to major losses among European banks which were themselves among the largest creditors of the US banks (Acharya and Schnabl, 2010; Borio and Disyatat, 2011; Lindner, 2013; Shin, 2012).

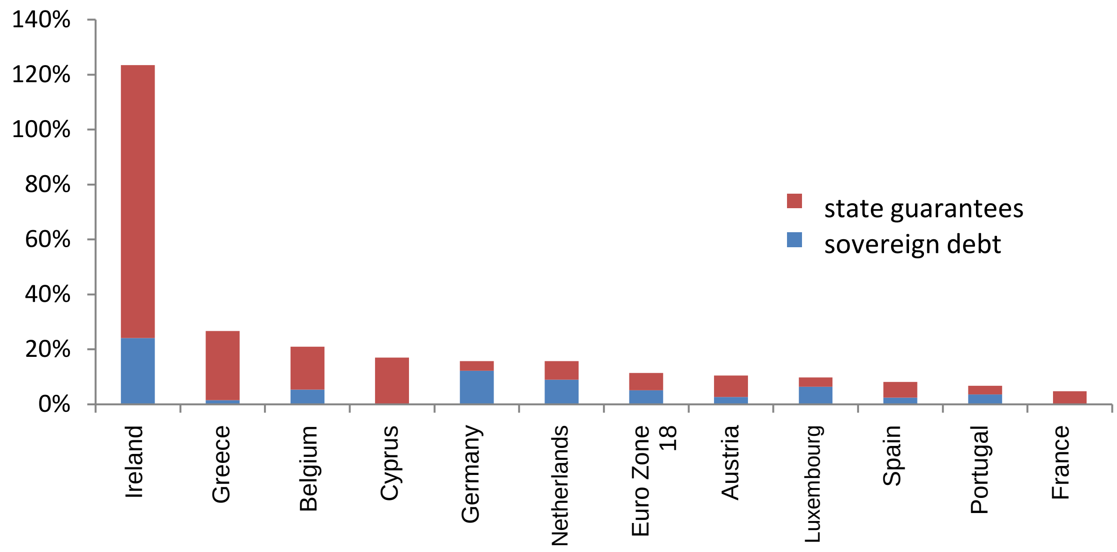
During the crisis, governments were faced with a conflict between endangering the stability of the financial markets, the payments system and bank deposits and placing the financial burden upon the taxpayer. In many countries there was no special insolvency process for banks by means of which banks could be wound up without putting the country's financial stability at risk (Zotter, 2012). In the absence of such a process, disorderly bank insolvencies constitute a potential threat to the entire financial system, as was witnessed following the bankruptcy of the US investment bank Lehman Brothers in October 2008.[2]

In the case of banks, insolvency is more problematic than with other companies, because they operate the payments system, manage the major part of their customers' deposits and are closely interconnected with one another. Any disruption of the payments system leads to serious economic and social disruption: people are no longer able to withdraw money, companies are no longer able to pay their employees and suppliers, etc. (Finance Watch, 2013a). As banks' equity ratios prior to the crisis were too low and as banks were heavily indebted to each other, crises of individual banks also led to crises of other banks, ultimately threatening the entire banking system and, with it, the payments system: the US banking crisis, for instance, led to losses for German, French and British banks which then reduced their exposure to banks in the crisis countries of the Eurozone, which again led to banking crises there; debt relief for the Greek state, for instance, resulted in losses for Greek banks, which in turn drove Cypriot banks into crisis, etc. (Lindner, 2013).

[2] Although a process did exist in the USA for resolving commercial banks, there was none for investment banks such as Lehman Brothers.

At the very onset of the crisis, in order to maintain financial market stability, politicians decided in favour of placing the burden on the taxpayer and protected creditors from losses by means of bail-outs (Dübel, 2013). Figure 1 shows how sharply sovereign debt and state guarantees had risen in many Eurozone countries as a result by 2010 – the year of the outbreak of the euro crisis. Higher debts and loan guarantees need not necessarily lead to losses for the taxpayer, as, in addition to the debts, the states partly took over the banks' assets which they may still be able to sell at a profit in the course of time. The proceeds of these sales might then be used to repay debts. In some cases, this has already happened.[3] However, the likelihood of losses on many of these nationalised assets remains very high (Dübel, 2013, pp. 61–62), with the result that taxpayers in many countries are still liable for sizeable bank risks.

Figure 1: Increase of sovereign debt and state guarantees as a result of bank rescues, 2010, in % of GDP



Source: Eurostat Supplementary Table for the Financial Crisis (Eurostat, 2014)

In the Eurozone, the bail-outs of the banks initially maintained financial market stability. However, it threatened it between 2010 and 2012. The sharp rise in sovereign debt increased the risk of state bankruptcies in the Eurozone, as a result of which many creditors – above all German and French banks – cancelled their loans to the crisis countries for fear of losses (Lindner, 2013). This was one of the reasons why the periphery countries were engulfed in a

[3] According to Eurostat, the sovereign debt that Germany assumed for bank rescues, for example, fell from a peak of 305 million euros in 2010 to 233 million in 2013, and its guarantees decreased from 159 million euros in 2009 to 50.2 million euros in 2013 (Eurostat, 2014).

financial crisis and severe recessions. The crisis was exacerbated by the Eurozone rules which made it extremely difficult for the European Central Bank – unlike the US Federal Reserve, the Bank of England or the Bank of Japan – to purchase government bonds and thus to maintain the states' solvency (De Grauwe and Ji, 2013; Kopf, 2011).

The depreciation of government bonds in the crisis countries acted as a burden on their banks, as the latter held large quantities of their countries' sovereign debt, which in turn made bank rescues necessary. This has resulted in the emergence of a vicious circle involving banks and states: banking crises threaten the solvency of the states and the states threaten the solvency of the banks (Merler and Pisani-Ferry, 2012). This vicious circle remained unbroken until 2012 when the ECB announced that in an emergency it would purchase a sufficient number of sovereign bonds on the secondary market and thus indirectly keep the states solvent (Outright Monetary Transactions, OMT). This decision is not without its critics, however. Some argue that the OMT programme sharply increases the risks for the ECB and ultimately, therefore, the risks for the taxpayer.

The European Banking Union, whose establishment was decided by the European heads of state and government in June 2012 (European Commission, 2014a), is an attempt to break this vicious circle between banks and states and resolve the conflict between financial market stability and taxpayer liability. In concrete terms, the banking union consists of the following three components:

- a Single Resolution Mechanism (SRM)
- a Single Supervisory Mechanism (SSM)
- a Deposit Guarantee Scheme (DGS).

Once established, the Single Resolution Mechanism will allow a bank to be completely or partly restructured and, if necessary, wound up, while maintaining central functions such as the payments system and the security of the deposits. In addition, the existence of clear rules regarding the resolution mechanism agreed before a possible crisis minimises the uncertainties surrounding the consequences of a bank getting into difficulties and thus protects the financial markets from uncertainty. In the event of losses that erode the bank's capital base, the cost of resolution will be supported by "bailing in" the bank's shareholders and creditors, so that the taxpayers do not have to bear the costs alone.

By harmonising supervision, it is hoped that ailing banks can be identified in good time and their difficulties can, if possible, thus be reduced by means of suitable preventative measures. A harmonised deposit guarantee scheme is intended to ensure that deposits up to a certain amount are protected from losses.

