

# The impact of the European Banking Union on risk attitudes among Global Systemically Important Institutions: Phoenix out of the ashes or ABACUS-2024-ECB in the making?

An inquiry through EU-Law, Judaeo-Christian doctrine and statistical evidence

LL.M Thesis

**Abstract**

The European Banking Union came into existence with the introduction of the Single Supervisory Mechanism as its first pillar, in 2013. Ever since, it has centralised supervision of all banks in the Eurozone, with direct supervision of Significant Institutions by the Supervisory Board of the European Central Bank. Having been complemented with two additional pillars to provide resolution as well as attempted common deposit insurance, the EBU has expanded in scope and scale. With centralised supervision and resolution competences, came increased power of the ECB, and increased independence both from national actors and Union bodies. On the business side, Global Systemically Important Institutions form the largest and most powerful banks, holding assets worth trillions of euros, and exposures in excess of that, which are not reported on the balance sheet. This paper investigates the incentives behind the creation of the EBU, tracking legal precedents and regulatory developments for all three pillars. Furthermore, the role of accountability is analysed through the prism of Judaeo-Christian principles, both on the regulatory as well as the business side. Finally, a statistical inquiry on interconnectedness and complexity of G-SIIs seals our findings on whether legal equals ethical, and whether the laws of the secular and the static, are in tune with the divine and the dynamic. Only that way, may the economy of the single market have the cornerstone it deserves: a financial system with skin in the game, built on moral responsibility and trust.

**Keywords:** Covered Bonds, CDO, Deposit Insurance Scheme, European Banking Union, Eurozone, Global Financial Crisis, Kehila, Meroni, Non-delegation, Pringle-ruling, 'Put-Opciju', Securitisation, Systemic risk, Talmud

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**Statement of originality:**
I, Ardi Awandi Kaars (5777631), herewith declare to have written this document and that I am responsible for the content of it. I declare that the text and the work presented in this document is original and that no sources other than those mentioned in the text and its references have been used in creating it.

Utrecht University School of Law is solely responsible for the supervision of completion of the work, not for the content.

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**Preface**
During a law tutorial on calculating cartel stability using interest rate as the discount factor, I noticed something peculiar: when interest becomes zero, cartel stability becomes infinite, or so I thought. When interest rate falls below that boundary, reaching negative territory, I wondered what would be left of such a calculation model. Raising this issue, my tutor remarked that cartel stability, according to him, is at an all-time high. This, as well as some readings on systemic risk and non-linearity regarding size, made me think about the stability of the financial system in which my country, among 18 others, is located: the Eurozone. Although it must be said that cartel stability among industries is not the same as stability of a financial system, it motivated me to think about the means through which existing economic structures are kept afloat. The fascination for systemic risk remained, and in particular with regard to banks, for I head various times that interest rates are at an all-time low, and that we may still be paying the price of the last GFC. I then recalled a presentation by Mr. Wellens from 11 May 2020, in which he raised the prospects of a Banking Union and risks in the financial system. All of the above events have inspired me to find out what risks Global Systemically Important Institutions pose to the Eurozone, and the global financial system for that matter. Hence, I have decided to find out how the European Banking Union affects risk attitudes among G-SIIs.

From this page onwards, the reader will be addressed using the royal plural, involving both reader and author into our research, in equal proportion. Besides developments in EU law and statistical trends, our analysis has documented some very important accounts of high-level corruption and conflict of interest, reaching all the way to the highest levels of the European Union, with traces to Latvia and Malta. These documentations include findings by genuine journalists including Wellens, and whistleblowers, who are willing to risk their reputation for the sake of truth, and sometimes risk more than just that. As a civilised society, we owe them an incredible debt for the service provided to their country, the EU, and the rule of law.

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# I. Introduction

During the summer of 2014, the European Central Bank had set interest rates below zero for the first time.[1] It was a rather experimental policy, and in March 2015, Quantitative Easing became fact. The main justification, according to official statement by the ECB, was the idea of helping sovereigns and putting banks financially back on track.[2] The latter was to be secured even more through a European Banking Union, formally introduced in 2012.[3] The EBU is one of the building blocks of the EU Economic and Monetary Union, and is entrusted with safeguarding stability in the banking sector across the EU, with the purpose of upholding a level playing field in bank regulation and supervision, and bringing the Too-Big-to-Fail problem to an end.[4] It was created following complaints by the de Larosière Report and the van Rompuy report on the inability to resolve banking sector problems at the national level alone, with existing mechanisms.[5] The idea behind a banking union is to have a closer grip on the more toxic aspects attached to banking, and is one more link in a chain of developments towards centralisation of financial regulation and supervision at the European level. The Banking Union consists of three pillars. In chronological order, these are: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the European Deposit and Insurance Scheme (EDIS), of which the last one is still to be implemented.[6]

It remains difficult to estimate the costs of the previous financial crisis, for there is no clear answer on whether or not its aftermath has been completely accounted for.[7] The main players that brought about the Global Financial Crisis were banks of such considerable size, that collapse would ruin the financial system. In the US alone, the losses incurred between 2008-2012 have been estimated at $12.8 trillion in actual loss of GDP and potential GDP loss due to fiscal and monetary policy. That estimate covers the period since the collapse of Lehman Brothers until two years after the Dodd-Frank Act[8] was signed into legislation. The estimate is a conservative one at best.[9] Millaruelo and del Río estimated that state aid to banks in the Eurozone amounted to €200 billion between 2008-2015, measured by deteriorations in government budget.[10]

Systemic risk in the banking system - whether in the US or in the EU, or elsewhere on the globe - has been attributed especially to large banks with a global systemic importance.[11] To address and contain systemic

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[1] European Central Bank, 'Official interest rates' (2020). <https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html> Accessed 27 January 2021

[2] European Central Bank,'How quantitative easing works' (2020). <https://www.ecb.europa.eu/explainers/show-me/html/app_infographic.en.html> Accessed 29 January 2021

[3] European Council, 'Banking Union' (2020). <https://www.consilium.europa.eu/en/policies/banking-union/> Accessed 27 January 2021

[4] Ibid 3

[5] Herman van Rompuy, 'Towards a Genuine Economic and Monetary Union' (2012). Report by the President of the European Council (EUCO 120/12). <https://www.consilium.europa.eu/media/21570/131201.pdf> Accessed 22 June 2021 (Van Rompuy Report)

[6] Ibid 3

7 Jim Reid & Craig Nicol, 'GFC 10 Years on – More debt & money printing has covered up a debt crisis' (2018). Deutsche Bank Research. <GFC 10 years on - More debt & money printing has covered up a debt crisis (dbresearch.com)> Accessed 27 August 2021

[8] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o)

[9] Stacy Curtin, '2008 Financial Crisis Cost Americans $12.8 Trillion: Report' (17 September 2012). Yahoo Finance. <2008 Financial Crisis Cost Americans $12.8 Trillion: Report (yahoo.com)> Accessed 20 August 2021

[10] Antonio Millaruelo & Ana del Río, 'The cost of interventions in the financial sector since 2008 in the EU countries' (2017). Banco de España, Analytical Articles 2017. <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/ArticulosAnaliticos/2017/T2/files/beaa1702-art10e.pdf> Accessed 27 August 2021

[11] Ibid 5

risk, the Bank of International Settlements defines criteria of Global Systemically Important Banks. Some main characteristics of a GSIB are its large size in terms of total exposure (Too-Big-To-Fail) and high degree of interconnectivity in the financial system (intra-financial assets and liabilities).[12] Specifically, Global Systemically Important Banks are defined using the Basel Committee on Banking Supervision (BCBS) methodology, and generally refers to banks with a Basel III Leverage ratio exposure (total exposures) of more than 200 billion euros.[13] This threshold also applies to banks identified as G-SIIs, as mentioned in Article 3(2) of Council regulation 1222/2014.[14]

No exact definition of a G-SII is given there, yet a Systemically Important Institution is defined as follows in Article 6 of the SSM regulation:
"(i) the total value of its assets exceeds EUR 30 billion;
(ii) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below EUR 5 billion;
(iii) following a notification by its national competent authority that it considers such an institution of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such significance following a comprehensive assessment by the ECB, including a balance-sheet assessment, of that credit institution."[15]

According to that definition, there also exist systemically important banks that do not fall within the scope of G-SIBs. We stick to the interpretation of G-SIIs as defined in the SSM regulation, for that definition closely follows the methodology of the Basel Committee, while also including some of the largest banks in the EU that do not strictly qualify as G-SIB. All of those have an exposure in excess of 200 billion euros, an amount that is used by the Basel Committee as a criterion for size of G-SIBs, hence we consider banks in the EU of that size to be of sufficient systemic importance to form part of our research.

## Research setup

In light of the above, the main question to be answered in this paper is as follows: How does the EBU affect risk-taking behaviour of Global Systemically Important Institutions in the EU over time?

This question can be subdivided into the following questions:
- What was the rationale behind the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism?
- What will the EDIS add to the existing pillars of the EBU in legal and economic terms?
- What role does accountability play in the EBU, including large banks and MSs it covers?
- How has balance sheet composition of G-SIIs changed in terms of complexity and intra-financial system connectivity, since the introduction of the EBU?

This paper contains a two-fold analysis. The first part (Section IV-VI) of our research is qualitative in nature and deals with three subquestions which track judicial developments and established legal principles, as well as religious principles that have been around for much longer. Hence, emphasis is added on the doctrine of precedent, on both counts. The first two subquestions may seem very straightforward, given the context

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[12] Basel Committee on Banking Supervision, 'Global systemically important banks: Assessment methodology and the additional loss absorbency requirement' (2011). Bank for International Settlements, Rules text, November 2011. ISBN print: 92-9131-893-0 ISBN web: 92-9197-893-0. pp 1-4 <https://www.bis.org/publ/bcbs201.pdf> Accessed 9 April 2021

[13] Basel Committee on Banking Supervision, 'Global systemically important banks: Updated assessment methodology and the higher loss absorbency requirement' (2011). Bank for International Settlements, July 2013. ISBN 92-9131-947-3 (print) ISBN 92-9197- 947-3 (online) . p. 2 <https://www.bis.org/publ/bcbs201.pdf> Accessed 15 April 2021 (BCBS Methodology)

[14] Commission Delegated Regulation (EU) No 1222/2014 of 8 October 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for the specification of the methodology for the identification of global systemically important institutions and for the definition of subcategories of global systemically important institutions *OJ L 330/27.*

[15] 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
*OJ L 287/63* (SSM Regulation), Art. 6

provided in the introduction. However, the analysis focuses on more than the economic statistics of the GFC, and identifies existing legal documents, cases and the motivations of EU institutions in setting up the Banking Union, as well as practical application thus far.

The second part (Section VII-IX) is quantitative in nature and answers the final topic through statistics on the development of several classes of assets and liabilities that we consider relevant indicators of systemic risk.

## Expectations

In legal terms, we expect from our qualitative legal analysis that the EBU and related institutions in the domain of banking supervision, resolution and regulation have a strong legal standing in the treaties as well as secondary law. That is likely to be the source from which the agencies involved derive a large degree of autonomy and power. Therefore, it is expected that under the SSM and SRM, swift decisions can be made to supervise and resolve banks, without much consultation of Member States and the European Parliament. The latter could explain why EDIS has not been implemented so far, due to friction between national and supranational level on further delegation of competences. This is relevant in order to understand the practical limitations to the proposed solutions of the EBU.

We expect that the rationale of the first two pillars is that the SRM provides financial and legal remedies to failing banks, whenever the administrative and sanctioning mechanisms of the first pillar, the SSM (with its supervisory tasks), are not strong enough to prevent a bank from reaching insolvency. The third pillar, the EDIS, will be implemented with the intention of providing a crisis response at the systemic level, should the other two pillars fail, for making the Eurozone safer. At the same time, financially prudent countries likely fear a transfer of funds towards riskier Member States, or are afraid that financially 'less' responsible Member States see an opportunity to contest rules that would make access to the EBU's safeguard subject to stricter requirements. The ability to pool fiscal transfers at the European level under EDIS, likely gives large banks in less prudent countries in the EU an incentive to engage in risky behaviour, and we expect that to be reflected in the statistics on risk in our analysis due to anticipation by G-SIIs, even though EDIS has not been implemented yet.

Regarding the third subquestion, on accountability, our expectation is that the ECB acquires increased supervisory power to make direct decisions in the activities of the EBU, with less procedural control through EU institutions and more discretion provided. The EBU is expected to have a *de jure* composition that intends to enforce transparency, by increasing reporting requirements to prevent deception, as well as balancing cooperation between NCAs and the ECB. Furthermore, increased capital requirements as well as restrictions on banks' lending behaviour are expected to show an improvement of solvability by banks (and hence the ability to repay debt), as well as less risky loans *on* the balance sheet. So far, the more visible parts of banks are considered, yet there is more, as explained below.

Despite the intentions of the EBU to safeguard the Eurozone financial system, our expectations from the quantitative analysis are an increase in risk-taking behaviour due to the additional safeguards put in place, encourage risk-taking and risk-shifting. Therefore we expect increases in the ratio of *Available-For-Sale Securities,* as well as the ratio of *Over-The-Counter Derivatives* - which are complex assets (explained later in the quantitative methodology - as percentage of total exposures. Moreover, we expect increased intra-financial system connectivity, meaning that the banks in our analysis hold more assets of each other, as well as increased lending between one another. All in all, the SRM and SSM, despite their efforts, are expected to reinforce a too-big-to-fail perception among G-SII investors and management.

Counter-intuitive as it may seem, with the above in mind, our expectation is that the EBU increases risk-taking among G-SIIs in terms of interconnectedness and complex assets.

# II. Relevance

### Scientific Relevance

The EBU, centralised banking supervision and resolution in general, raise more questions than what could be answered in this paper. These phenomena describe the very nature of a financial system built on the euro, and its compatibility or incompatibility with sovereign decision making, and hence with democracy as such. In terms of monetary policy, the following trilemma exists: the trade-off faced between sovereign monetary policy, a fixed exchange rate and free flow of capital, as only two out of three options are possible without causing collapse.[16] It is vital to understand what room is left for the EBU to uphold financial stability, after the effects of monetary policy have been accounted for, as to prevent new (agency) problems arising out of solutions to existing ones. The ability or inability to constrain risk-taking behaviour of Systemically Important Financial Institutions will have lasting consequences for the stability of the Eurozone and its resistance against future financial crises, and that is where the EBU comes into play. Risk-taking, in conjunction with bail-out guarantees[17] and limited liability are important factors to consider when assessing and solving the agency problems that cause a crisis in the first place. The Global Financial Crisis of 2008 forms an important reference in risk assessments by the ECB on which management targets for future crises are set[18], yet it is questionable to what extent a future crisis can be meaningfully predicted on past ones, with its causes identified after the fact.[19] Indicators that quantify interconnectivity and complexity help us understand whether lessons of past crises have been learned in practice (this will be explained in Section III and IV), and not just on paper.

### Social Relevance

The EBU (cl)aims to safeguard the financial stability of the Eurozone, and becomes an asset when it delivers on that promise. However, when its safeguards create a false sense of hope, society risks ending up with both financial and moral bankruptcy. More on that will be discussed in section III under 'accountability'. What is questionable - and that is something our research seeks to answer - is whether the EBU makes the Eurozone financially safer indeed, or creates an imaginary sense of stability. Centralised regulation of banks is only justifiable when it improves their behaviour and contributes to systemic safety, wherever that is unachievable by national decision-making alone. An analysis into the inner workings of the EBU therefore fits in a broader debate about the sustainability and the democratic legitimacy of the banking system in the Eurozone, and the way it is regulated.

The preparatory work leading up to the formation of the EBU pillars informs us about the way harmonisation is achieved, and whether the legal changes and delegation of competences occur smoothly, and on a democratically legitimate basis. When changes take place based on consistent legal precedent and existing procedures, the principles of proportionality, subsidiarity and conferral are to be respected.[20] Crises such as the GFC, debt crisis, and more recently, financial problems under COVID, may provide an incentive to accelerate legal changes that could not have been enforced otherwise, and therefore serve to test the consistency of these principles in legal decision-making. This is particularly relevant for answering the subquestion on accountability. Significant drifts in centralised decision-making may be illustrative of a more authoritarian approach by the EU in the future.

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[16] Pia Huettl & Dirk Schoenmaker, 'Should the 'Outs' Join the Banking Union?' (March 8, 2016). European Economy 2015.3, 89-112, Available at SSRN: https://ssrn.com/abstract=2744870, (Accessed 15 May 2021), p. 92 (Huettl & Schoenmaker (2016)

[17] Michael A Schillig, 'The (Il-)legitimacy of the EU Post-Crisis Bailout System.' *American Bankruptcy Institute Law Review*, Vol 28, 135. <https://www.abi.org/member-resources/law-review/the-il-legitimacy-of-the-eu-post-crisis-bailout-system> Accessed 29 January 2021

[18] Jacopo Carmassi, 'Completing the banking union with a European deposit insurance scheme: Who is afraid of cross-subsidisation?' (2018). *ECB Occasional Paper,* No. 208. <https://www.econstor.eu/bitstream/10419/192956/1/ecb.op208.en.pdf> Accessed 14 January 2021

[19] Nassim N Taleb, Daniel G Goldstein & Mark W Spitznagel,'The Six Mistakes Executives Make in Risk Management' (2009). *Harvard Business Review, October 2009,* pp 78-81. *(*Accessed 14 January 2021)

[20] Consolidated version of the Treaty on European Union [2008] C 115/13 (TEU), Art. 5(1)

Centralisation within the EBU and within the EU on a broader scale, is a key topic sparking debate about arising conflicts of interest between SIIs, European citizens and EU institutions. It is the fear of sacrifices in national sovereignty, and a sense of losing domestic financial belongings, that frustrates vast parts of the population in EU MSs. Furthermore - regarding nations as organisms made of their own fabric - it is worth reminding that, according to the Lindy-effect, what has been around for a long time is expected to live on by that same timespan in addition to its past.[21]

As Margaret Thatcher famously said during a lunch at the Hoover Institution in 1991, in which she contrasted European nations with the United States: "[T]hey are the product of history and not of philosophy. You can construct a nation on an idea; but you cannot reconstruct a nation on the basis of one. Political institutions cannot be imposed if they are to endure. They have to evolve and they have to command the affection, loyalty and respect of populations living under them, and they have to be accountable to the people."[22]

She seemed to have foreseen the conflict mentioned above, and acknowledged that each nation tends to grow at its own pace, as they have done in the past. Attempts to impose a single form of governance on top of countries will thus undeniably lead to friction. A sense of involuntary delegation of powers, as well as increasing bureaucratisation, have led to a style of governance within the EU that is perceived as anonymous and distant.[23] The result is an increase in popular fear and disdain for existing supranational legislation. Governments may arise in which an emphasis on authority, territory and citizenship - which are in themselves requirements for sovereignty[24] - takes hyperbolic proportions, resulting in more autocratic leadership and stronger opposition to international cooperation. The result is a further distortion in the balance between national sovereignty and harmony on a European level.

Similar concerns apply to the financial system in the shape of euroscepticism.[25] This scepticism largely attributable to fiscal imbalances that arose as a consequence of national rescue packages (see section III), as well as fiscal transfers considered problematic at the domestic level.[26] Moreover, recent history has demonstrated that financial developments in the United States tend to reach Europe in an exacerbated form. It is therefore relevant to keep in mind developments in the United States, while acknowledging the additional risks in centralised decision-making that Europe faces due to the delicate inner fabrics of its nations.

## Theological Relevance

For millennia, civilisations have sought religious guidance in application to the economy in order to trade and flourish. Early documentations on conceptions of money date back to Mesopotamia, Sparta and ancient Greece.[27] Initially, money was literally coined out of precious metals, and its availability often expanded through increased access provided by wars and conquests. Back then, coins still carried an intrinsic value. Over time, this has proven detrimental to the stability and well-being of states, for money itself tended to

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[21] Nassim N Taleb, *Skin in the Game: Hidden Asymmetries in Daily Life* (2018). Random House, New York. ISBN: 978-0-425-28464-3 (*Skin in the Game* (Taleb, 2018), p. 141

[22] Margaret Thatcher, Speech at Hoover Institution Lunch (8 March 1991). Four Seasons Hotel, Washington DC. Retrieved from <https://www.margaretthatcher.org/document/108264> Accessed 10 August 2021

[23] Kantar, 'A Glimpse of Certainty in Uncertain Times' (2021). Eurobarometer Survey 94.2 of the European Parliament, A Public Opinion Monitoring Study. <https://www.europarl.europa.eu/at-your-service/files/be-heard/eurobarometer/2020/parlemeter-2020/en-report.pdf> Accessed 10 August 2021

[24] Ton van den Brink, Michiel Luchtman and Mira Scholten, *Shaping Sovereignty in the EU Legal Order: The Role of Core Values* (2015), pp 325-334. Interstentia. ISBN: 978-1-78068-219-8

[25] Peri Bazoti, 'The missing European Deposit Insurance Scheme' (2020). Region & Periphery, 0(9), 151-158. DOI: <https://doi.org/10.12681/rp.23789> (Accessed 22 March 2021) (Bazoti (2020))

[26] Ibid

[27] Alexander Del Mar (Formerly Director of the Bureau of Statistics of the United States), *A History of Money in Ancient Countries, from the Earliest Times to the Present* (1885). George Bell and Sons, London (digitalised by Google in 2014. Retrieved from <books.google.nl> Accessed 15 August 2021

become the object of desire.[28] This is one of the dangers warned about by all three major monotheistic religions.[29] The financial system itself, as we know it today, has been around for approximately 5000 years,[30] with current interest rates at an all time low.[31] Interest is referred to as usury in sacred texts, and has frequently been scrutinised and labelled exploitative in nature. Some 500 years ago[32], however, exceptions to this standard were allowed, and restrictions were partially lifted, on the basis of compensation for losses.[33] These losses translate themselves into foregone investment opportunities (opportunity costs), in contrast to interest as a means of profiting. This concept of interest as a form of compensation has remained the justification for interest payments on loans, and the ability of banks to channel funds more effectively than the market itself justifies its profits (rather than raising interest rates to an excessive level).[34]

As the source of the Banking Crisis that hit Europe can be traced back to the United States, it is sensible to zoom into the mistakes that occurred over there. Interestingly, hardly any US laws were broken in 2008, as Friedman & Friedman have concluded. In contrast, six applicable business ethics according to Talmud, so they argue, have been violated.[35] Based on plenty examples of such violations, the conclusion was drawn that the GFC of 2008 could have been prevented.

In light of the mismatch between religious doctrine and official laws as mentioned above, it is even more important to know whether or not the substance of and procedures in the EBU follow a logic, i.e a consciousness of natural law, if the banking system in the EU is to be just and sustainable over time. The example set by Friedman & Friedman has shown that what is legally allowed may very well be immoral based on natural law. If this mismatch is not addressed, past mistakes in finance may repeat themselves. St. Thomas Aquinas answers on whether or not law binds man in conscience, and argues that just laws have the ability to do so, whereas unjust laws do not. In *Summa Theologiae*, he answered the following regarding unjust laws: "[l]aws may be unjust in two ways: first, by being contrary to human good, through being opposed to the things mentioned above---either in respect of the end, as when an authority imposes on his subjects burdensome laws, conducive, not to the common good, but rather to his own cupidity or vainglory---or in respect of the author, as when a man makes a law that goes beyond the power committed to him---or in respect of the form, as when burdens are imposed unequally on the community, although with a view to the common good."[36] With "mentioned above", he responds to objections to the idea that law binds man in conscience. Just laws should be aligned with eternal religious principles in his view.

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[28] Ibid, pp 335-345

[29] Susan S Case & Edward Chavez, 'Guiding lights for morally responsible sustainability in organizations: Revisiting sacred texts of Judaism, Christianity, and Islam' (2017). West Palm Beach, *Journal of Organizational Psychology*, *17*(2), 35. <http://www.na-businesspress.com/JOP/CaseSS_17_2_.pdf> Accessed 25 August 2021 (Case & Chavez (2017))

[30] Niall Ferguson, 'The Ascent of Money' (2016). Carnegie Council for Ethics in International Affairs (Describing the like-titled book by Niall Ferguson & Joanne J Myers, *The Ascent of Money, A Financial History of the World* (2008)). <https://www.researchgate.net/profile/Niall-Ferguson/publication/44286015_The_Ascent_of_Money_A_Financial_History_of_the_World_N_Ferguson/links/57069b3708ae04e9708c0847/The-Ascent-of-Money-A-Financial-History-of-the-World-N-Ferguson.pdf> Accessed 22 August 2021

[31] Steve Goldstein, 'Interest rates haven't been this low in 5,000 years' (last updated 30 July 2021). <https://www.marketwatch.com/story/interest-rates-havent-been-this-low-in-5-000-years-11627644496> Accessed 5 August 2021

[32] The Editors of Encyclopaedia Brittanica, 'Usury (law)' (1998). 20 July 2021. Britannica, Economics & Economic Systems. Last updated on 13 April 2018 <https://www.britannica.com/topic/usury> Accessed 20 August 2021

[33] Sylla Homer & Richard Eugene Sylla, *A History of Interest Rates* (Rutger University Press, 1996) pp 71-73. ISBN: 0813522889 or 9780813522883. Available at <books.google.com> Accessed 23 August 2021

[34] Ibid

[35] Hershey H Friedman & Linda W Friedman, 'The Financial Meltdown of 2008: The Perspective of Jewish Law' (2009). DOI: http://dx.doi.org/10.2139/ssrn.1419537 (Friedman & Friedman (2009))

[36] St. Thomas Aquinas, *Summa Theologiae* (Written 1265-1273, First Published in 1485, Benzinger Bros. edn 1947, translated by Fathers of the English Dominican Province). The Thomistic Institute <https://aquinas101.thomisticinstitute.org/st-index> Accessed 15 August 2021, Treatise on Law, Q.96 (4) Of the Power of Human Law

It is imperative that certain principles on which our Judeo-Christian civilisation was built are observed, if we are to uphold a financial system that serves society and the real economy, instead of the other way around. These principles allowed financial systems to function for millennia (further explained in Section III). This requires a deep understanding of the (sinful) behaviours that led to the previous crisis, and finding a balance in regulations that are effective, and also have moral legitimacy from the perspective of MSs. In that light, the works described above are more than relevant. Although the concept of externalities has a place in existing regulatory models, externalities tend to describe the undesirable effects of economic activity, whereas sins/bad behaviour describes acts that are immoral by default.

# III. Related research and connection to existing literature

### Risk assessment of Global Systemically Important Banks

Our analysis critically assesses the consensus on which the EBU was created, and aims to understand the mechanics behind the European banking system. Existing literature points at the importance of having a Banking Union to ensure that systemic risks of a financial system, with the Euro as its currency, are contained.[37] With the aim of reducing systemic risk often mentioned as an incentive for more centralisation, changes in risks and risk attitude become the eye-catcher for academic inquiry. Previous literature has shown that a Negative Deposit Facility rate, meaning that central bank interest rates are below zero, has contributed to an increase in the percentage of risky assets held, even more so for systemically important banks.[38] Their findings were based on a difference-in-difference regression with data from the Euro Area Securities Register. Most-importantly, a 'Reach for Yield' was found among large banking groups, which is an attempt to maximise the yield to maturity on assets. Evidence from Marapin supports the view that QE increases risk-taking.[39] Brunnermeier et al. found that non-interest income contributes towards systemic risk in the interconnectedness category for both large and midsize banks. Furthermore, non-performing loans and high leverage were found to increase systemic risk.[40] This is relevant as banks were found to increasingly derive income from non-interest activities.

After the first year of conducting QE in the Eurozone, warnings were already raised about the side-effects of this monetary policy, including the inflation of bank balance sheet values, propensity to create financial bubbles and the crowding out of its desired effect on target inflation, based on Eurostat statistics.[41] This is relevant, because centralised supervisory and resolution schemes are intended to support credit institutions, with particular attention to large banks, that are required to adhere to higher standards of prudence and conservative behaviour than others, and are among the main recipients of QE. Extra stringent requirements for G-SIIs are set out, for example, in the Capital Requirements Regulation (see introduction). Requirements for Global Systemically Important Banks are set out by the Basel Committee.[42]

### Concentration and stability in banking systems

Before diving into the legal setup of the EBU, it is important to know that several hypotheses exist surrounding the relationship between market concentration in the banking sector and systemic stability. Deltuvaité analysed this relationship, thereby testing which of the following three hypotheses was most relevant: H.1 concentration-stability relationship, meaning that increased concentration improves stability. H. 2 concentration-fragility relationship, meaning that increased concentration deteriorates the stability of the financial system, and H. 3, that there is no concrete relationship between the two.[43]

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[37] Bazoti (2020)

[38] Johannes Bubeck, Angela Maddaloni, José-Luis Pey, 'Negative Monetary Policy Rates and Systemic Banks' Risk-Taking: Evidence from the Euro Area Securities Register' (2020). <https://repositori.upf.edu/bitstream/handle/10230/44213/Negative_Rates__2nd_R_R__JMCB_WP_Series.pdf?sequence=4&isAllowed=y> Accessed 14 January 2021 (Bubeck and others (2020)

[39] Rajendra Marapin, 'Does Monetary Policy Affect Bank Risk-taking? An Empirical Study of U.S. Banks Following The 2008 Financial Crisis' (MSc Thesis, University of Groningen 2017)

[40] Markus K Brunnermeier, Gang Dong, and Darius Palia, 'Banks' Non-Interest Income and Systemic Risk' (2019). Review of Corporate Finance Studies (2020), 9(2):229-255. DOI: <http://dx.doi.org/10.2139/ssrn.3328890> (Brunnermeier and others (2019))

[41] Frank van Lerven, 'Quantitative Easing in the Eurozone: a One-Year Assessment' (2016). Intereconomics, Volume 51, 2016 · Number 4 · pp. 237–242 <https://www.intereconomics.eu/contents/year/2016/number/4/article/quantitative-easing-in-the-eurozone-a-one-year-assessment.html> Accessed 20 January 2021

[42] B Mesnard, A Margerit, M magnus, and C Katopodi, 'Global Systemically Important Banks in Europe' (2017). PE 574.406, European Parliament Directorate-General for Internal Policies Economic Governance Support Unit. <https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/574406/IPOL_BRI(2016)574406_EN.pdf> Accessed 26 March 2021

[43] Vilma Deltuvaité, 'The Concentration-Stability Relationship in the Banking System: An Empirical Research' (2010). Kaunas University of Technology, ECONOMICS AND MANAGEMENT: 2010. 15 pp 900-909. ISSN: 1822-6515. Available at Researchgate <https://www.researchgate.net/publication/228586766> Accessed 25 May 2021 (Deltuvaité (2010))

Based on a sample with data from 160 countries from the period of 1987-2007, as well as 47 crises in 37 countries from 1977 till 1998, a regression analysis has been conducted by Deltuvaité on the relationship between concentration and stability in banking systems.[44] Based on a linear, logarithmic and hyperbolic regression he found the strongest support for H.1, and in addition, concluded that a negative relationship between concentration and occurrence, as well as costs of crises, exists. The linear regression delivered the most accurate results, and showed that controlling for inflation as a contributor for rising borrowing costs as a result of increased interest rates, can mitigate risk-taking in case of an economic downturn.[45] Based on that, pro-cyclicality seems to cancel out some of the toxic behaviour of large banks in rich countries. In that light, the monetary policy of Quantitative Easing rightfully deserves scrutiny.

What distinguishes past crises form the last GFC, is the subsequent monetary policy that followed. Instead of temporary monetary expansion followed by higher interest rates, expansionary monetary policy has been applied 'all the way' to largely cope with the fiscal debts incurred both in the United States and European countries, and still has not ended as QE continues. The De Larosière report's emphasis on anti-cyclical stabilisation efforts are thus in contradiction with the idea of moderation through pro-cyclical policies in the light of Deltuvaité's findings. It remains to be seen what amount of stability is left in a highly concentrated banking sector without a pro-cyclical approach, and whether a comprehensive resolution and supervisory scheme, coupled with QE, replaces solutions that require a less interventionist approach. One can only hope the banking system does not become overly complicated (more on complexity under the 'Incerto' header somewhat below).

Deltuvaité's decision to interpret a linear regression as the most meaningful one is questionable at best. One of the flaws in Basel II that was corrected for in Basel III was the assumption that a linear relationship exists between size and risk,[46] an assumption that seems unrealistic given the strong correlation between losses and returns, which has been identified as a major source of systemic risk, attributable to balance sheet composition.[47] Interconnectedness amplifies the risk associated with large banks, and thus large, highly interconnected banks carry a systemic risk that is exponential vis-à-vis smaller ones.

This is relevant given the vast concentration of assets in this sector. Huettl & Schoenmaker found that at the end of 2014, the largest 25 banks (all G-SIIs) in the EBU owned a share of 42.2% of the Eurozone banking sector, equal to around €17.34 trillion. In contrast, the largest 10 non-member banks owned 2.9%.[48]

With regard to accurate stress-testing - another justification used for more centralisation of oversight - the ECB has conducted an inquiry into the coverage ratio for the European Deposit Insurance Scheme, such that a crisis would not require a transfer of funds from one MS to another. The main conclusion reached was that a fully funded deposit insurance would cover crises even worse than the one in 2007-2008.[49] Yet, in the words of Nassim Taleb: "One, we have an abysmal record of predicting Black Swan events. Two, by focusing our attention on a few extreme scenarios, we neglect other possibilities. In the process, we become more vulnerable."[50] Therefore, caution is required when attempting to predict and manage systemic risks.

## Accountability

Accountability is one of the most important aspects of any individual or organisation when it comes to delivering on promises. Regarding accountability in EU-agencies, previous literature has shown that oftentimes there is a trade-off to be faced between accountability and autonomy. As discussed by Scholten, it is not necessarily the tasks and competences of an agency that determines the ability to be held accountable.

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[44] Ibid

[45] Ibid, p. 903

[46] Péter Endre Kovács, 'Basel III: operational risk in banking' (1 October 2018). Finalyse <https://www.finalyse.com/blog/basel-iii-operational-risk-in-banking> Accessed 20 June 2021

[47] Vincent BY Gan, 'Banking Balance Sheet Channel of Systemic Risk' (2015). Journal of Risk Analysis and Crisis Response, Vol. 5, No. 1 (April 2015), 16-30 (Gan (2015)

[48] Huettl & Schoenmaker (2016), pp 100-103

[49] Ibid supra n. 6, p. 3

[50] Ibid supra n. 19 (Nassim N Taleb), p.1

Rather, it is the independent position some agencies enjoy that causes a potential dilemma that needs to be protected against. The degree of independence an agency enjoys is defined as fourfold: *institutional*, *functional, personal*, and *financial* independence.[51] Through this lens, an analysis was applied to the *de jure* accountability of three agencies that are autonomous legal entities, in succession of previous Lamfalussy-committees: the European Banking Authority, the European Investment and Occupational Funds Authority and the European Securities and Markets Authority.[52] One example of increased *de jure* accountability requirements vis-à-vis their predecessors is the obligation to send direct reports towards the European Council and European Parliament.[53] Previously an indirect route was chosen, in which the Commission acted as an intermediary.[54]

As much as *de jure* accountability seems to have improved, it is emphasised that *de facto* accountability can strongly deviate from this trend.[55] Evidence shows that accountability is in practice often compromised by political motives, with reports being more descriptive than analytical, thereby missing out on flaws in agencies.[56]

The abovementioned applies to agencies like the EBA, which have competences on the horizontal level. The EBU, though not a separate legal entity nor an agency, interacts with the EBA and exercises power on the vertical level, enjoying a significant degree of autonomy.[57]

## The importance of precedent in EU law: Meroni and Romano

As aristocratic historian Erik Ritter von Kuehnelt-Leddihn once formulated: "[T]raditions which have slowly grown and finally achieved organic status - institutions which are generally considered to be integral parts of a cultural pattern - should not be lightly sacrificed if they undergo a crisis, or even though they may be useless or oppressive for the moment."[58] Article 5 TFEU for example, fits such a tradition in the EU. And the UK House of Parliament is an example of an institution with organic status, like many other national parliaments.

In light of traditions that have achieved organic status, EU-institutions and agencies largely derive their legitimacy from the degree to which established precedent is observed. Case 9/56 was of particular importance in this respect, and led to the establishment of the *Meroni* doctrine. Its core message was that bodies in Brussels must act within clearly specified limits to prevent arbitrary decision-making. "[A]ny procedure for assessment by a body on its own authority and for provisional estimates must be subject to precise rules so as to exclude any arbitrary decisions and to render it possible to review the data used.

A delegation of powers cannot be presumed, and even when empowered to delegate its powers the delegating authority must take an express decision transferring them."[59] The judgement in that case has become the standard ever since, against which future delegation to the European Community, and later to the EU, would be measured.