Additionally, harmonisation of the various mechanisms at European level is meant to contribute to preventing any uncertainty concerning the resolution of a troubled bank operating in different countries that could otherwise arise as a result of different national legal frameworks. Moreover, any interim aid needed is to be provided from common European funds which are to be established by the banks themselves. In this way, the public purse is no longer to be expected to bear the financial burden of possible bank rescues, thus making it possible to avoid the vicious circle of state solvency and bank solvency.

Finally, the banking union builds on the higher capital requirements of Basel III. Those higher capital requirements are intended to reduce the likelihood of bank insolvencies.

The following sections present the structure, functions and problems of the banking union in detail.

2. The structure of the European Banking Union

This chapter provides a detailed description of the Single Supervisory Mechanism, the Single Resolution Mechanism and the Deposit Guarantee Scheme before individual aspects are subjected to a critical analysis.

2.1 The Single Supervisory Mechanism

In the future, European banking supervision will essentially be the responsibility of the European Central Bank (ECB). In the view of the European Commission and the European Council, the ECB is the institution best suited for this purpose, as it is able to guarantee its independence from national interests. The European System of Central Banks (ESCB) already has expertise in financial stability, and, in the opinion of the institutions involved, the legal basis for this task is ensured by Section 127 (6) of the Treaty of Lisbon (European Commission, 2013a).

2.1.1 Scope of supervision

The ECBwill take up its new duties as the banking supervisory authority for the Eurozone in November 2014. The other countries in the European Union may also join the supervisory mechanism on a voluntary basis.[4] Future banking supervision will be based on the Single Supervisory Mechanism Regulation (SSMR), which is binding for Eurozone countries, and the Single Rulebook in which, among others, the new Basel III regulatory rules on capital are laid down (cf. section 2.1.3).[5]

In operative terms, the ECB will act as the bank supervisor of the "significant" banks in the single currency zone ("direct supervision"). The remaining "indirectly supervised" institutions will remain under the supervision of the national authorities. Regardless of an institution's size, the final decision regarding the granting or withdrawal of its banking licence and the permission of acquisitions or disposals will always be made by the ECB.

A bank is deemed to be significant and therefore requiring direct supervision if

i. its total assets amount to at least 30 billion euros[6]
ii. its total assets exceed 20% of the gross domestic product of its domicile, insofar as its total assets exceed 5 billion euros, or
iii. it has a certain degree of cross-border activity: i.e. if the institution has established subsidiaries in more than one participating member state and its cross-border assets or liabilities make up a significant part (> 10%) of its total assets or liabilities (European Council, 2013; European Parliament, 2014b).

In addition, the three biggest banks of each Eurozone member state are to be directly supervised. Finally, banks whose domicile has requested financial support from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM) are also to be directly supervised. The ECB may also supervise non-significant banks directly if it sees the necessity for this.

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[4] This opt-in makes sense for countries wishing to introduce the euro as their currency and for countries which rely on the credibility of the ECB with regard to financial stability (Speyer, 2013). A non-euro country may opt out, i.e. leave the SSM, after three years and re-enter after another three years without stating its reasons.

[5] Basel III is implemented in the EU through the Capital Requirement Regulation (CRR) and Capital Requirement Directive IV (CRD IV).

[6] As total assets may fluctuate, a deviation of 10% is allowed. Therefore banks with total assets of €27bn and 18% of the GDP of their home country are included (ECB, 2013).

Of the approx. 6,000 banks within the Eurozone, a total of 128 institutions currently fall within the category of banks requiring direct supervision. These 128 banks hold approx. 85% of the banking assets of the Eurozone on their balance sheets (ECB, 2013).

In operative terms, these banks are supervised by joint supervisory teams consisting of representatives of the ECB and the national supervisors (ECB, 2014a). For all other banks, the operative activity of supervision will be carried out exclusively by the national supervisory authorities.

There is to be an annual review of whether a bank is to be supervised directly or indirectly: if a bank supervised directly by the ECB fails to meet any of the above-mentioned criteria for three years in succession, it will no longer be supervised by the ECB the following year. This may also happen at an earlier stage, if, for example, the bank's total assets are significantly reduced as a result of the sale of a business unit. If a bank meets one of the above-mentioned criteria, it will then be supervised by the ECB (ECB, 2014b).

2.1.2 Single Rulebook

The Single Rulebook, which came into effect throughout the EU in January 2014, includes regulations regarding management pay, for example, and in particular the new capital requirements under Basel III. The higher capital requirements are intended to improve banks' ability to absorb losses and thus to protect them better from default. In the future, the banking supervisory authority will have to orientate itself towards these rules. Although implementation of Basel III is not strictly part of the banking union, the banking union does build on it.

At this point it is worth examining the most important capital requirement reforms briefly, as these are also fundamental to the achievement of the objectives of the banking union which are intended to avoid taxpayer liability in the event of bank losses. The new capital requirements include in particular the ratio and level of risk-weighted[7] capital (Detzer und Herr, 2014). From 2014 the required risk-weighted capital ratio of 8% is to be made up of

[7] Risk-weighted means that the assets of a bank are weighted using factors reflecting the degree of credit risk of the assets. Sovereign bonds are essentially deemed to be virtually free of credit risk, with the result that their risk can count as zero. The bank's liabilities are then subtracted from the sum of the risk-weighted assets (RWA), thus showing the risk-weighted capital. If an asset is zero-weighted, the bank does not need to hold any capital; if the weighting is higher, it has to hold correspondingly more.

4.5% hard Tier 1 capital (equities and disclosed free reserves), 1.5% additional Tier 1 capital (e.g. participation certificates) and 2% Tier 2 capital (e.g. special subordinated debt).[8]

From the beginning of 2015 to the end of 2019, the capital conservation buffer will cause the minimum capital requirements to rise by an additional 2.5% to a total of 10.5% of risk-weighted assets (Deutsche Bundesbank, 2013). The capital conservation buffer also has to be held in hard Tier 1 capital, with the result that from 2019 banks will have to hold hard core capital totalling 7%. If this threshold is not met, the banks can be required to reduce or completely suspend dividend and bonus payments.

Furthermore, additional capital buffers can be introduced at the instigation of the ECB or the national supervisory authority, resulting in a total capital ratio of up to 18%[9]. This additional capital must also be held as core capital. This includes:

i. *Countercycle Buffer* (0 to 2.5%): the Countercycle Buffer (CCB) is intended to prevent asset price bubbles which may arise due to excessive lending. If this buffer is activated in the event of the threat of one or more economies overheating, credit growth can be restrained if the banks react immediately to the increased capital requirements by shrinking their balance sheets. CCBs can be introduced either by the national supervisory authorities or by the ECB who must inform each other in good time (European Council, 2013).
ii. *Systemic Risk Buffer* (0 to 5%): the Systemic Risk Buffer (SRB) is an instrument for use at national level with which additional capital requirements of up to 5 percentage points may be demanded from individual or all banks in a country. This buffer is designed to curb long-term systemic risks. In principle, any member state introducing an SRB of over 3% has to agree this with the European Commission which in turn coordinates its decision with the Supervisors and the European Systemic Risk Board. In addition, an SRB of 5 percentage points can be introduced by an implemented act of the European Commission (European

[8] For a precise definition of these forms of capital see p. 12ff (BCBS, 2011). Available at http://www.bis.org/publ/bcbs189.pdf

[9] In this example, in addition to the above-mentioned 10.5%, it is assumed that the countercycle buffer totalling 2.5% and the buffer for systemic risks amounting to 5% are fully capitalised.

Commission, 2013b). In order to limit lending in the property sector in particular, the national states are also given the possibility of weighting risks more heavily.[10]

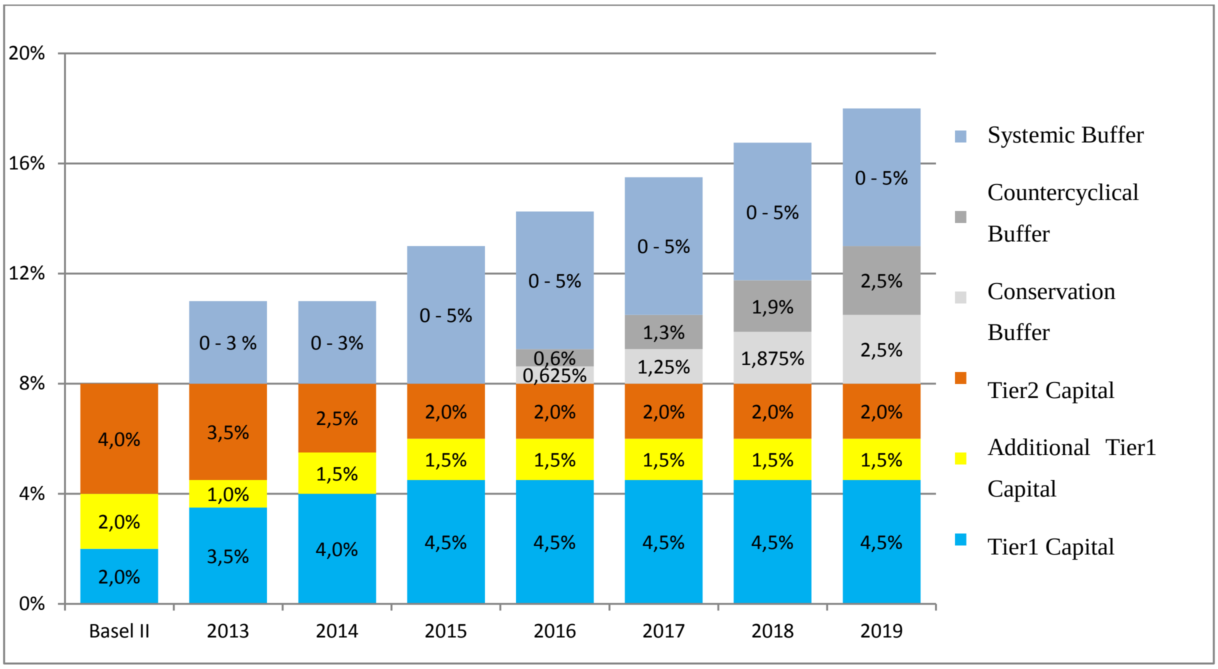
iii. *Global Systemic Institution Buffer* (1 to 3.5%): the Global Systemic Institution Buffer applies to banks which are classified by the G-20 as systemically important (Global Systemically Important Financial Institution, G-SIFI). These banks must hold additional core (Tier 1) capital of between 1% and 3.5%. The precise figure depends on their total assets and their interconnectedness within the financial system. This includes in particular their cross-border activities (European Commission, 2013b).

iv. *Buffer for Other Systemically Important Institutions* (0 to 2%): not only G-SIFIs, but also "Other Systemically Important Institutions" which are systemically important at national or European level must hold more capital. This buffer, which requires up to 2% additional core capital (Tier 1), is additional to the buffer mentioned in iii. Unlike for the G-SIFIs, it is at present not yet clear which banks are to be included.

For the three systemic buffers (ii. to iv.), the applicable buffer is as a rule the highest one. These buffers are therefore not added. Figure 2 shows the new capital requirements.

[10] For example, the loan-to-value ratio can be raised to 150% (based on a reference value of 100%) (European Commission, 2013b).

Figure 2: Development of capital requirements



* The Systemic Risk Buffer is the highest buffer that a bank must hold if it falls into several categories of systemic importance. Source: Council of Economic Experts (2013)

2.1.3 Decision-making structure of the Supervisory Mechanism

Responsibility for the Supervisory Mechanism within the ECB lies with the Supervisory Board. This body ultimately decides on the institutions' capital resources, forms the steering committee of the joint supervisory teams and is responsible for granting bank licences.

The Supervisory Board consists of a chair and vice-chair drawn from the ECB Directorate. Both are proposed by the ECB, approved by the EU Parliament and appointed by the Council of Ministers for five years und are not re-electable. In addition, the Board contains four other representatives from the ECB who must not be directly involved in questions of monetary policy and one representative of each of the respective eurozone member states (Council of Economic Experts, 2013).

The Board must submit its decision-making drafts to the ECB Governing Council which makes the final decision. The ECB Governing Council is made up of a president, a vice-president, the four members of the Directorate and the 18 presidents of the central banks of the eurozone. If a draft from the Supervisory Board is rejected, a mediation panel can be called upon to settle the differing views. This panel consists of one representative for each EU member state which also belongs to the ECB Council or the Supervisory Board (ECB, 2014c).

2.1.4 Preparation for the Single Supervisory Mechanism

In order to commence operative bank supervision in November 2014, a one-year comprehensive assessment of the banks was begun in October 2013. This is intended to create transparency regarding the banks' balance sheets and, if necessary, initiate repair measures in order to guarantee a smooth start to the banking union once these measures have been implemented. The intention here is to ensure that the new supervisory authority does not take over any of the banks' legacy assets which might endanger the whole mechanism, while at the same time establishing a data basis for supervision purposes.

The comprehensive assessment consists of three pillars:

i. *Supervisory risk assessment*: this is intended to assess the core risks of the individual banks, their capital resources, their business models, their degree of interconnectedness with other banks and their risk management. The ECB and the national competent authorities are also developing a common risk assessment system within the framework of this pillar. This will include, for example, a common definition of non-performing loans and a harmonised acceptance of banks' internal risk models.

ii. *Asset quality review*: this is intended to create transparency regarding the assets on bank balance sheets as at 31.12.2013. The assets are to be examined with regard to market and credit exposure in order to establish their value. In addition, off-balance sheet positions are to be analysed and cross-border activity assessed.

iii. *Stress test*: this is intended to examine the banks' capacity to absorb economic shocks, such as sharp changes in interest rates, recessions or exchange rate fluctuations. This includes a simulation of whether the banks' capital resources are adequate in the stress scenario (ECB, 2013).

The comprehensive assessment will enable the ECB to ensure that all 128 banks are "sound" before the new supervisory mechanism takes effect (Reischle, 2013).

2.2 The Single Resolution Mechanism

The Single Resolution Mechanism (SRM) was enacted in order to ensure that banks could be wound up efficiently at European level. An ordinary insolvency procedure is suitable for banks only to a limited extent, as banks play a central role in national financial systems (deposit holding, payments system, lending) and the smooth running of these systems has to be ensured even in the event of the insolvency of one or several banks.