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[51] Mira O Scholten, 'Independent, hence unaccountable? The need for a broader debate on accountability of the executive' (2011). Review of European Administrative Law, 4(1), 5-44. DOI: https://doi.org/10.7590/REAL_2011_01_02

[52] Ibid

[53] Mira O Scholten & Annetje Ottow, 'Institutional Design of Enforcement in the EU: The Case of Financial Markets' (2014). *Utrecht Law Review*, 10(5), pp.80–91. DOI: http://doi.org/10.18352/ulr.302

[54] Ibid

[55] Ibid supra n. 51

[56] Ibid supra n. 51

[57] Stefano Cappiello, 'The interplay between the EBA and the Banking Union' (2015). EUI RSCAS, 2015/77 Retrieved from Cadmus, European University Institute Research Repository, at: <http://hdl.handle.net/1814/37378> Accessed 20 June 2021 (Cappiello (2015))

[58] Erik Ritter von Kuehnelt-Leddihn, *Liberty or Equality, The Challenge of our Times* (First published in 1952, Ludwig von Mises Institute, 2008 edn). ISBN: 9-781610-160308. p. 177 (*Liberty or Equality* (Kuehnelt-Leddihn, 1952)

[59] Case 9/56 *Meroni v High Authority* [1958] ECR 133 (ECLI:EU:C:1958:7)

Another important case is that of *Giuseppe Romano* v *Institut Nationale d'Assurance Maladie-Invalidé*, C-89/80 from 1980.[60] This case concerned the interpretation of a decision by the Administrative Commission to oblige the usage of a specific method in calculating social security benefits to migrant workers. In §1 of its judgement the Court ruled as follows:

"1. [W]hilst a decision of the Administrative Commission of the European Communities on Social Security for Migrant Workers may provide an aid to social security institutions responsible for applying Community law in this field, it is not of such a nature as to require those institutions to use certain methods or adopt certain interpretations when they come to apply Community law. Decision No 101 of the Administrative Commission does not therefore bind national courts."[61] The decision clarifies that there are boundaries which the Commission is not allowed to cross in solving problems that do not have a community dimension. Among scholars, the judgement in that case, in combination with the judgement in *Meroni*, is known as the 'non-delegation' doctrine.[62] Kozina et al. identified the institutional balance of powers as the most important objective of these two cases.[63]

Scholten & van Rijsbergen found that the process of 'agencification' required the established Meroni and Romano doctrines to be put aside, or at least to be diluted.[64] It is highlighted that the creation of agencies in the European System of Financial Supervision, in response to the financial crisis of 2008 went directly against the Romano doctrine due to its creation without receiving approval from national competent authorities.[65] It also puts the Meroni doctrine under pressure, due to the discretionary powers given to those agencies, one of which is the European Banking Authority (more on that in section V). It must be said that the Meroni doctrine applies to agencies, and thus not the ECB in its capacity as supervisor.[66]

## Talmud and the Global Financial Crisis

Having covered secular legislation, we move to religious principles. Regarding the financial system in light of religious law, Friedman & Friedman conclude that an abandonment of Jewish principles were largely responsible for the missteps that led to the meltdown in 2008. Hereby, attention is drawn to the notion that in each branch of the economy and government involved, participants failed to even remotely approach the Jewish standards of decent business conduct.[67] Examples include stories of individuals with an income worth $14,000 to purchase $750,000 homes. It is mentioned that luring such poor people (in a state of financial disadvantage and with asymmetric information) into such lucrative mortgages that cannot reasonably be repaid, is sinful. On top of that, the inability of the borrower to repay debt, constitutes a sin in itself.[68] There are six relevant business principles discussed in their work, which stem from *halacha (Jewish law)* and can be found in the Talmud, which are as follows: Absence of: misleading with bad advice ('lifnei iver');

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[60] Ana Kozina, Stefan Martinić & Vedrana Mihalić, 'The delegation of Executive Powers to EU agencies and the Meroni and Romano Doctrines' (2017). Pravnik 51, 1 (102), 2017. UDK: 339.923:061.1](4)EU (Kozina and others (2017))

[61] Case 98/80 *Romano v Inami* [1981] ECR 1241 (ECLI:EU:C:1981:104)

[62] Mira O Scholten & Marloes van Rijsbergen, 'The Limits of Agencification in the European Union' (2014). German Law Journal, December 2014, Vol. 15(7):1223-1256. DOI:10.1017/S2071832200019350 (Scholten & van Rijsbergen (2014))

[63] Kozina and others (2017)

[64] Scholten & van Rijsbergen (2014)

[65] Ibid

[66] Argyro Karagianni & Mira O Scholten; 'Accountability Gaps in the Single Supervisory Mechanism (SSM) Framework' (2018). *Utrecht Journal of International and European Law*, 34(2), pp.185–194. DOI: http://doi.org/10.5334/ujiel.463 (Karagianni & Scholten (2018))

[67] Friedman & Friedman (2009)

[68] Ibid, p. 5

deception and fraud ('geneiva da'at'); bribery ('shochad devarim'); conflict of interest; presence of: honest weights; transparency.[69]

Besides that, there are two principles considered fundamental for an economy to succeed, as referred to in the Talmud. According to Case & Chavez, Kehila (meaning 'community') is one of the two Jewish principles considered fundamental in an economy in which business is conducted to the improvement of the economy as a whole.[70] Consequently, not only (short-term) added shareholder-value is considered, but also the improvement of living standards of society, and treatment of workers with dignity. The last GFC has shown what a subset of powerful banks in a highly concentrated industry can bring about, when mere short-term remuneration and shareholder-value is considered. This has proven particularly cumbersome in an industry that serves as the cornerstone of the economy, powerful enough to collectivise its losses. Kehila is thus a relevant principle to assess the presence (or absence) of an important social constraint.

The second principle considered fundamental for an (capitalist) economy to succeed, is Emet (meaning 'truth'). This is applicable to relationships, and hence to business ethics as well.[71] To prevent another episode of large-scale violation of business ethics through lifnei iver, shochem devarim and geneiva da'at from happening, the EBU requires safeguards upholding honesty and truth, otherwise lack of trust becomes a *Tantalus torment* for the remainder of the economy.

## Insights from *Incerto* (works from Nassim N Taleb)

### *I. Ergodicity: the EBU and tackling Anti-competitive feedback loops*

Key to a level-playing field in the banking sector, and moreover in the economy as a whole, is the equality of opportunity for newcomers versus incumbent firms. One of the causes of a system to be non-ergodic is the presence and persistence of powerful established economic players at the top, that are intertwined. An example of a non-ergodic situation is a single player who repeatedly plays Russian roulette, which will at some point be fatal.[72] Ergodicity in this context thus refers to the expectation of equal outcomes in the future through repeated exposure, when a sample is expanded over time. "[T]he central problem is that if there is a possibility of ruin, cost-benefit analyses are no longer possible.", with 'ruin' being the result of non-ergodicity.[73] Therefore it is vital that interconnectivity between G-SIIs is addressed by the EBU, for the alternative is a feedback-loop in which powerful, interconnected banks capture more market share, thereby leading to further interconnectivity. Where Too-Big-To-Fail problems persist, excessive risk-taking will be the norm, as it has been before. This is an example of the Peltzman-effect, named after Chicago School economics professor Sam Peltzman.[74] The systemic risks that arise as a consequence are difficult to precisely estimate, yet again, non-linearity is safe to assume (Also in light of Antifragile by Taleb).

### *II. Lindy-effect*

As briefly touched upon in the introduction, the reader has come across the Lindy-effect several times. It is a term explained into detail by Taleb in his works, particularly in *Antifragile* and *Skin-in-the-game.* The term itself underpins the historical importance of principles and developments in nations and systems, which tend to outweigh short-term developments and trends, including but not limited to law. Including this perspective in our analysis allows us to put developments in the EBU and the banking system it deals with into a timespan of millennia. It is in light of this effect that religious scripture comes into play, as well as historical laws. The Lindy-effect describes the theory that something which has been around for long, for example

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[69] Ibid

[70] Case & Chavez (2017)

[71] Ibid

[72] *Skin in the Game* (Taleb, 2018), pp 225-226

[73] Ibid, p. 225

[74] TradeSmith Research Team, 'The Peltzman Effect: How Safety Perception Increases Risk' (15 May 2019). TradeStops. <https://tradestops.com/blog/the-peltzman-effect-how-safety-perception-increases-risk/> Accessed 18 September 2021

3000 years, is expected to continue its existence for another 3000 years.[75] For all of the subquestions, but particularly so for the first three, emphasis is put on developments in the European banking system and its supervision in the context of established legal doctrine as well as Jewish and Christian principles. Whether the EBU is well-grounded in these two will determine if the EBU is here to stay, or if it is a matter of trial-and-error.

### *III. Black Swan*

A black swan is defined as an event so unlikely that it cannot meaningfully be predicted. Its occurrence has such high impact that fragile systems tend to collapse as a consequence. Black swans tend to be hidden at the tails of a statistical distribution.[76]

### *IV. Antifragility*

In his book *Antifragile,* Taleb points out that many of today's man-made systems are vulnerable to Black Swans. He refers to this vulnerability as *fragility.*[77] One of the aspects of fragility is that it is non-linear, and tends to exponentially increase with size of an object/system.[78] Another dimension in which fragility increases exponentially, is with the increase in complexity. Complexity can manifest itself in many ways, and is often demonstrated in the interplay between law and economics. An example described is the increased number of traffic rules in many Western countries, which seem to have negligible effect on accident rates.[79] By obscuring relevant details, complexity should be regarded as a source of systemic risk, the Devil is in the details. *Antifragile* systems, on the other hand, are those that grow stronger from crises, and tend to have a history of consistency with the Lindy-effect. For the sake of antifragility, religious principles as discussed above matter in banking, and ideally our research contributes to making the banking system in the EU antifragile.

### *V. Skin-in-the-game*

Skin-in-the-game, a term coined by Nassim Taleb, describes the willingness to hold oneself accountable for one's actions.[80] In the case of banks, this applies on two counts: the willingness of bank's shareholders to accept losses due to risk-taking as much as the gains, and secondly, the ability to credit bankers and hold managers accountable, not just for gains but also for losses. On the regulatory side, it means that agencies, institutions and personnel shall be held accountable for their policies.

## A note on the Sovereign-Bank nexus and monetary policy of the ECB

The relationship between fiscal balances and banking resolution has proven to be one of the main challenges in banking resolution in the Eurozone. When the GFC reached Europe, several Member States stepped in to save their banks at the national level, resulting in significant fiscal imbalances. At the end of 2011, Greece was on the brink of national bankruptcy after adopting national rescue packages for its domestic banks. As a result of the required interventions, the 10-year spread on Greek sovereign debt peaked at about 16%[81], and there are even sources claiming the interest rate on 10-year government bonds peaked at 35%.[82] This is likely

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[75] *Skin in the Game* (Taleb, 2018), Chapter 8

[76] Nassim N Taleb, *Antifragile, Things that gain from disorder* (2012). Random House, New York (2016 Random House Paperback edn). ISBN: 978-0-8129-7968-8 (Part of the *Incerto* series, ISBN: 978-0-399-59045-0) (*Antifragile* (Taleb, 2012)), pp 6-7

[77] Ibid

[78] Ibid, Chapter 18

[79] Ibid

[80] *Skin in the Game* (Taleb, 2018)

[81] Roberto A De Santis, 'The Euro area sovereign debt crisis: safe haven, credit rating agencies and the spread of the fever from Greece, Ireland and Portugal' (2012). ECB Working Paper, No. 1419, European Central Bank (ECB), Frankfurt a. M. <https://www.econstor.eu/bitstream/10419/153852/1/ecbwp1419.pdf> Accessed 10 September

[82] Greece recorded a Government Budget deficit equal to 9.70 percent of the country's Gross Domestic Product in 2020. source: National Statistical Service of Greece. Obtained through <https://tradingeconomics.com/greece/government-budget> Accessed 20 September 2021

one of the most notorious examples of the 'Sovereign-Bank' nexus, but other European countries have faced this problem as well. The 'Sovereign-Bank' nexus describes the relationship between national governments' fiscal policies and interventions in the financial sector, particularly in crisis situations. This relationship has been referred to as one the main obstacles in combatting systemic risks, as nations tend to resort to regulatory arbitrage to provide the most lenient conditions for domestic banks. Scholars such as Bazoti argue that the euro can only function as a currency under the Banking Union once the latter has been completed.[83]

Shortly after the events mentioned above, Quantitative Easing became the new monetary policy of the ECB, as briefly touched upon in the introduction. In its Asset Purchasing Programme, the ECB has bought €3207 billion of private and public sector assets, including Asset-Backed Securities and Covered Bonds.[84] These are assets with a collateral, and in case of securities, are readily marketable. The aimed objectives of this programme is i) Direct pass-through, which means direct purchase of private assets, ii) Portfolio rebalancing, which means investors re-evaluate their portfolios and shift towards the categories of assets that are also bought by the ECB and thus the NCBs, iii) Signalling, as the programme should signal ECBs aim of an inflation rate of 2%.[85] This rate dates back to the very first days of the European Central Bank's existence, and is in line with the Stability and Growth Pact.

The first version of the Stability and Growth Pact (SGP) was agreed on in 1996, and set out targets for budget and GDP growth for member states, as well as responses during a "serious economic setback".[86] The target for budget deficits was set at 3% under normal economic conditions. Any decline of more than 2% in GDP in one year is considered a serious economic setback. The pact applies to all members of the Economic and Monetary Union, and is based on a consensus that inflation stems from excessive national fiscal deficits. It is the same consensus that led to the Maastricht Treaty in 1991, Bofinger argued.[87] Two years later, in 1998, the European Central Bank was established in light of that pact.[88] Ever since, its main objective has been price stability, with a medium target inflation rate of 2%. In order to function, it has been highlighted time after time that national budgets should comply with the monetary policy based on nominal interest rates set by the ECB. Hence the attitude desired by the ECB vis-à-vis MSs seems to be 'adapt and overcome'.[89] Moreover, any deviations from the inflation targets above can lead to sanctions by the ECB, even if the budget deficit requirements have not been violated.[90] It is clear from the analysis who takes the lead in monetary matters, yet the spill-over effects of this centralised control on fiscal policy come to light as well. It is therefore surprising that no mention of this effect was given in the SGP, the author notes.[91] Despite this seeming friction between national fiscal policies and an 'independent' central bank, the euro was credited with its ability to maintain value at a time of corporate scandals, terrorism and " …[b]alance sheet problems

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[83] Bazoti (2020)

[84] European Central Bank, 'Asset Purchase Programmes' (last updated November 2021) <https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html> Accessed 20 September 2021

[85] European Central Bank, 'How does the ECB's asset purchase programme work' (22 January 2021, last updated 25 August 2021). <https://www.ecb.europa.eu/explainers/tell-me-more/html/app.en.html> Accessed 20 September 2021

[86] Manfred Gärtner, *Macroeconomics.* Pearson Education, Harlow (First published in 1997, 5th edn published in 2016). ISBN: 978-1-292-11520-7, pp 363-364

[87] Peter Bofinger, 'The Stability and Growth Pact Neglects the Policy Mix between Fiscal and Monetary Policy' (2003). Intereconomics January/February 2003 Forum:' Should the European Stability and Growth Pact be Changed', pp 4-7 <https://www.uni-wuerzburg.de/fileadmin/12010100/Publikationen/Bofinger/Beitraege_in_Fachzeitschriften/The_stability_and_growth_pact_neglects_the_policy_mix_between_fiscal_and_monetary_policy.pdf> Accessed 3 September 2021 (Bofinger (2003))

[88] Ibid

[89] Ibid

[90] Barry Eichengreen, 'What To Do with the Stability Pact' (2003). Intereconomics January/February 2003 Forum: 'Should the European Stability and Growth Pact be Changed', p.7 <https://www.uni-wuerzburg.de/fileadmin/12010100/Publikationen/Bofinger/Beitraege_in_Fachzeitschriften/The_stability_and_growth_pact_neglects_the_policy_mix_between_fiscal_and_monetary_policy.pdf> Accessed 3 September 2021 (Eichengreen (2003))

[91] Ibid

for a growing number of European banks …".[92] This finding indicates that a mismatch between optimism about the single currency and increasing financial problems existed as early as 2002. Moreover, the enormous expansion of securities markets and access to sub-investment grade companies was well received, as a means of stimulating the backbone of the economy.[93]

One might wonder when will be the last time such a message is given, and how effective QE of the euro really is at improving economic growth and sound banking. Monetary policy and its influence on the sovereign-bank nexus are vital for all subquestions, but particularly for subquestion three, on accountability, and four, on risk indicators.

## CDS spreads

Developments within the European Banking Union have been subject to previous quantitative research, in which different 'steps of the way' have been included. Hahn et al. have analysed 34 key events involving the EBU, with emphasis added onto the SRM.[94] Their multivariate regression method focused on the influence on stock returns and Credit Default Swap spreads. CDSs are derivatives used to hedge risks of default, for example on debt obligations from banks.As the EBU is intended as a bail-in-regime, meant to eliminate Implicit Government Guarantees (IGGs), the authors expected a reduction in stock profits and an increase in CDS spreads, meaning the CDS market is less liquid due to reduced usage.[95] The regression pointed into the opposite direction for both variables, indicating that the EBU, with its updated rescue package, had not effectively eliminated IGGs. This was particularly so for G-SIBs, which saw an average reduction of 23.53% in Senior CDS spreads, as well as 28.53% for Subordinated CDS spreads (below investment grade).[96] CDS spreads are the difference between bid and ask price on CDS markets. A smaller spread indicates more liquidity in the market, and hence more trading activity. These findings suggest two things: thus far, the EBU is not effective in achieving its proposed goals.[97] Secondly, the mechanisms in place favour the largest banks,[98], thereby increasing social-economic risk non-linearly. These findings form an important reference point for Chapter 3, demonstrating whether the findings therein rhyme or contrast with Hahn and others (2020).

## The problem of Non-Performing Loans

In the ordinary course of business, when a bank is a going concern, it derives an income out of interest payments. Macaulay's Duration Formula describes how this mechanism works by synchronising the duration of the different classes of assets with those of a firm's liabilities.[99] This means that the earned yield on assets is calibrated with the interest payments towards creditors, over the same timespan. When the duration is equal on both sides, interest-rate risk is minimised.[100] For banks to deviate from this, using a Duration Gap to achieve a specified net interest income, requires strategic management of interest-rate risk.[101] As much as

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[92] Ibid

[93] Ibid

[94] Sascha Hahn, Paul P Momtaz, and Axel Wieandt, 'Implementing a European Bail-In Regime: Do BRRD & SRM-R Effectively Eliminate Implicit Government Guarantees in the European Banking Sector? An Empirical Analysis' (October 7, 2020). Available at SSRN: <https://ssrn.com/abstract=3645298>. DOI: http://dx.doi.org/10.2139/ssrn.3645298 (Hahn and others (2020))

[95] Ibid

[96] Ibid

[97] Ibid

[98] See Taleb on non-linearity

[99] Dan Armeanu, Florentina-Olivia Bãlu & Carmen Obreja, 'Interest rate risk management using duration gap methodology' (2008). *Theoretical and Applied Economics*, *518*(1), 3-10 (Armenau and others (2008))

[100] Ibid, pp 4-7

[101] Ibid, pp 4-7

this method may appear useful in determining changes in banks' risk attitudes, we have decided to omit it as a risk indicator, as several assumptions used in the analysis by Armenau et al. are violated:
i) the method assumes that there are no defaults, prepayments, and early withdrawals.[102] The securitisation of NPLs proofs that there are large stocks of loans that are not paid back in time and rebuffs this assumption with ease.[103] ii) all securities pay equal annual interest amounts and compound.[104] Again, the securitisation of NPLs makes this assumption not credible anymore. iii) both on- and off-balance sheet effects are included.[105] This remains to be seen based on our own quantitative analysis. Our quantitative methodology takes these issues into account, as we omit both interest-income and Non-Performing-Loans and search for more reliable indicators in analysing systemic risk. The problem of underreported NPLs has been stressed by Wellens in 2020. During a presentation of his, he referred to changes in NPL definition from 30 to 90 days past due (more on that in Chapter 3).[106] Two months after the presentation, Borrelli described in Financial Times how UniCredit SpA, one of Italy's largest banks, sold off NPLs worth €1.5 billion, thereby transforming 'trashy' loans into marketable securities.[107] This was reportedly done in anticipation of a new wave of defaults related to COVID restrictions. Two-thirds of Italian SMEs were rated B to triple B, being the highest risk category according to Credit Rating Agency Cerved.[108] Moreover, UniCredit was not the first major bank making such a move: Monte dei Paschi di Siena shifted €8.14 billion of NPLs towards state-owned asset management company AMCO.[109]

In light of the above it is ambiguous that the securitisation of NPLs in Italian banks has been proposed as a solution to credit risk, a refreshing breach of 'taboo'.[110] The justifications provided for securitising NPLs are a reduction in credit costs due to credit-screening problems in the NPL-market. Furthermore, such a scheme is said to work particularly well when a government guarantee scheme is established. Besides the moral considerations of a scheme backed up by state guarantees, its results seem to serve as a very hypothetical solution at best, and a systemic burden at worst. Abolishing the assumption that banks shall be held liable for future losses is justified by the authors on the grounds that banks have otherwise less incentive to securitise debt in the first place.[111] This again, indicates a disregard for moral hazard and the social consequences of such a scheme, and suggests that it requires, almost by definition, a guarantee by the government if any guarantee is to exist. Hence, if the securitisation of NPLs serves any interest, it is likely not the public interest.

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[102] Ibid, p. 5

[103] Silvia S Borrelli 'UniCredit sells non-performing loans worth €1.5bn' (22 July 2020). Financial Times <https://www.ft.com/content/cb54d588-909b-4b89-ac3b-bd4817fd7cc0> Accessed 20 April 2021

[104] Ibid supra n. 99, p. 7

[105] Ibid, p. 7

[106] Arno Wellens, Chief Editor at 925, presentation for investment club Zwolle (11 May 2020) (Ask author for details)

[107] Ibid, supra n. 103

[108] Ibid

[109] Ibid

[110] Brunella Bruno, Giuseppe Lusignani, and Marco Onado, 'Why We Need to Breach the Taboos on European Banks' Non-Performing Loans' (2017). European Economy, Banks, Regulation, And the Real Sector. <https://european-economy.eu/2017-1/why-we-need-to-breach-the-taboos-on-european-banks-non-performing-loans/> Accessed 20 May 2021 (Bruno and others (2017))

[111] Ibid

# IV. Qualitative methodology

### Rationale behind the creation and implementation of the first two EBU pillars

To find out the rationale behind the creation of the EBU pillars , an analysis of working papers on the EBU is required. These include literature on potential advantages and disadvantages, legal articles as well as practical examples of bank resolution. Furthermore, our focus extends to court cases concerning, in particular, the power of the ECB. This qualitative analysis indicates the justifications for the EBU from within the Union's own institutions. It sheds light on the financial risks identified by these institutions and the methods used to calculate and contain them. Secondly, we analyse the legal documents behind the three pillars of the EBU. Attention will be paid to the relevant directives and regulations, as well as its implementation and transposition into the laws of MSs. This qualitative analysis follows the legal developments over time, and indicates the ease or difficulty of delegation of powers from MSs towards the European institutions and agencies involved in the EBU. Input can be found on websites of EU institutions, as well as (EU) working papers. Besides laws, court cases may identify specific moments in time, at which a need for precedent was required before (voluntary) acceptance of a law or decision.

### The role of accountability

Besides the legal developments as such, our work considers the role accountability plays in the EBU, regarding its substance and powers conferred upon it, as well as the obligations that G-SIIs have to live up to. In reference to Friedman & Friedman, we analyse the content of the EBU and the important banks it supervises through six business principles, and moral considerations of the Talmud, which, again, are as follows: misleading, deception, bribery, conflict of interest, honest weights and transparency. In addition, we analyse the extent to which Kehila applies. Based on these seven standards we evaluate to what extent Emet is observed, from which trust in the economy is derived. This is relevant for the financial system in Europe as much as that in the United States, both largely founded on the same doctrine, and whose principles have been reaffirmed by that ultimate capitalist and English pastor, i.e Adam Smith, whose work was presented shortly before the US Declaration of Independence.[112] Whereas Kehila will be added as a seventh principle in our Chapter 3, Emet will be the guiding principle for our qualitative evaluation (Section VI).

In our view, true accountability stretches beyond mere legal compliance, a kind of accountability defined by St. Thomas Aquinas as follows: moral responsibility comprising of an epistemic condition as well as a control condition. In the Summa Theologiae, he describes these two conditions as interconnected.[113] The epistemic condition refers to the state of mind of an agent, which defines whether or not an agent has free will, knows how to act based on the information available to him, whereas the control condition describes the reach of the agent's rule. [114] These two aspects and their interrelationship are relevant, if we are to know whether the governing bodies in the EBU have the capacity to act as rational decision-maker in their efforts to control the banking system. Likewise, these aspects apply to banks and determine to what extent bank managers act as rational, accountable agents. In answering the vital subquestion on the role of accountability, we compare substantive and procedural EU law with practical examples inside the European banking system. As this requires deep knowledge of the internal structure of the banking system, a qualitative interview will be conducted with Mr. Arno Wellens. He is a highly respected journalist in his field, mainly focused on tax evasion, the European Banking Union, shadow-banking as well as the future of the Euro as a currency.[115]

Our aim is to put the role of accountability in the perspective of Judaeo-Christian doctrine, stretching over approximately 5,000 years of Western civilisation. Being one of the most important thinkers in christianity, St. Thomas fits well into this tradition, as do the halachic principles. These principles are relevant, as they

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[112] Adam Smith, *The Wealth of Nations Books I-III* (1776). Penguin Classics, London (1999 edn with introduction and notes by Andrew Skinner). ISBN: 978-0-140-43208-4, p. 6

[113] Tyrone A Myers, 'Thomas Aquinas on the Conditions of Moral Responsibility' (2019). Holy Apostles College & Seminary <https://www.academia.edu/44551078/St_Thomas_Aquinas_on_the_Conditions_of_Moral_Responsibility> Accessed 26 August 2021(Myers (2019))

[114] Ibid

[115] Arno Wellens, 'Home'. <https://arnowellens.eu/home> Accessed 5 August 2021

are applied in daily life of religious people in order to strive for and maintain a sustainable life, which extends towards business conduct if consistently applied.[116]

The TBTF problem has proven to be a major source of moral hazard and social damage during the GFC. Central to the question of accountability in the EBU is whether or not moral hazard can finally be curbed, paving the way for a more equitable financial system in which IGGs and the TBTF problem are credibly brought to an end.

## Information collection

For the qualitative part, we mostly rely on literature accessible through Worldcat and Google Scholar. Our focus lays on economic and legal journals, with an accent on precedent, historical developments, and religious doctrine as well. In addition, the European Commission databases contain regulations and directives that form the basis of the EBU, and the EBA has information as well on legal decisions. Moreover, case studies and Curia provide information on court cases that shed light on the validity and functioning of supervisory and resolution measures.

Furthermore, given his knowledge and practical experience in the field of finance and the banking system, Arno Wellens is more than able to provide us with examples of *de jure* decision-making in the Banking Union, as well as *de facto* effects and implementation. He is specialised in analysing financial scandals as well as systemic flaws, hence the more suitable to include his insights.

## Qualitative plus quantitative: seeking balanced observations

The qualitative and the quantitative part of our analysis, seen together, allow us to infer the degree by which the centralisation of powers towards the EBU and the scope of its regulations affect risky behaviour by banks. The timespan of the dynamic graphs produced by the quantitative part cover the period of 2013-2020. That is, since the BCBS method for defining G-SIBs has been applied and recorded. This time period follows the aftermath of the Sovereign Debt Crisis, and coincided with the creation of the EBU[117]. In 2020, the first year in which EU MSs have been subjected to COVID-based lockdown measures, efforts have been made to complete the third pillar. So far, that has not occurred yet.[118]

## Limitations

We acknowledge that our assumption regarding non-linearity between risk and size excludes a large number of banks from our sample, which are subjected to the EBU as well. Some banks may fall below the threshold of G-SIIs and still be of considerable size and regional importance. Furthermore, the EBU has never thrown its full weight into the banking system yet, because no situation thus far required it (although there has been one case of resolution). This adds to the burden of proving its (in)effectiveness. The setup of this research thus sets the stage for future research and is not a method to seal existing consensus, challenging systemic flaws instead.

## Update following our interview

Following the interview with Mr. Wellens, we have updated some aspects of our literature review, particularly regarding the connection between monetary policy, the Stability and Growth Pact, and the Sovereign-Bank Nexus. Next, we have discovered several counts of high-level corruption, which would have escaped our attention, had the interview not taken place. Chapter 3 has become the longest chapter of our research, and for good reasons.

***A list of abbreviations and terminology can be found in Appendix 1 (p. 86)***

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[116] Case & Chavez (2017)

[117] Van Rompuy Report

[118] Balazs Koranyi, 'Europe's Insurance Deposit Scheme still years away - ECB' (18 November 2020). Reuters (Business News) <https://www.reuters.com/article/uk-eurozone-banks-ecb-idUKKBN27Y0W4> Accessed 20 March 2021

# V. Qualitative Results

## Chapter 1. Rationale behind the SSM and SRM

At the moment of writing, the European Banking Union has not been completed, as it consists of two pillars, the third one still to be implemented.[119] Two important players preceding the establishment of the EBU are the Lamfalussy Committee as well as the de Larosière group.[120] First of all, the Lamfalussy Committee was set up in July 2000 as the Council of Wise Men, guided by Baron Alexander Lamfalussy.[121] It was established with the purpose of creating a common framework within the Single Market to regulate capital and securities markets, which led to the Four Framework Directives: The Market Abuse Directive, the Prospectus Directive, the Misuse of Funds Directive (predecessor to the Anti-Money Laundering Directive) and the Transparency Directive. In order to ensure the effectiveness of these directives and subsequent law in support of these initial four, two new committees were established: the European Securities Committee as well as the Committee of European Securities Regulators. These committees operated in a four-stage process: During the first two stages, the European Parliament drafts the legislation in consultation with the two said committees. During the third stage, these committees review the drafted legislation and step in to provide recommendations and guidelines to ensure smooth implementation of new laws. At the fourth stage, the Commission provides a final review, though not legislative in itself, before implementing new legislation. These four stages are referred to as the Lamfalussy Process.[122]

### *Lamfalussy Process and binding effect*

Möllers, having analysed the mentioned four steps in detail, recognises that the differences between legal solutions and the friction that arises vis-a-vis national legislation can complicate attempts to implement them, particularly so for directives and guidelines, as they do not require a literal implementation into national law, unlike regulations. This friction has translated itself into court disputes on normative interpretations, on issues such as the validity of memoranda requirements imposed on banks in Germany.[123] He emphasises that the nature of the recommendations and guidelines, although formally described as non-binding, have been called into question and may in reality be more fit for a third category of law besides strict definitions of hard- and soft-law. The conclusion reached by Möllers is that a normative binding effect can be established. Whether a *de facto* binding effect can be established too remains harder to proof, but the legal decisions resulting from the Lamfalussy Process and its committees suggest there is a binding effect, and not least in application to banks.[124]

### *Judgement on binding effects: Case C-911/19 Fédération bancaire française v ACPR*

Investigations into this effect have been reopened in C-911/19, in which the French Banking Federation asked the CJEU to provide a preliminary ruling on the validity of EBA guidelines, which the French Prudential Control and Resolution Authority demanded compliance with. The FBF questioned the validity of these guidelines, on the premise that these soft-law instruments produced a binding effect on the national level, invoking Article 263 and 267.[125] On 15 April 2021, the Advocate General of the Court held that the guidelines could impossibly be intended to have a binding legal effect by default of their construction (§43-44 of the case), and as such, no intention of a binding legal effect should be established according to the

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[119] Ibid

[120] Marco Onado, 'Is the Larosière Proposal on European Financial Regulation on the Right Path?' (2010). The International Spectator, 45:1, 59-73, DOI: https://doi.org/10.1080/03932720903562528 (Accessed 20 May 2021)

[121] Thomas MJ Möllers, 'Sources of Law in European Securities Regulation - Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to Larosière' (2010). European Business Organization Law Review 11(3) pp 379-407 · December 2010. DOI:10.1017/S1566752910300048 Available at Research Gate <https://www.researchgate.net/publication/228126330> Accessed 16 June 2021

[122] Ibid

[123] Ibid

[124] Ibid

[125] Case C-911/19 Fédération bancaire française (FBF) v Autorité de contrôle prudentiel et de résolution (ACPR) (CJEU, 15 July 2021) Opinion of AG Bobek, paras 38-49 (ECLI:EU:C:2021:294)

traditional test to contest such guidelines.[126] Despite no formal binding effect, the Advocate-General acknowledges the circular reasoning used therein.[127] In addition, he warns of "[c]ircumstances where there is already a 'distinct escape into soft-law instruments' present in a number of new policy areas, with the banking union and financial supervision being vivid examples of that phenomenon. Within that context, it is paradoxical to see that, while the Treaty of Lisbon finally provided the Court with full default jurisdiction vis-à-vis all acts adopted by EU bodies and institutions, by abolishing the – in terms of legal protection, incomplete – pillar structure, (49) the same problem may now be replicated internally, with areas of EU action governing the behaviour of individuals being once again effectively excluded from any review, this time by the Court's own choice."[128] The preliminary judgement of 15 July 2021 sparks a contrast with the affirmative arguments issued in the AG's opinion: the EBA guidelines of 22 March 2016 could not be deemed invalid and annulled under TFEU 263.[129] Meanwhile, the negative arguments have largely been ignored, such as the circular reasoning, formal versus de facto effect. This judgement strengthens the position of soft-law instruments through a rather 'newly' created precedent.

### *De Larosière Report*

In response to the Lamfalussy Process and its track-record, especially during the Global Financial Crisis, the de Larosière group released a report addressing the shortcomings of the former.[130] One of the criticisms on the Lamfalussy Process mentioned in this report is the emphasis put on institutional convergence in a rather evolutionary fashion, in line with the *Meroni* doctrine. The report emphasises that such an approach no longer suffices.[131] It found that procedures for financial supervision were not even across Member States, and that plans to contain and resolve systemic risks of significant financial institutions were often too vague. The report provided 31 recommendations, many of which called for a broader European cooperation in containing systemic risk attributed to large financial institutions, as well as insurance companies and pension funds.[132] The recommendations identified *securitised financial products* and *Over-The-Counter Derivatives* as major contributors to the crisis, arguing that transparency surrounding these products was weak at the time. Being two major sources of hidden risk, a new supervisory mechanism was to be set up at the European level, so too serving as a benchmark for other countries facing supervisory and resolution challenges.[133] This was achieved through the introduction of the Single Rulebook in 2009.[134] Unlike the EBU, the Singe Rulebook applies to all MSs, not just those in the Eurozone.[135]

The European Economic and Social Committee submitted opinion paper on the de Larosière report ECO/259, in which it is highlighted that financial innovations as well as excess liquidity were caused by trade imbalances between China and the United States have caused the Global Financial Crisis.[136] Subsequent regulation and supervision, it is mentioned, should be used to empower the EU to combat future crises

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[126] Ibid, paras 43-44

[127] Ibid, par. 43

[128] Ibid, par. 87

[129] Case C-911/19 Fédération bancaire française (FBF) v Autorité de contrôle prudentiel et de résolution (ACPR) (CJEU, 15 July 2021) (ECLI:EU:C:2021:599)

[130] Jacques de Larosière and others, 'The High-Level Group On Financial Supervision In the EU' (2009) (Chaired by Jacques de Larosière) (25 February 2009). The de Larosière Group, Brussels. <https://ec.europa.eu/economy_finance/publications/pages/publication14527_en.pdf> Accessed 20 May 2021 (De Larosière Report)

[131] Ibid

[132] Ibid

[133] Ibid, p 25

[134] European Banking Authority, 'The Single Rulebook' (2018). EBA Regulation and policy <https://www.eba.europa.eu/regulation-and-policy/single-rulebook> Accessed 2 September 2021

[135] Uwe Vollmer, 'The Asymmetric Implementation of the European Banking Union (EBU): Consequences for Financial Stability' (2016). International Journal of Management and Economics. No. 50, April–June 2016, pp. 7–26. DOI:10.1515/ijme-2016-0009 Available at ResearchGate (Accessed 02 August 2021), p. 10 (Vollmer (2016))

[136] European Economic and Social Committee, 'OPINION of the European Economic and Social Committee on the Report of the de Larosière Group' (2009). OJ C 318/57 (Opinion paper on De Larosière)

through a counter-cyclical policy.[137] Furthermore, §5.7 questions the sensibility of trading around assets with concealed risks throughout the banking system.[138]

### Basel I: the birth of capital requirements

The first Basel accord, primarily focusing on capital requirements in an attempt to contain systemic risk, was achieved by the Basel Committee of Banking Supervision in 1988. The agreement was set up in such a way that for all assets, a weight would be attributed based on borrower's identity, with a total capital ratio of 8% for each loan.[139] The accord was reached between the G-10 countries, and, by the end of 1993, all 10 countries adhered to the requirements. This requirement has remained in place ever since, and is referred to as the Own Fund Requirements in Article 92 (1)(c) of the Capital Requirements Regulation.[140]

The Basel I Accord has been amended three times: in 1991, regarding calculation methods for capital adequacy, in 1995, to include the effects of bilateral netting on exposures. Not much later, in 1996, market risks and the effects of multilateral netting were included in the assessment procedures. With a main focus on credit risk, this agreement turned out to be of little use, and in particular, led to regulatory arbitrage in two ways: shifting funds into riskier assets within the same category to increase yield, and increase in off-sheet activity and securitisation of debt.[141]

### Basel II: a more comprehensive attempt to manage risks

The existing capital accord was replaced in 2004 by Basel II, divided into three pillars and allowing internationally active banks to use their own methodology to assess risks. Besides the initial objective to promote financial soundness, two other objectives were added: upholding competitive equality, and more comprehensive assessment of risks. One of the criticisms of this accord, which allowed the application of the Advanced Internal Ratings Based approach (A-IRB), is the power that was put into the hands of a few large banks that could afford the costly method, thereby giving them an advantage over smaller banks.[142] Furthermore, Lall found that large banks could use their own method to address undefined exposures and estimate the risks of their securities, versus the standard approach for smaller banks, exacerbating the competitive mismatch even further.[143] In order to comply with Basel II, the Capital Requirements Directive was introduced in 2007.[144] It was introduced in two stages, with most rules effective as of 1 January 2007.[145] Successive versions of the CRD have been introduced to include counter-cyclical measures against systemic risk.[146]

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[137] Ibid

[138] Ibid, par. 5.7

[139] Ranjit Lall, 'Why Basel II Failed And Why Any Basel III Is Doomed. Global Economic Governance Programme' (2009). Working Paper 2009/52. <https://www.econstor.eu/bitstream/10419/196313/1/GEG-WP-052.pdf> Accessed 20 May 2021 (Lall (2009))

[140] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 *OJ L 176/1,* Art. 92 (CRR I)

[141] Lall (supra n. 139)

[142] Ibid

[143] Ibid

[144] Marianne Ojo, 'Basel II and the Capital Requirements Directive: Responding to the 2008/09 Financial Crisis' (2016). MPRA Paper No. 70886 <https://mpra.ub.uni-muenchen.de/70886/1/MPRA_paper_70886.pdf> Accessed 25 May 2021

[145] Ibid

[146] Ibid (these counter-cyclical measures will be explained using the CRD)

### Basel III: quest for a phoenix out of the ashes

The subsequent Basel accords and history on financial crisis from the 1980s onwards have provided ample evidence on the risks related to securitisation of assets, as well as exposures through derivatives. These are two main reasons the Basel methodology is being revised over and over, and still seems to have difficulty to account for these risks in an appropriate manner. In 2010, after the GFC, the Basel III framework was agreed upon by the G-20.[147] The same pillar structure was upheld, yet credit and capital requirements tightened the Basel III framework applies to G-SIBs, and in the EU this extends to the definition of G-SIIs.[148] One of the corrections vis-à-vis Basel II is the acknowledgement that the relationship between gross income and risk exposure is not linear, and that complexity increases with size, which have both painfully been demonstrated by the GFC. Its capital requirements as well as methods to assess risks play an important role in legal harmonisation of banks in the EU, as will be demonstrated below by the Single Rulebook and the European Banking Authority.