Nevertheless, it is considered to be necessary to break with the current regime whereby banks are systemically important due to their size alone and therefore automatically have to be rescued using taxpayers' money. On the one hand, it is planned that shareholders and creditors will assume a greater share of bank losses (bail-in), although deposits of up to 100,000 EUR per customer are explicitly exempted from this. On the other hand, it is regarded as imperative to involve the banking sector as a whole in the insolvency costs for individual institutions by establishing a resolution fund.

2.2.1 Decision-making structure of the Resolution Mechanism

The Single Resolution Mechanism is to become operative from the beginning of 2015 and will apply to all banks that are supervised within the framework of the ECB's Single Supervisory Mechanism (European Commission, 2014b). The central institution of the SRM is the Single Resolution Board (SRB) which decides on bank restructuring and resolution. The Board is made up of an executive director[11], four permanent members and one representative each of the EU Commission, the ECB and the national supervisory authorities. Supervisors in the ECB and the national competent authorities are to report to the Board on their preventative measures at regular intervals. In principle, the ECB (SSM) in its function as competent supervisor triggers the resolution mechanism, thus initiating the work of the SRB. However, the SRB has its own rights to information from the supervisory authorities (Council of Economic Experts, 2013) with regard to resolution issues. For example, it can inspect the restructuring plans for a bank at any time.

The Board convenes to decide in two different constellations: a plenary session, attended by all representatives of the SRB, is called to discuss matters of a general nature or resolution decisions involving more than five billion euros from the Single Resolution Fund. Only part of the Board (executive session) convenes to discuss matters concerning the preparation or implementation of the resolution of a bank for which less than five billion euros is required.

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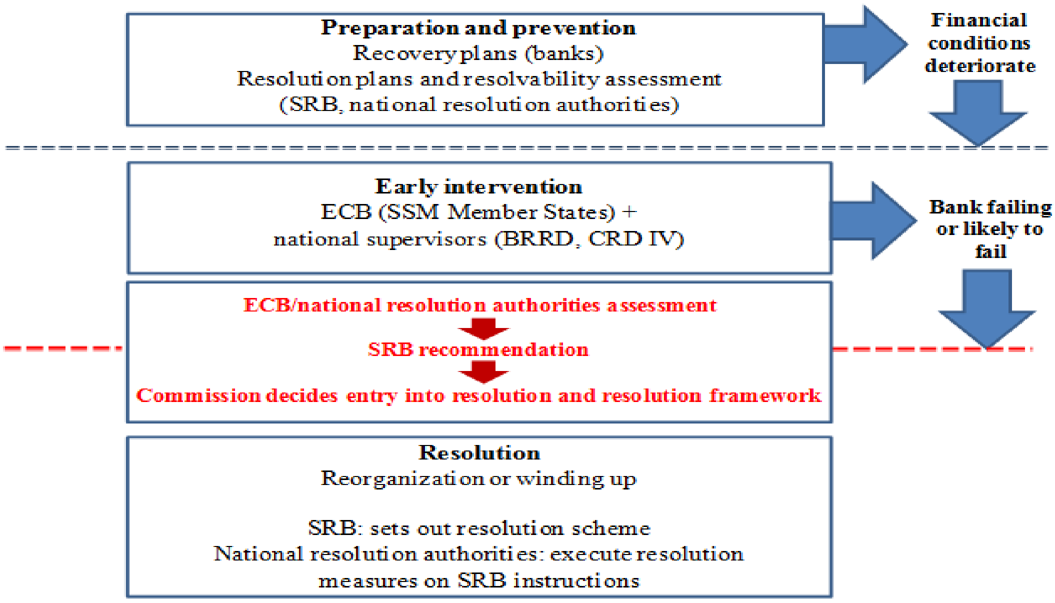
[11] The executive director is proposed by the Commission. Both the European Parliament and the European Council may exercise their right of veto, however, before the executive director is appointed.[12] Who these investors are will be explained later.

Figure 3: Ideal-typical bank resolution process



Source: http://www.voxeu.org/article/eu-s-new-single-bank-resolution-mechanism.

Representatives of national resolution authorities from countries in which the bank concerned does not operate do not take part in sessions of the SRB. Each attendee has one vote and voting in both sessions is by simple majority. In the executive session, the votes of the representatives of the national states in which the bank to be resolved operates, but is not based, are pooled into one vote (European Commission, 2013c).

2.2.2 Restructuring and resolution instruments

The restructuring and resolution framework of the Single Resolution Mechanism consists of three basic elements:

i. *Preparation and prevention*: in order to guarantee the smooth resolution of any bank, each financial institution is required to draw up a recovery and resolution plan, irrespective of its current soundness. The recovery and resolution plan must contain the bank's explanation of the measures that would be taken in the event of the deterioration of its financial position in order to restore its viability (European Commission, 2012). Parallel to this, the competent authority, the ECB or the national supervisory authority has to develop resolution plans for the bank. If the competent authority identifies obstacles to an institution's resolvability, it is required to demand that these obstacles be eliminated.

ii. *Early intervention*: the ECB or the national supervisory authorities may intervene at an early stage if an institution is facing financial distress. For example, if an institution breaches regulatory capital requirements (see section 2.1.2) or is about to do so, it can be required to work out a debt-restructuring plan with its shareholders and creditors. The competent supervisory authority may also appoint a special administrator for the bank who is responsible for guaranteeing prudent and sound governance (European Commission, 2012). The authority also has to report any case of early intervention to the SRB.

iii. *Resolution instruments and powers:* in principle, in its function as the competent supervisor, the ECB triggers the resolution mechanism. In addition, if the SRB considers it necessary for a bank to be placed into resolution, it can ask the ECB to trigger the mechanism. If the ECB refuses, the Board itself may make this decision (European Parliament, 2014b). In any case, the Board prepares a resolution draft with corresponding resolution objectives and forwards this to the EU Commission. The latter then considers whether one or more of the resolution objectives is in the public interest.

Resolution objectives are: i) to ensure the continuity of banks' essential functions; ii) to avoid significant adverse effects on financial stability, including avoiding contagion and maintaining market discipline, iii) to protect public funds by minimising the need for extraordinary financial support from the public purse and iv) to protect deposits and certain short-term investors[12] (European Commission, 2013d).