### Single Rulebook and the creation of the EBA

Both the Lamfalussy Process and the de Larosière Report have contributed to the creation of the Single Rulebook, as has the Basel III accord. As briefly touched upon before, the Single Rulebook sets out steps and requirements to ensure a level playing field in the Single Market and harmonise legal differences between MSs. As explicitly stated, it was also meant as a step to a harmonised market for financial services.[149]

In that context, Regulation 1092/2010 from 24 November 2010 set out the requirements for a European Systemic Risk Board in response to the de Larosière Report.[150] Regulation 1093/2010 outlines the creation of the European Banking Authority, which was established on 1 January 2011 as part of the European System of Financial Supervision.[151] The EBA has the power to provide Regulatory Technical Standards, and implementation of the objectives set out in the Single Rulebook has been delegated to this ESA by the Commission. Indeed one of its core tasks is to ensure compliance with the prudential requirements of Basel III.[152] Consequently, the EBA has the legal mandate to establish regulatory technical standards, which the pillars of the EBU apply to financial institutions in their capacity[153] as supervisor, resolution authority and, after completion, as deposit insurer.

### Single Supervisory Mechanism

The first pillar of the EBU is the Single Supervisory Mechanism. Regulation 1093/2010 forms the foundation for the European Supervisory Authority, introduced in 2010, following the Global Financial Crisis.[154] After formally establishing the Banking Union in 2012 upon recommendation of the Van Rompuy Report, the European Commission introduced Regulation 1024/2013[155] adopted on 26 June 2013, thereby establishing the SSM, covering direct supervision of 115 important financial institutions in the EU by the

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[147] European Banking Authority, 'Implementing Basel III in Europe' (2018). EBA Regulation and Policy <https://www.eba.europa.eu/regulation-and-policy/implementing-basel-iii-europe> Accessed 3 September 2021

[148] CRR I

[149] Europese Raad & Raad van de Europese Unie, 'Single Rulebook (bundeling van alle regels)'. Last updated 18 June 2021. Beleidsgebieden <https://www.consilium.europa.eu/nl/policies/banking-union/single-rulebook/> Accessed 3 September 2021

[150] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331/1

[151] Ibid

[152] Europese Raad & Raad van de Europese Unie (supra n. 149)

[153] Cappiello (2015)

[154] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC *OJ L 331/12*

[155] Ignazio Angeloni, 'The Single Supervisory Mechanism' (2015). *European Economy, Banks, Regulation and the Real Sector*. <https://european-economy.eu/leading-articles/the-single-supervisory-mechanism/> Accessed 20 May 2021

ECB, the Systemically Important Financial Institutions. As of 11 November 2020, there are 37 G-SIIs inside the EU.[156] Although led by the ECB, most of the daily supervision tasks take place at the level of National Competent Authorities.[157] Nevertheless, Article 14 gives the ECB exclusive competence to license credit institutions.[158]

The SSM has been subdivided into four directorates, of which two are concerned with monitoring SIIs, the Directorate-General Microprudential Supervision I and II. The third group, Directorate General Microprudential Supervision III is concerned with the daily supervision of Less Significant Institutions, which are mostly overseen by National Competent Authorities. The fourth DG focuses on special supervisory tasks and operations, including stress-testing, using a so-called 'consensus-scenario' and 'adverse scenario'.[159] Its tasks are carried out at a horizontal level, in particular for On-Site inspections.[160] Article 12 and 13 of the SSM Regulation define the conditions under which these inspections occur, following a decision by the ECB and a notification to the NCA(s).[161]

### *Monitoring compliance with EBA guidelines*

Recital 6 of the SSM Regulation recognises the Sovereign-Bank Nexus, and emphasises that The SSM monitors the adherence of credit institutions to technical standards, guidelines and opinions of the EBA. These include i) harmonisation of definitions that affect the own funds ii) implementation of the Basel III requirements on liquidity and capital, through uniform definitions of e.g 'highly liquid assets' iii) establishment of common reporting for accounting and prudential purposes.[162] An important example is Regulation 1030/2014 laying down implementing technical standards on the identification of G-SIIs. Article 2 requires G-SIIs to publicly disclose the necessary information within four months of each fiscal year-end.[163] The exact definitions have been updated, most recently on 29 March 2021, and now includes trading volume in the risk assessment.[164] Cappiello highlights that the SSM seeks to reduce the probability of default of banks. The SSM provides the vertical tools necessary to ensure compliance with the prudential requirements of the EBA as set out in Article 4 (3) of the SSM regulation,[165] with the interaction between EBU and EBA meant to leverage each other's effectiveness.[166]

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[156] European Banking Authority; 2021; 'Global Systemically Important Institutions (G-SIIs)' (2021). https://www.eba.europa.eu/risk-analysis-and-data/global-systemically-important-institutions Accessed 20 March 2021 (Last checked September 2021)

[157] SSM Supervisory Manual, p. and Karagianni & Scholten (2018)

[158] SSM Regulation , Art. 14

[159] SSM Supervisory Manual, p. 10

[160] Ibid

[161] SSM Regulation (SSMR), recital 6 of the Header

[162] Cappiello (2015)

[163] Commission Implementing Regulation (EU) No 1030/2014 of 29 September 2014 laying down implementing technical standards with regard to the uniform formats and date for the disclosure of the values used to identify global systemically important institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council *OJ L 284/14*

[164] Commission Delegated Regulation (EU) 2021/539 of 11 February 2021 amending Delegated Regulation (EU) No 1222/2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for the specification of the methodology for the identification of global systemically important institutions and for the definition of subcategories of global systemically important institutions *OJ L 108/10* Article 1(5)

[165] SSMR, Art. 4

[166] Cappiello (2015)

### *CRR and CRD*

Two important documents set out the capital requirements on which prudential supervision applies: Regulation 575/2013, also known as Capital Requirements Regulation (CRR),[167] for which Regulation 680/2014 laid down the implementing technical standards and Regulation 2021/451 after that.[168] Secondly, Directive 2013/36/EU, known as the fourth Capital Requirements Directive (CRD IV) provides EU-wide guidelines on prudential supervision.[169] The latter has been updated into CRD V on 20 May 2019, with a broader definition of what constitutes a financial institution.[170] Whereas the CRR is directly transposed into national law, the CRD provides the guidelines for the different actors in the SSM (as mentioned above) to adhere to the CRR.[171]

Article 131 of the CRD requires G-SIIs to hold a capital conservation buffer, counter-cyclical buffer and a systemic risk buffer.[172] The first two are defined according to Article 131 whereas Articles 133 describes the systemic buffer rate. These buffers are mandatory for all Systemically Important Institutions, yet G-SIIs require a higher percentage, and are subdivided into risk intervals on which the rate is set.[173] The SSM Framework Regulation, Articles 3-6, outline the composition of Joint Supervisory Teams, which are used to supervise SIIs, through instructions of the ECB, in cooperation with NCAs.[174]

### *Stress-tests*

As briefly touched upon, besides prudential supervision, the SSM requires banks to be subjected to stress-tests for six different scenarios, ranging from baseline scenario to adverse scenario.[175] First of all, the EBA is required to perform an EU-wide stress test every two years together with the ECB, ESRB and National Supervisory Authorities.[176] Under Article 100 of the CRD, the ECB is required to conduct an annual stress-test for the banks which it directly supervises.[177] The relevant assumptions have been updated over time. In 2018, the ECB published definitive guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). These have been in use since 2019, and contain the same 7 principles for both sides of the balance sheet as follows[178][179]:

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[167] CRR I

[168] See CRR I and updates

[169] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC *OJ L 176/338* (CRD IV)

[170] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures *OJ L 150/253* (CRD V)

[171] See CRD IV

[172] CRD, Art. 131

[173] Ibid, Art. 131-133

[174] Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) *OJ L 141/1,* Art. 3-6

[175] European Central Bank, 'The Supervisory Review and Evaluation Process in 2019' <https://www.bankingsupervision.europa.eu/banking/srep/2019/html/index.en.html> Accessed 15 September 2021

[176] European Banking Authority, 'EU-wide stress-testing' (Last Updated 2021) <https://www.eba.europa.eu/risk-analysis-and-data/eu-wide-stress-testing> Accessed 15 September 2021

[177] CRD IV, Art. 100

[178] European Central Bank, 'ECB Guide to the internal capital adequacy assessment process (ICAAP)' (2018). <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.icaap_guide_201811.en.pdf> Accessed 27 May 2021

[179] European Central Bank, 'ECB Guide to the internal liquidity adequacy assessment process (ILAAP)' (2018). <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ilaap_guide_201811.en.pdf> Accessed 27 May 2021

1. The management body is responsible for the sound governance of the process
2. The ICAAP/ILAAP is an integral part of the overall management framework
3. The ICAAP/ILAAP contributes fundamentally to the continuity of the institution by ensuring its capital/ liquidity adequacy from different perspectives
4. All material risks are identified and taken into account in the ICAAP/ILAAP
5. The internal capital/liquidity buffers are of high quality and clearly defined
6. ICAAP/ILAAP risk quantification methodologies are adequate, consistent and independently validated
7. Regular stress testing is aimed at ensuring capital adequacy in adverse circumstances

Based on the results of stress-tests and prudential requirements, the ECB (or NCA for LSIs) may decide that an institution is Failing or Likely to Fail (FOLTF).[180] In 2017, before the implementation of the above scheme, the German Banking Industry Committee issued a commentary criticising several of these 7 principles. Particularly, the Committee demanded that the requirement to include the full set of very rare unexpected economic losses be deleted as it was deemed impossible.[181] This shows that some MSs see limits to the interventionist approach of the ECB and the EBU to manage and stabilise systemic risk. This sceptical attitude can be explained through the work of Behn et al., who concluded that model-based regulation has led to underreporting of loan failures in the German banking sector, showing both the limitations of risk models (including stress-tests) as well as incentives to withhold information.[182]

### *Sanctioning Mechanisms*

The legal competences of the SSM and its supervisory teams have been set out in Regulation 1024/2013, the SSMFR and the SSM manual. These include besides monitoring and compliance, the ability to impose sanctions, which are defined in Article 18 of the SSM regulation.[183] Directive 2013/36/EU (CRD IV, now V) Article 66 defines unauthorised operation as a credit institution as a valid ground for administrative sanctions, where negligence can be established. Article 67 provides remedies against criminal intents.[184] Sanctions are further specified in the SSM Framework Regulation, e.g administrative penalties may include up to 10% of annual turnover.[185]

Article 122 of the SSMFR gives the ECB power to impose administrative penalties on SIIs or on LSIIs insofar they impose obligations towards the ECB. These include pecuniary penalties under Article 18(1) of the SSM, in the case of intentional breach or negligence towards acts of Union law, up to 10% of annual turnover.[186] Instead, fines or periodic payments may be installed under Article 18(7) when ECB regulations or decisions are violated.[187] It is stressed that Article 18(5) puts a constraint on the ECB to affect criminal penalties under harmonised national banking laws.[188]

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[180] SRMR, Art. 18

[181] Bernard Krob & René Schilling, 'Comments regarding the multi-year plan on SSM Guides on ICAAP/ ILAAP' (2017). German Banking Industry Committee. <https://bankenverband.de/media/files/170530_DK_SSM_ICAAP-ILAAP_eng_1.0.pdf> Accessed 28 May 2021

[182] Markus Behn, Rainer FH Haselmann and Vikrant Vig, 'The Limits of Model-based Regulation' (July 4, 2016). ECB Working Paper No. 1928, Available at SSRN: https://ssrn.com/abstract=2804598 or http://dx.doi.org/10.2139/ssrn.2804598

[183] SSMR, Art. 18

[184] CRD IV, Art. 66-67

[185] SSM Framework Regulation

[186] SSM Framework Regulation, Art. 122

[187] SSMR, Art. 18

[188] Martin Götz & Tobias H. Tröger, 'Fines for misconduct in the banking sector – what is the situation in the EU?' (2017). European Parliament In-Depth Analysis. Provided in advance of the public hearing with the Chair of the Supervisory Board of the ECB in ECON on 23 March 2017 <https://www.europarl.europa.eu/RegData/etudes/IDAN/2017/587401/IPOL_IDA(2017)587401_EN.pdf> Accessed 14 September 2021, p 12

### *Margin of discretion: Case T-122/15 Landeskreditbank v ECB*

Cappiello argued that margins of national discretion persisting under the SSM are problematic to its functioning, at the time of his writing.[189] As Karagianni & Scholten have pointed out, the de Larosière Report was cautious about handing over supervisory power to the ECB due to concerns about the independence between monetary and supervisory tasks.[190] They concluded that the opposite is the case, given that the ECB can even bring NCAs before the Court of Justice of the European Union or the General Court when it deems their performance of supervisory activities inadequate.[191] This happened in Case T-122/15 involving Landesbank (Landeskreditbank).[192] The case brought to the attention a shift in prudential requirements as Landesbank increased in size, so that the ECB deemed it necessary to take over supervision from the NCA and treat Landesbank as a Significant Institution, rather than a Less Significant Institution. The court ruled that despite objections, the ECB was exclusively entitled to make such a decision, even if an NCAs is in principle competent to carry out the required supervisory tasks[193], and Article 263 TFEU served as a basis for the applicant.[194] The German BVerfG reviewed the decision of the CJEU regarding this case, and held that NCAs competences arise out of national legislation in the first place, instead of reverse delegation by the ECB. Given the CJEU's decision, Article 6 of the SSM regulation seems an auxiliary to Article 4, rather than an article in its own right.[195]

## Single Resolution Mechanism

Shortly after the SSM was established, the legal foundation was laid for the Single Resolution Mechanism with Regulation 806/2014 as its legal basis, entering into force on 1 January 2016,[196] amending Regulation 1093/2010.[197] The other most important directive in this mechanism is the Banking Recovery and Resolution Directive,[198] together referred to as the 'cornerstone of the bail-in regime' (Hahn et al., 2020).[199] Deriving power from these two documents, this second pillar of the EBU aims to tackle the long-existing TBTF problem.[200] The SRM manual highlights that the combination of SSM and SRM will make the Eurozone safer and resolution more efficient than before, to the benefit of the taxpayer.[201] Unfortunately, as there has

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[189] Cappiello (2015)

[190] Karagianni & Scholten (2018)

[191] Ibid

[192] Ibid

[193] Case T-122/15 *Landeskreditbank Baden-Württemberg — Förderbank v European Central Bank (ECB*) [2017] (ECLI:EU:T:2017:337), par. 54

[194] Ibid, p. 1

[195] Ibid, paras 50-60; Case C-450/17 P *Landeskreditbank Baden-Württemberg — Förderbank v European Central Bank (ECB*) [2019] (ECLI:EU:C:2019:372)

[196] SRM Regulation, Art. 99

[197] 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 *OJ L 225/1* (SRMR)

[198] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council *OJ L 173/190* (BRRD I)

[199] Hahn and others (2020)

[200] Ibid

[201] Single Resolution Board, 'The Single Resolution Mechanism - Introduction to Resolution Planning' (2016). DOI: 10.2877/910065 Retrieved from <https://srb.europa.eu/sites/default/files/intro_resplanning.pdf.pdf> Accessed 12 June 2021 (SRM Manual)

been only one case that required resolution by the SRM,[202] it remains difficult to prove whether the mechanism really delivers on its promises.

### *Modus operandi and Board composition*

The SRM operates in close coordination with the SSM. Like the ECB in the SSM, the Single Resolution Board has the authority to sanction banks that do not comply. So far there has been only one case in which resolution of a bank was deemed necessary, albeit one concerning national interest (not EU-wide). The SRB takes the lead in decisions applying to SIIs, as well as providing the standards for LSIIs.[203]

The SRB, the leading authority within the SRM, is an independent EU agency that has been operational since January 2015. It is in charge of the Single Resolution Fund, which collects fees from the banking sector to cover the potential systemic imbalances when one or more SIs require resolution.[204] Together with National Resolution Authorities, it prepares resolution plans and sets up resolution schemes, whereby the SRB directs the decisions aimed at SIs. The Board has been divided into five directorates, of which the first one is Directorate A Strategy and Cooperation. This directorate provides detailed knowledge applied to resolution and financial stability, and cooperates with its stakeholders, i.e the ECB and the EC.[205] Directorates B, C, and D are then entrusted with the set-up of resolution plans and schemes, in cooperation with National Resolution Authorities and Joint Resolution Teams.[206] Furthermore, Directorate E collects and manages contributions towards the Single Resolution Fund.

Once the competent authorities have been consulted by the SRB (including the ECB), it provides an assessment of resolvability in accordance with Article 10 of the SRM Regulation.[207] Should the ECB decide that an SI qualifies as FOLTF under Article 18 (1) SRMR, the SRB decides under Article 18 (3) if there is a public interest that requires the use of resolution tools.[208]

### *Resolution tools*

Once resolution is required, there are four different options at the SRM's disposal, referred to in Article 22(2) of the SRM Regulation:

"a) the sale of business tool;
b) the bridge institution tool;
c) the asset separation tool;
d) the bail-in-tool. "[209]

The first two tools have been used in previous cases in the US and Canada, as well as the EU, and are regarded in international settings as a pre-crisis recommendation.[210] Similarly, the asset separation tool has been applied to previous crises.[211] The bail-in-tool, on the other hand, is a response to the GFC of 2008, and there is little reference material available to it, for it has been used only in a few cases, yet never in the EBU.

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[202] Single Resolution Board, 'When does a bank resolution occur?' (Last updated 2021) <https://www.srb.europa.eu/en/cases> Accessed 12 June 2021

[203] SRM Manual

[204] Ibid

[205] SRM Manual, p. 9

[206] Ibid, p. 9

[207] Jens-Hinrich Binder, 'The Relevance of the Resolution Tools Within the SRM' (October 29, 2018). European Banking Institute Working Paper Series 2018 - no. 29, Available at SSRN: <https://ssrn.com/abstract=3274520> Accessed 12 June 2021 (Binder (2018))

[208] SRMR, Art. 18

[209] SRMR, Art. 22

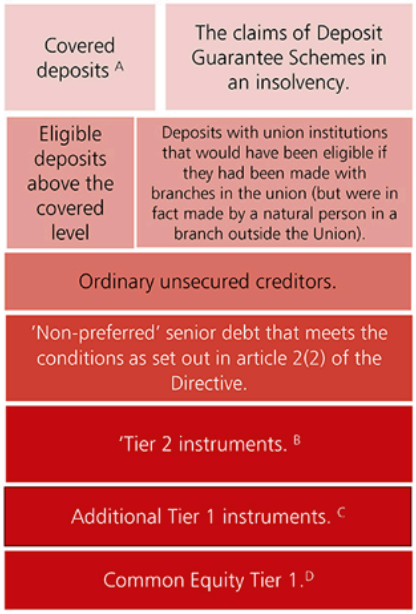
[210] Binder (2018), p. 12

[211] Ibid

Article 27 (1) of the SRM regulation describes the bail-in process as (i) conversion of debt claims to equity in order of decreasing risk (riskiest debt comes first), (ii) reduction of principal amount of claims, or (iii) recapitalisation.[212] All three variants involve the write down or conversion of the buffers discussed in the paragraphs on SSM. Article 27 (4) mentions that "The Board shall ensure that all secured assets relating to a covered bond cover pool remain unaffected, segregated and with enough funding."[213], meaning there are classes of assets whose pay-out is guaranteed. As this regulation stems from 2014, the ECB must have been aware of this fact before starting the QE-programme in 2015 (relevant in light of Asset Purchase Programmes). Figure 1 illustrates the hierarchy in which liabilities can be converted into equity during a bail-in, and which ones are exempted. Although the figure stems from the UK (when it was still in the EU), it illustrates the mechanism perfectly and shows the UK has implemented a deposit guarantee similar to Eurozone members.[214] Covered deposits cannot be converted, and CBs completely fall outside of the picture due to their priority claim under the SRM regulation.

Fig. 1.1: Excerpt from UK.Gov on creditor hierarchy under bail-in regime

**Box 1: The creditor hierarchy as required by BRRD Article 108 (as amended by the directive)**




Notes: A - The coverage level provided for in Article 6 of Directive 2014/49/EU. In the UK, the FSCS guarantees eligible deposits up to £85,000. B, C, D - These capital instruments are referred to in points (a) to (c) of Article 48(1) of the BRRD.

The asset separation programme, defined in SRM Regulation article 26, is an interesting tool as well, involving the use of Asset Management Vehicles.[215] These are separate legal persons, into which assets can be shifted away from the balance sheet of a bank. In fact, it has been described as a vital mechanism to clean up balance sheets from Non-Performing Loans (more on that later).[216]

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[212] SRMR, Art. 27

[213] Ibid

[214] HM Treasury, 'Consultation Outcome, Technical consultation on the draft Banks and Building Societies (Priorities on Insolvency) Order 2018'. Last updated 29 November 2018. HM Treasury, UK Government <https://www.gov.uk/government/consultations/draft-banks-and-building-societies-priorities-on-insolvency-order-2018-technical-consultation/technical-consultation-on-the-draft-banks-and-building-societies-priorities-on-insolvency-order-2018> Accessed 3 November 2021

[215] SRMR, Art. 26

[216] Bruno and others (2017)

### *Banco Popular: The only case of resolution that made it to the SRM*

So far, the only case in which a bank in the EU has been resolved according to the SRM Regulation is Banco Popular Español.[217] Article 4.4.2 of the decision defined the institution as being the parent undertaking of one of the largest banking groups in Spain. It received the qualification of O-SII, and insolvency would have an adverse effect on the economic stability of Spain. Ultimately, at the end of the resolution procedure, the bank was acquired by Banco Santander.[218] The SRB appointed Deloitte to conduct valuation of Banco Popular.[219]

Furthermore, three cases have been recorded in which the Failing-or-Likely-to-Fail criteria were met.[220] In 2017, Banco Popolare di Vicenza, as well as Veneto Banca, were found to be in significant distress and thus FOLTF. ABLV will be discussed in Chapter 3. Per decision by the SRB the banks did not qualify for resolution at the EU-level, as it decided there was no compelling public interest in doing so.[221]

### *Effectiveness of SRM*

There are two main approaches in resolving banks according to the SRM manual. The first one is a Single Point of Entry approach, in which one resolution authority targets a single institution and provides one of the mentioned strategies. Secondly, there is a Multiple Point of Entry approach, in which two or more resolution authorities target multiple (regional) banks, often forming part of a group.[222] In the case of Banco Popular, the institution was resolved using the Sale-of-Business-Tool.[223] While doing so, the SRB took into account the 'no creditor worse off' principle, meaning that none of the creditors involved will have a disadvantage compared to normal insolvency proceedings.[224] It is highlighted by the Commission that no taxpayer funds have been used, as a proof of the effectiveness of the SRM.[225] This enthusiasm is to be interpreted with caution: it is based on only one observation as if it were conclusive evidence for effectiveness on a larger scale. Secondly, while Banco Popular is a SII, it is not a G-SII, and the assessment focused on possible systemic impact in Spain. Therefore it is hard to prove if the SRM will be just as effective in resolving G-SIIs, especially when several ones at the same time are at risk of failure. In fact, one could wonder why a common deposit insurance would be necessary at all if the SRM would suffice at resolving G-SIIs without any social cost. Such a claim on effectiveness would be unscientific at best and systemically dangerous at worst.

### *Sanctions*

Article 110 of the BRRD sets out the administrative penalties and measures that can be imposed under the SRM.[226] As with the SSM, these include administrative penalties and other measures that can be imposed under national law by competent authorities. That means nations have a margin of discretion in deciding what penalty is imposed on a credit institution. Nevertheless, the Directive specifies the grounds on which a

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[217] Decision (SRB/EES/2017/08) of the Single Resolution Board in its Executive Session of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español, S.A., (the "Institution") with a Legal Entity Identifier 80H66LPTVDLM0P28XF25 addressed to FROB [2017] <https://www.srb.europa.eu/system/files/media/document/srb_decision_srb_ees_2017_08_non-confidential_scanned.pdf> Accessed 12 June 2021

[218] Ibid

[219] Ibid, p. 7

[220] Single Resolution Board, 'When does a bank resolution occur?' (Last updated 2021) <https://www.srb.europa.eu/en/cases> Accessed 12 June 2021

[221] Ibid

[222] SRM Manual, p. 30

[223] SRB (supra n. 217)

[224] SRMR

[225] European Commission, 'Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union'. Brussels, 11.10.2017 COM (2017) 592 final <https://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf> Accessed 20 March 2021 (COM 592 (2017)), p. 5

[226] BRRD, Art. 110

penalty is to be imposed in Article 111 as follows: failure to provide and update recovery plans, failure to notify the competent authority about intention to provide financial support, failure to provide all the required inputs for a resolution plan, or failure by the management board of an entity to notify the competent authority of a FOLTF signal.[227]

### *BRRD, COVID and State Aid*

One of the prime objectives set out in the BRRD is to prevent taxpayer funds from usage in banking resolution, so as to minimise social costs.[228] Even though state aid has been found to be reduced significantly, the Directive exempts G-SIBs from the prohibition on State Aid.[229] The BRRD outlines the conditions for credit institutions to qualify for resolution, as well as the assumptions used in drawing resolution plans. Article 5 says (as do subsequent Articles) that resolution plans will be made, without assuming central bank emergency liquidity assistance as well as 'exceptional public support'.[230]

During the COVID-pandemic, the EBA has recommended to change the definition of a G-SIIs, to include individual banks, with a total exposure measure exceeding €125 billion (instead of €200 billion).[231] The G-SII definition already extends to individual banks, not just groups, since the updated version of CRR.[232] In addition, the risk buffers previously required under BCBS and discussed in this chapter, have been relaxed since March 2020. According to Haselmann & Tröger, strict enforcement of the regulatory requirements during the pandemic would have triggered a banking crisis. On the same page, he expresses a belief that the EU crisis framework of banks is suitable to address existing problems.[233] These findings seem like a somewhat mutually exclusive combination. The report describes the temporary measures to relieve European banks, with the ECB allowing capital ratios to be lower than required by the CRR and CRD, with relaxations in place until at least the end of 2022.[234] Meanwhile, the authors warn of artificially suppressed NPL statistics due to loan moratoria. When both end, defaults are expected to accelerate.[235] The Pandemic Emergency Purchase Programme now has a total volume of €1,850 billion to pay for relieve measures, and will continue at least until March 2022, with maturities being reinvested until at least the end of 2023.[236] Meanwhile, the same ECB has given 'full flexibility' for banks in the assessment of NPLs.[237] (explained in Chapter 3)

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[227] BRRD, Art. 111

[228] Cappiello (2015)

[229] Phedon Nicolaides, 'State aid after the Banking Union: serious disturbance and public interest' (2021). *Journal of Banking Regulation* (2021). DOI: https://doi.org/10.1057/s41261-021-00173-1

[230] BRRD, Art. 5

[231] European Banking Authority Consultation Paper Draft Implementing Technical Standards amending Commission Implementing Regulation (EU) 2021/451 with regard to COREP, asset encumbrance and G-SII reporting *EBA/CP/2021/24 of 23 June 2021*, p 4

[232] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 *OJ L 150/1*

[233] Rainer Haselmann & Tobias Tröger, 'When and how to un- wind COVID-support measures to the banking system?' (2021). EP, Economic Governance Support Unit (EGOV) Directorate-General for Internal Policies PE 659.649 - March 2021 <https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/659649/IPOL_IDA(2021)659649_EN.pdf> Accessed 13 December 2021, p. 9

[234] Ibid, p. 11

[235] Ibid, p. 14

[236] European Central Bank, 'Pandemic emergency purchase programme (PEPP)' (Updated December 2021). European Central Bank | Eurosystem <https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html> Accessed 13 December 2021

[237] Thorsten Beck, Brunella Bruno & Elena Carletti, 'When and how to unwind COVID- support measures to the banking system?' (2021). Economic Governance Support Unit (EGOV) Directorate-General for Internal Policies PE 659.646 - March 2021 <https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/659646/IPOL_IDA(2021)659646_EN.pdf> Accessed 10 October 2021 (Beck and others (2021))

# Chapter 2. The added value of EDIS

Having covered the structure of the SSM and the SRM, as well as the economic and legal developments preceding their creation, we now turn towards the final pillar of the Banking Union: The European Deposit Insurance Scheme. While it is still to be implemented, such a scheme has been discussed after the Global Financial Crisis took place, from early onwards.

§5.9 of opinion paper ECO/259 regarding the De Larosière Report highlights the latter one's call for harmonisation of rules regarding deposit guarantee schemes to ensure equal protection of bank customers in all MSs. At the same time the paper calls into question the sources of funding to support such a scheme.[238] What it does not mention, however, is whether or not it is safe to assume that mere harmonisation of rules will ensure equal protection or that country-specific factors may drive a wedge between MSs that mainly incur associated risks versus others that mainly enjoy its associated benefits.

The amended Article 4 of Regulation 1093/2010, and Directive 2014/49/EU form the legal basis for this third and final pillar of the EBU.[239] It sets out the requirements for deposit coverage and exceptions to general guidelines. Specifically, Article 10 (6) allows derogations from Directive 2014/59/EU for large financial institutions, when these are of such magnitude that they will likely be subjected to a resolution mechanism in case of a default. In that case the minimum deposit coverage has been reduced such that at least 0.5% of such institutions has been covered, instead of 0.8%.[240]

## Asymmetric Implementation

The creation of the final EBU pillar, the European Deposit Insurance Scheme, was mentioned as a crucial element in the van Rompuy Report in the first place.[241] Even though its exact structure had not been defined, the pillar was described as one of the main components of an integrated financial framework, in which the TBTF problem would be eliminated.[242] A full setup of the scheme was not included in the report, yet existed on the background already. In 2012, Germany objected to this setup, after which it had been omitted from the 'equation' for some time. Shortly thereafter, it returned on the Commission's agenda.[243]

### *Case C-414/18 Iccrea v Banca d'Italia: EU Courts' Exclusive competence on SRB contributions*

One case illustrating problems around implementation, Case C-414/18, concerns the interpretation of the CRR, and Directives on the SRF and deposit guarantees.[244] §77 refers to article 102(1) of Council Directive 2014/59, highlighting that all MSs must cover at least 1% of the deposits of its country's financial institutions by 31 December 2024. Iccrea has been described as leading a network of cooperative banks in Italy, from which Banca d'Italia asked an *ex ante* contribution. Iccrea held that, while calculating the fee, Banco d'Italia wrongly interpreted Article 5 of Delegated Regulation 2015/63.[245] §34 of the case held that besides the interpretation of that article in light of Directive 2014/59, Regulation 806/2014 applies, solely referring to the contribution requirements to the SRF, not the national resolution fund.[246] §48-57 hold that national courts

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[238] Opinion paper on De Larosière, par. 5.9

[239] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes *OJ L 173/149* (DGS Directive), Art. 10

[240] Ibid, Art. 6

[241] Van Rompuy report

[242] Ibid

[243] David Howarth & Lucia Quaglia 'The Difficult Construction of a European Deposit Insurance Scheme: a step too far in Banking Union?' (2018). *Journal of Economic Policy Reform*, 21, 3, p.194. DOI:10.1080/17487870.2017.1402682. Available at ResearchGate (Accessed 22 June 2021) (Howarth & Quaglia (2018))

[244] Case C-414/18 *Iccrea Banca SpA Istituto Centrale del Credito Cooperativo v Banca d'Italia* [2019] ECLI:EU:C:2019:1036

[245] Ibid, par. 23

[246] Ibid, par. 34

can only be held responsible for implementation of the decisions regarding SRF requirements, not alter them. Thus, the EU Courts have exclusive competence in deciding how to calculate contributions to the SRF based on decisions by the board, even regarding the behaviour of national resolution authorities in anticipation of contribution towards the SRF, as described in §39, using Article 263 TFEU as the legal basis for this exclusive competence.[247] Hence, the CJEU gave a preliminary ruling that Iccrea was to pay its ex ante contribution as decided by the SRB, without leaving a margin of discretion for Banca d'Italia, contrary to the interpretations of the national court.[248]

Even though the aforementioned case focuses on the second EBU pillar, it addresses one of the most important objectives of the EDIS, which faces scrutiny till today: a *uniform* approach to systemic failure, by which banks from all MSs in the EBU contribute to a system-wide pool of funds. This pool should cover system-wide failure by banks to guarantee payments to their depositors up to €100000, under the central authority of the SRB.[249]

## Predecessors to EDIS

Before the EDIS, other deposit guarantee schemes have been implemented inside the European Union (previously European Community). As early as 1994, the first Deposit Guarantee Scheme Directive was adopted, which required all Community members to adopt a Deposit Guarantee Scheme which harmonised the requirement to cover deposits of up to €20000 for at least 90 percent of the deposit amounts.[250] Before that, Germany, as did other MSs, already relied on their own national DGSs coverage amounts, higher than required. The DGS Directive of 1994 turned out to be detrimental to financial stability in the internal market, especially during the time of the GFC, according to Cerrone.[251] After that, in 2009, adjustments were made, requiring a floor of €50000 deposit protection, followed by a uniform level of €100000.[252] During the attempt in 2015 to initiate EDIS, Germany was one of its' main opponents, arguing that such a move by the European Commission would lead to a gap between net receivers and net contributors.[253] Likewise, Finland pointed out that the national differences between banking systems (and fiscal components) are so large that EDIS could impossibly impose a uniform regime on all MSs.[254] One of the key characteristics in which national deposit schemes differ is the moment at which funds are collected: some MSs rely on ex ante funding (e.g Germany), others use ex post compensation (e.g Netherlands, UK).[255]

## EDIS Effect analysis

In 2016, an effect analysis was released on the Commission's proposal to implement the EDIS in three phases. These are: the reinsurance phase (2017-2020), the coinsurance phase (2020-2024) and finally, a full insurance steady state (2024 onwards), in which the EDIS is entirely financed through the European Deposit Insurance Fund, managed by the SRB.[256] An illustration is given on the next page. The chart shows that the contributions by national DGSs towards EDIS were planned to gradually decrease towards zero by 2024.

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[247] Ibid, paras 39-57

[248] Ibid, par. 24

[249] DGS Directive

[250] Howarth & Quaglia (2018)

[251] Rosaria Cerrone, 'Deposit guarantee reform in Europe: does European deposit insurance scheme increase banking stability?' (2018). *Journal of Economic Policy Reform*, 21:3, 224-239, DOI: 10.1080/17487870.2017.1400434, pp 229-230

[252] Ibid

[253] Howarth & Quaglia (2018), p. 200

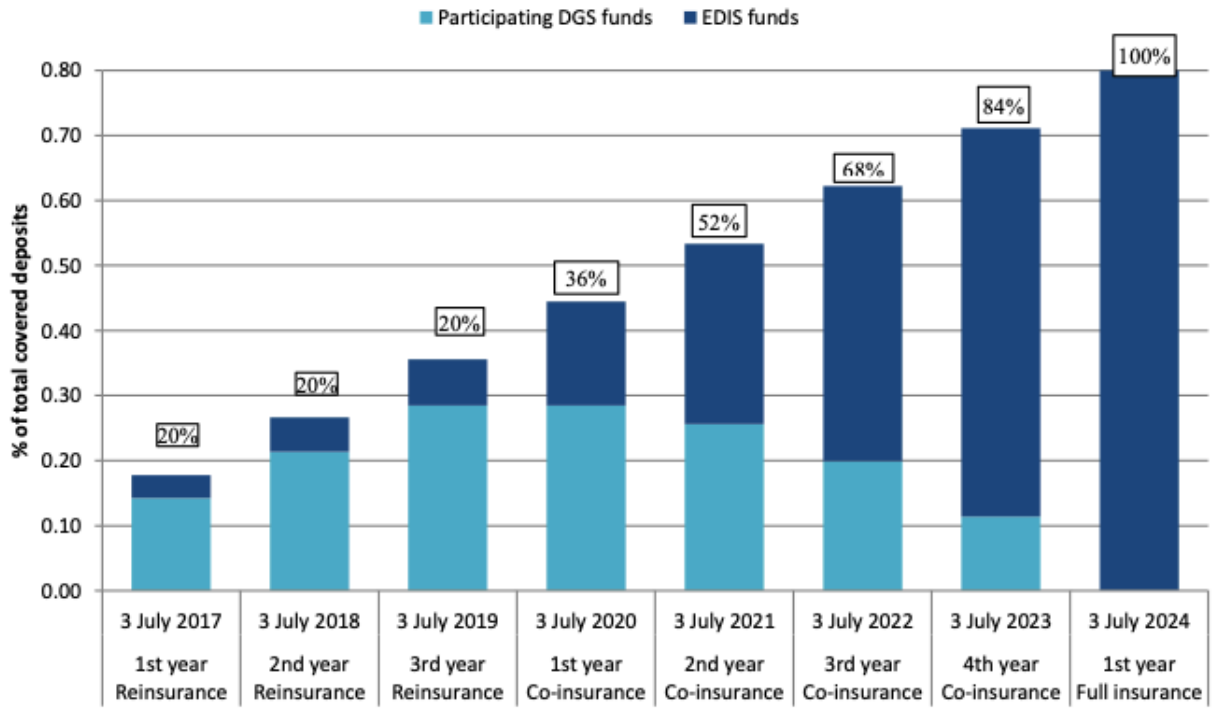
[254] Ibid

[255] Ibid

[256] 'Effect Analysis (EA) on the European Deposit Insurance Scheme (EDIS)' (2016). European Commission;. <https://ec.europa.eu/info/sites/default/files/161011-edis-effect-analysis_en.pdf> Accessed 10 September 2021 (EDIS Effect Analysis of 2016)

The third pillar is still said to be far away from completion.[257] Likewise, not all MSs have implemented the existing pillars (since not all MSs are participants in the EBU), and some have separate agreements about the extent to which they can rely on supervisory and resolution schemes.[258] The United Kingdom, although currently not a member of the EU anymore, has an opt-out agreement with the EBU.[259] In a similar fashion Denmark has an opt-out agreement.[260] Such an agreement means it does not need to adopt the Euro and be part of the EMU. Nevertheless, unlike Sweden, having an opt-out agreement regarding the EBU, Denmark has stated that it may want to join the Banking Union in the future.[261]

Fig. 2.1: EDIS build-up plan (excerpt from effect analysis)




The effect analysis ran multiple regressions, comparing the effectiveness of mandatory lending with mandatory re-insurance, and full mutualisation, all three repeated 100,000 times. The author concluded that full mutualisation was the most cost-effective of these three mandatory options, with the lowest amount of uncovered losses.[262] The regressions were carried out using the Systemic Model of Banking Originated Losses (SYMBOL). The core assumptions of this model are as follows: " (a) the Basel 3 regulatory model for credit risk is correct; (b) banks report risks accurately and in line with this model; (c) all risks in the bank can be represented as a single portfolio of credit risks." Should any bank violate assumption (b), then a correction factor will be applied making the regime of that bank compatible with Basel III. Footnote 54 of the report highlights that SYMBOL originally used Basel II compatible data, not Basel III.[263] Whether the Basel III regulatory model for credit risk is correct, has been questioned by Lall (see Chapter 1), yet it must be noted some important flaws of Basel II have been removed (non-linearity instead of linearity regarding size vis-à-vis systemic risk).

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[257] Reuters

[258] Vollmer (2016))

[259] Ibid

[260] European Commission, 'What is the euro area?'. *EC, Business, Economy, Euro* <https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en> Accessed 26 March 2021 (Last checked December 2021)

[261] Huettl & Schoenmaker (2016)

[262] EDIS Effect Analysis (2016)

[263] Ibid, p. 63

As with the SSM and SRM, EDIS aims to eliminate regulatory arbitrage. Until now, MSs had the possibility to set their own ceiling amount at which deposits are covered. There is a risk that politicians at the national level will extract private benefits from a deposit scheme that has more favourable terms than is required through EU law.[264] It should also be noted that banks from MSs which have not decided to participate in this scheme, can hold vast amounts of assets or liabilities that correlate to banks in participating MSs, or are exposed to them. Therefore it is rather difficult to judge whether this scheme really creates a level playing field. It is not just exposures in neighbouring MSs that matter in this respect. Worldwide exposures are relevant too, as EDIS subjects European MSs to these as well, without any favour in return from the places where these exposures stem from (outward banking). Although Huettl & Schoenmaker demonstrated that outward banking among large banks within the EBU is less than for the largest EU-located banks outside the EBU 9% with the rest of Europe and 17% with the rest of the world, versus 8% and 32% respectively for non-EBU members),[265], it is still considerable. Moreover, only assets on the balance sheet are included in this calculation, so the worldwide exposures through derivative positions may be much larger and difficult to estimate (more in Chapter 4).

EDIS aims to prevent a bank run, and raising the amount of deposit protection seems to enforce that more so than existing DGSs, coupled with de-politisation. This view is shared by Cerroni and also by Howarth and Quaglia. At the same time, it means MSs will be forced to protect each other's exposures, once fully fledged. Moreover, it covers deposits of G-SIIs whose exposures stretch far beyond the boundaries of the internal market as discussed above.[266] It remains questionable whether or not this pooling on a gigantic scale does exceed the boundaries of 'economies of scale', for example due to enforcement costs and organisational slack, as well as risks becoming more 'anonymous'.

### ESM as a fiscal backstop

The van Rompuy report mentioned the creation of a pan-European deposit scheme as one of its ambitions. For such a scheme to function reliably, a fiscal backstop is said to be required through the European Stability Mechanism.[267] The SSM Regulation has taken this condition into account.[268] Likewise, the SRM Regulation defines this as a vital mechanism to allow its functioning.[269] The contributions of the ESM towards the EDIS have increased gradually, and are planned to cover 100% of the deposit guarantees by 2024.[270] The ESM, having entered into force through the ESM treaty based on Decision 2011/199, required amendment of Article 136 TFEU by insertion of a third paragraph.[271] It currently has a lending capacity of approximately €700 billion.[272] That is in line with Article 8(1) of the ESM Treaty, which says "The authorised capital stock shall be EUR 704 798.7 million. It shall be divided into seven million forty-seven thousand nine hundred and eighty-seven shares, having a nominal value of EUR 100 000 each …".[273] How ESM was made compatible with MSs government, is explained below.

#### *C-370/12 Pringle v Government of Ireland and others: Birth of the Pringle ruling*

Mr. Pringle, a Member of Irish Parliament, sought to contest the decision to implement the ESM due to inapplicability with the 'no-bailout' clause.[274] §131 of case C-370/12 refers to Article 122 TFEU, in which it

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[264] Huettl & Schoenmaker (2016)

[265] Ibid, pp 100-103

[266] Ibid

[267] Van Rompuy Report

[268] SSM Regulation, recital 12 of the header

[269] SRM Regulation

[270] EDIS Effect Analysis (2016)

[271] Treaty Establishing the European Stability Mechanism (ESM Treaty) T/ESM 2012-LT/en 1, §2

[272] European Stability Mechanism, 'About us'. Copyright 2021. <https://www.esm.europa.eu/about-us/intro> Accessed 10 October 2021

[273] ESM Treaty, Art. 8(1)

[274] Case C-370/12 *Thomas Pringle v Government of Ireland and Others* [2012] (ECLI:EU:C:2012:756)

is stated that ad hoc decisions may be taken when a MS is in severe difficulty caused by 'exceptional occurrences beyond its control'.[275] In our view, this is a tricky rule, exactly because much of that control was already being delegated to the EBU and ECB, thereby giving the ECB more opportunity to invoke Article 122 as a justification for its power, as its supervisory powers under SSM - used as input for the plans under the SRM - puts banking risks of G-SIIs much more outside the control of a MS than before. The CJEU nevertheless ruled that Decision 2011/199 was valid and could not be the subject of ratification of the TEU by a MS.[276] This judgement is known as the *Pringle* ruling.

### *EC Communication*

In 2017, the Communication from the Commission on completing the EBU highlighted the necessity of EDIS as a final seal harmonising the risks of default through deposit coverage, after supervisory rules and resolution plans have been exhausted.[277] The funds to EDIS are to be managed by the SRB.[278] Remarkably, QE was not mentioned once, suggesting that all EU institutions involved in the Communication (the Commission, the Council, and even the European Parliament) assume the impact of monetary policies to be irrelevant when discussing the EBU. Cross-border subsidisation is thereby seen as a suitable form of risk-sharing. Also, the problem of NPLs has been raised, and suggestions have been made to 'get rid' of them.[279] Formally explained as a solution compatible with State-aid rules, no real concrete measures are given. A real, and important step can be found at footnote 20 of that report: "Finally, more recently, the Commission also facilitated the setting up of State aid-free schemes, such as schemes to facilitate the securitisation of Non-Performing Loans."[280] It is a controversial statement in light of our literature review, and NPLs that circulated in the banking system just before the GFC.[281]

The Single Resolution Fund collects contributions from banks and currently stands at around €52 billion.[282] The common backstop, to be introduced in 2022, will be twice the size of the SRF. It is said that taxpayers will be reimbursed by banks after having contributed ex ante to these funds.[283] However, such a scenario can only be credible when all participants are fully compliant with EU law, enforce adequately, and have a reputation for paying bills on time. Even then it is questionable to assume that banks in the meantime do not experience such adverse shocks that repayment is impossible. If G-SIIs are solid at the moment, we see little reason not to pay ex ante contributions fully by themselves.

EDIS has not been finished yet, and thus the plans of the effect analysis do not fully apply. Although the ESM essentially mandates lending among MSs to provide fiscal support, the mechanism for full mutualisation as proposed by the EDIS effect analysis has not been implemented. However, there is a mandatory re-insurance model in place already through the SRF, as evident from case C-414/18. Moreover, the introduction of a common backstop in 2022 is essentially a form of mandatory lending, because it is essentially a bail-out fund with capacity to lend, should a MSs be unable to cover its own losses.[284] Full mutualisation remains the main stumbling block that keeps EDIS away from implementation (also discussed in Chapter 3 regarding conflicts of interest).

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[275] Ibid, par. 131

[276] Ibid

[277] COM 592 (2017)

[278] Ibid

[279] Ibid, p. 5

[280] Ibid, p. 5

[281] De Larosière Report

[282] Single Resolution Board, 'The Single Resolution Fund' (Last updated 5 July 2021) <https://www.srb.europa.eu/en/content/single-resolution-fund> Accessed 10 October 2021

[283] Ibid

[284] Based on our sources thus far and our interview with Arno Wellens (see Appendix 2)

# Chapter 3. Accountability: the legal, the financial, and the moral

As is well known at this point, one of the leading authorities within the EBU is the European Central Bank. The fact that the ECB is in itself largely an autonomous institution, adds to the question as in what way the EBU can be held accountable for its actions. The Van Rompuy Report highlighted the importance of "joined exercise of sovereignty for common policies and solidarity" to ensure democratic legitimacy within the Economic and Monetary Union.[285] At the same time, later in that report, emphasis is put on the importance of "supervisory authority and pre-emptive intervention powers applicable to all banks" at the European level.[286] The legal findings below demonstrate how that is being put into practice. The rest of this chapter focuses on the halachic principles as discussed in Section III, and a bit more: Kehila. Special attention is paid to high-level corruption and conflict of interest. Not all may refer to G-SIIs, but our findings provide a glimpse into the system in which they operate.

## Legal interpretations on democratic accountability of the EBU: BverfG

Since the establishment of the EBU, questions have been raised on the margin of discretion provided by the Treaties, legal articles and the compatibility of the EBU with democratic national governments. As apparent from the previous sections, Germany and German actors have been critical about the scope of the ECB with regard to supervisory powers. Likewise, criticism was drawn by Italy regarding supervisory powers in case C-414/18. More recently, a landmark decision by the German Federal Constitutional Court on the EBU was reached, in which it ruled that the powers delegated to the ECB did not conflict with German constitutional rights and that *ultra vires* does not apply to the ECB.[287] Faraguna & Messineo have analysed this decision and questioned its validity on several points.

Firstly, as mentioned in the article, the decision reached in case *Bundesverfassungsgericht, 30 July 2019, 2 BvR 1685/14, 2 BvR 2631/14* is based on meeting two conditions: necessary for the pursuit of a compelling public interest, and compensation by accountability obligations and judicial control.[288] Even though the FCC reached the conclusion that both conditions were satisfied, the authors argue that by narrowly interpreting the powers of the ECB as set out in the SSM regulation and the margin of discretion given therein, the FCC took a rather opportunistic stance. By assuming the ECB does not deviate from those boundaries in any case, the interpretation can be deemed valid on paper. However, a contrast is drawn with reality. The first example raised is the ECB Guidance on NPLs, deemed a soft-law instrument.[289] The detailed requirements to comply with, indicate the ECB acted as a legislator, it is argued. As a second example, during the judicial procedure, the FCC stated that the powers conferred upon the ECB are in line with TFEU Article 127 (6), whereby NCAs remain largely responsible for the execution of daily tasks under the SSM.[290] The authors deem the judgement sensible in itself, yet in contrast with the *Landesbank* case. The claimants had sought proof of *ultra vires,* which means the ECB has exclusive power over supervised entities and would require Treaty changes, yet failed to provide convincing evidence in the eyes of the FCC.[291]

Secondly, the authors were critical about the FCC's interpretation on the EC holding the SRB accountable for its decisions under article 18 SRM.[292] Whereas the FCC stressed the Commission's ability to object to SRB resolution plans, the SRB enjoys sole competence in determining whether there is a compelling public

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[285] Van Rompuy Report, p. 3

[286] Ibid p. 4

[287] Pietro Faraguna & Donato Messineo, 'Light and shadows in the Bundesverfassungsgericht's decision upholding the European Banking Union' (2020). Common Market Law Review, Vol. 57, Issue 5 (2020), pp 1629-1646. Retrieved from <https://kluwerlawonline-com.proxy.library.uu.nl/api/Product/CitationPDFURL?file=Journals\COLA\COLA2020750.pdf> Accessed 25 August 2021(Faraguna & Messineo (2020))

[288] Ibid, pp 1631-1633

[289] Ibid, p. 1631

[290] Ibid

[291] Ibid

[292] Ibid

interest. Nevertheless, the FCC concluded the SRM limits discretionary power so that SRB has no de facto exclusive decision-making competences, given that the ECB determines the FOLTF criterion.[293]

Based on the above, it can be observed that precedent on non-delegation has been put aside and procedure has been bent largely in favour of the ECB and SRB. The ECB Guidance on NPLs has indeed outlined the treatment of NPLs in detail, such as how to securitise and sell NPLs,[294] into the very securities the ECB purchases as part of its QE programme, making the ECB investor as well as portfolio selector, as well as legislator. As a result of the unusual procedure of BVerfG, the role of the ECB and SRB are deemed compatible with the *Eternity Clause* of the German constitution, a safeguard meant to uphold the German state under a democratic national government.[295] It must be stressed that the SRB is an agency, whereas the ECB is an institution. Therefore, the SRB can be held accountable more easily by the EP and be dissolved when it fails to deliver on its functions.

## The EBU and halachic principles: lest we forget

The lessons by Friedman & Friedman are to be learned and remembered, if we are to prevent another financial catastrophe, the likes of 2008 or worse. Through six principles on business ethics from the Talmud (building on their method), a rich list has emerged on peculiarities in the Banking Union and the attitude of large banks regarding risk and financial reporting.

## Misleading with bad advice ('lifnei iver')

Despite the criticism on excessive lending raised after the GFC, there are still loans provided by large banks to EU households (Netherlands as an example), with a value of eight to nine times the annual salary of the borrowing household in question.[296] This is similar to the NINJA (No Income, No Job and No Assets) loans described by Friedman & Friedman[297]. It is not very surprising given the vast increase of real estate prices compared to average and modal annual income over the past decades,[298] which is described as a side-effect of monetary policy.[299] Low Income, Low-paid Job and Little Assets would be an accurate term, but then the abbreviation is hard to pronounce (LILJA).

Furthermore, an increase in mortgages without interest payments means a shift of interest risk towards the longer term.[300] It is called inter-temporal risk-shifting. In addition, with increased emphasis on CSR, amendments have been made to article 519 of the CRR as part of a pandemic relief package, now including environmental sustainability criteria in securitisations, even for for NPEs.[301] Essentially, 'green' faulty loans can now be added to the existing pile of NPLs in the Eurozone, at a time during which that pile is already

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[293] Ibid

[294] European Central Bank, 'Guidance to banks on non-performing loans' (2017). ECB | Banking Supervision, March 2017 <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf> Accessed 20 November 2021

[295] Faraguna & Messineo (2020)

[296] Arno Wellens, Chief Editor at 925. Amsterdam (Interview of 30 August 2021) (Copy is with the author, hereafter referred to as *Interview*);
Arno Wellens, 'Deutsche Bank #5 - 'Shadow Banking" - Arno Wellens' (14 August 2021) <https://www.youtube.com/watch?v=cpvqxzYu3_Q> Accessed 20 August 2021 (Deutsche Bank part 5)

[297] Friedman & Friedman (2009)

[298] Arno Wellens, 'Deutsche Bank deel 4: de bankenunie' (2 December 2020) <https://www.youtube.com/watch?v=51B_HT13Df8> Accessed 10 August 2021 (Deutsche Bank part 4)

[299] Interview, see Appendix 2 §

[300] Deutsche Bank part 5

[301] CRR II amended version

growing as a result of pandemic-related restrictions on businesses.[302] Meanwhile, the Green Deal of €500 billion is being pushed forward,[303] at the speed of light, one might say.

## Deception and fraud ('geneiva da'at')

### *Non-Performing Loans, SPVs and Covered Bonds: the holy trinity of the Eurozone?*

In the previous crisis, securitisation was one of the main sources of excessive risk, and largely due to the information asymmetry between bank and regulator, exacerbated by Credit Rating Agencies (CRAs).[304] Securitisation of NPLs has now become a major source of risk again according to Wellens,[305] a process that experienced a rebirth in 2017. He claims the COVID-19 pandemic has exacerbated that in the shape of PEPP, in which additional NPLs, that arose as a result of economic downturn have been securitised and sold.[306] This is relevant as it leads to off- balance sheet activity. Previously, he already emphasised the change in definition of NPLs, from 30 days to 90 days.[307] This new definition can be seen in the ECB Guidance on NPLs. Particularly worrisome in that context are constructions in which pay-out is guaranteed for SPVs into which NPLs can be securitised, discussed below. Obviously, his contradicts the very definition of NPLs.[308] SPVs can then be used to shift a very important form of wrong-way risks from large banks to Eurozone governments and its taxpayers. Hence, from a bank's perspective, these NPLs are conveniently 'dumped' off balance sheets. In a sense, the taxpayer becomes a put option for SPVs and CB investors, as explained below.

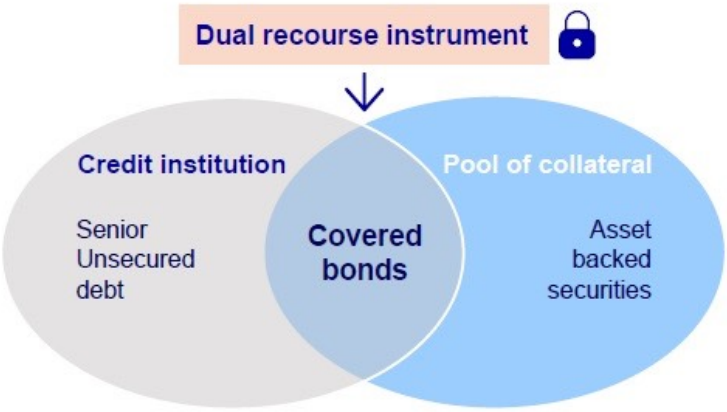



Fig. 3.1: Covered Bond setup[309]

SPVs may qualify as eligible collateral for Covered Bonds.[310] These are bonds that always pay-out, because of their (state) guarantees (see Appendix 6.1-4).[311] CBs have received a derogation under Article 496 CRR, to include securities as

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[302] See ECB and Beck and others (2021)

[303] Ursula von der Leyen, 'Statement by President von der Leyen on delivering the European Green Deal' (14 July 2021). EC, Brussels <https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_3701> Accessed 13 December 2021

[304] Friedman & Friedman (2008)

[305] Interview, see Appendix 2 §9

[306] Ibid, see ECB as well

[307] Presentation of 11 May 2020, see ECB Guidance on NPLs for definition

[308] Deutsche Bank part 5

[309] RF 'Covered bonds, an asset class to discover' (November 2018). Next Finance <https://www.next-finance.net/Covered-bonds-an-asset-class-to> Accessed 4 November 2021

[310] European Bank for Reconstruction and Development, 'Introduction of a Covered Bond and Securitisation Legal Framework in Latvia' (7 February 2019). EBRD <https://www.fm.gov.lv/sites/fm/files/2019-02-22_11_54_37_concept-paper.abs-securitization.2019-02-07.eng.final.with-logos1.pdf> Accessed 3 November 2021, p. 24 (EBRD CBs Framework Latvia) as well as ECB

[311] Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU *OJ L 328/29* (CB Supervision Directive)

eligible collateral.[312] Since these securities often entail SPVs, they can be kept off a bank's balance sheet. In fact, it has been recommended as the preferred option for implementing the Covered Bonds Directive in Latvia.[313] The legal justification for guaranteed pay-out of cover assets in CBs is shown in Article 4 and 5 of Directive 2019/2162. Article 4 describes 'dual recourse' (see Figure 3.1), which means that investors in CBs hold a claim against the issuer, always a credit institution,[314] as well as a guarantor (often national government), should the issuer fail.[315] Article 5, on remoteness from bankruptcy, describes that MSs are responsible for shielding CBs from bankruptcy proceedings against the originator.[316] §17 of the header fits in flawlessly with Article 27 SRMR, since "… the purpose of the segregation of cover assets is to put them legally beyond the reach of creditors other than covered bond investors.".[317]

Furthermore, Article 129 (d) and (f) CRR originally limited the inclusion of securities in the cover pool to 10%. However, the CBs Directive includes waivers to this rule, as explained in §20 of the header. This means that credit institutions can put more securities into the CB, potentially increasing correlation with their balance sheets. The second part of §20 describes the usage of 'European Covered Bonds', which means that banking groups instituted in multiple MSs, may issue CBs in all these countries.[318] Article 17(1)(a) stresses that maturity extensions can exclusively be given based on "…[o]bjective triggers in national law …".[319] It is thus up to MSs to extend the maturity of loans that it guarantees, with potential help of a fiscal backstop at the EU-level. In any case, Article 17 ensures that the favourable conditions described in Article 4 and 5, remain intact.[320] To help absorb downfalls, overcollateralisation is required, for example 5% in the Netherlands[321] which means that more collateral is held, than is invested in with the expectance of a return.

The ECB itself explained that Multi-cédulas (a subset of CDOs) are eligible collateral under CBPP3, so residential mortgages can be pooled and put into CBs (a BIS report on re-securitisation covers the balance sheet correlation risks of loan pools, see next page).[322] Moreover, the SPVs used for Asset-Backed Securities in this context are categorised under non-financial sector entities.[323] As a result, the obligation on credit institutions to report the 10 largest exposures according to Article 394 (2) CRR does not apply for SPVs.[324]

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[312] European Banking Authority, EBA Report on EU Covered Bond Frameworks and Capital Treatment. Response to the Commission's call for advice of December 2013 related to Article 503 of the Regulation (EU) No 575/2013 and to the ESRB Recommendation E on the funding of credit institutions of December 2012 (ESRB/12/2). <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/534414/fa5bf6ec-6301-4b90-8f98-3324333c82a4/EBA%20Report%20on%20EU%20Covered%20Bond%20Frameworks%20and%20Capital%20Treatment.pdf?retry=1> Accessed 3 November 2021, p. 126

[313] EBRD CBs Framework Latvia, pp 25-26

[314] CB Supervision Directive, Art. 4

[315] Ibid, § 10

[316] Ibid, Art. 5

[317] Ibid, § 17

[318] Ibid, § 20

[319] Ibid, Art. 17(a)

[320] Ibid, Art. 17

[321] De Nederlandsche Bank, 'Toetsing minimale OC van 105%' (26 January 2015). DNB, Q&A <https://www.dnb.nl/voor-de-sector/open-boek-toezicht-sectoren/banken/prudentieel-toezicht/gedekte-obligaties/toetsing-minimale-oc-van-105/> Accessed 12 December 2021

[322] European Central Bank, 'Third covered bond purchase programme (CBPP3) - Questions & answers'. (Last updated 30 October 2021). <https://www.ecb.europa.eu/mopo/implement/app/html/cbpp3-qa.en.html> Accessed 3 November 2021, Q.1.4 (ECB Q&A on CBPP3)

[323] European Banking Authority, 'Definition of Special Purpose Vehicle (SPV) as Financial Institution' (9 October 2014). EBA, Question ID 2014_1530 (Last updated 4 October 2019). <https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_1530> Accessed 25 October 2021

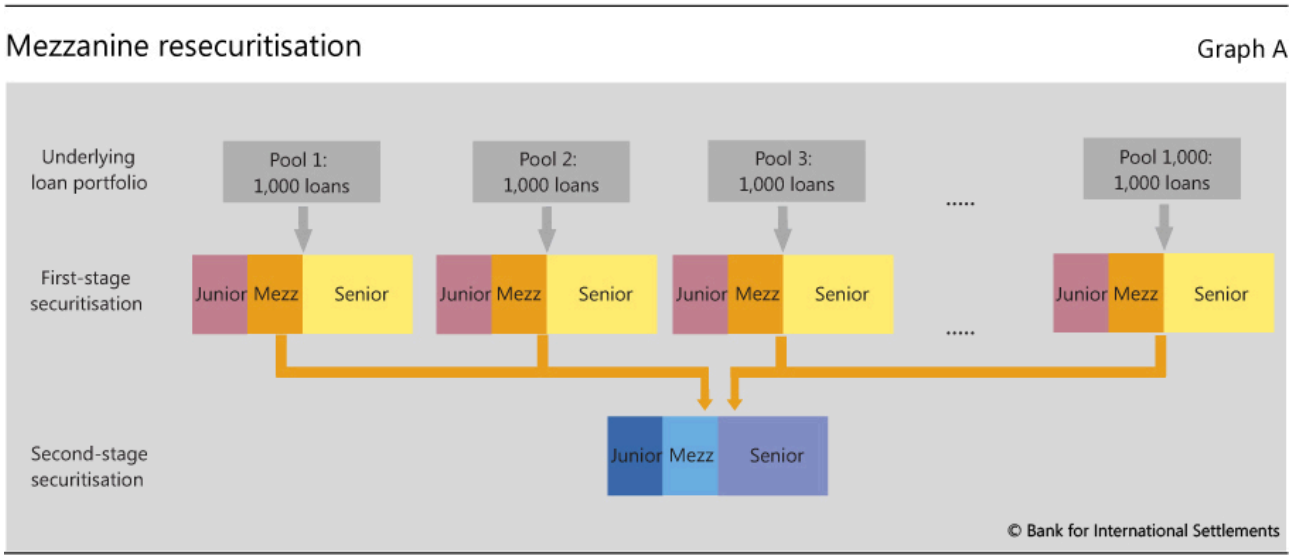
[324] Ibid

Therefore, there may be piles of non-financial corporations in the Eurozone covered by state guarantees without appearing on record, it is simply impossible to accurately verify that amount.

***Resecuritisation, a financial Achilles tendon? Think ABACUS, think twice***

The figure below describes what resecuritisation of mezzanine tranches looks like. Mezzanine comes from the Italian word 'mezzano' which roughly translates to middle, in between other levels. This refers to tranches of loans whose investors hold a claim lower than senior secured debt, yet higher than other tranches further below, with an equity tranche at the bottom, in which residual claimants invest. The intermediate rating of mezzanine tranches varies, yet ratings of BBB are common for this category, as apparent from Wojtowicz.[325] Nevertheless, a rating of A or B- is possible too, yet most importantly the rating is below AAA, yet higher than 'unrated' or junior tranches.[326]

Fig. 3.2 Resecuritisation of mezzanine tranches (Excerpt from BIS[327])




When these tranches are securitised, backed up by residential mortgages, and those entities are packed into securities themselves, into a structured product with junior, mezzanine and senior tranches (the Stage 2 securitisation in Fig. 3.2), the correlation of risks in the underlying pool of loans may lead to a misplaced sense of diversification, and a credit rating uplift that is not in tune with the assets' fundamentals.[328] This causes a funding advantage and thus draws more investors: the value of the securitised product inflates, as the value of a loan increases when funding cost/interest decreases. Because more funds are attracted than is justified by fundamentals, speculation becomes inherent. That may persist, so long as the underlying loans in general *do* perform. Because nobody invests into something with an actual ánd perceived value of nothing.

Resecuritisation, due to hidden risk, has thus contributed to the magnitude of the GFC.[329] Such a construction is reminiscent of *Goldman Sachs & Fabrice Tourre v SEC,* in which an SPV by the name of ABACUS-2007-AC1 contained tranches of which the originator reportedly knew they were likely to

[325] Marcin Wojtowicz, 'CDOs and the Financial Crisis: Credit Ratings and Fair Premia' (2011). Duisenberg school of finance - Tinbergen Institute Discussion Paper TI 11-022 / DSF 8. <https://papers.tinbergen.nl/11022.pdf> Accessed 11 December 2021

[326] Ibid, p. 2

[327] Adonis Antoniades & Nikola Tarashev, 'Securitisations: tranching concentrates uncertainty' (2014). BIS Quarterly review, December 2014 <https://www.bis.org/publ/qtrpdf/r_qt1412f.pdf> Accessed 10 December 2021, p. 44

[328] Ibid

[329] Ibid

default.[330] It is a relevant case as it shows one of those instances in which secular laws *have* been broken. The entire idea behind the product was that investors could hire a third party to select a reliable portfolio on which the synthetic investment could be based.[331] Instead, Fabrice Tourre, responsible for this investment product in his capacity as employee at Goldman Sachs,[332] hired ACA to put its name on the portfolio selection procedure, hiding the fact that Tourre contacted a firm called Paulson to select the portfolio, knowing full well that Paulson had an interest in the default of the portfolio he selected, while ACA was not aware.[333] In fact, rather than mentioning Paulson, an equity tranch of 0-9% was mentioned (Paulson had a swap *against* the underlying loans, the polar opposite), despite the fact this ABACUS was never meant to market an equity tranche.[334] Several months after closing out on 26 April 2007, investor IKB lost all of its $150 million invested in AAA-rated notes of the SPV, of which most was paid out to Paulson.[335] Likewise, ABN AMRO invested in this product at a considerable loss, after which it was acquired by a consortium of banks including the Royal Bank of Scotland. The latter paid for ABN's losses suffered from ABACUS of around $840 million towards Goldman Sachs, most of which ended up in Paulson's pockets.[336] As a result of the complaint, the judge Forrest, in 2014, ordered Fabrice Tourre to pay a civil penalty of $856,514 for disgorgement of nearly $200,000,[337] and for violating Section 10(b) and 20(e) of the Securities Exchange Act of 1934, as well as Section 17(a) of the Securities Act of 1933.[338] As described in an news article by Follow The Money, Tourre said, in relation to the scandal: "Nobody ever corrected me."[339]

It must be said that ABACUS-2007-AC1 was a synthetic securitisation of a mezzanine CDO,[340] meaning a shorted CDS on a CDO containing BBB-rated Residential-Mortgage Backed Securities (RMBS). A synthetic securitisation is not the same as a resecuritisation: one could think of it as loans being securitised in Stage 1, while remaining on the balance sheet of the originator. In a second stage, reference is made to this CDO in the form of a CDS - that is, a credit protection on the CDO of Stage 1. In order to synthesise the returns on the CDO, the SPV investing in the CDS needs to take a short position. The responsibility to provide returns and sufficient collateral thus remains with the originator, not with the SPV. However, the layering structure is very similar and allows for speculation on underlying assets, resulting in a price that may in no way resemble the underlying value. This takes even worse proportions when the ratio NPLs increases, and once defaulted, they are worthless. According to Wellens, Islam forbids speculation to make profits out of usury, called *bilaa-riba*, meaning banking that forbids *al riba* (supernormal profits due to usury or speculation).[341] The constructions above show that *al riba* is alive and well in the Eurozone, dancing in the limelight, visible enough to attract 'investors', yet officially not defined as usury.

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[330] *SEC v Goldman Sachs & Co. and Fabrice Tourre* Complaint [Fraud] (US) [10-CV-3229] (15 april 2010)

[331] Ibid

[332] Ibid, par. 9

[333] Ibid, par. 32

[334] Ibid, par. 47

[335] Ibid, par. 58-60

[336] Ibid, par. 66

[337] ECF Case [10-CV-3229] *SEC v Fabrice Tourre* US District Court, Southern District of New York (27 March 2014), par. 2

[338] Ibid, par. 1

[339] FTM Redactie, 'Goldman Sachs-bankier Tourre: 'Nobody ever corrected me' '(25 July 2013). Follow The Money <https://www.ftm.nl/artikelen/fabrice-tourre-geeft-dat-email-incorrect-was?share=a5ndOlLzBJUz7xMr%2Bg4CVzwMUm8dUCR0g4RgAlMBihvWbrjEjKNfKx0u7TsPrw%3D%3D> Accessed 14 December 2021

[340] *SEC v Goldman Sachs & Co. and Fabrice Tourre*, par. 14

[341] Interview, see Appendix 2 §1

***A sinful practice finally rooted out, ' … Ma shaa Allah!', or not …***

Article 8 (1) of the Securitisation Regulation imposes a ban on resecuritisation, that is a ban on the very procedure described in Fig. 3.2, which seems appropriate in light of the above findings. Nevertheless, derogations are allowed when used for recapitalisation of credit institutions,[342] and can thus be applied on a large scale. Article 8(3) specifically allows resecuritisation of NPLs/NPEs when necessary to preserve the interests of investors.[343] In light of the vast sums of securitised NPLs, that seems detrimental to the overall financial health in the Eurozone. Moreover, the ban only applies on assets issued after 1 January 2019. In addition, CBs are not defined as securitisations,[344] and can thus circumvent Article 8 SR altogether while technically being very similar to a resecuritisation, when SPVs are included. Resecuritised products are reminiscent of the CDO squared (a CDO whose underlying positions are other CDOs or parts thereof - in fact a CDO-squared is a resecuritisation) described in the movie 'The Big Short'.[345] As recent history demonstrated, they can be very risky, especially when used at systemic level, because it allows for speculation on products whose underlying exposures are worth only a fraction of the market price, or worthless in case of defaulting loans.

The derogations under Article 8 of the Securitisation Regulation effectively allow compliance with the prudential requirements of the SSM, avoiding a FOLTF-classification and preventing resolution under SRM, by selling off trash, when all sound options to improve balance sheets have been exhausted. It is deceptive in the sense that it allows large banks to be resolved under the SRM, after they have been zombified down to their bones (i.e till there are no real critical functions left). SPVs are kept alive through 'predatory lending', by issuing new loans and charging insurance premia on top of existing loans.[346] The 'loophole' in Article 8 applies to all EU MSs as the Securitisation Regulation is part of the Single Rulebook. MSs can determine at their own discretion whether resecuritisation may be used to serve a legitimate purpose.[347] Such is the confidence of the EP and the Council in the application of the rule of law across the EU in this matter, and there is reason to contest that (see 'Bribery'). Another way to keep SPVs alive is overcollateralisation, as discussed with regard to CBs.

It is interesting too that Article 42 exempts OTC Derivatives concluded by SPVs and CBs from the clearing obligation as defined in the European Market Infrastructure Regulation.[348] Should implementation of the CBs be completed, securitisations can be put into them and be settled on a bilateral basis, which may thus result in a new EU-wide class of bilaterally cleared OTC Derivatives in the future.

***Malta Development Bank and its guarantees***

Finally, not just the reliability of asset ratings have been compromised. In 2017, the Maltese government established the Malta Development Bank under the Malta Development Bank Act (Act No XXI of 2017 – CAP 574).[349] Article 5 of that act says that the government shall guarantee "… up to 100% of all obligations of the MDB and up to 100% of the loans, facilities or guarantees issued by the Bank. The Government

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[342] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 *OJ L 347/35* (Securitisation Regulation)

[343] Ibid, Art. 8

[344] European Central Bank, 'Do covered bond transactions qualify as a securitisation?'. Question ID: 2020/0009, 31 January 2020. <https://www.ecb.europa.eu/stats/money_credit_banking/anacredit/questions/html/ecb.anaq.200131.0009.en.html> Accessed 25 October 2021

[345] The Big Short (2015) - Mark Baum (Steve Eisman) Meets a CDO Manager [HD 1080p] (uploaded on 24 April 2016) <https://www.youtube.com/watch?v=A25EUhZGBws> Accessed 15 October 2021

[346] Deutsche Bank part 5

[347] Securitisation Regulation, Art. 8(2)

[348] White & Case, 'Securitisation Derivatives and the Margin Exemption' (30 July 2018). White & Case Derivatives Insight – The Delta Report <https://www.whitecase.com/publications/article/securitisation-derivatives-and-margin-exemption> Accessed 4 November 2021

[349] Malta Development Bank, 'About Malta Development Bank' MDB, Home <https://mdb.org.mt/en/home/Pages/About-Us.aspx> Accessed 1 December 2021 (In reference to Act No XXI of 2017 – CAP 574, Art. 5)

guarantee is unconditional and irrevocable."[350] Moreover, Eurostat determined in 2016 that MDB "should be classified outside the general government sector for the purposes of classification by sector under ESA 2010", all the while being compatible with State Aid and rules on the internal market."[351] This construction allows Malta (and would enable other MSs) to suppress their official statistics and meet Eurozone requirements under the SGP, in manner that used to be illegal for good reasons, as explained under 'Bribery'. These findings are relevant in light of the MSs participating in the EBU, and the kind of legal and financial regimes covered by the European tax payer as a consequence.

Under the current Eurozone regime, derivatives can be used on a bilateral basis and privately be settled, for example, to conduct transactions between a bank and national government.[352] This way certain assets can be shifted off bank balance sheets, but also concealed from government records, as happened in Latvia, with documented evidence.[353] In the context of the ESM, and the guarantees given by MDB, it is not surprising that the EBRD expresses confidence in its payments remaining unaffected in case of sovereign default.[354] The equity derivatives held in relation to Banking Portfolio stand at €200 million, and within that portfolio "[o]ption contracts are privately negotiated with third parties to provide potential exit routes for the Bank on many of its unlisted share investments", explained in the 2020 Annual Report.[355] The next chapter covers a very controversial one of those option contracts, one which was highly illegal. This is relevant in assessing the financial hygiene of the Eurozone on which the EBU is being imposed.