If the European Commission identifies a public interest, it will instruct the SRB to carry out the resolution. The European Council can be involved at the Commission's request. However, the Council may only be involved to the extent that it assesses whether resolution of the bank is in the public interest. The Council may also be required to mediate if the sum to be dispensed from the Single Resolution Fund (SRF) upon the Board's advice differs from the sum envisaged by the Commission (European Parliament, 2014a). As a permanent representative of the European Commission sits on the Single Resolution Board and is involved in the resolution draft, it is unlikely that the Commission will reject the Board's draft

[12] Who these investors are will be explained later.

in an urgent case. In order to take advantage of stock exchanges being closed and not to endanger financial stability, the resolution decision must be reached within the course of one weekend (European Parliament, 2014b). The SRB has several instruments at its disposal for resolving an institution. The measures accepted by the Commission and the Council are to be implemented by the national resolution authorities. In this case, the SRB only has a monitoring function (Council of Economic Experts, 2013). The central resolution instruments are:

i. *Sale of the company*: the SRB can propose that individual business units or the entire bank be sold to another institution.

ii. *Bridge bank*: the SRB can propose the establishment of a bridge bank to which, following the separation of the "good" and "bad" assets, only the good ones are transferred, so that they can be gradually sold off. In the meantime, the "bad" assets are to be sold or written off immediately – at the expense of the shareholders, unless otherwise agreed.

iii. *Bad bank*: the SRB can also have assets divested. Here, "bad" assets are transferred to a special-purpose entity (bad bank), thus removing them from the bank's balance sheet. In the case of a bad bank, there is a change of focus because, unlike the immediate sale of "good" assets, the immediate sale of "bad" assets entails considerable disadvantages. In this case, it is highly likely that an agreement will be made between the (administrator,) shareholders and the creditors as to how the liability side of the bad bank will be structured. In order to prevent banks from taking advantage of this instrument to obtain state subsidies, it may only be used in conjunction with other instruments (sale of the company or bridge bank) which ensure the continued existence of the actual bank.

iv. *Bail-in*: the SRB can propose a bail-in, which means that a bank is recapitalised by cancelling or diluting shares and reducing creditors' claims or converting them into equity (European Commission, 2012). The bail-in must follow a clearly defined "liability cascade" which will be described in detail in the next section.

2.2.3 Establishment of the resolution fund

In order to be able to use the above-mentioned resolution instruments effectively, funds may be required which exceed the contribution towards the resolution costs obtained by bailing in the shareholders and creditors. In order to protect the taxpayers from the need to stand for bank risks, the banking sector itself is to build up a corresponding risk fund. From 2015 banks will be obliged to make contributions to the Single Resolution Fund (SRF).

The contribution to be made by each bank depends on i) its total assets minus its capital and its (covered) deposits (leverage ratio), ii) the risk rating of its portfolio (market and credit risks), iii) liquidity risks and iv) its general resolvability. This multi-dimensional approach to calculating the contribution is designed to adequately take the institution's business risk and its significance for the financial system as a whole into account (Council of Economic Experts, 2013).

After an establishment phase lasting eight years (2015 to 2023), the fund should have a total volume of 55bn euros. This sum is equal to 1% of the covered deposits in the EU according to calculations by the European Commission in late 2011 (Council of Economic Experts, 2013). The fund will initially consist of individual national compartments[13] which are to be mutualised over the years. 40% will be mutualised in the first year, another 20% in the second and the rest equally divided over the remaining 6 years (European Parliament, 2014b).

The fund can be used as part of bail-in measures from 2018. In order for the resolution fund to be tapped, the European Commission first has to decide that creditors are to be involved in the losses. However, there are certain liabilities that are categorically exempted from a bail-in. These include insured deposits, covered liabilities or very short-term liabilities stemming from interbank relationships and payment systems (Council of Economic Experts, 2013).[14] All other liabilities are to be used for bail-in purposes, but in certain circumstances they too may be excluded from a bail-in. For example, the losses for lenders should not exceed the losses that would hypothetically have been incurred in the event of ordinary insolvency

[13] What is to happen to SoFFin funds which are not directly merged into the Single Resolution Fund has yet to be clarified. These funds should first be made available to the special sectoral fund (authors' proposal, see section 3.1) instead of returning them to the banking sector. In the long term the special sectoral fund could be merged with the SRF.

[14] It is imperative to ensure that these exceptions do not lead to banks refinancing themselves in a particularly short-term manner. According to the Basel III liquidity guidelines, it must be possible to assign the assets and liabilities on the bank balance sheet into congruent liquidity bands according to maturity. Nevertheless, the ongoing supervision activities should include an evaluation as to whether the above-mentioned exceptions create the wrong incentives.

proceedings (Council of Economic Experts, 2013).[15] As it is possible to spare individual groups of creditors from a bail-in, the Fund may only contribute funds if shareholders and lenders take losses of at least 8% of the liabilities. As a rule, the Fund may not recapitalise more than 5% of the bank's total assets. It is only possible to contribute more than 5 % of the total assets in exceptional cases and on condition that all the lenders participate in the bail-in (Council of Economic Experts, 2013).

In the event of resolution, the national deposit guarantee schemes are to contribute to the extent that they would in the event of ordinary insolvency proceedings (in both cases, the contribution of the deposit guarantee schemes is derived from the sums per customer). If the SRF has insufficient capital, it may borrow on the capital market. However, the SRF is not permitted to borrow directly from the ESM (European Parliament, 2014b).

2.3 The harmonised Deposit Guarantee Scheme

The European deposit guarantee schemes, which are to be harmonised by the end of 2014, were introduced at European level as long ago as 1994. The schemes have further features which distinguish them from the other elements of the banking union: they apply not only to the members of the Eurozone, but to all members of the EU and, furthermore, there will not be a pan-European scheme – only the existing national deposit guarantee schemes are harmonized.

2.3.1 Scope and financing of the Deposit Guarantee Scheme

Each of the national schemes must guarantee deposits of up to 100,000 euros per bank and customer. Outside the Eurozone the equivalent amount is guaranteed in the respective national currency. For this purpose each scheme has to raise capital equal to 0.8% of the covered deposits in the respective country over a period of ten years (2014 to 2024). A maximum of 30% of the deposits in the scheme is permitted in the form of payment commitments. Payment commitments are promises to pay which are backed up by collaterals

[15] When losses within the framework of the resolution mechanism are compared with those resulting from ordinary insolvency proceedings, this means that the costs of the ordinary insolvency have to be simulated, where necessary. Even though such a procedure is a standard practice in national insolvency law, the result of the simulation may be a matter of dispute among the company's various stakeholders (shareholders, creditors). The power of decision regarding acceptance of the simulation results must therefore lie with the SRB.

(usually securities). The collaterals themselves must be low-risk and be deposited with the deposit guarantee scheme. If a scheme has to make payments during the establishment phase, it may apply for a four-year extension of the establishment phase. In the case of states with a highly concentrated banking sector, the Commission may approve a sum equivalent to only 0.5% of the covered deposits.

The schemes are financed by levies on the banks in the respective country. The higher the risk in a bank's portfolio, the higher the levies it has to pay, as the likelihood that the deposit guarantee scheme will be called upon rises in line with the increasing degree of risk. The indicators according to which a bank's contribution is determined include its capital base, asset quality, profitability and liquidity (European Parliament, 2010).

If claims are made against the deposit guarantee scheme following the insolvency of a bank, the scheme will have to be replenished by means of new bank levies. A scheme may also borrow from public or private third parties. In addition, the schemes are to be allowed to lend money to one another (European Commission, 2013e). Furthermore, the SRF is to support any deposit guarantee scheme which finds itself unable to meet its obligations (Council of Economic Experts, 2013). As already mentioned, in the event of a bank resolution, the claims against the deposit guarantee scheme are to be exactly the same as they would have been in the event of ordinary insolvency proceedings.

2.3.2 Claims against the Deposit Guarantee Scheme

The period in which deposits will be returned to savers claiming against the deposit guarantee scheme are to be reduced from the current 20 working days to 7 working days by 2024. As a result of the harmonisation process, the deposit guarantee scheme of the bank's domicile will also be liable for the deposits of subsidiaries of the respective bank in other European countries. However, the local deposit guarantee schemes will serve as the point of contact for the customers affected in these countries and will pass on the corresponding amounts (European Commission, 2013e).