## Bribery ('shochad devarim')

Bribery, described as bias due to past favours, was one of the issues raised by Friedman in 2009.[356] This can manifest itself in direct bribes, as well as connections between political and economic life (lobbying). One of the mechanisms employed in the EBU to prevent this is an Administrative Board of Review, in accordance with Article 24 SSMR, whose members are appointed for a term of five years, excluding current staff of the ECB, or other competent authorities at the national level or Union bodies.[357] This measure prevents the ABoR from intertwining with the actual tasks of the ECB. The members of the ABoR should be of good repute,[358] and this equally applies to members of the Supervisory Board, the ECB Governing Council.

### *Bring in the action: Latvia, law(lessness), leveraged corruption and more*

The definition of good repute under EU legislation deserves attention, after several financial journalists, including Wellens,[359] and whistleblower John Christmas, have found evidence of corruption in Latvia, surrounding Eurostat and the European Bank for Reconstruction and Development (EBRD) and the former Latvian government under Dombrovskis.[360] In his capacity as former Latvian Prime Minister, Valdis Dombrovskis reportedly oversaw one of the most corrupt economies in Europe (reports follow in the paragraphs below), upheld by a corrupt dealing between Latvia's second largest bank and the Latvian

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[350] Ibid

[351] Malta Development Bank, 'Establishing the Malta Development Bank'. MDB, Home <https://mdb.org.mt/en/home/Pages/Establishing_the_MDB.aspx> Accessed 1 December 2021

[352] Deutsche Bank part 4

[353] Ibid, 28:00-30:00 and Eurostat report (investigated by John Christmas)

[354] European Bank for Reconstruction and Development, 'Financial Report 2020', (17 May 2021). EBRD <https://www.ebrd.com/news/publications/financial-report/financial-report-2020.html> Accessed 12 December 2021, p. 38

[355] Ibid p. 41

[356] Friedman & Friedman (2009)

[357] SSMR, Art. 24

[358] Ibid

[359] Deutsche Bank part 4

[360] John Christmas, 'Confirmed Fraudster becomes European Commission Executive Vice President' (22 September 2019). The EU bubble <http://eububble.eu/parex-bank-money-laundering-valdis-dombrovskis> Accessed 25 October 2021

government, that took place during his reign.[361] Back in 2008, Parex Banka (worth approximately €4.9 billion at the time, on paper) was severely hit by the GFC, according to Eurostat, and received financial assistance from the government. To comply with the assistance requirements, the bank was split up into "good bank" *Citadele* and "bad bank" *Reverta* in November 2008.[362] It has been reported that large portions of Parex' assets were fictive.[363] In April 2009, Citadele, the Latvian Privatisation Authority and the EBRD signed a put option agreement, in which the EBRD acquired 25% of Citadele's shares plus 1 voting share and LPA acquired 75% minus 1 share.[364] This agreement meant that the EBRD lent LPA to invest in its stake, in exchange for a guarantee by LPA through a put option on LPA's amount of Citadele's shares. The EBRD thus gave a loan €93 million notional amount to LPA, so the latter could buy Citadele shares. The 'restructuring' agreement was approved by PM Dombrovskis.[365]

A document of consultancy firm Nomura has been found, showing that the law firm assisting in this operation was Sorainen, to fit the tailor-made needs of the LPA.[366] Specifically, Nomura refers to a Sorainen memo of 9 March 2010.[367] The document indicates that Parex was planned to collapse within 5 years.[368] That is, after the split into Citadele and Reverta. Strangely then, did they receive an enormous total bailout of €7.5 billion by the IMF and the EC, the latter having granted €3.1 billion.[369] As a result, the Latvian public debt skyrocketed, holding the tax payer liable for the troubles at Parex.[370] We do not have exact numbers on the amount that flowed into Reverta, yet Parex' bad assets reportedly amounted to around half of its assets in 2010, which makes it probable that over a billion euros of bail-out funds have flowed into Reverta.[371] Of course that makes no sense if a company is about to stop its existence anyway. The document of the restructuring plan was classified, and credit is due to those who had the courage to investigate and publish those findings. The government records of Latvia show that it entered into an agreement with Nomura on 25 January 2010 to set up the restructuring plan for Parex.[372] The 'restructuring plan' was submitted to the EC on

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[361] John Christmas, 'GUEST POST: Eurostat and the Malta Development Bank' (27 June 2019) <https://manueldelia.com/2019/06/guest-post-eurostat-malta-development-bank/> Accessed 9 November 2021 (John Christmas guest post)

[362] Eurostat, 'FINAL FINDINGS Eurostat EDP dialogue visit to Latvia' (7-9 June 2017). European Commission Directorate D: Government Finance Statistics (GFS) and quality
Unit D-3: Excessive deficit procedure (EDP) 2'. Luxembourg, 23 April 2018, p. 28. Obtained through John Christmas guest post <https://ec.europa.eu/eurostat/documents/1015035/8054610/Final-findings-EDP-dialogue-visit-LV-7-9-June-2017.pdf> Accessed 9 November 2021 (Eurostat Final Findings on Latvia (2017))

[363] Christmas (supra n. 360 & 361)

[364] Ibid, p. 30

[365] 'Nomura delivers Parex restructuring plan' (25 March 2010). The Baltic Times, Riga <https://www.baltictimes.com/news/articles/25337/> Accessed 12 December 2021

[366] Arno Wellens, 'Via Letland reikt de macht van de Russische maffia tot in de top van de ECB' (8 August 2018). Follow the Money <https://www.ftm.nl/artikelen/letland-russische-maffia-ecb-deel-2?share=yETXmq8xcWOqC4k6Ei%2BpMN3YZGEZ87X2U0F%2FSq7bXsUKDQRA%2FGlXxdmswdF%2Bxw%3D%3D> Accessed 5 December 2021 (Wellens at Follow the Money)

[367] Ibid, see Appendix 6.9

[368] Ibid

[369] European Commission, 'EU provides €3.1 billion Community financial assistance to Latvia' (27 January 2017). EC Economic and Financial Affairs <https://ec.europa.eu/economy_finance/articles/financial_operations/article13872_en.htm> Accessed 12 December 2021

[370] Wellens at Follow the Money

[371] John Christmas, 'Latvian Narratives and the EBRD 2' (29 May 2019). *Baltic Rim Economies Review* <https://sites.utu.fi/bre/latvian-narratives-and-the-ebrd-2/> Accessed 12 December 2021

[372] 'OVERVIEW OF JSC PAREX BANKA TAKEOVER' (8 May 2009). Updated in 2010. <https://www.fktk.lv/wp-content/uploads/2019/05/Parnemsanas_apskats_02.02Eng.pdf> Accessed 12 December 2021, p. 12

31 March 2010, approved in June.[373] That means the EC (or people therein) must have had reason to be aware of the fraudulent nature of the transaction, or have been. On 28 December 2013, Christmas wrote a letter to Mario Draghi, expressing his concern that similar cases could arise in other MSs (we have contained an excerpt in Appendix 6.8, as proof of the document).[374] The answer has been a deafening silence according to Lawless Latvia, as Price Waterhouse Coopers reportedly destroyed this letter when asked to forward it to the ECB.[375]

The agreement meant that the EBRD did technically not own a stake in Citadele as a genuine investor, but rather provided funds to be paid back at the privatisation (with the exception of the 25% stake), and that the LPA used more borrowed money than officially stated. This directly contradicts the official line of the EBRD in 2009, in which only a subordinated loan of €22 million is mentioned.[376] The mere interest payments on the agreement nearly exceed that amount already, and reference is made to it in the paper of Nomura.[377] This agreement meant the transaction was kept off the government's financial records as well as Citadele's, as long as this put option had not been exercised under the agreement, which Wellens emphasised at Follow The Money. In 2014, the put option was recorded as a guarantee call (while privatisation officially took place in 2015), and hence reversed the transaction described as 'deficit increasing capital transfer' between brackets, as if it were an anomaly.[378] The repurchase agreement amounted to €114.3 million, due to interest (a usurious amount of over €21 million on a €93 million loan, referred to as '22%' in the Nomura paper[379]), subtracting the 25% stake the EBRD has kept, valued at €24.9 million, as well as payments for having modified the agreement in the meantime, resulting in €88 million payment made by LPA (and thus the Latvian government).[380] Subsequently, the 75% stake was sold at €74.7 million to private investors.

Wellens raised this fraudulent transaction, after which a parliamentary inquiry took place.[381] In response to a letter by MP Pieter Omtzigt, who requested clarification, Walter Radermacher - on behalf of Eurostat - explained in 2014 that Eurostat was aware of the put option agreement and that it did not require to be recorded in Latvian statistics. Furthermore, the amount agreed upon would appear in government records as a debt increase, once the put option had been exercised.[382] All the while, the transaction was highly illegal under national law (and would violate the SGP requirements). According to Christmas, it was so illegal that the government under Dombrovskis prosecuted anyone who sought to investigate the transaction  efforts by other media to discredit his story.[383] Ever since,  Mr. Dombrovskis has been EC Vice-president in multiple

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[373] Ibid

[374] John Christmas, 'RE: EBRD helping falsify financial statements of Latvia & Lithuania (28 December 2013). Letter to Mario Draghi, President of the ECB. <http://www.lawlesslatvia.com/wp-content/uploads/2014/02/ECB-letter-scan.pdf> Accessed 12 December 2021, see Appendix 6.8

[375] Lawless Latvia, 'ECB letter about EBRD fraud and PWC response' (17 February 2014) <https://lawlesslatvia.com/like-and-share-to-fight-corruption-latvia-lithuania-russia-ukraine-belarus-eu/> 12 December 2021

[376] European Bank for Reconstruction and Development, 'Parex Bank Subordinated Loan' (7 April 2009). EBRD, project nr. 40374 (FI) <https://www.ebrd.com/work-with-us/projects/psd/parex-bank-subordinated-loan.html> Accessed 25 November 2021

[377] Wellens at Follow the Money

[378] Eurostat Final Findings on Latvia (2017)

[379] See Appendix 6.7

[380] Ibid, p. 30

[381] Deutsche Bank part 4

[382] Walter Radermacher, 'Parex Bank and the EBRD'. Letter to Mr Pieter Omtzigt, Member of Parliament for the Dutch Christian Democratic Party CDA. Ref. Ares(2014)3026697 - 16/09/2014, Luxembourg, ESTAT/DGAVR/D3/JV/PL/eb/D(2014)3304947. Retrieved from <http://www.lawlesslatvia.com/wp-content/uploads/2014/10/Eurostat-letter-September-2014.pdf> Accessed 9 November 2021

[383] John Christmas at EU Bubble (29 September 2019)

fields (not at the same time yet one after another) ,[384] after Latvia fraudulently complied with the EU debt requirements to be eligible for Eurozone membership.[385] He is now Executive Vice-President of the EC for economic matters (an Economy that works for people, as he calls it), a function he has held since 2019, and until 2024, which means his decisions as EU-official in that timeframe are protected by diplomatic immunity.[386] Moreover, his functions in the EU (many of which are top-level functions) are immune to national law, under the scope Article 343 TFEU, as discussed by Wessel.[387] This timeframe also covers the period in which the EBU has been planned for completion.

Latvia has been able to hide its true public debt figure, because of the transaction and parties described above. And because reporting requirements of such agreements, once exercised, have expired in 2013, other MSs may engage in similar behaviour without being noticed, according to Wellens.[388] The amount of fraudulent funds from Latvia has been estimated at 1 trillion euros, reportedly capable of bribing Latvia a way into the Eurozone, thereby bringing the exposures of the Latvian banking system into the EBU.[389] Christmas described Latvia's financial system as one of the largest slush funds in history.[390] Though a 2017 report concluded that corruption in Latvia had strongly decreased, the report was found to be funded by ABLV, one of the largest Latvian banks at the time.[391] Anders Aslund, author of this 2017 report at the Atlantic Council, was asked to do so by Sally Painter, a woman described as "… [l]ong-time lobbyist for Latvia's non-resident banks …", was appointed to the Atlantic Council board that year.[392] Aslund, who co-authored "How Latvia Came through the Financial Crisis" with Dombrovskis[393], admitted to have been paid by a consortium of Latvian banks, including a subsidiary of ABLV to write his 2017 report.[394] And moreover, in 2018, FinCEN concluded that ABLV institutionalised money-laundering, including corruption related to Ukraine and Russia, as well as transactions linked to North-Koreas ballistic missiles programme.[395] Martins Bunkus, lawyer and bankruptcy administrator, analysed these transactions and called for an independent investigation, seeking help from the US National Security Council. On 30 May 2018, he was killed with a Kalashnikov rifle in Riga.[396]

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[384] European Commission, '(Executive Vice President 2019-2024) Valdis Dombrovskis, An Economy that Works for People' (Last updated 3 December 2021). EC, The Commissioners <https://ec.europa.eu/commission/commissioners/2019-2024/dombrovskis_en#news> Accessed 27 October 2021(Dombrovskis EC profile)

[385] John Christmas at EU Bubble (29 September 2019)

[386] Protocol (No 7) On the Privileges and Immunities of the European Union *OJ C326/1*

[387] Ramses A Wessel, 'Immunities of the European Union' (2013). (Forthcoming in) *International Organizations Law Review*, Volume 10, 2013, No. 2 <https://ris.utwente.nl/ws/portalfiles/portal/6933860> Accessed 16 November 2021, p. 7

[388] Deutsche Bank part 4

[389] John Christmas at EU Bubble (22 September 2019)

[390] Ibid

[391] Steve Komarnyckyj, 'The Atlantic Council: independent think tank, or lobbyists for oligarchs?' (3 March 2020). EUtoday, Politics. <https://eutoday.net/news/politics/2020/atlantic-council> Accessed 30 November 2021

[392] Inga Springe, Emily Tamkin, Sanita Jemberga, 'A Report On Money Laundering At Latvian Banks Raises Questions About Conflict Of Interest At The Atlantic Council' (30 July 2018). BuzzFeed News <https://www.buzzfeednews.com/article/ingaspringe/report-on-money-laundering-at-latvian-banks-raises> Accessed 30 November 2021

[393] Stephen Komarnyckyj, 'The Colour of Russian Money Part 2: A Latvian Laundromat' (6 April 2018). Byline <https://byline.com/2018/04/16/the-colour-of-russian-money-part-2-a-latvian-laundromat/> Accessed 10 November 2021

[394] Komarnyckyj (supra n. 391) & Springe and others (supra n. 392)

[395] Steve Huddak, 'FinCEN Names ABLV Bank of Latvia an Institution of Primary Money Laundering Concern and Proposes Section 311 Special Measure' (13 February 2018). Financial Crimes Enforcement Network. An official website of the United States Government <https://www.fincen.gov/news/news-releases/fincen-names-ablv-bank-latvia-institution-primary-money-laundering-concern-and> Accessed 29 November 2021

[396] Graham Stack, 'A Latvian Bank's Last Sweetheart Deal for Kremlin-Linked Clients' (6 October 2021). OCCRP, The Pandora Papers. <https://www.occrp.org/en/the-pandora-papers/a-latvian-banks-last-sweetheart-deal-for-kremlin-linked-clients> Accessed 1 December 2021

As a result of the violations of ABLV found by FinCen, the US government imposed sanctions under Section 311 of the USA PATRIOT Act, prohibiting correspondent bank accounts for ABLV to be held in the US.[397] The full range of complaints can be found at the Federal Register, Volume 83, No. 33.[398] Several days later, the ECB concluded that ABLV was FOLTF due to US-imposed sanctions.[399] Not surprising then, the SRB could not establish a public interest under Article 18(1)(c) SRMR, as the bank did not significantly contribute to the real economy.[400]

ABLV also appeared in corruption investigations in Malta. Specifically, Daphne Caruana Galizia was investigating 17 Black, to which $1.4 million was found to have been sent from an off-shore account held at ABLV.[401] Following that investigation, on 16 October 2017, she was killed by a car bomb, which led to a parliamentary inquiry.[402] Like ABLV, 17 Black had reputational problems related to off-shore accounts of high-profile figures, most notably former Maltese PM Muscat.[403] Both in the case of Latvia and Malta, those who sought independent corruption investigations have either been assassinated or fled their country following death threats. Mr. Christmas described these gruesome findings too, and added that he knows Mrs. Painter from back in his career, as she reportedly worked at Parex too.[404]

As mentioned, Mr. Aslund and Mr. Dombrovskis wrote a book, describing Latvia's path through the GFC, crediting austerity measures of the Dombrovskis administration as an extraordinary accomplishment that prevented a need for currency devaluation.[405] On page 68, Ilmars Rimšēvičs, then Latvian Central bank governor, was credited as "[a] constant force in keeping Latvia's budget deficit below 3% of GDP".[406] The findings of Wellens, Omtzigt, Christmas and Eurostat have proven how that was fraudulently achieved. It is clear why Mr. Christmas has lauded Wellens as one of the only two journalists willing to analyse his findings, besides Italian journalist Mauro Caterina.[407] Despite the findings above, Mr. Dombrovskis is now a

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[397] Huddak (supra n. 395)

[398] FinCen, 'Proposal of Special Measure Against ABLV Bank, AS as a Financial Institution of Primary Money Laundering Concern' (16 February 2018). Federal Register/Vol. 83, No. 33, pp 6986-6994 <https://www.fincen.gov/sites/default/files/federal_register_notices/2018-02-16/2018-03214.pdf> Accessed 29 November 2021

[399] European Central Bank, "Failing or Likely to Fail' assessment of ABLV Bank, AS - ECB' (24 February 2018). ECB Banking Supervision <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.2019_FOLTF_assessment_ABLV_Bank_AS~48046b4adb.en.pdf> Accessed 1 December 2021

[400] Ibid

[401] Jacob Borg, 'Watch: $1.6m wired to Mizzi and Schembri's Panama 'target client'' (18 April 2018). Times of Malta <https://timesofmalta.com/articles/view/mizzi-and-schembris-panama-target-client-received-16-million.676783> Accessed 30 November 2021

[402] Parliamentary Assembly, 'Resolution 2293 (2019) 'Daphne Caruana Galizia's assassination and the rule of law in Malta and beyond: ensuring that the whole truth emerges' (26 June 2019). Council of Europe Resolution 2293 (2019) <https://assembly.coe.int/nw/xml/XRef/Xref-XML2HTML-EN.asp?fileid=28053&lang=en> Accessed 1 December 2021

[403] Matthew Vella, 'Muscat admits knowing that 17 Black was Schembri's and Fenech's 'business matter'' (4 December 2020). Maltatoday <https://www.maltatoday.com.mt/news/national/106313/muscat_admits_knowing_that_17_black_was_schembris_and_fenechs_business_matter#.Ya6V_C9x8Wo> Accessed 6 December 2021

[404] John Christmas, 'Two countries, two murders that deserve answers' (6 August 2020). *The Shift* <https://theshiftnews.com/2020/08/06/two-countries-two-murders-that-deserve-answers/> Accessed 6 December 2021

[405] Anders Aslund & Valdis Dombrovskis, *How Latvia Came through the Financial Crisis* (2011). Peterson Institute for International Economics, Washington. ISBN**:** 978-0-88132-602-4. Available from: ProQuest Ebook Central. [30 November 2021]

[406] Ibid, p. 68

[407] John Christmas, 'Latvian narratives and the EBRD' (2018). *Baltic Rim Economic Review*, May 2018, Issue no. 2. Retrieved from <https://www.academia.edu/37344559/The_Baltic_States_and_Japan_What_if_any_are_the_possibilities_of_further_cooperation_p_35_> Accessed 1 December 2021, p. 38

strong advocate for the completion of the EBU, which he defended despite objections raised by finance ministers from several MSs.[408]

Another key player in the EU who no longer needs an introduction is Mr. Rimšēvičs, former head of the Latvian Central Bank, as well as former Governor at the ECB.[409] Mr. Rimšēvičs was appointed Governor of the Central Bank of Latvia on 31 October 2013, for the period of 31 December 2013-2019.[410] In 2018, he was charged with taking bribes in his capacity as Latvian central banker. As a result, the Republic of Latvia filed a lawsuit against Mr. Rimšēvičs and the ECB in 2018, for allegedly having violated Article 14.2 of the Statute of ESCBs.[411] The Court ruled that Latvia provided insufficient evidence, and that prosecution at the national level should be annulled to the extent it hampered Mr. Rimšēvičs from operating in his function at the ECB.[412] It demonstrates the immense degree of diplomatic immunity enjoyed by ECB officials, which has been reinvestigated in Case C-3/20. Therein, the Court rules that the EP retains the right to waive diplomatic immunity of EU officials (including ECB) found guilty of serious misconduct. Nevertheless, the ECB retains the exclusive right to determine whether such a decision is contrary to the interests of the Union, and hence has a final say on immunity of its officials. The Court did rule however, that alleged crimes committed outside one's role as ECB official, may still be subject of national prosecution.[413] Following the judgement, Mr. Rimšēvičs has no longer diplomatic immunity against national charges on his functions outside the ECB.

Similar to the allegations against Mr. Rimšēvičs, as recent as 12 October 2021, Peter Kazimir, member of the ECB Governing Council and director of the Slovakian central bank, has been charged with bribery by Slovakia's national prosecutor. Given that no concrete evidence of corruption has been found, he retains his function at the ECB.[414] So far so good, yet there is a clear pattern showing when high-ranking ECB officials alleged of violating the Statute of ESCBs, the ECB has no real interest in allowing MSs proceed their investigations.

Latvia, among other European countries, have been found to be subject of systemic corruption at the highest echelons of society, and the above observations attest to that. The whistleblower exposing corruption, in Latvia, was the former head of Parex bank when he stumbled upon mismanagement, and escaped several assassination attempts because of his work on exposing it.[415] With the CBs Directive, Latvia and other (Eastern-)European countries would technically be able to bail out oligarchs and their shell companies (SPVs) through European listed CBs, using the ESM, without having to inflate their national deficit one penny, and qualify for Eurozone (and thus EBU-) membership, and without having to break any secular law. The findings above help explain why the EBRD's attitude in Malta resembles its past approach in Latvia.

Not only do the mentioned examples compromise the reliability of the EBRD, the TFEU articles conferring powers upon the ECB, and the independence of the European Commission in serving the interests of the Union. In the cases discussed, the ECB has proven to have the power to annul criminal investigation at MS

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[408] János Ammann, 'Basel III: Member states see national financial stability at risk' (10 nov. 2021). Euractiv. <https://www.euractiv.com/section/banking-union/news/basel-iii-member-states-see-national-financial-stability-at-risk/> Accessed 6 December 2021

[409] Wellens at Follow the Money

[410] Joined Cases C-202/18 and C-238/18 *Ilmārs Rimšēvičs and European Central Bank v Republic of Latvia* Judgment of the Court (Grand Chamber) of 26 February 2019 [ECLI:EU:C:2019:139], par. 13

[411] Ibid

[412] Judgment of the Court (Grand Chamber) of 30 November 2021 Criminal proceedings against AB and Others, Request for a preliminary ruling from the Rīgas rajona tiesa, Reference for a preliminary ruling – Protocol (No 7) on the privileges and immunities of the European Union – Member of an organ of the European Central Bank – Governor of a national central bank of a Member State – Immunity from criminal proceedings – Indictment connected with activities carried out in the course of employment within the Member State, Case C-3/20 [ECLI:EU:C:2021:969] (Case C-3/20)

[413] Ibid

[414] Robert Muller & Jan Lopatka, 'ECB policymaker Kazimir charged with bribery, denies wrongdoing' (12 October 2021). Reuters, Europe. <https://www.reuters.com/world/europe/ecb-policymaker-kazimir-charged-with-bribery-denies-wrongdoing-2021-10-12/> Accessed 3 November 2021

[415] John Christmas guest post

level, effectively putting national criminal law aside when it sees fit. These findings combined, damage the very integrity of article 2 TEU, which stresses that the rule of law should prevail.[416] The relevance of the controversies cannot be stressed often enough, as they describe some of the most important and controversial mechanics of the financial system that is covered by the EBU.

### Conflict of interest

The importance of preventing conflict of interest has been clarified in the legal documents applicable to the SSM as well as SRM. These can be conflict of interest between different employers at different times, between supervisor and supervised entity, between national and European competent authorities, among others. In the previous subchapters, multiple conflicts of interest have been discussed already.

Wellens credited the composition of JSTs, with staff from different MSs being a means to mitigate political biases.[417] The JSTs are specified and described in Article 3-6 of Regulation 468/2014,[418] as well as Article 31 SSM.[419] The JST-coordinator is generally not from the country same country as the supervised entity, and appointed for three to five years, with rotation from time to time. This is called the 'rotation principle'.[420] A somewhat similar structure applies to Internal Resolution Teams in the SRM, in which each IRT is focused on specific MSs.[421] Karagianni & Scholten also described JSTs as a means of achieving political independence, in their findings of 2018.[422] Moreover, Article 31(3) of the SSM Regulation applies a two year rule including procedures to prevent conflict of interest between new employment of former Supervisory Board Members.[423] Thus far, the formal procedures to safeguard independence seem adequate and as apolitical as possible. In addition to these moderations, limits have been set on variable remuneration schemes of banks, with updates in CRD V.[424] During the pandemic, the ECB has written a memo in which it describes the attempt to monitor remuneration policies among all banks it supervises.[425] When consistently applied, such a mechanism can remove an important asymmetry between risk and reward that was present during the GFC.[426]

The Directives and Regulations applicable to the EBU, all contain an article on accountability mechanisms. Article 20 of the SSM Regulation demands the ECB to be accountable to the EP and the Council. It therefore has to submit an annual report and be answerable to parliamentary questions.[427] Similarly, Article 45 of the SRM demands the SRB to submit an annual report towards the EP, Council, EC, national parliaments and the European Court of Auditors.[428] Hence, there are formal obligations imposing *ex* ante as well as *ex* post

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[416] TEU, Art. 2

[417] Interview, see Appendix 2 §3

[418] SSM Framework Regulation, Art. 3

[419] SSMR, Art. 31

[420] European Central Bank, 'Joint Supervisory Teams' (Copyright 2021, ECB). ECB | Banking Supervision. <https://www.bankingsupervision.europa.eu/banking/approach/jst/html/index.en.html> 6 December 2021

[421] SRM Manual

[422] Karagianni & Scholten (2018)

[423] SSMR, Art. 31

[424] CRD V

[425] Andrea Enria, 'Remuneration policies in the context of the coronavirus (COVID-19) pandemic' (15 December 2020). European Central Bank | Banking Supervision, SSM-2020-0763 <https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2020/ssm.201215_letter_remuneration_policies_in_the_context_of_the_coronavirus_COVID_19_pandemic.en.pdf> Accessed 12 December 2021

[426] Financial Stability Forum, 'FSF Principles for Sound Compensation Practices' (2 April 2009). FSF <https://www.fsb.org/wp-content/uploads/r_0904b.pdf> Accessed 10 November 2021

[427] SSMR, Art. 20

[428] SRMR, Art. 45

accountability on the ECB,[429] and on the SRB too, as described above. Although formally existent, its substance varies due to the high margin of discretion enjoyed by both. Besides, the findings of Christmas show what margin of discretion can do when asking questions to hold the ECB genuinely accountable.

There are several ways in which conflict of interest can manifest itself inside a banking system. One of the documented conflicts of interest by Friedman & Friedman is the relationship between CRAs and financial institutions. Even now, in the EU, credit ratings are still given on the basis of payments by the firm to be rated, even in crisis situations. (see Chapter 1 on Banco Popular).

Another potential conflict of interest manifests when monetary policy of the ECB is not strictly independent of Banking Supervision.[430] In 2016, Vollmer already issued a warning that the ECB may make its interest rate decisions dependent on the financial situation of supervised banks.[431] The artificial inflation of housing prices, which increases demand for loans and 'improves' balance sheets of G-SIIs, causes such conflict of interest between the ECB's monetary branch and the supervisory branch (explained in 'Transparency').[432] Moreover, the fact that the ECB has a function in the SSM with the Supervisory Board, as well as multiple other functions under different 'hats' as Fromage calls them, make it harder to assess its accountability because the right 'hat' needs to be sorted out first.[433]

### *Moral Hazard Loophole of EDIS*

As discussed, the EDIS has not been implemented yet. Opinions vary on the underlying reasons, yet Kuznichenko et al. conclude that moral hazard divides fiscally frugal, law-abiding MSs from those that seek to circumvent existing rules.[434] In their analysis, Germany, the Netherlands, Finland and other MSs that value fiscal prudence are pitched against those that are more decadent, such as Italy. Germany has repeatedly raised objections to the EDIS. It illustrates that common rules, and especially cross-subsidisation are prone to abuse when not all MSs pay equal attention to the rule of law and fiscal prudence.[435] This criticism seems justified, as for example, Italy could have used QE to clean up its national debt. Instead, Asset swaps took place.[436] Kuznichenko et al. emphasise that moral hazard will remain as long as the state retains a large role in finance.[437] The fact that EDIS would guarantee deposits at EU-level, also means that MSs government have an incentive to be lenient towards banks, for the nation under their governance would no longer have to justify the cost of that guarantee towards the taxpayer (recall the ex-ante reimbursement of banks, discussed in Chapter 2).[438] In addition, most MSs have largely refused to implement the CB Directive so far, used to ensure CB investors' priority claim before depositors, essentially a pre-condition for the bail-in tool to function.[439] Since CBs hold this priority claim over deposits and all other holders on the liability side, they require safeguards by law before deposit protection can be considered/funded, and that in itself has proven at least controversial, if not highly immoral, based on our findings. Despite that, harmonising rules on deposit protection may create a level-playing field, provided that all MSs show equal respect for the rule of law.

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[429] Fromage (2020)

[430] Ibid

[431] Vollmer (2016), p. 22

[432] Interview, see Appendix 2 §7

[433] Fromage (2020)

[434] Polina Kuznichenko, Serhiy Frolov, Volodymyr Orlov and Oleksii Boiko, 'European Deposit Insurance Scheme implementation: pros and cons' (2021). *Banks and Bank Systems*, *16*(1), 116-126. DOI: 10.21511/bbs.16(1).2021.11 (Kuznichenko and others (2021))

[435] Ibid

[436] Interview, see Appendix 2 §3

[437] Kuznichenko and others (2021)

[438] Ibid

[439] SRMR, Art. 27(3)

***Latvia again: the Medusa of the Eurozone?***

Remarkably, Latvia is one of the only eight MSs that have fully implemented the CBs Directive,[440] having received technical advice from the EBRD.[441] Meanwhile, Mr. Dombrovskis - as Commission Executive VP - is responsible for managing relations with the same EBRD.[442] Furthermore, the CBs directive was proposed by Mr. Dombrovskis himself, as he addressed a conference in Berlin in 2018 in the same capacity.[443] Given that Latvia has built up a reputation for corruption, and given the reported use of Latvian shell companies for ML and TF purposes in the recent past, compliance with the CBs Directive adds insult to injury.

At the same time, the Commission has opened infringement proceedings, pending against 22 EU MSs that have not complied with this Directive.[444] In our view, this fact as well as those mentioned above, tilt the Commission's attempts to impose the CBs Directive highly in favour of MSs compliant with this Directive, including Latvia. This is relevant in light of state guarantees and the EBU's emphasis on cross-border subsidisation. Article 17 (1)(a) of the CBs Directive says that maturity extensions require "… [o]bjective triggers in national law …".[445] It means that Latvia (one of the compliant eight) is able to guarantee payments to CBs that are overdue, with access to the ESM for fiscal help. Our findings on conflict of interest illustrate that the CBs Directive, essentially a pre-requisite for the bail-in tool, proposed by a former Latvian PM, has been implemented in Latvia using legal advice from the same legal persons that allowed the MS to fraudulently enter the Eurozone: EBRD and law-firm Sorainen.[446] All the while, this has been approved by the very same person as Commission Executive responsible for managing smooth relations with the EBRD, having been Latvia's PM at the time of the stated fraudulent transaction. In the meantime, the MSs receiving infringement proceedings are in many cases net contributors to the EU budget,[447] that was used to pay for the described legal trickery.

The other seven countries that have transposed this Directive into national law are Cyprus, Denmark, France, Germany, Hungary, Ireland and Slovenia.[448] Like Latvia, four out of those MSs are net recipients of EU funds.[449]

Finally, the CBs allow assets to receive a ratings uplift. The EBRD project used for implementation in Latvia even highlighted this as an important benefit.[450] Meanwhile, the SPVs eligible for the cover pool in CBs qualify as obliged entities under the draft 6th AML Directive.[451] Article 13 of that draft includes exemptions

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[440] European Commission, 'Covered Bonds Directive Transposition Status' (5 October 2021, last updated 30 November 2021). EC publications <https://ec.europa.eu/info/publications/covered-bonds-supervision-directive-transposition-status_en> Accessed 10 November 2021 (CB Directive transposition)

[441] EBRD CBs Framework Latvia

[442] Dombrovskis EC profile

[443] Huw Jones, 'EU to propose pan-EU covered bond rules' (23 February 2018. Reuters, Banking and Financial News. Last updated 4 years ago. <https://www.reuters.com/article/eu-markets-regulations/eu-to-propose-pan-eu-covered-bond-rules-idUKL8N1QD2EQ> Accessed 7 November 2021

[444] CB Directive transposition status

[445] CB Supervision Directive, Art. 17

[446] EBRD CBs Framework Latvia

[447] Zsolt Darvas, 'How could net balances change in the next EU budget?' (23 January 2020). Bruegel (Macroeconomic Policy) <https://www.bruegel.org/2020/01/how-could-net-balances-change-in-the-next-eu-budget/> Accessed 12 November 2021

[448] CB Directive transposition status

[449] Darvas (supra n. 447)

[450] EBRD CBs Framework Latvia, pp 20-26

[451] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849 COM/2021/423 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0423> Accessed 10 November 2021 (Draft 6th AML Directive)

from supervision of obliged entities as determined by national law. These exemptions apply when public registration puts the manager or beneficiary owner at high risk of extreme violence or exploitation (of various forms), or when the beneficiary owner is a minor.[452] As a consequence, SPVs in MSs may appear compliant with the AML requirements of the internal markets, either because they *are*, or because proving otherwise is *too dangerous*. Regardless of that, they enjoy a priority claim. In Latvia, the latter may very well be the case, given Komarnycjkyj's documentation on John Christmas: "… [o]n 25 January 2006, a former colleague telephoned him. She said that the bank was hunting him down and that he should stay out of Latvia. He had kept swapping addresses after leaving Parex because of concerns for his safety. “I was told that Parex was the mafia, the KGB, and killed anyone who got in their way,” he said. Christmas’s life may still be in danger because of his allegations."[453] Christmas himself has tonnes of evidence that his safety is indeed in jeopardy after his efforts to expose the truth.[454]

Ironically, Mr. Dombrovskis is now leading a crusade against money-laundering and terrorist financing, pushing for the completion and implementation of the 6th AML Directive.[455]In that crusade, the European Court of Auditors appointee to audit MSs is Mihails Koslovs from Latvia, who - according to Christmas - previously worked for the EBRD.[456] This is verifiable through parliamentary inquiry: Mr. Kozlovs worked at the EBRD from 2010-2012 as advisor to the Executive Board Director representing Finland, Norway & Latvia.[457] He received accolades by the Latvian PM (Dombrovskis) for "personal contribution 1) to the successful Latvian Presidency in the EU, 2015, and 2) to the introduction of euro in Latvia, 2014".[458] The time he worked at the EBRD, covers the period in which the illegal put-option agreement was adjusted multiple times.[459] This, according to us, is a source of conflicts of interest, in line with Mr. Christmas findings.

## Honest weights and measures

Honest weights are referred to in Judaism as stone-weights, which should be exactly of the same size on both sides of a balance. Friedman & Friedman refer to Credit Rating Agencies as the modern equivalent of these stone weights.[460] They have criticised the remuneration of CRAs on the basis of fees paid by the issuer of securities, instead of charging investors, as before the 1970s. In particular, CRAs " … rated 'trash' securities as high-quality and investment grade so there would be a market for them.".[461] Credit ratings are still given on the basis of payments by the firm to be rated.[462]

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[452] Ibid, Art. 13

[453] Stephen Komarnyckyj, 'The Insider who Revealed the Russian Money Nexus in Latvia' (5 September 2019). Byline Times <https://bylinetimes.com/2019/09/05/the-insider-who-revealed-the-russian-money-nexus-in-latvia/> Accessed 10 November 2021

[454] 'EBRD subsidiary Parex Bank threatened whistleblower' (28 March 2012). Lawless Latvia <https://lawlesslatvia.com/ebrd-subsidiary-parex-bank-threatened-whistleblower/> Accessed 12 December 2021

[455] Bernd Riegert, 'The EU declares war on money laundering' (22 July 2021). DW, Europe. **Permalink** <https://p.dw.com/p/3xoH0> (Accessed 10 November 2021)

[456] John Christmas, 'European Commission’s Anti-Money Laundering : Fake?' (22 June 2020). The EU Bubble <http://eububble.eu/european-commissions-anti-money-laundering-fake> Accessed 5 November 2021

[457] Report on the nomination of Mihails Kozlovs as a Member of the Court of Auditors (C8−0411/2015 – 2015/0814(NLE)). Committee on Budgetary Control (Rapporteur Igor Šoltes, 17 March 2016) <https://www.europarl.europa.eu/doceo/document/A-8-2016-0059_EN.html#title1> Accessed 30 November 2021

[458] Ibid, Annex 1

[459] Eurostat

[460] Friedman & Friedman (2009)

[461] Ibid

[462] see chapter 1 on Banco Popular

Benchmarking in credit ratings then compromises the accuracy of risk measurements. The ECB allows ABSs with a second-best rating of A- to include NPLs. For ABSs with a second-best rating of BBB, the loans have to be performing at the time of inclusion.[463] This category of eligible collateral is very similar, in fact deemed riskier, than the 'mezzanine' tranche involved in ABACUS-2007.[464] Additionally, CRR Article 178 (1)(b) allows a derogation: "Competent authorities may replace the 90 days with 180 days for exposures secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities).".[465] As this derogation covers very precisely those sectors affected by COVID restrictions, 'performing at the time of inclusion' then becomes a less meaningful term, with the very definition of creditworthiness being at stake. These 180 days past due mean that it could take six months before loans are officially recognisable as 'trash'. Additionally, moratoria imposed on NPLs during the pandemic,[466] can stretch that term with 18 months, and even more, at the discretion of MSs.[467]

Moreover, Eurozone CBs have generally received very high ratings compared to 'normal' sovereign or corporate bonds, that is to say 75% enjoy AAA ratings and 99% is rated an A at least.[468] According to Méro, rating uplifts can give the illusion that covered bonds containing risky assets are on par with risk-free assets.[469] She deems it problematic that the ECB is the main purchaser of these bonds, holding a 70% share, and stresses that guaranteed pay-out enforced through regulation has worked well in general, though it remains unclear whether that changes in case of extreme events.[470] Many of the American Collateralised Debt Obligations (CDOs) carried such high ratings too, which were adjusted only once the CDO market collapsed.[471] The author describes CDOs to be different from CBs except for coverage by mortgage loans, CBs being less complex, its risks being more transparent. The latter is questionable, again, given our findings on flexible NPL definitions, eligible collateral and SPVs.