When opening an account, savers must now be informed better about the deposit guarantee scheme. Banks are therefore required to obtain written confirmation from customers that they have received and read a standardised information sheet about the deposit guarantee scheme.

In addition, there will be restrictions on advertising for bank accounts. This advertising will only be permitted to contain factual information and no allusions to unlimited protection.

3. Assessment of the European Banking Union

In this chapter, individual aspects of the European Banking Union (as at May 2014) are subjected to critical examination. The key instrument for this assessment, with particular regard to the size of the resolution and deposit insurance funds, is a comparison with other institutions that have a similar range of responsibilities at national level. These include the Federal Deposit Insurance Corporation (FDIC) in the USA and Financial Market Stabilisation Fund (SoFFin) in Germany. Founded in accordance with the Glass-Steagall Act of 1933, the FDIC is the deposit insurance fund of the United States. The FDIC is also responsible for resolving insolvent banks. It thereby assumes the roles of both the Single Resolution Mechanism and the Deposit Guarantee Scheme. Germany's SoFFin was created by the Financial Market Stabilization Fund Act in 2008 in order to contain the problems of individual German banks following the financial market crisis und and to resolve some of the institutions affected.

3.1 The Single Supervisory Mechanism

The comprehensive assessment of banks which is currently being conducted may prove to be the Achilles' heel of the Single Supervisory Mechanism. For simplicity's sake the following assessment focuses on possible results of the examination of bank balance sheets referred to as the Asset Quality Review (AQR). Basically, however, the conclusions drawn can also be applied to the results of the Supervisory Risk Assessment or the Stress Test.

We share the view of the German Council of Economic Experts that there must be "clarity about the legacy assets on banks' balance sheets" (Council of Economic Experts, 2013) if the success of the European Banking Union is to be guaranteed.[16] This means that the AQR has to be strict in its assessment of the status quo and must not be politically watered down. The latter might happen in order to enable the banking union to commence as planned in

[16] Cf. section 3.2 on the assessment of the volume of the Single Resolution Fund. If the European Banking Union commences with massive legacy assets, it is almost inevitable that the restructuring and resolution instruments will be overextended.

November 2014 and to avoid a possible destabilisation of the European banking sector by a too strict AQR. Indeed, it is very possible that an effective AQR shows banks to be undercapitalised. In the event that the banks concerned were unable to respond with a capital increase or balance sheet contraction, other financing and resolution instruments would be required prior to or in addition to the actual banking union.

For this eventuality the Council of Economic Experts (2013) has described that prior to publication of the results of the AQR national backstops will be put in place, which would allow member states to take liability for banks' legacy assets. In effect this means that the member state in which the bank concerned is based at first takes the restructuring or resolution costs.[17] In our opinion, this construction contradicts the objective of the banking union to separate the risks of the banks and the states. As the euro crisis demonstrated, this approach contains the risk that the budgetary position of individual member states will deteriorate to such an extent that they can either no longer refinance themselves through the capital market or can only refinance themselves on unfavourable terms, which would cause the euro crisis, which has only just died down, to flare up again.

Given the current situation, an ultimate access to the ESM as a hedging mechanism for overextended national backstops seems to be possible – but only under the additional liability of the member state concerned. For access to the ESM the member state will have to implement an adjustment program specific to the finance sector, accompanied, if necessary, by a macroeconomic program[18] in order to ensure repayment of the ESM aid.

In order to improve the constellation, the German Council of Economic Experts therefore proposes an easier access to the ESM in figure 379: "In contrast to direct recapitalization by the ESM the member states would remain liable. The conditionality associated with the use of ESM funds, however, would primarily apply to the banks concerned." Even though this proposal goes into the right direction, we consider the construction of national backstops in principle as suboptimal. As outlined in the next section, we recommend instead the creation of

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[17] Indirectly, these costs are to be borne by the national banking sector.

[18] The logic of connecting national macroeconomic adjustment programmes with financial market stability issues is not obvious to us here. Applicable thereto the German Council of Economic Experts notes in figure 378: "The adoption of an ESM program, starting from the application, continuing via the agreement about the Memorandum of Understanding and terminating in the consent of national parliaments, requires a very long way to go. In addition, an application for ESM aid is not very appealing since the ESM program is connected with a temporary delivery of sovereignty to the European level."

a pan-European backstop (a special sectoral fund) with funding from the pan-European banking sector and, if necessary, with direct access to the ESM.

A special sectoral fund as a meaningful supplement to the European Banking Union

In order not to place the budgets of the member states under undue pressure, we propose a special sectoral fund rather than national backstops. This fund would have to be financed by a pan-European bank levy instead of national ones. As the Eurozone is an integrated financial market, solvent financial market participants[19] from other member states as the domicile should ultimately contribute to pan-European financial market stability. The advantage of a special sectoral fund instead of a national one would also be a coordinated process in dealing with banks from different countries which receive a problematic rating in the AQR.

The contributions to the special sectoral fund should be collected over an extended period so as not to put financial market stability at risk. Conversely, the contributions for individual institutions (G-SIFI) should be so substantial that in the long term they have to sell assets in order to pay the contributions. In the event of a claim against the special sectoral fund, all the restructuring and resolution instruments contained in the banking union, which would commence in parallel to the proposed fund, should be used, with the exception of financing by the Single Resolution Fund. In our opinion, this would include the right of intervention for the Single Resolution Board / ECB in the governance of the institution concerned, e.g. in questions of dividend and bonus payments.

As a meaningful incentive to reduce the size of individual institutions in the long term and thus to limit the too-big-to-fail problem, the contributions to the special sectoral fund should depend on the size of the institution. The European G-SIFIs in particular, regardless of which country they are based in, should be required to contribute a disproportionally large share of the financing. As already mentioned, the contribution period has to be stretched in order not to place a strain on lending or on financial market stability as a result of direct and high[20]

[19] The involvement of non-banks, such as hedge funds and other shadow banks whose business is only possible within the framework of a stable financial market, is also desirable.

[20] It is fully intended to set the contributions for G-SIFIs and other large institutions so high that asset sales become necessary to pay the contributions and consequently the total assets of the institutions concerned decrease in the long term.

contribution payments. For this reason the special sectoral fund may require direct financing when the European Banking Union goes into operation. In this case, the financing could be provided by the ESM, as is conceded in the analysis by the German Council of Economic Experts in the last instance.

Currently, the role of the ESM in the financing of a backstop is imprecisely formulated and communicated in the legislative acts which have been adopted thus far. Our enquiry was answered by the Economic and Financial Committee (ecofin) of the European Parliament with reference to a provisional version of November 2013 (European Parliament, 2014a).[21] This reads similarly to the recommendations of the German Council of Economic Experts. In Germany, the financial market stabilisation fund (SoFFin) can certainly be used as a national backstop. However, it is unclear whether it will be possible to set up functioning national funds everywhere in time for the start of the banking union. The only thing that is now clear is that the ESM is not able to recapitalise banks directly. If the European legislative acts adopted do not enable an adequate backstop to be established, however, there is a risk of a "soft" Asset Quality Review and with it a false start for the European Banking Union.

Further points of criticism with regard to the Single Supervisory Mechanism

A further criticism of the supervisory scheme concerns the approach to the leverage ratio. Even though this criticism actually concerns the European implementation of the Basel III rules (cf. section 2.1.2), it is central to the single banking supervision mechanism. The European regulations as they now stand only envisage capital requirements for risk-weighted assets. In contrast, the leverage ratio restricts the debts relative to the absolute, i.e. non-weighted, assets. During the crisis it became apparent that the leverage ratio is a much better indicator of the probability of a bank becoming insolvent than its risk-weighted capital ratio (Blundell-Wignall and Roulet, 2012). At least, from 2016 a leverage ratio is to be monitored in addition to the risk-weighted capital requirement mentioned in section 2.1.2 (European Commission, 2013b).

On 12 January 2014 the Basel Committee presented its final recommendation on this point in which it envisaged a leverage ratio of 3%. According to reports in the media (The Economist,

[21] The version of the SRM directive adopted on 26.03.2014 does not address this question adequately either.

2014), however, in response to pressure from France and Germany exemptions were conceded which allow preferential treatment in particular for derivatives, known as netting.[22] It should also be noted here that the US FDIC rates a bank as being well or adequately capitalised if it has a leverage ratio of 5% or 4% respectively (US Government, 2005). We consider the level in the American rules on leverage ratio to be more expedient. Against this background, adjustment of the Single Rulebook would be desirable.

Finally, the ECB's role in the supervisory mechanism has to be considered. Here there is a distinct possibility of a conflict arising between monetary policy and financial market stability (Lautenschläger, 2013). The problem results from the fact that the European central bank system has lent the banks large sums for which the ECB and the national central banks have received collateral. This collateral is therefore not available for sale or transfer to a bridge bank or bad bank. In addition, central banks have seniority status, which means that their claims as creditors are preferred over those of other creditors. Central bank claims can therefore not be written off and are not available for bail-ins. It is therefore virtually impossible for banks with high liabilities towards central banks to be resolved (Finance Watch, 2013b, p. 21). On the other hand, however, there is at present no other credible and competent institution in the eurozone that could assume the responsibility of bank supervision. Therefore, it is necessary to ensure strictly that supervision and monetary policy are effectively kept separate.

3.2 The Single Resolution Mechanism

The most critical point within the Single Resolution Mechanism could turn out to be the volume of the resolution fund. Figure 4 illustrates why the targeted sum of 55 billion euros is too low. The lending volume of SoFFin, the financial market stabilisation fund established solely to resolve the consequences of the financial market crisis in Germany, exceeded this figure by 15 billion euros. The maximum potential liquidity support required by certain large European financial institutions (European G-SIFIs) would far exceed the lending volume of the Single Resolution Fund. This calculation was based on the assumption of the maximum

[22] This means that opposite market risk positions, e.g. interest positions, cancel each other out and thus do not affect the leverage ratio. However, this can become problematic if, for example, both derivatives have been contracted with different counterparties, and the counterparty risks thus do not cancel each other out.

Figure 4: Comparison of the volume of funds for financial stabilisation with the potential maximum requirement of large European banks.

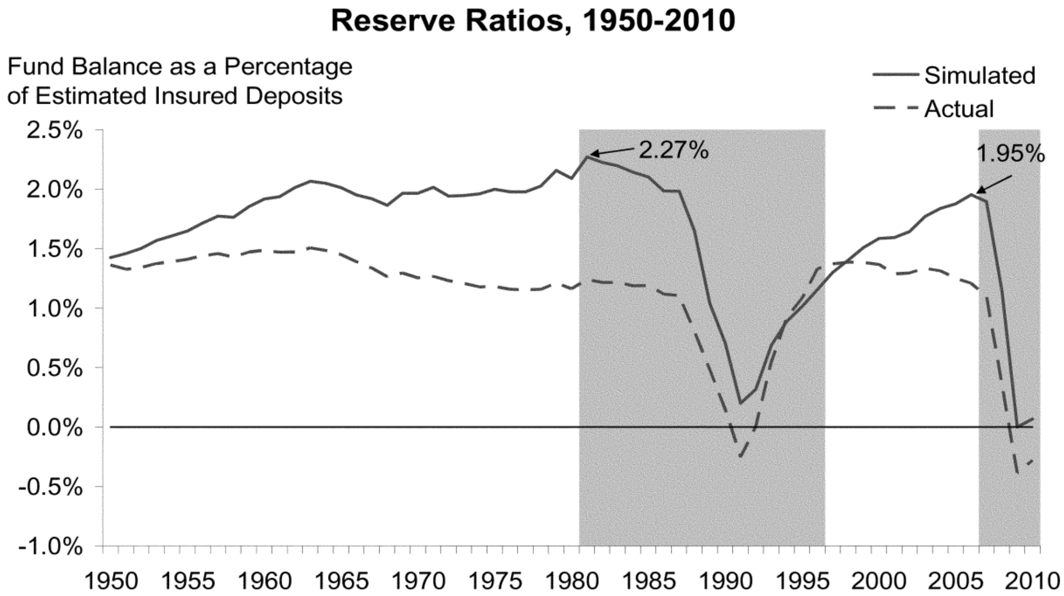
FUND SIZE IN COMPARISON (BN €)		
Fund		**Fund Size**
Single Resolution Fund		55
SoFFin		70*
G-SIF Institute	**Total Assets**	**Maximum Support****
BNP Paribas	1800	83
Deutsche Bank	1611	74
Santander	1116	51
ING Bank	788	36
Société Générale	1235	57

* SoFFin currently serves only for the restructuring of German banks. Its lending volume may be raised by 10bn € by resolution of the Bundestag. In addition, it may give guarantees totalling 400bn € (FMSA, 2013). ** The maximum permitted support assumed here is calculated on the basis of the SRM directive (European Commission, 2013c) at 5% of the total assets of the institution concerned. Source: European Parliament, 2013 annual reports of the banks and SoFFin.

permitted support of 5% of total assets being subsequently reduced by 8% by means of a bail-in. Comparison with the US FDIC, whose Deposit Insurance Fund (DIF) is used both for bank resolution and for deposit insurance, clearly shows that funding of the resolution mechanism and deposit guarantee scheme are too low. Since the financial market crisis, the target size of the DIF has been 2% (FDIC, 2013a) of the insured deposits (Figure 5). If this target figure falls below 1.5%, the fund is not permitted to pay back any bank contributions; if it is above 2%, a reduction of the levy is envisaged (FDIC, 2011).

The target size of the DIF is based on historic experience. As Figure 5 shows, if the DIF had always been established with 2%, this would have been sufficient to prevent the fund's reserves from being completely exhausted (solid line). In fact (dotted line), however, on two occasions during the considered period the fund became negative (net debt), because the target volume of 2% was not firmly required until 2011.

Figure 5: Simulated and actual fund balance of the Federal Deposit Insurance Corporation fund (FDIC, 2011). The shaded areas are periods of crisis.



Source: FDIC (2011).

Figure 6: Capital ratios at which individual measures by the FDIC are initiated, effective January 2015. The infringement of one criterion per column is sufficient for an institution to fall into the next-lower capitalisation category.