## Transparency

Transparency is the sixth halachic principle in our analysis, and without it, no real accountability is possible. Several measures within the EBU have increased transparency. For example, Article 113 of the BRRD describes how the EBA keeps track of breaches through an EU-wide database, using naming and shaming.[472] Such approach applies for violations both identified at the SRM as well as the SSM. Hence, there is increased incentive for banks, including G-SIIs, to legally comply. Likewise, sanctions imposed on staff in the SSM and SRM are made public.[473] However, credit is due mostly to the EBA with regard to the databases.

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[463] European Central Bank, 'Asset-backed securities purchase programme (ABSPP) - Questions & Answers'. Updated on 28 June 2021. Q2.13 <https://www.ecb.europa.eu/mopo/implement/app/html/abspp-faq.en.html> Accessed 15 September 2021

[464] *SEC v Goldman Sachs & Co. and Fabrice Tourre*

[465] CRR, Art. 178

[466] Andrea Resti, (2020) When and how to unwind COVID- support measures to the banking system?, The quest for safe landing place <https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/659650/IPOL_IDA(2021)659650_EN.pdf> Accessed 5 October 2021

[467] European Banking Authority, 'First evidence on the use of moratoria and public guarantees in the EU banking sector'. NOVEMBER 2020 – THEMATIC NOTE EBA/Rep/2020/31. Available at <www.eba.europa.eu> Accessed 11 December 2021

[468] Katalin Mérõ, 'The Practice of Rating Covered Bonds. Budapest Business School' (2021). *Economy and Finance* • Vol. 8. iss. 3 • sept. 2021 • DOI: 10.33908/EF.2021.3.3 (Accessed 3 November 2021)

[469] Ibid, p. 322

[470] Ibid, p. 332

[471] Ibid

[472] BRRD, Art. 113

[473] SSMR & SRMR

Despite formal compliance, Wellens has observed a shift towards off-sheet activity, called shadow banking.[474] As controls on the visible parts of financial institutions tightens, an incentive is created to downplay risks up to the point that their presence can be proven.[475] This is especially problematic when the shadow-banking system inflates itself with ever increasing returns, through constructions such as SPVs,[476] which we covered under *Deception and Fraud.* Just as with ABACUS 2007-AC1, similar mezzanine tranches are often included in these SPVs, and may include NPLs, which will be discussed below. The ECB itself has admitted this and estimated the NPL market could grow to €1.4 trillion in 2022 as a result of the pandemic (excluding NPLs securitised thus far), in an adverse but plausible scenario.[477] This amount far exceeds the size of the SRF, the common backstop to be introduced, and ESM lending capacity combined.

Not surprisingly then, attempts are made to introduce Eurobonds, issued on an EU-wide basis, for the existing backstops may not be enough.[478] The Commission highlights that it will become the single largest issuer of Green Bonds in the world, issuing up to €250 billion of these bonds.[479] It does not take a genius to recall that amendments have been made to the CRR, including 'green' criteria in assessing (or manipulating) the risks attached to NPEs. In light of our subchapters, *Misleading* and *Deception and Fraud,* one may have a guess who is ultimately the guarantor to these (something with Eurozone MSs and taxpayer).

In addition, Wellens emphasised that real estate prices have been left out of inflation models.[480] Even back in 2006, Dominguez highlighted this as a problem.[481] Including real estate prices would endanger the QE programme and the assumption that it does not lead to excessive inflation, according to him.[482] Data shows that in July 2021 alone, the average real estate price in the Netherlands increased around 17 percent compared to that same month in 2020.[483] Including these facts in the Harmonised Index of Consumer Prices would make the legitimacy of the ECB's decisions to buy ABSs with negative yields from large banks out of 'necessity' very disputable, failing at the primary goal of price stability as laid out in Article 127 (1) TFEU.[484] As such, the QE-programme of the ECB has a negligible effect on the real economy, reportedly leading to a meagre €3 worth of newly issued loans for each €100 increase of ECB reserves provided to a bank.[485] In one of his articles, he demonstrates that despite an increase in reserves held at the ECB, ING has even shown a decrease in lending.[486]

As his example contains the difference after one year, it is difficult to establish an exact correlation, with lagged effects included. Moreover, a counterfactual would have to be analysed, in which lending by banks in the absence of a PEPP are simulated to assess whether or not that amount would be even less. We have not

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[474] Interview, see Appendix 2

[475] Ibid

[476] Deutsche Bank part 5

[477] European Central Bank, 'Non-performing loans' (Last updated 2021). ECB | Eurosystem <https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html> Accessed 20 October 2021

[478] Interview, see Appendix 2 §9

[479] European Commission, 'The EU as a borrower – investor relations' (updated December 2021). EC <https://ec.europa.eu/info/strategy/eu-budget/eu-borrower-investor-relations_en> Accessed 13 December 2021

[480] Interview, see Appendix 2 §3, 7 & 8

[481] Kathryn ME Dominguez, (2006) 'The European Central Bank, The Euro, and Global Financial Markets' (2006). *Journal of Economic Perspectives—Volume 20, Number 4—Fall 2006—Pages 67–88* DOI: 10.1257/jep.20.4.67

[482] Interview, see Appendix 2 §3, 7 & 8

[483] Centraal Bureau voor Statistiek, 'Prijsstijging koopwoningen neemt opnieuw toe' (23 August 2021). CBS <https://www.cbs.nl/nl-nl/nieuws/2021/34/prijsstijging-koopwoningen-neemt-opnieuw-toe> Accessed 10 September 2021

[484] Article 127 (1) TFEU

[485] Interview. see Appendix 2 §8

[486] Arno Wellens, 'ABN AMRO doet woke, laat rekeninghouders braken en die rennen weg' (5 August 2021). <https://arnowellens.eu/article/55409/abn-amro-doet-woke-laat-rekeninghouders-braken-en-die-rennen-weg> Accessed 5 August 2021 (Wellens, 'ABN AMRO doet woke')

verified the calculation of 3% effect on the real economy, yet the estimates of van Lerven (2016) were rather conservative too, consumer lending having increased with 1.4% and business lending having declined with 0.55%. He criticised the effect back in 2016 due to accumulation towards wealthy asset owners, arguing that the richest 10% of the Eurozone have a marginal propensity to consume of only 6%, referring to ECB Working Paper Series 1655 of 2014, by Caroll et al.[487] QE then largely pumps up the balance sheets of large banks due to demand for new loans to afford (overvalued) real estate.[488] The ECB may decide on its own to keep real estate prices out of the HICP, and has insisted on maintaining that stance.[489] Meanwhile, other firms that would not survive if it were not for the extremely low interest rates, deflate the prices of productive firms, as a result of oversupply. This phenomenon is referred to as 'zombification' of the economy.[490] As early as 2017, the head of the Dutch Central Bank (Klaas Knot) warned about this phenomenon in light of continued asset purchases by the ECB.[491] Both inflation of real estate markets and zombification have been highlighted as some of the main negative externalities of QE.[492] This is relevant to take into account for the EBU, as it gives the ECB powers to directly supervise the very same (G-)SIIs whose balance sheets have been subject of the unconventional monetary treatments described above (and so below), in line with Vollmer's warning.

A third limitation to transparency is article 132 (2) TFEU, which says the ECB "… [m]ay decide to publish its decisions, recommendations and opinions."[493] In that light, the ECB answer on Q 4.2 of the Q&A of 30 October 2020 that "… [t]he ECB does not publish a list of ABSs it has purchased, nor does it publish a list of ABSs that are not eligible for ABSPP purchases" is rather worrisome.[494] This is especially tricky during the COVID pandemic, as it makes the ECB's behaviour less predictable, given increased flexibility on NPLs. Likewise, on 20 October 2021, to Q5.1 on CBs, ECB answers that "[S]ince 12 September 2019 purchases of eligible covered bonds at yields to maturity below the deposit facility rate can be conducted to the extent necessary."[495] Wellens referred to a similar answer by the ECB regarding ABSs.[496] Unfortunately, nowhere has been mentioned how 'necessary' is defined, and by whom. Nevertheless, the ECB keeps purchasing CBs at a 70% limit, including privately issued ones.[497]

Fourthly, window-dressing among G-SIIs is allegedly a major problem.[498] This manifests itself through overoptimistic reporting but also, more recently, involving woke-culture. It is a culture that proclaims to address all forms of inequality and injustice, including gender-neutrality and 'positive' discrimination as

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[487] van Lerven (2016)

[488] Deutsche Bank part 5

[489] European Central Bank, 'Measuring inflation – the Harmonised Index of Consumer Prices (HICP)' (Last updated 17 November 2021). ECB | Eurosystem <https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.el.html> Accessed 20 November 2021

[490] Daan Ballegeer, 'Studie: 'zombiebedrijven' drukken inflatie waar ECB zo op hoopt' (3 June 2020). Financieel Dagblad. <https://fd.nl/economie-politiek/1346549/studie-zombiebedrijven-drukken-inflatie-waar-ecb-zo-op-hoopt-pvk1ca6FT7Pp> Accessed 16 September 2021

[491] Giel ten Bosch& Jules Hendriks, 'Klaas Knot: Het wordt tijd dat de marktdiscipline terugkeert in de Eurozone' (30 March 2017). Financieel Dagblad. <https://fd.nl/economie-politiek/1194844/knot-het-wordt-tijd-dat-de-marktdiscipline-terugkeert-in-de-eurozone-vsk1ca6FT7Pp> Accessed 19 November 2021

[492] Fabian Ambtenbrink, Dirk Bezemer & Maria Demertzis, 'Economische en Juridische Aspecten van de ECB Opkoopprogramma's' (January 2021). Studiegroep ECB. Retrieved from <www.tweedekamer.nl> Accessed 10 September 2021 (Studiegroep ECB (2021))

[493] Article 132 TFEU

[494] ECB Q&A on ABSPP

[495] ECB Q&A on CBPP3

[496] Interview, see Appendix 2

[497] ECB Q&A on CBPP3, Q. 5.10

[498] Interview, see Appendix 2 §6

important aspects of achieving progress in businesses.[499] According to him, even senior insiders in the banking industry have admitted that such approaches are smokescreens to underlying problems.[500] This is plausible, not just by his examples[501], but those on the other side of the world too. In *Australian Financial Review,* Roskam described, back in 2019, a case involving an Australian bank called Westpac, advocating this cultural agenda, meanwhile failing to address 23 million breaches of AML law, mostly related to 12 customers, out of 14 million, and potentially resulting in a fine of $400 trillion.[502] Ultimately, in 2020, Westpac, was ordered by the Australian government, and agreed, to pay a $1.3 billion fine for 23 million breaches of AML laws.[503] Although considerably less than $400 trillion, it is still the largest fine in Australian corporate history.[504]

Hahn et al. highlighted that 'precautionary recapitalisation' can be used as a loophole.[505] It describes a process in which institutions receive capital injections while they are still solvent, against a 'serious disturbance'.[506] The ECB is the main institution overseeing this process, besides providing additional liquidity. Moreover, it leaves the leverage ratio untouched, so that CET1 is unadjusted for riskiness and only accounts for size of exposures.[507]

Despite regulatory efforts enforcing formal compliance, Wellens argues the size of the Eurozone shadow-banking system has increased significantly since the adoption of the euro, being an incredible source of hidden risk.[508] Kehila, the final principle discussed further below, explains why more regulations and tighter enforcement may not improve behaviour and combat risks per se.

## Kehila, limited liability and legal-equals-ethical

As discussed in the literature section, Kehila refers to a deep sense of responsibility, beyond what is legally required. Soul-in-the-game, in the words of Nassim Taleb, would be an accurate term to describe it.[509] One of the trends observed by Wellens is therefore shocking: an increase in complex regulation among G-SIIs has coincided with increased emphasis on 'passing' the test, rather than upholding principles. The examples given on the next page, demonstrate what that looks like in theory and practice.

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[499] Wellens, 'ABN AMRO doet woke'

[500] Interview, See Appendix 2 §9

[501] Ibid

[502] John Roskam, 'The woke bank asleep at the wheel' (21 November 2019). *Australian Financial Review*. <https://www.afr.com/companies/financial-services/the-woke-bank-asleep-at-the-wheel-20191121-p53cq7> Accessed 3 November 2021

[503] Michael Janda, 'Westpac's record $1.3 billion AUSTRAC money laundering fine explained' (24 September 2020). ABC News <https://www.abc.net.au/news/2020-09-24/westpac-money-laundering-austrac-fine-explained/12696746> Accessed 4 November 2021

[504] Ibid

[505] Hahn and others (2020)

[506] European Central Bank, 'What is a precautionary recapitalisation and how does it work?' (27 December 2016, updated 2 May 2018). ECB <https://www.bankingsupervision.europa.eu/about/ssmexplained/html/precautionary_recapitalisation.en.html> Accessed 4 November 2021

[507] Ibid

[508] Ibid

[509] *Skin in the Game* (Taleb, 2018), pp 33-40

### *I. Contingent Convertibles*

Benchmarking, according to him, has encouraged large banks to pass legal thresholds to their worst abilities, provided the risks of detection are low.[510] This is an example of the Peltzman effect (see literature review on ergodicity). An example given by Wellens is the ability of Deutsche Bank to increase the share of Contingent Convertibles, so that leverage is allowed to be increased, making risky behaviour more profitable.[511] This attitude was described in a 2016 paper of Kiewiet et al., which mentioned that the market for CoCos has grown from 32 billion euros in 2013 to 157 billion in 2017[512], following the introduction of the CRR and CRD.[513] Deutsche Bank experienced an sudden drop in the value of its CoCos, causing turmoil in the entire European CoCos market.[514] On one hand, the authors recognise potential benefits of CoCos, such as the potentially disciplining effect on shareholders by effectively replacing government-bailouts and the risks associated with it. However, it is highlighted that "CoCos certainly add complexity to the financial system and may therefore lead to a more opaque capital structure: a CoCo prospectus consists of hundreds of pages, is complex and difficult to understand. Conversion of debt to equity often lead to legal cases and very long legal proceedings that may take several years before being finalized."[515] That again, is a disincentive to challenge potential hazards attached to CoCos.

### *II. King John v ECB (the most powerful institution in 5000 years?): Kehila explained through the concept of 'reverse delegation'*

The European Central Bank, having acquired vast powers in the monetary and the supervisory domain, and the (in)direct ability to steer fiscal policy, can hand over some of its competence back to NCAs when it sees fit. This occurs, not least, in the supervisory domain and is referred to as 'reverse delegation'[516], and it is not the first time in history such a trend has occurred. The most famous historical example of reverse delegation in our mind is the delegation of powers by King John towards British nobility in 1215. He did so after a rebellion whereby aristocrats peacefully gathered and demanded that the monarch's absolute power over its people (monetary and fiscal power to a large extent) be constrained by law, so as to protect the noblemen against arbitrary decision-making.[517] The resulting document, Magna Carta, contains 63 prohibitions and limitations to absolute power, and have given rise to due process, protection against tyranny, and greater amounts of liberty for the general population. The document is regarded as the fundament of British common law. It was more than just a reverse delegation of legal powers, it was a necessity to uphold a social contract between the king and its people, and prevent a less peaceful rebellion, which reminds us of the French Revolution. Whereas former King John can be seen as part of a control group (stretching through history) of reverse delegation in the presence of a social contract with organic status - involving a natural person (history offers plenty of examples) - the reverse delegation of the ECB is of a more arbitrary nature, without such a contract, and without real precedent, either legal or moral.

As the ECB is independent and rather anonymous (somewhat applicable to central banks in genera), it experiences no real influence by European citizens, and moreover, it is neither an institution that has achieved organic status by the standards of Kuehnelt-Leddihn (see Section III), nor one with a social contract as defined by thinkers such as Burke or Locke.[518] Instead, it largely consolidated power after several swift

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[510] Interview, see Appendix 2 §5-9

[511] Ibid

[512] Gera Kiewit, Iman PP van Lelyveld & Sweder JG van Wijnbergen, 'Contingent Convertibles: Can the Market handle them?' (2017). Tinbergen Institute Discussion Paper TI 2017-095/VI <https://papers.tinbergen.nl/17095.pdf> Accessed 10 September 2021 (Kiewit and others (2017))

[513] Ibid, p. 2

[514] Ibid

[515] Ibid

[516] Karagianni & Scholten (2018)

[517] King John of England, *Magna Carta* (1215). Rennymede (First published in 1225, Penguin Classics Edition of 1215 with commentary by David Carpenter). ISBN: 978-0-241-95337-2

[518] Terence Ball and others, 'Intellectual roots of conservatism, The Burkean foundations' (Last updated 17 May 2021). Brittanica <https://www.britannica.com/topic/conservatism/Intellectual-roots-of-conservatism> Accessed 15 October 2021

treaty adjustments, provided during the economic and sovereign debt crises, the pandemic, as well as favourable court procedures. Although there may be some legal constraints, such as the reporting obligation to EP and national parliament, as well as a tempering role of the ABoR, there are no real social or cultural constraints that could undermine its power, nor can it truly be sanctioned.[519] Despite the judgement in Case C-3/20 allowing prosecution for acts committed outside the function as ECB official, ECB board Members enjoy near diplomatic immunity from legal proceedings in MSs, given that the ECB determines the Union's interest (as discussed), when the EP attempts to waive that immunity. Moreover, whereas governments of MSs can be subjected to article 7 TEU for breaching the rule of law,[520] a similar article does not exist in application to the ECB, despite its immense power in the governance in MSs. In other words, the ECB enjoys protection against the rule of law, on a personal level regarding its managers, and on an institutional level given its legal status.

The findings above help us explain why Kehila and genuine accountability appear rather absent, especially in the SSM,[521] in which the ECB directly supervises SIIs and holds almost absolute power, despite an acceleration in regulatory updates and formal notifications towards the EP and Commission.[522] Before detecting non-compliance, the ECB - through its monetary branch - has already had the opportunity to provide near infinite liquidity (essentially lending money, thereby devaluating the euro) to the (temporary) benefit of these banks.[523] Since there is no organic social contract on which it can default, both popular and parliamentary scrutiny have not stopped this trend. And because such a contract between the ECB and citizens in the Eurozone (and EU as whole) does not exist, it is a folly to assume that the interests of the Union will simply be served when decisions are left to the discretion of the ECB. Reverse delegation as discussed, then becomes rather arbitrary as illustrated in case T-122/15 (see chapter 1).[524] It is a move in the opposite direction of Magna Carta, as the arbitrary option to reverse back competences can be used as a justification for handing over even more competences.

Our findings demonstrate that even the most powerful monarchs in history had a constraint that the ECB - underpinned by its role in the Banking Union - is not bound to: Kehila. Even the competences of the Federal Reserve of the US can be limited or expanded by legal changes in Congress,[525] whereas the ECB has been fixed into the European Treaties. In our view, this, and the above findings, have turned the ECB into one of the most powerful institutions since the first conceptions of this Jewish principle came to life. That is to say, the most powerful since approximately 5,000 years of civilisation, and - with the exception of the ABoR and some formalities, such as Article 263 and 265 TFEU - nearly unconstrained. The ECB has been found to behave accordingly, regarding monetary policies of a Eurzone which seems to expand itself at all costs, using its margin of discretion in supervisory matters, and increasingly, as the author of EU law covering the internal market, as well as its judge, handing out sanctions. Both its scale and scope seem to have given the ECB a religious-like status,[526] yet without Kehila, and without a supra-rational element (yet plenty of irrational elements as illustrated). Should taxpayers in Europe bear the costs of toxic policies conducted by the ECB, its rescue can be found in that catchphrase from 'Fabulous Fab': "Nobody ever corrected me".

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[519] Diane Fromage, 'Guaranteeing the ECB's democratic accountability in the post-Banking Union era: An ever more difficult task?' (2019). *Maastricht Journal of European and Comparative Law* 2019, Vol. 26(1) 48–62, DOI: 10.1177/1023263X18822788 (Fromage (2019)

[520] TEU, Art. 7

[521] Fromage (2019), Faraguna & Messineo (2020)

[522] Ibid

[523] Interview and our findings in this chapter

[524] Case T122/15 again (see Chapter 1)

[525] Anthanasios Orphanides, 'The Federal Reserve and Global Central Banking' (13 November 2013). Washington D.C. <https://mitsloan.mit.edu/shared/ods/documents?DocumentID=2358> Accessed 9 December 2021, p. 3

[526] In line with interview, See Appendix 2 §4

# VI. Qualitative Evaluation

**The EBU, crisis situations and the role of precedent: Conflicts with established principles**
Our qualitative findings indicate a strong deviation from established doctrines on proportionality, subsidiarity and conferral, with *Meroni* and *Romano* in particular having been pushed aside for convenience. Whereas the aftermath of the GFC led to a call for more harmonisation, caution remained at first, especially in conferral of new powers to the ECB. This changed with the creation of the Banking Union and responses to the sovereign debt crisis, and particularly during the COVID pandemic, emphasis has been put on completing the Banking Union by implementing the EDIS. The three-stage approach to implement EDIS has not been adhered to so far, following friction from several MSs. In particular, Germany has consistently criticised the various steps by which the Banking Union is being implemented.

**Emet**
Emet (meaning 'truth') is a principle that must not be violated if an economy is to succeed, built on mutual trust and reliable laws. Emet is applicable to relationships, and hence to business ethics as well.[527] To prevent another episode of large-scale violation of business ethics through lifnei iver, shochad devarim and geneiva da'at from affecting the Eurozone, the EBU needs to be provided with the right information in the right frequency, that is to say, a fulfilment of the epistemic condition as described by St. Thomas (see literature review again). Chapter 1 and 2 have demonstrated the different obligations on banks to provide information (stress-tests, risk valuations). Some of the requirements imposed on G-SIIs go beyond the standards of Basel III, such as the EU-wide systemic risk buffer. Moreover, reducing the threshold for credit institutions worth towards €125 billion euros would further emphasise the non-linear risks attached to large banks, yet the threshold may lose its value over time as QE pumps up the balance sheets of large banks and thus deflates the real value of that threshold. The common databases in which sanctions are recorded can be regarded as an asset to the rule of law, as do the attempts to depoliticise the supervision and resolution plans of banks. In theory, it is a good concept (but practice may differ, as shown three paragraphs below).

At the same time, vast amounts of direct power the ECB has in supervision makes any real parliamentary scrutiny difficult, and allows for derogations for G-SIIs on an individual basis. As apparent from our writing on CoCos, G-SIIs are able to treat debt-holders as debt-holder in terms of return, while treating them as residual claimants regarding risk. Moreover, the COVID pandemic has demonstrated that the ECB is willing to relax many of the Basel III requirements and even the treatment of NPLs, at a time when the existing pile of NPLs is very high already, and sold off in controversial manners, backed up by state guarantees.

In case the CB Directive will be fully implemented, European taxpayers may well have 'consented' to guarantee assets whose quality is questionable, in favour of the ECB as main investor, among others, creating one gigantic Collateralised Debt Obligation of assets, with reason to believe that large-scale defaults are not unlikely. Our findings show that fiscally prudent nations have already been at odds with those considered more 'decadent', and this Directive might exacerbate that friction.

In our introduction, the reader may well have noticed some skepticism from our side already. Though we have remained analytical, our skepticism has strengthened somewhat, particularly on the powers acquired by the ECB, and the short timeframe in which that took place, with little constraints imposed on it. Our findings show that the ECB manipulates existing models to continue a policy that, very likely, artificially boosts G-SIIs' balance sheets as a side-effect. Likewise, MSs have familiarised themselves with ways to circumvent SGP requirements on national debt and deficits. Should the ECB reflect the true effects on inflation, its mandate under the SGP may very well be in jeopardy. Moreover, combatting those effects would credibly require an increase in interest rates, which in turn jeopardises the balance sheets of the very banks it directly supervises. Should instead the ECB continue its current monetary policy in conjunction with its supervisory decisions, it is not unlikely that G-SIIs are inflated even further, as does the housing market on which mortgages depend. Mr. Kazimir, on behalf of the ECB, expressed concern about inflation rates that have exceeded expectations.[528] There are no real penalties under EU law that can be imposed on the policies of the ECB, even if forecasts turn out to be wrong and wreck the economy of MSs.

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[527] Case & Chavez (2017)

[528] Balasz Koranyi, 'ECB should keep policy commitment short, focus on APP - Kazimir' (7 December 2021). Euractiv, European Markets <https://www.reuters.com/markets/europe/ecb-should-keep-policy-commitment-short-focus-app-kazimir-2021-12-07/> Accessed 10 December 2021

The situation described above is very similar to inflation during the Kipper-und-Wipper Zeit (1618-1623), in which competing monarchs of German federal states kept some of each others currency and scrapped off the edges to melt additional coins, causing hyperinflation after a while.[529] The German Bundesbank has an archive of the coins which have been mutilated to create additional ones , during the Thirty Years' War.[530] QE resembles this mechanism to some extent. The difference between then and now is that the ECB is doing this to the currency that it controls by itself and that inflation seems to go unnoticed by statistics on the MSs that have adopted this currency, at least until recently.

It flows form our findings that the ECB as a legal person partially fulfils the epistemic condition described by St. Thomas, meaning that it has its own free will, and all available information to fulfill its monetary tasks, yet slightly less so for its supervisory tasks. The ECB does violate the control condition, in the sense that its scope of power exceeds the amount it is morally entitled to, as it can rather arbitrarily put banks under its direct supervision, all the while allowing the prudential requirements to be stretched whenever it deems that suitable. Meanwhile, monetary operations are used to buy up toxic parts of the very same banks under its supervision. This is best illustrated in its purchase of CBs, a market in which the ECB has a 70% stake, backed up by tax guarantees due to the Dual Recourse, while leaving this market untouched by the Supervisory Board (see Article 27 (4) SRM again). The supervisory side, making FOLTF decisions, essentially has an information monopoly vis-à-vis the SRB, and the monetary branch has a monopoly in cosmetically re-arranging SIIs through QE. All the while, the ECB's choice to exclude real estate and to invest in fraudulent MSs to uphold its SGP mandate and expand its sphere of influence shows a willingness to cover up truth in exchange for power. The newest inflation numbers put this mandate under even further pressure, housing prices excluded.[531]

Essentially, the SRB acts as an agent based upon the information of the ECB Supervisory Board, so despite its large degree of autonomy in establishing a 'compelling public interest', it does not entirely have a free will as its actions depend on the ECB's FOLTF notifications. Furthermore, the information it is provided with, is only as good as the reporting practices of the banks under its auspices. Its control condition is rather absolute as it has the sole competence to determine whether there is a public interest in 'setting up a resolution of FOLTF banks, without assuming special liquidity assistance by the ECB', reaching through the entire Eurozone. Meanwhile, practical proof of its effectiveness is limited to one case of an SII whose systemic importance was limited to Spain.

Our judgement is that the creation of the EBU, while allowing for improvements in common supervisory standards and sanction approaches, has empowered the ECB beyond its mandate (control condition), and led to disdain of the most important precedents that allowed the EU and internal market to function thus far, replacing them by artificial ones that are just by a small margin legally compliant with democracy. Technically, the ECB bears moral responsibility for the financial stability/instability of the Eurozone, yet it is not treated and held accountable accordingly due to its immense margin of discretion, while legally avoiding an ultra vires qualification. Instead, taxpayers are bearing the downside of its decisions, and the EBU amplifies the ECB's competences in ways that are at odds with an equally odd monetary regime.

What shocked us most is the reported, and proven, high-level corruption at the top of several EU bodies in an attempt to 'harmonise' policies that shift wrong-way risk away from banks to taxpayers, in favour of investors, including corrupt oligarchs and others that are part of the shadow banking system. Centralisation of powers may remove political pressure from MSs, but that only works if those at the top are of the highest integrity and able of guaranteeing a uniform quality of law enforcement in the entire EU. Our findings on Latvia and Malta indicate the EBU is not merely a gigantic CDO, but also one that is expanding itself through corruption and shady constructions, capable of ignoring the organic social contract by which each country evolved over the centuries into the one it has become. One can only hope that independent investigations shed light on that, without those involved being ignored, marginalised, their existence denied or their lives jeopardised.

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[529] Interview, see Appendix 2 §7

[530] Deutsche Bundesbank, 'The German economic crisis of 1618 to 1623 (the Kipper and Wipper period). 2009 <https://www.bundesbank.de/resource/blob/616858/314894679a92f4ba2c07263311c2c900/mL/the-german-economic-crisis-of-1618-to-1623-data.pdf> Accessed 12 December 2021

[531] Eurostat, 'Flash estimate - November 2021 Euro area annual inflation up to 4.9%' (30 November 2021). Eurostat | euroindicators. 133/2021 <https://ec.europa.eu/eurostat/documents/2995521/11563387/2-30112021-AP-EN.pdf/8072b1c7-4379-7fbe-af36-ec2300c42265> Accessed 8 December 2021

# VII. Quantitative Methodology

Our quantitative analysis focuses on changes in composition of G-SII balance sheets regarding several classes of assets that carry systemic risk. We obtain the balance sheets of GSIIs from the six largest EU MSs in terms of GDP: Netherlands, Belgium, Germany, France, Spain and Italy.[532] These provide a decent pool for our sample and allows us to distinguish between Northern-and Southern-Europe. We also include Denmark, Sweden and the UK, (up to 2020) EU countries outside the euro area, which have their own currencies and are not covered by the EBU, to calibrate for differences attributed to currency regimes as well as absence of the EBU regime.[533] Despite that, it must be noted that all three non-members in our sample do have an opt-out agreement (UK did when it was still in the EU).[534] Bubeck et al. have emphasised the impact of a negative DFR, accounting for changes in risk-attitudes attributable to monetary policy in the Eurozone, before measuring the influence of EBU policies. In addition, our literature review demonstrated that the sovereign debt crisis was largely a currency crisis instead of a genuine debt-crisis.[535] Thirdly, Deltuvaité and Taleb's insights allow us to assume non-linearity, regarding size, and non-ergodicity regarding the Eurozone banking system, at the time the EBU was introduced by van Rompuy. As such, we can infer the ability of EBU's existence and its phased implementation to address the systemic risks. The resulting graphs are dynamic and describe the change of presence (or absence) of two sources we regard as the main causes of systemic risk: complexity and interconnectivity.

### Data Description

Our sample includes all banks that consistently classify as G-SIIs through the period of 2013-2019, from the countries mentioned above. During those years, we have highlighted G-SIBs with a star, as the EBA has done (one must recall that not all G-SIIs are G-SIBs). The result is a robust sample of 31 banks. For 2020 we have omitted the UK banks from our sample, as on the date on which the 2020 results of the G-SIB exercise were released (that is 30 April 2021)[536], the UK was no longer member of the EU. Furthermore, Denmark enjoys a 'special' status due to its opt-out agreement regarding the Euro.[537] The UK banks that qualified as G-SIBs in 2020 have been analysed in a separate sheet (see Appendix 4).

### Intra-financial system assets & liabilities

Firstly, we include intra-financial system assets, which are part of the Interconnectedness category of the BCBS framework.[538] We divide those by total exposure (per bank, as well as total sample). For the liability side, we measure intra-financial system liabilities as the ratio of total exposures. As with intra-financial assets, this is a metric from the Interconnectedness category, and as such, its methodology can be traced back to 2013 (also through the EBA). Both are relevant as these forms of correlation between banks constitute a major source of balance sheet risk.[539]

Intra-financial system assets are funds deposited at or lent to other financial institutions.[540] Its full definition is given by BCBS, and these assets clearly play an important role in Fractional Reserve banking. It is one of the three determinants of intra-financial system connectivity, besides intra-financial liabilities and securities

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[532] Eurostat, 'GDP and main components (output, expenditure and income)'. Last updated 8 April 2021. <http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do> Accessed 12 April 2021

[533] European Commission, 'What is the euro area?'. *EC, Business, Economy, Euro* <https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en> Accessed 26 March 2021 (Last checked December 2021)

[534] Bazoti (2020)

[535] Luiz Carlos Bresser-Pereira & Pedro Rossi, 'Sovereignty, the exchange rate, collective deceit, and the euro crisis' (2015). *Journal of Post Keynesian Economics*, 38:3, 355-375, DOI: 10.1080/01603477.2015.1087807

[536] see EBA

[537] EC (supra n. 533)

[538] BCBS Methodology

[539] Gan (2015)

[540] BCBS Methodology

outstanding. Both indicators describe interconnectivity within the global financial system (so not just EU or Eurozone).
Intra-financial liabilities define the degree of interconnectedness on the other side of the balance sheet. Comparing both indicators of interconnectedness, allows us to infer to what extent risk and returns of large banks in the EU correlate with each other. These two indicators are especially important in light of the findings by Gan that have demonstrated balance sheet risk due to correlation in returns. As with intra-financial assets, its methodology can be traced back to 2013 (also through the EBA). As known, correlations between bank returns constitute a major source of balance sheet risk.[541] A high ratio of interconnectivity on both counts then indicates a higher risk of contagion within the banking system, due to balance sheet correlation on both sides (see section III). In short, intra-financial system assets are claims a bank hold on other banks, whereas intra-financial liabilities are claims other financial institutions hold on the financial institution at hand.

### OTC Derivatives

Secondly, OTC derivates as a percentage of total exposures forms a relevant indicator. This is an important indicator for bank complexity, one of the five assessment criteria of the BCBS approach.[542] OTC Derivatives are transacted outside the ordinary rules of market clearing that would apply on a public exchange, and are as such subject to less regulation.[543] The definition is given in Article 2(7) of the European Market Infrastructure Regulation.[544] Derivatives are financial products that reflect movements in underlying assets or claims, without directly owning it. These can include mortgages, stock, amounts of currency, or claims like interest payments, which can then be swapped.[545] Due to such financial activities outside the normal course of regulation, it was difficult to estimate volume and value in this branch of financial markets, and therefore a source of hidden risk.[546] OTC Derivatives are off-balance sheet items.[547] Although banks are required to use the Standardised Method approach to report its exposure values under CRR Article 276, they can use their internal methods when calculating the risks involved.[548] Hence, there is an information asymmetry between the market participant and market regulator in these situations. In response to the last financial crisis, ESMA has established requirements to either centrally clear OTC Derivatives, or apply 'risk-mitigation' techniques, which have been amended in 2019.[549] However, even as these measures are in place, there is a potential operational risk that requires constant management and highly skilled traders. In 2018, Deutsche Bank was estimated to have such an exposure worth €43.5 trillion[550], roughly twice the global economic output of that year. The risk is not limited to the operational aspects of the bank, there is a counter-

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[541] Gan (2015)

[542] BCBS Methodology, p. 5

[543] European Commission, 'Regulation on Over-the-Counter Derivatives and Market infrastructures – Frequently Asked Questions' (29 March 2012). EC MEMO 12/232 <https://ec.europa.eu/commission/presscorner/detail/fr/MEMO_12_232> Accessed 12 April 2021

[544] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories *OJ L 201/1,* Art. 2 (EMIR)

[545] International Swaps and Derivatives Association, 'Non-Cleared OTC Derivatives:
Their Importance to the Global Economy' (March 2013). ISDA <https://www.isda.org/a/AeiDE/non-cleared-otc-derivatives-paper.pdf> Accessed 20 August 2021

[546] Johan A Lybeck, 'A Global History of the Financial Crash of 2007–10' (2011). Cambridge University Press, October 2011. ISBN: 9781107011496 p. 153 as well as Regulation 2019/834

[547] CRR, Art. 389

[548] CRR, Art. 276

[549] Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories *OJ L 141/42*

[550] Mayra Valladares, 'Deutsche Bank's Death By A Thousand Cuts Is Not Over' (8 July 2019). Forbes, *Banking & Insurance* <https://www.forbes.com/sites/mayrarodriguezvalladares/2019/07/08/deutsche-banks-death-by-a-thousand-cuts-is-not-over/?sh=7959f71824bd> Accessed 25 August 2021

party risk as well. This is another potential source of information asymmetry, as the bank may be exposed to counter-parties for which it cannot credibly monitor business activities due to personal and organisational distance. We are uncertain about the extent Central Clearing applies to OTC Derivatives of banks in our sample. The Bank of International Settlements, acknowledges that particular attention must be paid to non-Centrally cleared OTC derivatives.[551]

As should be clear by now, OTC Derivatives, particularly when non-centrally cleared, are an important source of risk, caused by multiple layers of information asymmetries. Being one of the main sources of collapse in the CDS (a subset of OTC Derivatives used to hedge CDOs) market in 2008,[552] it clearly is a factor of relevance in measuring risk attitudes of large banks. We are somewhat critical about the fact that one indicator is used in the BCBS methodology to denote the total amount of OTC Derivatives as part of the 'bucket approach', so that equal weight is attributed to both categories of OTC Derivatives (centrally and non-centrally cleared), summed up with a weight of 6.67%.[553] This, in our view, provides a biased risk estimate, and hence we include bilaterally cleared OTC Derivatives/total OTC Derivatives to detect shifts of balance between the two variants of OTC Derivatives.