Promp Corrective Action (PCA)					
PCA Categories	Tier 1 Leverage (%)	Tier 1 Capital (%)	Tier1 + Additional Tier 1 Capital current (%)	Tier1 + Additional Tier 1 Capital new (%)	RWA (%)
Well Capitalized	≥5,0	≥ 6,5	≥ 6,0	≥ 8,0	≥ 10,0
Adequately Capitalized	≥ 4,0	≥ 4,5	≥ 4,0	≥ 6,0	≥ 8,0
Undercapitalized	< 4,0	< 4,5	< 4,0	< 6,0	< 8,0
Significantly Undercapitalized	< 3,0	< 3,0	< 3,0	< 4,0	< 6,0
Critically Undercapitalized	Tangible Equity/Total Assets ≤ 2%				

Quelle: FDIC (2013b).

The significance of this development for the European Banking Union becomes clear when the volumes of the resolution and deposit guarantee funds are added together. The total is 1.8% of the covered deposits, which is below the target figure of 2%.[23]

The lack of clear details regarding the financing and the investments of the resolution fund has also proved to be problematic. Articles 63 and 66 of the SRM regulation (European Parliament, 2014c) state that the bank contributions are to consist of two components: a fixed percentage contribution per institution and a share that is based on the risk rating of the respective bank's portfolio. Until now the Commission has only been tasked with defining the ratio of the two components. If the share that is based on the risk rating of the respective bank's portfolio was underestimated, this would in our opinion be critical. The form of assets in which the resolution fund will hold non-utilised funds also remains unclear. A transparent and coherent investment strategy has yet to be drawn up in detail by the Single Resolution Board.

A further point of criticism of the Single Resolution Mechanism is the specification of measures with regard to capital requirements. Figure 6 shows the FDIC thresholds for comparison. If a bank falls into the "undercapitalized" category, for example, the FDIC can cut dividend payments and managers' salaries. Furthermore, the bank concerned may only increase its total assets with the permission of the FDIC. If a bank falls into the "significantly undercapitalized" category, the salaries of its senior management will be cut. Finally, if a bank is "critically undercapitalized", the FDIC will intervene directly in its operative business. For example, creditors may only be served with the permission of the FDIC.

The measures to be taken by the ECB and the Single Resolution Board have yet to be specified. Moreover, Véron (2014) sees scope for discretion with regard to participation in bail-ins depending on the creditor structure (senior/junior liabilities).[24]

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[23] It is not clear from the European legislative acts why especially country-specific risk characteristics should lead to the target figure being reduced by 0.2 %.

[24] "The first question is whether to impose losses on problem banks' senior creditors, assuming the 'bailing in' of junior ones is not sufficient to absorb the identified financial gap. As previously mentioned, the European

Unlike the above-mentioned critical aspects within the resolution mechanism, the decision-making structure of the SRM does appear to be appropriate for emergencies. The European Parliament was able to establish the requirement for a decision within the course of one weekend where necessary (European Parliament, 2014b).

3.3 The single Deposit Guarantee Scheme

As already mentioned in the comparison with the FDIC, the regulatory basis for the volume of the Deposit Guarantee Scheme with a total of 0.8% of the covered European deposits is not evident either. It is open to question whether a simulated requirement primarily based on historical values was assumed in determining the threshold.[25] This also raises the question of why the European Commission can approve a volume of 0.5% of the covered deposits in the case of a concentrated banking sector (European Commission, 2013e). If the reason for this lower level was the timely establishment of one of the deposit insurance funds, it would appear to be better from a risk perspective to approve a longer establishment period in exceptional cases instead of reducing the volume of the deposit guarantee scheme.

3.4 Expectations on the European Banking Union

One of the main objectives formulated for the European Banking Union is that bank rescues using taxpayers' money are to be avoided in the future. Although the banking union does make state bail-outs less likely, it cannot entirely rule out the future necessity of such rescue measures. The main reasons for systemic risk remaining too high in the European financial system are the size and interconnectedness of individual financial institutions (the too-big-to-fail and too-interconnected-to-fail problems). This can be seen clearly in Figure 4 which shows what support can be given to certain major European banks. Even after the maximum bail-in, the difficulties of only one major bank could eat up the entire volume of the Single

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Commission's state aid framework does not prescribe a stance in this respect. Nor does EU legislation: the bail-in provisions of the BRRD and SRM will not in any scenario enter into force before 2016" (Véron, 2014).

[25] According to the (European Commission, 2010), the targeted volume of the deposit insurance funds is sufficient to insure the deposits in the event of the insolvency of one medium-size bank in each member state: "The new financing requirements will ensure that each scheme has enough funds in place to deal with a medium-size bank failure." However, this statement does not take potential difficulties of major European financial institutions (in particular G-SIFIs) into consideration.

Resolution Fund. Even without thespill-over effects which banks requiring resolution would have on other banks, the resolution mechanism would be overstretched (Finance Watch, 2013a). That, however, would entirely undermine the credibility of the resolution mechanism. There is therefore still a risk that the taxpayer will once again be required to pay. If the resolution mechanism is not sufficiently credible, banks may be tempted to increase their risks again because they will count on being rescued in an emergency.

Measures to combat this problem do not constitute a sufficiently large element of the European Banking Union. In particular, its concentration on capital requirements is not enough.[26] Instead, upper limits should be imposed upon individual banks' business activities (not only indirectly in terms of capital resources, but also directly in terms of market share, for example), and existing institutions should be broken up if they exceed these limits (Finance Watch, 2013a).

4. Conclusion

The European Banking Union was initiated with the aim of creating a single supervisory and resolution mechanism for banks in order to resolve the conflict between financial market stability and taxpayers' liability and to break through the vicious circle in the relationship between states and banks. The necessary European legislative process for this was completed with the approval of the European Parliament in April 2014. One important component still has to be completed by November 2014, however, before the European Banking Union becomes operative. This is the transparent evaluation of the banks' balance sheets, i.e. the Asset Quality Review. The necessary back-up mechanism (backstop) has also not yet been adequately provided.

The European Union has attempted to combat the problem of excessively large and interconnected banks by means of increased capital requirements for systemically important financial institutions (Basel III). However, the question remains as to whether higher capital requirements alone will suffice. Instead, upper limits should be imposed upon banks with

[26] For example, a scenario could conceivably arise in which an institution with adequate capital resources constitutes an enormous systemic risk due to the monopolistic position of individual parts of its operations, such as foreign exchange trading.

regard to their business activities, and existing institutions should be broken up if they exceed these limits.

A major bank in distress would very probably block the resolution mechanism because the resolution and deposit insurance fund sizes have been calculated too tightly. As a last resort, the taxpayers' money would once again have to be employed in order to maintain financial stability. Major banks would then respond by taking on increased risk because they considered effective resolution to be unlikely in their case. In this context, it would be helpful to have a defined absolute limit based on leverage ratios which, although planned, has not yet been implemented rigorously.

All in all, the European Banking Union is an important step in the right direction, for it has introduced clear, harmonised rules for bank resolution which did not exist before. The expectation that taxpayers' money will consequently never again be required for bank rescues cannot be fulfilled, however. The European resolution and deposit guarantee schemes in particular are inadequately funded and the too-big-to-fail problem has not been addressed adequately. In this context, the special sectoral fund proposed by the authors might prove useful.

*** Finalized in May 2014 ***

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