**AFS Securities**

Finally, the percentage of Available-for-sale securities as a percentage of total exposures is relevant. AFS Securities are useful to quantify systemic risk, due to its peculiar definition as well as the role of NPLs in securitisation strategies, as discussed in Section III and Chapter 3. AFS securities are asset-backed securities,[554] and the reader may wonder why AFS Securities are a relevant proxy. An important justification can be found in FASB Statement no. 115, which describes different categories of securities in a framework that has been introduced in 1993. Firstly, there are securities held to be sold for short-term profit, i.e *trading securities*, which require gains and losses to be recorded on the balance sheet and reported on the income statement. Secondly there is a category of securities that is *held to maturity*, which is also reported on the balance sheet and relatively easy to keep track of until it has reached its full yield. However, AFS is a remaining category, not clearly held for trading or investment purposes, with value and changes in value therein kept off the income statement, even though the securities are reported on sheet at fair value.[555] It is reported that Mortgage-backed-securities can be denoted in either three categories, yet again, the purpose of AFS securities is least clearly defined.[556] Therefore we consider it to be a source of risk due to private information, that cannot be fully grasped by regulators or stakeholders. A 2020 paper by Molyneux et. al. highlights that a shift from trading to AFS securities is a significant indicator of risk-shifting over time, particularly so for large banks.[557] This is the case as its purpose tends to be less clear than with trading securities or held-to-maturity securities, which leads us again to FASB statement 115. The findings of Molyneux et al. were obtained by measuring the ratio to total assets for both categories, the latter being the ratio used in this analysis too. Their findings reaffirm the relevance of analysing developments in the AFS-securities/total exposures ratio in our research.

For each of the four mentioned indicators, we divide its amount by total exposures as defined in the Basel III method. In addition, there is a fifth indicator: bilaterally cleared OTC Derivatives (a definition of the variables will be given in the sub-chapters below). For each variable we also compare the maximum ratio with the ratio of the full sample. Furthermore we include for each ratio the sample average, and the average

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[551] BCBS Methodology

[552] Lybeck (2011) Chapter 5

[553] BCBS Methodology

[554] Tim Krumwiede, Ryan M Scadding & Craig D Stevens, 'Mortgage-Backed Securities and Fair-Value Accounting' (2008). *The CPA Journal*, *78*(5) (May 2008), 30. <http://archives.cpajournal.com/2008/508/essentials/p30.htm> Accessed 5 September 2021(In reference to SFAS 115)

[555] Ibid

[556] Financial Accounting Standards Board, 'Summary of Statement No. 115'. FASB <https://www.fasb.org/st/summary/stsum115.shtml> Accessed 10 September 2021

[557] Philip Molyneux, Alessio Reghezza, Chiara Torriero & Jonathan Williams, 'Banks' noninterest income and securities holdings in a low interest rate environment: The case of Italy' (2020). *European Financial Management*. 2021;27:98–119. Wiley. DOI: 10.1111/eufm.12268 (Molyneux and others (2020)

for three regions divided as follows: 'North' including the Netherlands, Belgium and Germany; 'South' including Spain, France & Italy; 'Non-Member' including Denmark, Sweden and the UK.

It should be noted that the sample average does not necessary equal the ratio of the full sample. If the sample average is smaller than the ratio of the full sample, that means the median ratio is below average: that is to say, more than 50% of the banks involved have a ratio below the average score, consequently, a few banks have a score that is vastly higher compared to the rest of the sample. Vice versa when the sample average is larger than the ratio of the full sample. This is relevant in light of non-linearity.

## Assumptions

By exclusively focusing on G-SIIs in our sample (instead of including O-SIIs too), we assume a non-linear relationship between size and risk-taking, in line with Section III. As we track legal developments within the EBU over time, it becomes possible to measure whether or not the EBU has delivered so far on its promise to improve stability and reduce risky behaviour. Furthermore, distinctions and similarities may be drawn between members and non-members.

We remain somewhat reserved on changes in the ratio per region over time. Based on our readings, the following changes are assumed to have taken place from 2013-2020:

**For the northern sample average:**
Intra-financial system assets ratio -> increase
Intra-financial system liabilities ratio -> increase
OTC derivatives ratio -> increase
Bilateral-total OTC Derivatives ratio -> decrease
AFS securities ratio -> increase

**For the southern sample average:**
Intra-financial system assets ratio -> increase
Intra-financial system liabilities ratio -> increase
OTC derivatives ratio -> increase
Bilateral-total OTC Derivatives ratio -> decrease
AFS securities ratio -> increase

**For the non-EBU sample average:**
Intra-financial system assets ratio -> increase
Intra-financial system liabilities ratio -> increase
OTC derivatives ratio -> increase
Bilateral-total OTC Derivatives ratio -> decrease
AFS securities ratio -> increase

Bilateral/total OTC Derivatives ratio is the only indicator for which we expect a decrease in all three regions. This is because of the Central Clearing mechanisms to be put in place since the EMIR of 2012, and amendments in 2019.[558]

## Limitations

We acknowledge that our assumption regarding non-linearity between risk and size excludes a large number of banks from our sample, which are subjected to the EBU as well. Some banks may fall below the threshold of G-SII and still be of considerable size and regional importance. Then there are banks that fall within the scope of G-SII during one year, but not during other years. Those will be left out of our sample, to prevent flip-flops and maintain robustness. Furthermore, the EBU as an institution that has never thrown its full weight into the banking system yet, because no situation thus far required it, adds to the burden of proving its (in)effectiveness. The setup of this research thus sets a tone for future research and is not a method to seal consensus. Unfortunately, our sample leaves out vast areas in the EU, as no banks in Eastern Europe have been found to qualify as a G-SII.

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[558] Regulation 2019/834

**Data collection**
The data behind the variables as described above can be found at the website of the EBA, holding several databases on balance sheet metrics, as of 2013. Both individual templates as well as summary charts are available on which annual statistics can be found reporting year-end amounts. The databases include the G-SIIs in the EU, which can be further categorised into members of the EBU and those EU-members that are not part to the EBU. Any discrepancies that are present in our table are the result of rounding when calculating exchange rates, for the non-EBU members have their own currency.

**A note on reverse causality**
The informed reader has likely noticed that there is an interplay between market developments and legal responses. Therefore our method of analysing market changes in response to legal decisions may be called into question by some. We assume that there is a sufficient lag in legal response to economic problems so as not to distort the picture, given the time it often takes to adopt and implement legal acts in the EU, such as the CRR, SSM regulation, SRM regulation, as well as legal procedures on their validity (see Section V). In contrast, markets tend to respond almost instantly, to the extent new information (including legal developments) has been made publicly available.

**A note on Granger causality**
As we plot our indicators against time, yet without an explicit equation, the reader may wonder if we do not attribute wrong causal relationships to our indicators. To clarify our stance, it is assumed that QE is one of the main propellants of risky behaviour by large banks as clearly shown in our literature review. Furthermore, our analysis very much serves to demonstrate whether or not G-SIIs in the EBU have seen a decrease in the risk factors we identified. We can, for the time-being, not exactly quantify coefficient values between the EBU and the various indicators we use, and here lays a task for econometricians and statisticians. Yet, we can infer whether or not the EBU has - in line with its promise to reduce systemic risk and improve financial stability in the Eurozone (and EU as a whole) - contributed to reduced interconnectedness and complexity, or not so.

# VIII. Quantitative results

## Chapter 4. The influence of the EBU on balance sheet composition of G-SIIs

Fig. 4.1 Intra-financial assets/total exposures

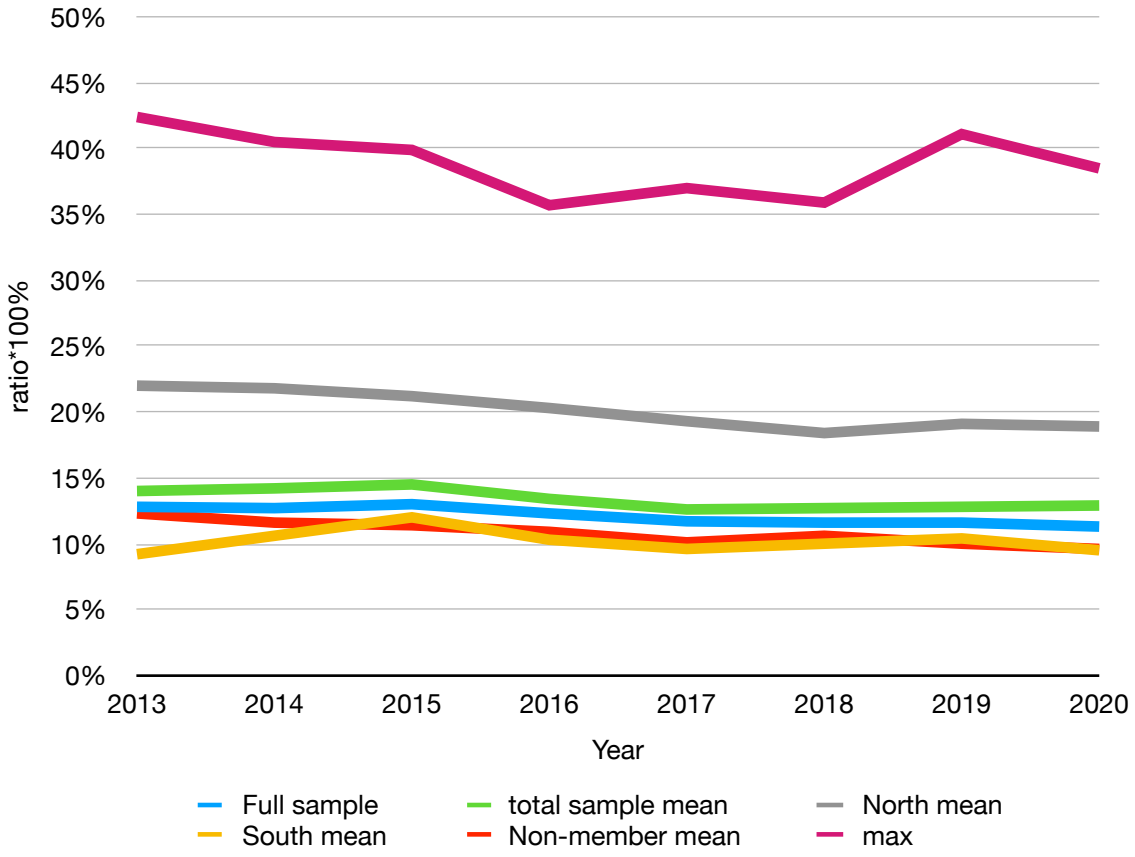
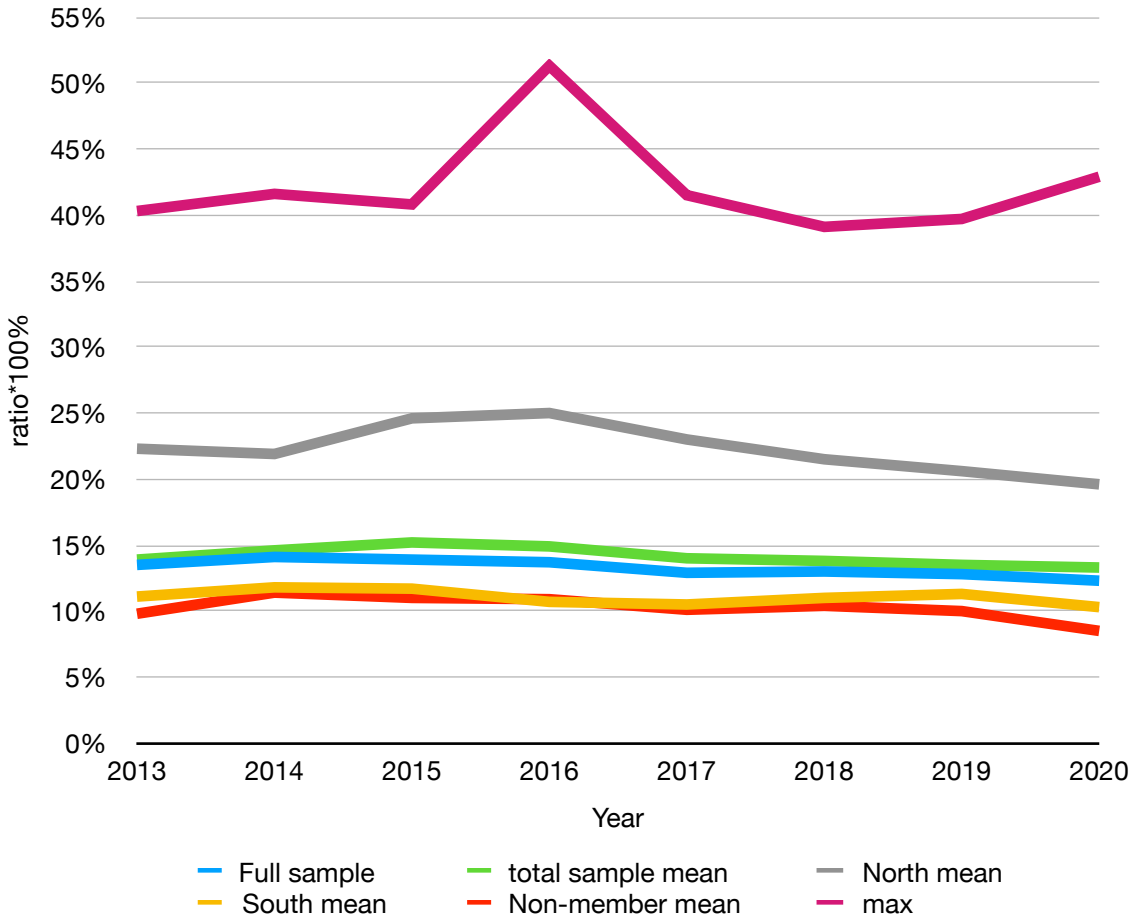



Figure 4.1 shows the intra-financial system assets within our sample, and distinguishes between the three different regions and the average ratio within the sample. As is visible, the percentage of intra-financial system assets within our sample has remained relatively stable for all regions combined, with the highest volatility in the Southern region. Throughout the years, the Northern region in our sample has had the highest average ratio of reported intra-financial system assets of 22.8% in 2013, which has shown gradual and consistent (each year) decline to 18.9% in 2020. In contrast, the Southern region had an average ratio of 9.2%, which has slightly increased towards 9.5% in 2020. Non-EBU member states have started with an average ratio of 12.3%, having declined to 9.6% in 2020. In comparison, the total sample average was 14.0% in 2013 and declined to 12.9% in 2020. The full sample ratio started off at 12.8% in 2013 with a peak of 13.0% in 2015, after which the ratio declined towards 11.3%. This shows there is a slight mismatch between the average ratio, being somewhat higher than that of the full sample, which means that more than 50% of the banks in our sample have a higher ratio than that of the full sample. Finally, it is noticed that all five indicators mentioned above, had a peak in 2015. The highest ratio value measured has fluctuated around 40% with a slight decline.

Fig. 4.2 Intra-financial liabilities/total exposures




The results of Figure 4.2 show that the intra-financial liabilities ratio is mostly on par with the intra-financial assets ratio for the Southern region as well as for non-members. The Southern region and non-member region started off in 2013 at 11.1% and 9.8% respectively. After a slight fluctuation, these regions end up in 2020 at 10.3% and 8.5% respectively. The Northern region, has also had an increase from 22.5% in 2013 towards 19.6% in 2020, with a peak in 2016 at 25.0%. Despite that decline, the ratio for the Northern regions is about twice as high as those in the other regions. The full sample ratio and the total sample average ratio have developed in a manner consistent with each other, the latter one having decreased from 13.9% to 13.3%. The maximum ratio in the full sample has somewhat increased from 40.3% to 42.9%. Finally, it should be noted that the maximum ratio had a peak of 51.3% in 2016.

Fig. 4.3 OTC Derivatives/total exposures

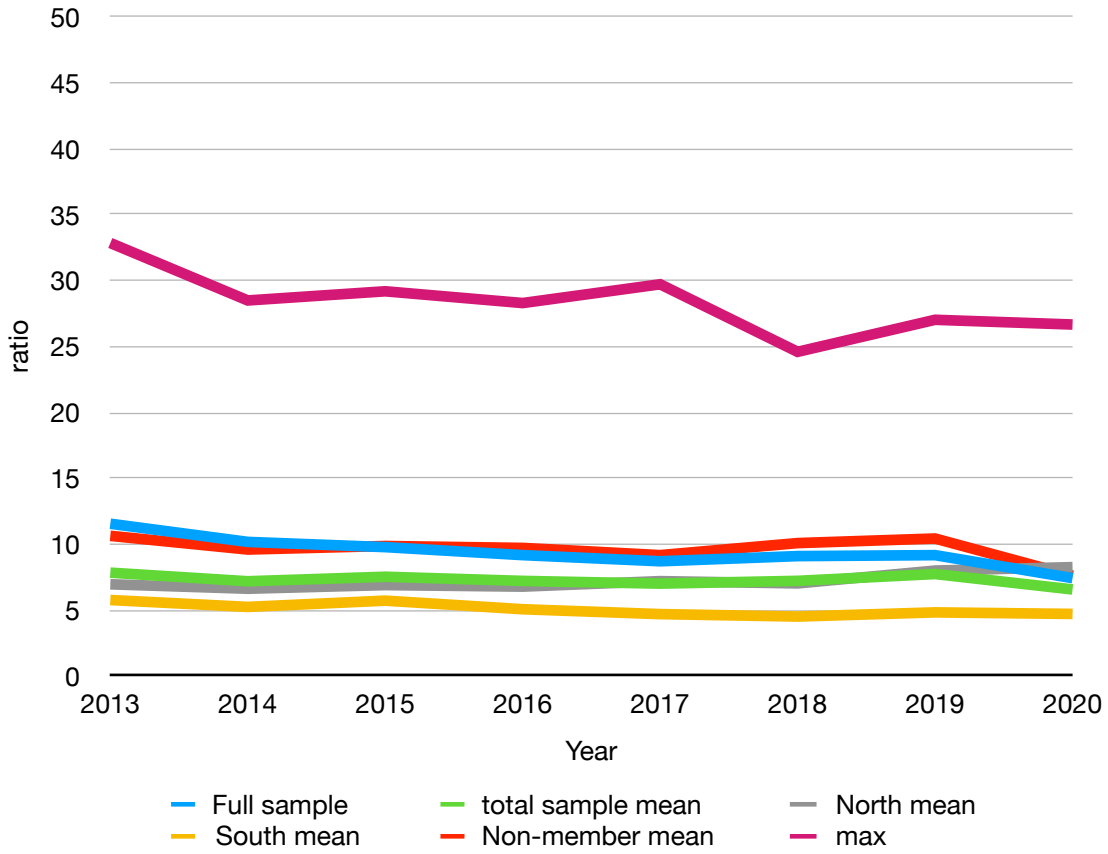



Figure 4.3 shows the change of average OTC Derivatives/total exposure ratio per region, as well as changes in the full sample. Being one of the most important indicators in our sample, this indicator requires a thorough reflection, in which following can be observed: The average ratio for the Southern region shows a decrease from 5.741 in 2013 towards 4.685 in 2020, without any peak in between. At the same time, the minimum and maximum in this region have converged from 0.191 to 0.418 and 19.248 to 11.544 respectively. In contrast, the Northern region shows an increase from 6.935 towards 8.237 in 2020. Meanwhile, the minimum and maximum have remained almost the same. Finally, the non-EBU member states showed an average ratio of 10.613 in 2013, which decreased to 7.583 in 2020. The year before, when the UK was still part of this sample, the sample had a much higher ratio of 10.411. Furthermore, the maximum in this sample decreased from 25.310 in 2019 towards 14.650 in 2020. The role of Brexit in affecting these results will be interpreted in the subsection 'A No-Brexit counterfactual, ceteris paribus' (see below). Besides, the maximum value in the sample has gradually decreased from 32.851 towards 26.660 in 2020. Finally, the absolute gap between full sample score and total sample average has decreased from +3.716 (11.533 minus 7.817) towards (7.402 minus 6.543) +0.859. This indicates a more equal distribution in 2020 than in 2013, and can be explained by the decrease in standard deviation for the Southern region and Non-EBU member states.

Fig. 4.4 Bilaterally cleared OTC Derivatives/OTC Derivatives

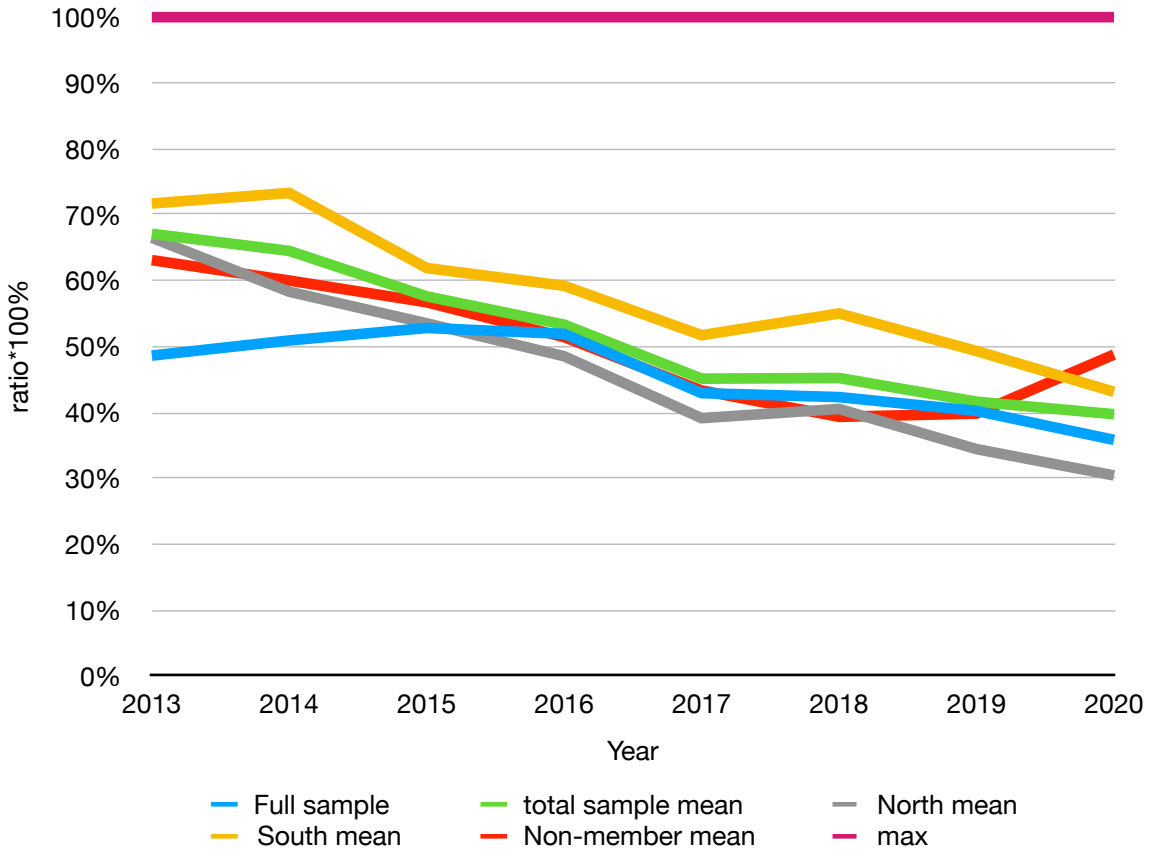



Figure 4.4 indicates to what extent G-SIIs in our sample have subjected themselves to central-clearing procedures for OTC Derivatives. The first thing noticed is that the Northern and Southern region follow a very similar pattern of decline, especially from 2015 onwards. The former shows a decline from 66.5% to 30.4% in ratio average, whereas the latter declined from 71.7% to 43.1%. Remarkably, both had a slight trough in 2017 (39.1% and 51.7% respectively), followed by a small peak in 2018 (45.0% and 55.0% respectively), after which decline has continued. The non-EBU member states have seen a decline in average ratio from 63.1% in 2013 to 39.3% in 2018, followed by a steep increase towards 48.8% in 2020. Especially after 2019, this increase can be observed, as well as significantly higher standard deviation and an upward shift in interval (space between min and max), with the UK excluded. Besides that, the gap between full sample score and total sample average has declined from -18.5% point (48.6% minus 67.1%) in 2013 towards -3.9% point (35.8% minus 39.7%) in 2020. This indicates a more equal distribution of the sample in the end. Last but not least, throughout the entire period of measurement, the maximum ratio has remained at 100%, which means that some banks exclusively clear OTC Derivatives on a bilateral basis. It is noteworthy that the Northern region has seen a decline from 100% as the highest ratio towards 49.4% in 2020.

Fig. 4.5 Available-For-Sale Securities/total exposures

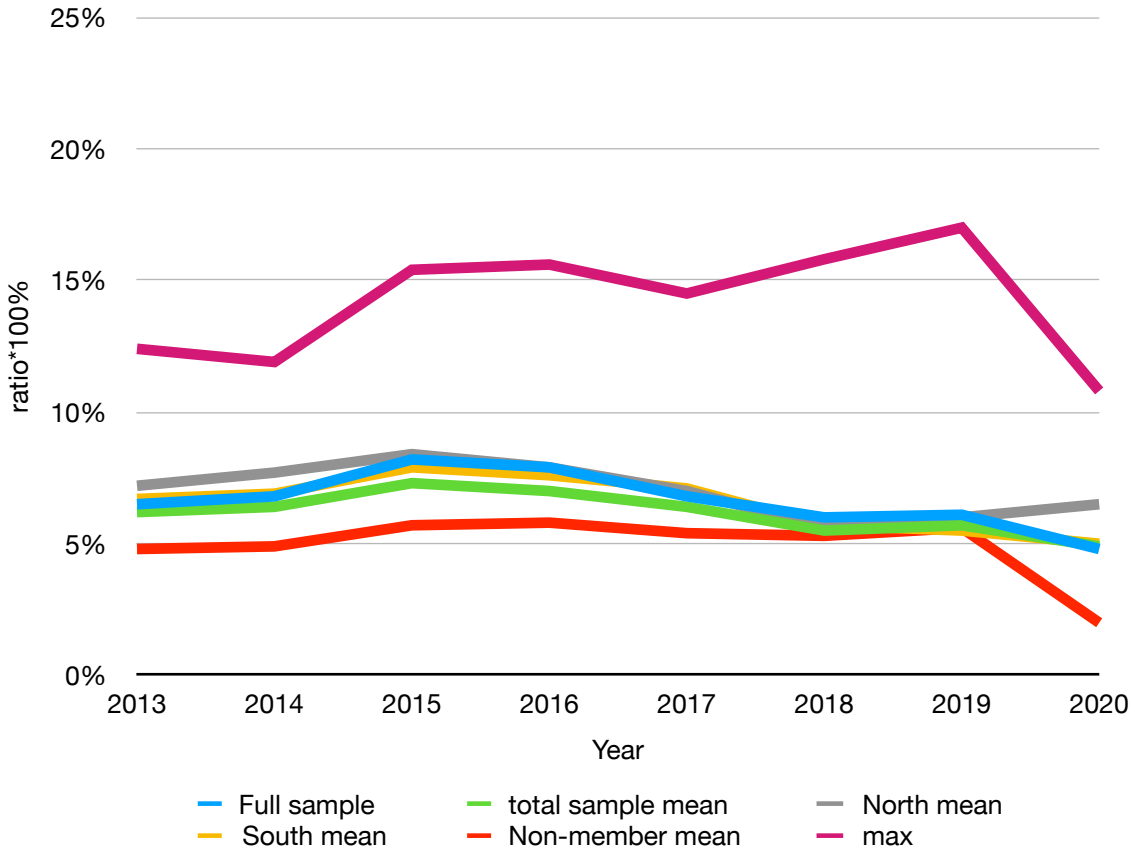



Figure 4.5 represents the last of our indicators, AFS Securities. Firstly, all regions saw an increase in the average ratio from 2013 towards 2015, after which they stabilised. The Northern region started at 7.2% in 2013, followed by an increase towards 8.4% in 2015, after which a gradual decline took place towards 6.0% in 2019, followed by an increase to 6.5% the year after. For the Southern region, the ratio started at 6.7%, with an increase to 7.9% in 2015, after which it consistently declined towards 5.0%. The non-EBU member states in our sample started off at 4.8%, increasing towards 5.8% in 2016, after which it declined towards 5.6% in 2019. In 2020, the decline was much steeper, towards 2.0%. Of course, it was the year in which Brexit negotiations were finished, so the UK is left out of the sample. It will therefore be interesting to see what the counterfactual looks like (see below). In addition, the minimum in the non-EBU part of the sample has equaled 0 throughout the years, unlike the other two regions. This is relevant regarding the two countries that are left in the non-EBU region: Sweden and Denmark (this will be discussed in the evaluation). Finally, the total sample average decreased from 6.2% in 2013 towards 4.9% in 2020.

### A No-Brexit counterfactual, ceteris paribus

As mentioned before, the last year of our sample excluded the United Kingdom. Nevertheless, the data on UK banks that qualified as G-SIBs have been included in the appendix. These are: Barclays,[559] Standard Chartered,[560] National West Group[561] and Lloyds Banking Group.[562] Unfortunately, two out of those banks

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[559] Barclays PLC, 'Global Systemically Important Institutions (G-SIIs) Disclosure' (31 December 2020). <https://home.barclays/content/dam/home-barclays/documents/investor-relations/reports-and-events/annual-reports/2020/G-SII-external-disclosure-Dec-2020.pdf> Accessed 20 September 2021

[560] Standard Chartered PLC, 'Disclosure for Global Systemically Important Institutions (G-SIIs)' (31 December 2020). <https://av.sc.com/corp-en/content/docs/Standard-Chartered-PLC-2020-G-SII-disclosure.pdf> Accessed 20 September 2021

[561] NatWest Group, 'Globally Systemically Important Banks (G-SIB) - 2020 Indicators' (31 December 2020). <GSIB Indicators - NatWest Group – Investors> Accessed 20 September 2021

[562] Lloyds Banking Group PLC, 'Disclosure for Global systemically important banks (G-SIB) Indicators as of 31 December 2020' (31 December 2020). <https://www.lloydsbankinggroup.com/assets/pdfs/investors/financial-performance/lloyds-banking-group-plc/2020/full-year/2020-lbg-g-sibs-disclosure.pdf> Accessed 20 September 2021

have not subjected themselves to the G-SIB exercise last year. When including the ratios of those banks, the average outcome for the non-EBU members changes as follows: i) The intra-financial ratio equals 10.3% in 2020 instead of 9.6%. ii) The intra-financial ratio equals 11.5% in 2020 instead of 8.5%. iii) The OTC Derivatives ratio equals 10.889 instead of 7.583. iv) The bilateral/total OTC Derivatives ratio equals 43.8% instead of 48.8%. v) The AFS securities ratio equals 4.7% instead of 2.0%, which is more than twice as high. These findings indicate that the UK G-SIIs tend to have a higher degree of intra-financial system connectivity, as well as a higher complexity, compared to Swedish and Danish G-SIIs. At the same time, OTC Derivatives appear to be cleared relatively more often through a central-clearing party.

### From Sweden to Finland: the case of Nordea

From 2019 onwards, Nordea has been headquartered in Finland rather than Sweden (see Appendix 3), thereby bringing it into the Eurozone.[563] This means Nordea is now directly supervised by the ECB and covered by the EBU.

### Assumptions: which ones are correct?

In summation, a general trend observed among all regions is a decrease in intra-financial system connectivity and complexity, based on the indicators used. An exception is the visible increase in the OTC Derivatives ratio for the Northern region. This means that most of our assumptions are rejected, with the exception of our assumptions on bilateral OTC Derivatives, and the OTC Derivatives ratio for 'North'. Figure 4.6 provides a summary of the main results in relation to our assumptions (see next page).

Figure 6: Results per region-1-1

| Ratio (divided by total exposures) | 2013 | 2019 | 2020 | Cumulative | Explanation | Assumption |
|---|---|---|---|---|---|---|
| **Northern mean:** | | | | | | |
| Intra-financial assets | 22.0% | 19.1% | 12.9% | -9.1% point | decrease | rejected |
| Intra-financial liabilities | 22.3% | 20.6% | 19.6% | -2.7% point | decrease | rejected |
| OTC Derivatives | 6.935 | 7.976 | 8.237 | plus 1.302 | increase | accepted |
| Bilateral/total OTC | 66.5% | 34.4% | 30.4% | -35.1% point | decrease | accepted |
| AFS Securities | 7.2% | 6.0% | 6.5% | -0.7% point | decrease | rejected |
| **Southern mean:** | | | | | | |
| Intra-financial assets | 9.2% | 10.4% | 9.5% | -0.3% point | decrease | rejected |
| Intra-financial liabilities | 11.1% | 11.3% | 10.3% | -0.8% point | decrease | rejected |
| OTC Derivatives | 5.741 | 4.802 | 4.685 | -1.056 | decrease | rejected |
| Bilateral/total OTC | 71.7% | 49.3% | 43.1% | -28.6% | decrease | accepted |
| AFS Securities | 6.7% | 5.5% | 5.0% | -1.7% | decrease | rejected |
| **Non-member mean:** | | | | | | |
| Intra-financial assets | 12.3% | 10.0% | 9.6% | -2.7% point | decrease | rejected |
| Intra-financial liabilities | 9.8% | 10.0% | 8.5% | -1.3% point | decrease | rejected |
| OTC Derivatives | 10.613 | 10.411 | 7.583 | -3.030 | decrease | rejected |
| Bilateral/total OTC | 63.1% | 39.8% | 48.8% | -14.3% point | decrease | accepted |
| AFS Securities | 4.8% | 5.6% | 2.0% | -2.8% point | decrease | rejected |

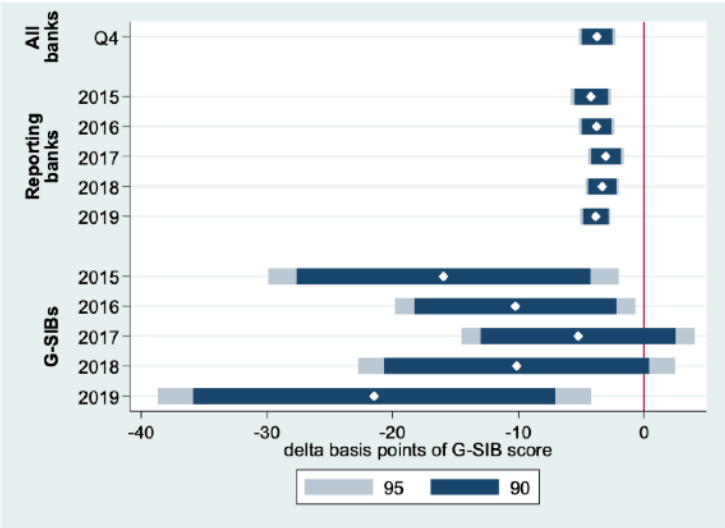
[563] Fredrik Wilkens & Henrik Schön, 'A general introduction to the banking regulatory regime in Sweden' (5 May 2021). Lexology <https://www.lexology.com/library/detail.aspx?g=c434a182-937a-4610-ac01-c74c072c56f0> Accessed 10 November 2021

# IX. Quantitative evaluation

The reported decrease in intra-financial system connectivity, while the ratio of OTC derivatives has remained rather high, are in line with qualitative findings indicating a regulator's focus on managing on-sheet risks and compliance with capital buffers, while shadow-banking remains popular among G-SIIs. When comparing G-SIIs of EBU members with non-EBU MSs for the said indicators, it must be stressed that there is more heterogeneity in the latter category. In particular, UK banks were found to have significantly higher ratios of OTC Derivatives than Sweden and Denmark. In addition, Sweden in particular has very low levels of AFS securities (and Denmark too). This was also observed by Wellens.[564] The peak in 2015 for most indicators can be explained, based on our literature, by the start of the QE programme, propelling risky assets held. Although none of the risk indicators in our analysis show a genuine increase, but stabilise or even decrease instead (e.g bilateral OTC Derivatives), our results must be interpreted with immense caution: a recent investigation on behalf of the EBA has found evidence of window-dressing on a systemic level. Garcia et al. concluded that the true values of risk-indicators may on average be much higher throughout the year (Quarter 1-3) than visible in the year-end exercise (Quarter 4) used to estimate risks.[565] This is referred to as 'year-end balance sheet contraction'.[566] An excerpt from the report is shown below, and indicates that this contraction has increased over time, and especially for G-SIBs (that covers our G-SIIs), as can be seen in Figure 3 of the report. The reduction in basis points of G-SIB score often results in a lower bucket, with less risk buffer requirements. The authors attach this trend to increase in regulatory *tightness,* referring to more stringent requirements on risk-buffers for example.[567]

Excerpt from Garcia et al., part 1 (p. 15)

Figure 3: G-SIBs' year-end window dressing intensifies over time




Notes: Coefficient estimates based on equation (3) with robust standard errors, clustered by bank. The light (dark) bars indicate the 95% (90%) confidence intervals.

Appendix 5.1 shows the mean G-SIB score in basis points for all BCBS indicators for the sample of Garcia et al., and Appendix 5.2 shows the average rate of year-end compression rate per indicator. It follows that for G-SIBs, indicator score in Q3 compared to year-end is on average:

- |-53.90|/513 = 10.51% higher for intra-financial system assets
- |-34.58|/435 = 7.95% higher for intra-financial liabilities
- |-26.19|/284 = 9.22% higher for OTC Derivatives
- |-16.42|/518 = 3.17% higher for Trading and AFS securities (not significant at 95% confidence interval)

[564] Interview, see Appendix 2, paras 6-8

[565] Luis Garcia, Ulf Lewrick & Taja Sečnik, 'Window Dressing Systemic Importance, Evidence From EU Banks and the G-SIB Framework' (2021). EBA Staff Paper Series No 12 - 2021 DOI: 10.2853/688189 (Accessed 4 September 2021) (Garcia and others (2021))

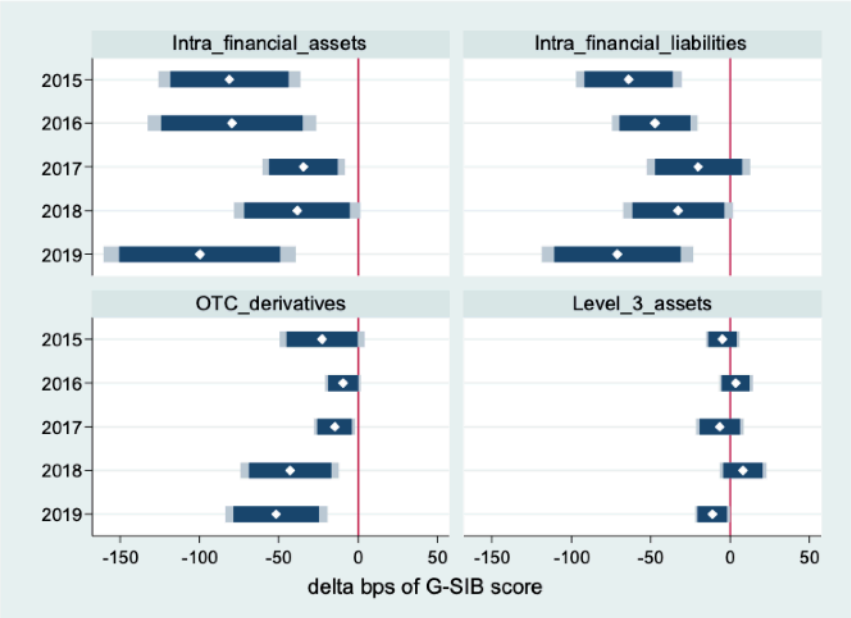
[566] Ibid, pp 12-15

[567] Ibid

Breakdown year-end contraction by category over the years can be seen below:

Excerpt from Garcia et al., part 2 (p. 15)

Figure 4: G-SIBs' year-end score contraction for selected indicators




Notes: Coefficient estimates based on equation (3) with robust standard errors, clustered by bank. The light (dark) bars indicate the 95% (90%) confidence intervals.

Following these observations, we disagree with Wellens' findings during the interview, indicating that regulators seem unaware of 'sleezy' reporting behaviour, which would give banks an implicit *carte blanche* to continue their malevolent reporting behaviour (although it confirms his suspicion towards G-SII reporting behaviour). We now have documented evidence that both sides of the (euro) coin, the regulatory side and the business side, have reason to be aware of the toxic behaviours that exist among G-SIIs, amplified by their size and discretion to use internal methods to obtain optimistic external risk weights and ratings. Garcia et al. recommend to emphasise averages above points in time to measuring risk.[568] Their remarks are a crucial form of constructive criticism on our own method, based on year-end data. It remains unclear whether compression is more prevalent among bilaterally or centrally cleared OTC Derivatives, leaving room for future research.

In our own sample, the North displayed an unusually high maximum value for the OTC Derivatives ratio of 26.660 in 2020 compared to to other regions. When zooming in, this result displays Deutsche Bank, which has topped that ratio for years. In that same year, DB had a Basel III leverage ratio of 4.8%.[569] This means OTC Derivatives notional amount was 26.660*(100/4.8) = 555.42 as large as the amount of Common Equity Tier 1, at least according to the year-end exercise. The findings of Garcia et al. on year-end contractions suggests this amount could be as high as (100%+9.22%)*555.42 = 606.62, and even higher. Our interview with Wellens has made us increasingly aware of OTC Derivatives as an indication of the shadow-banking system, and we conclude that CET 1 held by G-SIIs are crumbles compared to the size of the shadow-banking system. The increased supervisory 'flexibility' during the pandemic has made that system even more opaque in our view. When doing a back-of-the-envelope calculation for total volume of OTC Derivatives of the six EBU-members, divided by total exposures, we end up with a ratio of 7.37 (2020 sample minus UK, Sweden and Denmark). In light of Garcia et alii's findings on underreporting, the shadow-banking system of the G-SIIs in the six largest Eurozone economies (plus Nordea) may thus be around eight times as large as total exposures, and even more when compared to total assets (which is less than Basel III total exposures).

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[568] Ibid

[569] Deutsche Bank, 'Pillar 3 Report as of June 30, 2021' (2021). Deutsche Bank, Investor Relations <https://investor-relations.db.com/files/documents/regulatory-reporting/Pillar_3_Report_2Q2021.pdf> Accessed 5 November 2021, pp 32-33

# X. Conclusion

Our qualitative and quantitative findings combined, indicate that from the Global Financial Crisis onwards, repeated attempts have been made to contain systemic risk in the Eurozone banking sector, with special attention to G-SIIs, through different approaches. Whereas the first attempt in doing so expressed concern for upholding legal precedent (Meroni in particular), that seems no longer the case. This decoupling of the legal past from the present is best demonstrated in *Pringle v Ireland,* the Bunderverfassungsgericht's judgement on the powers of the ECB and its 'compatibility' with democracy, case T-122/15 on *Landesbank v ECB,* and case C-911/19 on the effects of soft-law instruments, as well as Case C-414/18 on the exclusive competence of the SRB in determining contributions to the SRF.

With the judgements in the said cases, the principles laid out in TEU Article 5 seem to have become irrelevant too, despite reference made to it in the SSM and SRM regulations. Instead, the attitude within the Banking Union seems to be that whatever is good for the ECB, is good for Europe. "L'état Européen, c'est moi!", seems to be the creed by which it abides. It may be the only creed by which the ECB can retain such power, as there is no organic social contract between the ECB and citizens in the Eurozone, and with the exception of some formalities, moral responsibility seems non-existent. The best example of what margins of discretion can be abused for, is the letter written by John Christmas to the ECB in 2013, being ignored and his letter reportedly destroyed by PWC. The mandate under TFEU Article 127(6) to conduct supervision under the SSM does not blend well with its prime goal of price stability, of which the real estate price inflation, and the statistical cherry-picking in the HICP, as well as the latest numbers on inflation, are all good examples.

The promise to provide a common supervisory regime with common sanctions, insensitive to national politics, has largely been fulfilled, and credit is due both to the SSM and the EBA in that regard, so long as the top officials involved are of the highest integrity. The SSM and SRM have been created with the purpose of eliminating regulatory arbitrage, as well as the TBTF problem. Although regulations, including reporting standards have been harmonised, the margin of discretion enjoyed by the ECB determines the final verdict on the viability of G-SIIs. With a culture in which legal-equals-ethical, the banking sector has once again pushed aside the very principles that could have prevented the GFC. This time it is recorded in a much more centralised manner at the supranational level, with immense margins of discretion, and even more anonymously.

The European Deposit Insurance Scheme has not been implemented so far. Despite that, full mutualisation has been hallmarked as the cheapest remedy against a liquidity shortfall among the available policy options. Yet, it must be said that data stems from the Basel II era. Furthermore, organisational slack and corruption, are difficult to take into account, let alone be a core assumption, for any institution that markets itself in such a way would be discounted rather quickly.

In contrast to the qualitative analysis, our quantitative findings indicated a stabilising trend for all of the risk-indicators that we analysed, despite our expectations of reported increases in risk-taking among large banks. However, the findings by Garcia et al. (2021) indicate that the optimistic numbers are very much attributable to balance sheet 'year-end contraction' by G-SIIs. Unfortunately we had not thought of that in the first place. At the same time, the proposals by Garcia et al. on using averages instead of year-ends to analyse risk, give hope of improvement in the quality of G-SII assessments at EU-wide level. Nevertheless, large-scale underreporting among G-SIIs indicates that something is seriously wrong with the Eurozone financial system, something the Banking Union has been unable to address thus far.

Our findings have shown that the concerns mentioned in the De Larosière Report, about conflict of interest between the monetary and the supervisory branch of the ECB, are more than justified. The combination of the two branches have contributed to the zombification of the Eurozone economy, in exchange for upholding a system that is characterised by large-scale violations of the halachic principles as described, under the guise of 'stability' and 'continuity'. In fact, the setup of the Banking Union, especially the SSM, can give G-SIIs an additional aura of legitimacy when they 'use the right tricks', or rely on individual derogations. Despite the professed intentions to turn the Eurozone system into one with a level-playing field, it is still a non-ergodic system, just as in 2008, but with additional legal complexity. What the De Larosière Report could not foresee, is the way in which MSs have fraudulently circumvented the SGP requirements, thereby expanding the Euro to the point that it becomes increasingly difficult for the ECB to live up to its own mandate under the SGP, due to socio-economic differences between MSs. The functional and personnel independence of the ECB describes to a large extent, the ability to circumvent the rule of law and any kind of moral

responsibility. The reported corruption and conflicts of interest seem to be the tip of an iceberg, but, as is typical for a non-ergodic system, estimates may not be accurate at all, and thus we simply do not know the size of that iceberg. The talks about increased 'inclusivity' and 'greenification' in the Eurozone leave behind a somewhat bitter taste, in light of the systemic shortcomings that we have found, and give the impression of a modern-looking car with poor crumple zones and a wobbly automatic transmission.

Our conclusion is that the EBU, and the G-SIIs it supervises and resolves, are compliant with Gresham's Law. Given the accounts of corruption, malevolent banks may now pave their way into the Banking Union through MSs that are secretly capable of circumventing the SGP. The fact that MSs retain a final say on AML investigations in their country, will not help either for the well-functioning of the market. All that is required is a single-point-of-entry into the Eurozone, which can be established with ease, based on our findings about Latvia. Meanwhile, the exclusive right of credit institutions to issue Covered Bonds enables G-SIIs to dispose of toxic assets with a rating uplift, receiving waivers to increase the percentage of securitisations in the cover pool, at the expense of taxpayers. The ECB has an exclusive right to supervise these entities, all the while buying up to 70% of their Covered Bonds, besides Asset-Backed Securities, and below the Deposit Facility Rate when it deems that necessary. During the pandemic, the regulatory requirements as well as asset eligibility criteria have been eased. The result seems to be the creation of one of the largest (potentially the largest) and intransparent Collateralised Debt Obligations ever, with Eurozone taxpayers - and the EU in general if all MSs adopt the Euro - being the guarantor, or 'put - opciju', using Latvia's terminology. Such a structure, in which a third party - in this case the ECB - invests, with reason to expect defaults, with self-created money at a staggering pace, using the taxpayer as credit protection, has all the hallmarks of ABACUS-2007-AC1. In our view, ABACUS-2024-ECB is an accurate term to describe the Eurozone financial system under the EBU. It is a system whose bones are cracking under its weight, largely in the hands of G-SIIs, kept 'alive' by the ECB, potentially the most powerful institution in 5,000 years. When asked whether the laws of the EBU bind its pillars and the G-SIIs in consciousness or not, we answer that it does not, at least not in its current configuration. The TBTF problem persists, albeit in a different shape than before the GFC. Meanwhile, the documents meant to safeguard stability and prudence, such as the SGP, have been taken with a grain of salt, by the ECB and by MSs such as Latvia. But as the saying goes, "Nobody ever corrected me."

# XI. Caveats & Implications

Due to temporal and size constraints, we have abbreviated the quantitative part significantly. Originally, our plan was to include time series regressions for the said variables, calibrated by independent variables (and their lags) in the shape of country-specific factors, monetary policy and EBU membership, as well as business-cycle developments prior to 2013. Unfortunately, that proved infeasible for the moment, although our literature review has provided ample evidence for the role of monetary policy on risky behaviour, and the relationship between concentration and stability. In hindsight, it would likely complicate the connection between the qualitative and quantitative analysis, had we proceeded with the initial approach. Therefore, we encourage econometricians/statisticians to continue research into this area, as we deem the relevance high enough. As Oscar Wilde once said: "A cynic is a man who knows the price of everything, and the value of nothing."[570] Against that background, and with our findings on G-SIIs and their regulatory coverage by the EBU, we observe a system characterised by cynicism, and we ask ourselves: Is this the system we want to keep alive? And if so, at what cost, or better said, in exchange for which values?

As the Euro grows weaker, by virtue or by vice of Quantitative Easing, the Eurozone is subject to zombification. Consequently, the case for research and development in the field of decentralised finance grows stronger. Although shadow-banking can be considered a form of decentralised finance in its own, its connection to the balance sheet of the respective G-SIIs and, the implicit protections enjoyed with it, make the safety of the financial system questionable, indicated by our findings. As Ayn Rand once described, "[M]oney is the barometer of a society's virtue. When you see that trading is done, not by consent, but by compulsion–when you see that in order to produce, you need to obtain permission from men who produce nothing–when you see that money is flowing to those who deal, not in goods, but in favors–when you see that men get richer by graft and by pull than by work, and your laws don't protect you against them, but protect them against you–when you see corruption being rewarded and honesty becoming a self-sacrifice–you may know that your society is doomed."[571] Her passionate call for financial system integrity is a stark contrast with the emotionally rather unavailable Communication of the Commission in COM 592, calling for NPLs to be made compatible with State Aid, which roughly translates to 'selling trash to the taxpayer without ending up in legal trouble', which has become increasingly clear. It is remarkable that the former of the two comes from a woman who claimed to hold reason as her only absolute, with no room for influence by emotions. Let us ensure that we calibrate this barometer and have a currency that accurately reflects society's virtue, properly channeled by financial institutions or citizens themselves, acting as an honest weight. And above all, we should prevent a currency regime that fits the last qualification of that quote, or the one in between, the mezzanine. Caveat emptor …

~ "Ye shall know the truth, and the truth shall make you free." ( John 8:32). Sol Iustitiae Illustra Nos. End of content ~

I have no interests to declare with the exception of my loyalty to the Kingdom of the Netherlands as a Dutch citizen.

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[570] Oscar Wilde, *For Love Of The King* (1894). First published in 1984. Quote, retrieved from <https://www.goodreads.com/book/show/30837491-for-love-of-the-king?ac=1&from_search=true&qid=cWbvwjQSMn&rank=1> Accessed 13 December 2021

[571] Ayn Rand, *Atlas Shrugged* (1957). Quote, retrieved from <https://www.goodreads.com/quotes/663434-money-is-the-barometer-of-a-society-s-virtue-when-you> Accessed 13 December 2021

# Appendix 1. Abbreviations and Terminology

**ABoR** - Administrative Board of Review
**AFS Securities -** Available-For-Sale Securities
**BCBS -** Basel Committee on Banking Supervision
**BIS -** Bank for International Settlements
**BRRD -** Bank Recovery and Resolution Directive
**CB -** Covered Bond
**CDO -** Collateralised Debt Obligation
**CDS -** Credit Default Swap
**CoCo -** Contingent Convertible
**CRD -** Capital Requirements Directive
**CRR -** Capital Requirements Regulation
**DFR -** Deposit Facility Rate - Nominal interest rate set by the ECB for overnight deposits

**EBA -** European Banking Authority - regulatory authority defining regulatory standards on prudential supervision, part of the European System of Financial Supervision
**EBRD -** European Bank for Reconstruction and Development
**EBU -** European Banking Union
**ECB -** European Central Bank
**EDIS -** European Deposit Insurance Scheme
**ESFS -** European System of Financial Supervision
**ESM -** European Stability Mechanism
**ESMA -** European Securities and Markets Authority
**ESRB -** European Systemic Risk Board

**FASB -** Financial Accounting Standards Board
**FOLTF -** Failing or Likely to Fail
**FSB -** Financial Stability Board
**GFC -** Global Financial Crisis
**G-SIB -** Global Systemically Important Bank
**G-SII -** Global Systemically Important Institution
**Hard-law -** Legal content (articles, treaties, standards, regulations) with a formally binding effect

**IFRS -** International Financial Reporting Standards
**IGG -** Implicit Government Guarantee
**LPA -** Latvian Privatization Agency
**LSI -** Less Significant Institution
**Mezzanine -** in between levels (regarding tranch risk and return in structured products)
**MREL -** Marginal Requirement of Eligible Liabilities
**MS -** Member State
**NPE -** Non-Performing Exposure
**NPL -** Non-Performing Loan

**OTC Derivatives -** Over-The-Counter Derivatives: Defined in EMIR as all Derivatives that are not executed on the regulated market
**O-SII -** Other Systemically Important Institution
**QE -** Quantitative Easing
**SGP -** Stability and Growth Pact
**SI -** Significant Institution
**Soft-law -** Legal instruments without a formally binding effect
**SPV -** Special Purpose Vehicle
**SRM -** Single Resolution Mechanism
**SSM -** Single Supervisory Mechanism
**TBTF -** Too Big to Fail

# Appendix 2. Key takeaways from the interview with Mr. Arno Wellens

§1. Could you say something about the information asymmetries and transparency in the Banking Union and the banks therein?
- transparency in banking is at stake; bank and insurance sector are intertwined -> mortgages attached to life insurances -> inquiry by VARA Kassa 2018 (Dutch program on consumer protections) -> promised returns of 15%, which are unrealistic -> over-crediting -> main cause of financial problems in banking

§2. Has a decrease of religious principles led to more immoral behaviour according to you?
- Bila Riba, or *speculation* in English, is forbidden in Islam
- Business culture on Zuidas (Amsterdam Business district) is rather godless; 'woke' banking merely a smokescreen to create artificial trust while hiding underlying problems, propagated by the same people who previously facilitated money-laundering; Chodorkovski is a case which showcases lack of morality by embracing a victory of an authoritarian regime

§3. Would you say the Banking Union was thus founded on the wrong assumptions?
- Banking Union seen as a proof of lacking knowledge about moral hazard -> dragged to European level -> banks have increased pools of funds that can be accessed -> Banking Union founded on wrong assumptions
- Wim Boonstra (appears in Arno's recording titled '10 year after Lehman Brothers') is optimistic nevertheless -> danger lays in the pre-emptive attempts to contain losses by buying junk bonds -> no political election programme advocates this approach, yet it still takes place
- Banking Union currently has 2 pillars -> his conversations with Wim Boonstra -> useful to have turnover of staff between different member states; more problematic is the common resolution
- Deutsche Bank series number IV (a series of recordings by Mr. Wellens on systemic risk and shadowbanking -> doing the job of risk management 'together' -> similar to solving an argument between people by including several people in the fight, hence more potential casualties -> Banking Union is about each member solving all of each others banking problems
- SRM without fiscal backstop? -> then it would not work right? -> true, yet more prudent member states do not want this fiscal backstop as it will likely cost them
- INO research -> 71% of a sample involving Dutch people oppose this approach -> Dutch tend to be very stingy, yet also morally concerned -> very unwise to have the Banking Union according to Mr. Wellens -> matter of time until the pooled funds will be made use of
- The ECB takes on many of the financial tasks that would otherwise be in the scope of national governments regarding fiscal and banking prudence -> national governments tend to become 'lazier' -> QE buys time for politicians which could give the opportunity to enforce changes such as cleaning up debt in Italy, unfortunately this has not occurred -> Asset Swap instead -> housing bubble arises in other Euro countries such as the Netherlands

§4. Is the Euro taking on religious proportions?
- 'together' thus also leads to more disharmony in this regard -> Zuidas -> large corporations acquire smaller ones, sacrificing internal management culture for scale efficiencies, increasing complexity -> euro has caused instability -> youth unemployment statistics in Greece are cumbersome -> Euro Evangelie is one of his books (Evangelie means 'Gospel'), describing how the euro as a currency has become a religion of its own kind -> Irelend, Portugal and the like saw a decrease in yield as soon as this currency that largely reflected German's monetary position was adopted -> explosion of government debts
- André Szász (former director of Dutch Central Bank), referred to by Arno, stressed that the quadrupled national debt in Greece is no coincidence -> euro has paved the way for its own crisis
- Rarely is the question asked if this unhappy 'marriage' between countries through the euro currency should be ended instead of artificially being kept alive -> statistics indicate keeping the currency alive in its current form is not very clever -> statics swept under the carpet as a response

§5. Would you say shadow-banking has increased following the introduction of the Euro
- Debt problems were already in place to some extent before the euro -> deregulation of banking system in the 90s -> banks have had a destabilising tendency during the last 2 to 3 centuries, yet the euro exacerbated this problem -> increase shadow economy
- Merely abolishing the euro would not end speculation, and merely regulating risky behaviour will not solve problems either

§6. Kehila means to go beyond the strictly necessary. Would you say there is something left of that principle in banks and the EBU?
- More centralisation in banking at EU level -> less adherence to Kehila principle -> book by Nout Wellink about solvability requirements BIS -> highlighted that bankers take around half a year to circumvent new rules -> an example is securitisation -> seeking the legal 'edges' -> there are still loans of 8 to 9 times annual salary being granted to people while just barely fulfilling the minimum requirement for triple A credit rating, since there are no subclassifications -> even more addition of junk loans next time a rating is given -> Gresham's Law
- Solvability calculations -> Contingent Convertibles -> no the same as equity but still potential to lose its preferential characteristics -> altering classification gives the impression of more equity, on paper -> more risky behaviour allowed -> loophole -> banks inherently unstable

§7. Friedman & Friedman warned about Shochad dervarim in 2008. It seems this problems persists, yet in a more sophisticated manner, isn't it?
- Shochad devarim -> still the case regarding securitisation -> Arno calls for leverage of 10% worth of shares outstanding and retained earnings instead of dividends -> problematic is that nobody seems eager to buy to the existing problematic balance sheets
- Kipper- und Wipperzeit coincided with final 30 years of the 80-year war (17th century) -> Germany comprised of several regional principalities -> one of the rulers discovered that his own territory harboured foreign currency's of conflicting neighbours -> scrapping off metal from foreign currency and replication allows new coins without the -> local citizens noticed massive inflation -> lead to one of the worst financial crisis in history -> strictly no theft, yet socially undesirable therefore modern day coins have ridges; a similar problem seems to occur with the euro -> loss in purchasing power in the real estate market, as with securitisation -> ECB essentially inflates housing market through its QE program, and not including real estate in the purchasing power projections allows this problem to continue -> to the advantage of banks that should have paid the price of the crisis instead
- Zuidas in Amsterdam obtains high profits from services attributable to the above mentioned problem

§8. Incredible profits are made as a result of QE, but does it contribute to the real economy?
- Central Bank buys government bonds in exchange for liquidity -> supposed to make loans more accessible and affordable to firms and stimulate the economy -> see ECB site for clarification -> in practice: only 3% of liquidity provided by QE reaches society for those purposes, the remainder 97% is an externality (and not in a positive way)

§9. Is there any role left for personal accountability?
- Are banks and their managers accountable for their actions? -> well, mostly risk-sharing, mutualisation, containing NPLs, in which government takes over responsibility from banks, often formulated in a rather vague manner
- No proof? -> No problem, absence of evidence seems to be interpreted as evidence of absence
- Monetary tricks and changes in the definition of 'gifts'; creating money out of nothing is not possible -> externalities can be seen in the real estate prices
- Estimating resolution costs based on previous crisis is somewhat unfair, given that the ECB also buys Asset-Backed-Securities with a negative yield, so it essentially becomes a lender of last resort, which is against the Treaties -> more sophisticated version of the 2008 bail-outs -> Corona has accelerated this in the form of Pandemic Emergency Program -> the relevant bonds are often sold by banks with a mark-up (exacerbating the negative yield problem) -> recapitalisation in this way is essentially a smoke-screen to cover internal failures
- Meroni doctrine -> hard to determine to what extent it has been taken into account -> ESM can lend money already, which is in essence a eurobond

# Appendix 3. Tables used for Quantitative Methodology

Intra-financial assets/total exposures (*100%)

| Intra-financial assets/total exposures | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Full sample | 0,128 | 0,127 | 0,130 | 0,123 | 0,117 | 0,116 | 0,116 | 0,113 |
| total sample mean | 0,140 | 0,142 | 0,145 | 0,134 | 0,126 | 0,127 | 0,128 | 0,129 |
| std dev | 0,096 | 0,092 | 0,086 | 0,080 | 0,083 | 0,081 | 0,088 | 0,091 |
| min | 0,012 | 0,014 | 0,014 | 0,011 | 0,012 | 0,014 | 0,012 | 0,039 |
| max | 0,424 | 0,405 | 0,399 | 0,357 | 0,370 | 0,359 | 0,411 | 0,385 |
| North mean | 0,22 | 0,218 | 0,212 | 0,203 | 0,193 | 0,184 | 0,191 | 0,189 |
| std dev | 0,134 | 0,128 | 0,119 | 0,102 | 0,106 | 0,109 | 0,125 | 0,119 |
| min | 0,062 | 0,047 | 0,040 | 0,038 | 0,036 | 0,038 | 0,036 | 0,041 |
| max | 0,424 | 0,405 | 0,399 | 0,357 | 0,370 | 0,359 | 0,411 | 0,385 |
| South mean | 0,092 | 0,106 | 0,120 | 0,103 | 0,096 | 0,100 | 0,104 | 0,095 |
| std dev | 0,029 | 0,038 | 0,046 | 0,048 | 0,053 | 0,050 | 0,058 | 0,052 |
| min | 0,049 | 0,034 | 0,069 | 0,036 | 0,025 | 0,052 | 0,042 | 0,039 |
| max | 0,143 | 0,151 | 0,214 | 0,208 | 0,211 | 0,206 | 0,216 | 0,199 |
| Non-member mean | 0,123 | 0,116 | 0,114 | 0,109 | 0,101 | 0,106 | 0,100 | 0,096 |
| std dev | 0,061 | 0,061 | 0,053 | 0,051 | 0,053 | 0,060 | 0,050 | 0,047 |
| min | 0,012 | 0,014 | 0,014 | 0,011 | 0,012 | 0,014 | 0,012 | 0,043 |
| max | 0,238 | 0,226 | 0,185 | 0,182 | 0,182 | 0,199 | 0,166 | 0,159 |
| | | | | | | | | |

Intra-financial liabilities/total exposures (*100%)

| Intra-financial liabilities/total exposures | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Full sample | 0,135 | 0,141 | 0,139 | 0,137 | 0,129 | 0,130 | 0,128 | 0,123 |
| total sample mean | 0,139 | 0,146 | 0,152 | 0,149 | 0,140 | 0,138 | 0,135 | 0,133 |
| std dev | 0,097 | 0,099 | 0,100 | 0,111 | 0,099 | 0,096 | 0,095 | 0,094 |
| min | 0,030 | 0,016 | 0,015 | 0,013 | 0,010 | 0,014 | 0,008 | 0,028 |
| max | 0,403 | 0,416 | 0,408 | 0,513 | 0,415 | 0,391 | 0,397 | 0,429 |
| North mean | 0,223 | 0,219 | 0,246 | 0,250 | 0,230 | 0,215 | 0,206 | 0,196 |
| std dev | 0,134 | 0,142 | 0,127 | 0,148 | 0,133 | 0,131 | 0,131 | 0,124 |
| min | 0,061 | 0,062 | 0,071 | 0,079 | 0,071 | 0,060 | 0,059 | 0,076 |
| max | 0,403 | 0,416 | 0,408 | 0,513 | 0,415 | 0,391 | 0,397 | 0,429 |
| South mean | 0,111 | 0,118 | 0,117 | 0,107 | 0,105 | 0,110 | 0,113 | 0,103 |
| std dev | 0,050 | 0,056 | 0,049 | 0,050 | 0,044 | 0,060 | 0,061 | 0,054 |
| min | 0,056 | 0,016 | 0,015 | 0,024 | 0,028 | 0,028 | 0,034 | 0,028 |
| max | 0,214 | 0,208 | 0,218 | 0,199 | 0,198 | 0,233 | 0,243 | 0,209 |
| Non-member mean | 0,098 | 0,114 | 0,110 | 0,109 | 0,101 | 0,104 | 0,100 | 0,085 |
| std dev | 0,049 | 0,056 | 0,059 | 0,064 | 0,054 | 0,051 | 0,054 | 0,025 |
| min | 0,030 | 0,032 | 0,020 | 0,013 | 0,010 | 0,014 | 0,008 | 0,051 |
| max | 0,170 | 0,210 | 0,219 | 0,224 | 0,204 | 0,200 | 0,210 | 0,118 |
| | | | | | | | | |

OTC Derivatives/total exposures (*100%)

| OTC Derivatives/ total exposures | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Full sample | 11,533 | 10,154 | 9,758 | 9,15 | 8,683 | 9,075 | 9,148 | 7,402 |
| total sample mean | 7,817 | 7,165 | 7,508 | 7,192 | 6,987 | 7,196 | 7,714 | 6,543 |
| std dev | 8,247 | 7,221 | 7,269 | 7,112 | 6,803 | 6,205 | 7,075 | 6,114 |
| min | 0,191 | 0,270 | 0,306 | 0,316 | 0,310 | 0,340 | 0,419 | 0,418 |
| max | 32,851 | 28,488 | 29,184 | 28,291 | 29,716 | 24,587 | 27,020 | 26,660 |
| North mean | 6,935 | 6,598 | 6,874 | 6,758 | 7,174 | 7,003 | 7,976 | 8,237 |
| std dev | 8,440 | 8,399 | 7,204 | 7,571 | 8,729 | 6,397 | 8,329 | 8,244 |
| min | 1,894 | 1,992 | 2,054 | 2,131 | 1,524 | 1,555 | 1,847 | 1,796 |
| max | 28,367 | 28,488 | 25,106 | 26,343 | 29,716 | 22,390 | 27,020 | 26,660 |
| South mean | 5,741 | 5,217 | 5,693 | 5,041 | 4,671 | 4,486 | 4,802 | 4,685 |
| std dev | 6,060 | 5,208 | 5,286 | 4,424 | 4,290 | 3,599 | 3,777 | 3,646 |
| min | 0,191 | 0,270 | 0,306 | 0,316 | 0,310 | 0,340 | 0,419 | 0,418 |
| max | 19,248 | 15,638 | 15,083 | 12,621 | 13,190 | 11,030 | 11,777 | 11,544 |
| Non-member mean | 10,613 | 9,575 | 9,842 | 9,696 | 9,149 | 10,064 | 10,411 | 7,583 |
| std dev | 9,812 | 7,874 | 8,892 | 8,611 | 6,960 | 7,257 | 7,940 | 6,150 |
| min | 0,532 | 0,620 | 0,757 | 0,842 | 0,909 | 1,257 | 1,167 | 1,169 |
| max | 32,851 | 27,099 | 29,184 | 28,291 | 21,447 | 24,587 | 25,310 | 14,650 |
| | | | | | | | | |

Bilaterally cleared OTC Derivatives/OTC Derivatives (*100%)

| bilateral/total OTC | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Full sample | 0,486 | 0,509 | 0,528 | 0,519 | 0,429 | 0,423 | 0,402 | 0,358 |
| total sample mean | 0,671 | 0,645 | 0,576 | 0,533 | 0,451 | 0,452 | 0,416 | 0,397 |
| std dev | 0,229 | 0,223 | 0,190 | 0,162 | 0,157 | 0,165 | 0,186 | 0,217 |
| min | 0,256 | 0,201 | 0,260 | 0,235 | 0,180 | 0,112 | 0,103 | 0,156 |
| max | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| North mean | 0,665 | 0,583 | 0,535 | 0,485 | 0,391 | 0,405 | 0,344 | 0,304 |
| std dev | 0,212 | 0,145 | 0,126 | 0,142 | 0,123 | 0,128 | 0,136 | 0,132 |
| min | 0,374 | 0,436 | 0,389 | 0,309 | 0,257 | 0,235 | 0,170 | 0,156 |
| max | 0,998 | 0,854 | 0,759 | 0,746 | 0,634 | 0,636 | 0,599 | 0,494 |
| South mean | 0,717 | 0,733 | 0,619 | 0,592 | 0,517 | 0,550 | 0,493 | 0,431 |
| std dev | 0,206 | 0,204 | 0,209 | 0,190 | 0,197 | 0,187 | 0,211 | 0,225 |
| min | 0,400 | 0,474 | 0,311 | 0,279 | 0,248 | 0,257 | 0,272 | 0,206 |
| max | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Non-member mean | 0,631 | 0,60 | 0,567 | 0,514 | 0,433 | 0,393 | 0,398 | 0,4876 |
| std dev | 0,273 | 0,278 | 0,219 | 0,141 | 0,122 | 0,131 | 0,181 | 0,298 |
| min | 0,256 | 0,201 | 0,260 | 0,235 | 0,180 | 0,112 | 0,103 | 0,248 |
| max | 1,000 | 1,000 | 0,983 | 0,716 | 0,638 | 0,562 | 0,775 | 0,986 |
| | | | | | | | | |

Available-For-Sale Securities/total exposures

| AFS securities/ total exposures | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Full sample | 0,065 | 0,068 | 0,082 | 0,079 | 0,068 | 0,060 | 0,061 | 0,048 |
| total sample mean | 0,062 | 0,064 | 0,073 | 0,070 | 0,064 | 0,055 | 0,057 | 0,049 |
| std dev | 0,030 | 0,031 | 0,036 | 0,037 | 0,032 | 0,035 | 0,037 | 0,029 |
| min | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0 |
| max | 0,124 | 0,119 | 0,154 | 0,156 | 0,145 | 0,158 | 0,170 | 0,108 |
| North mean | 0,072 | 0,077 | 0,084 | 0,079 | 0,070 | 0,056 | 0,060 | 0,065 |
| std dev | 0,027 | 0,023 | 0,021 | 0,026 | 0,021 | 0,027 | 0,029 | 0,032 |
| min | 0,024 | 0,033 | 0,055 | 0,034 | 0,032 | 0,021 | 0,021 | 0,019 |
| max | 0,119 | 0,113 | 0,120 | 0,113 | 0,096 | 0,102 | 0,095 | 0,108 |
| South mean | 0,067 | 0,069 | 0,079 | 0,076 | 0,071 | 0,057 | 0,055 | 0,050 |
| std dev | 0,014 | 0,021 | 0,023 | 0,021 | 0,019 | 0,021 | 0,024 | 0,016 |
| min | 0,046 | 0,032 | 0,045 | 0,045 | 0,045 | 0,032 | 0,028 | 0,027 |
| max | 0,089 | 0,101 | 0,116 | 0,115 | 0,111 | 0,093 | 0,109 | 0,070 |
| Non-member mean | 0,048 | 0,049 | 0,057 | 0,058 | 0,054 | 0,053 | 0,056 | 0,020 |
| std dev | 0,040 | 0,040 | 0,051 | 0,053 | 0,047 | 0,050 | 0,053 | 0,027 |
| min | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0,000 | 0 |
| max | 0,124 | 0,119 | 0,154 | 0,156 | 0,145 | 0,158 | 0,170 | 0,063 |
| | | | | | | | | |

# Appendix 4. Annual inputs for tables in Appendix 3

G-SIBS have been highlighted with (*) from 2013-2019

Systemic risk indicators 2013 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilaterally cleared OTC derivatives | AFS securities | Intra-financial assets/total exposures | Intra-financial liabilities/total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 236939 | 26157 | 34568 | 448696 | 414364 | 14724 | 0,110 | 0,146 | 1,894 | 0,923 | 0,062 |
| NL: ABN AMRO | 421708 | 52974 | 44558 | 947002 | 944768 | 27581 | 0,126 | 0,106 | 2,246 | 0,998 | 0,065 |
| ING* | 934934 | 120153 | 112744 | 3445785 | 1717477 | 95377 | 0,129 | 0,121 | 3,686 | 0,498 | 0,102 |
| RABOBANK | 731867 | 45189 | 44298 | 2821127 | 1548481 | 51382 | 0,062 | 0,061 | 3,855 | 0,549 | 0,070 |
| DE: Bayern LB | 289757 | 72793 | 108240 | 1425526 | 1081439 | 22512 | 0,251 | 0,374 | 4,920 | 0,759 | 0,078 |
| Commerzbank | 686192 | 196056 | 198439 | 7294752 | 2730257 | 42596 | 0,286 | 0,289 | 10,631 | 0,374 | 0,062 |
| Deutsche Bank* | 1747748 | 303108 | 249662 | 49579006 | 24757989 | 42666 | 0,173 | 0,143 | 28,367 | 0,499 | 0,024 |
| DZ Bank | 335984 | 140782 | 123554 | 970582 | 761005 | 39998 | 0,419 | 0,368 | 2,889 | 0,784 | 0,119 |
| LBBW | 312951 | 132618 | 125891 | 1228573 | 739801 | 21451 | 0,424 | 0,403 | 3,930 | 0,602 | 0,069 |
| France: Banque Postale | 212493 | 22171 | 17026 | 40568 | 40568 | 12025 | 0,104 | 0,080 | 0,191 | 1,000 | 0,057 |
| BNP Paribas* | 2031623 | 205329 | 435011 | 39104387 | 15641755 | 115459 | 0,101 | 0,214 | 19,248 | 0,400 | 0,057 |
| Credit Agricole* | 1746395 | 163301 | 286461 | 13817621 | 9395983 | 109886 | 0,094 | 0,164 | 7,036 | 0,680 | 0,063 |
| BPCE* | 1235027 | 106016 | 161284 | 10521128 | 7039708 | 79271 | 0,086 | 0,134 | 8,519 | 0,669 | 0,064 |
| Credit Mutuel | 635773 | 53685 | 45729 | 658496 | 658458 | 40889 | 0,084 | 0,072 | 1,036 | 1,000 | 0,064 |
| Societe Generale* | 1296685 | 109774 | 199270 | 18272869 | 8453336 | 60229 | 0,085 | 0,154 | 14,092 | 0,463 | 0,046 |
| Italy: Intesa Sanpaolo | 686739 | 91100 | 52929 | 2593372 | 1428399 | 60985 | 0,133 | 0,077 | 3,776 | 0,551 | 0,089 |
| Unicredit* | 1004590 | 143439 | 106319 | 2704553 | 2591355 | 85874 | 0,143 | 0,106 | 2,692 | 0,958 | 0,085 |
| Spain: Santander* | 1379107 | 102202 | 128859 | 3815072 | 2519140 | 85080 | 0,074 | 0,093 | 2,766 | 0,660 | 0,062 |
| BBVA | 681164 | 36560 | 47166 | 1809907 | 1293637 | 59134 | 0,054 | 0,069 | 2,657 | 0,715 | 0,087 |
| La Caixa | 376236 | 18551 | 21010 | 428133 | 337214 | 24288 | 0,049 | 0,056 | 1,138 | 0,788 | 0,065 |
| Sweden: Nordea* | 663362 | 91594 | 66764 | 6037650 | 3131871 | 28006 | 0,138 | 0,101 | 9,102 | 0,519 | 0,042 |
| SEB | 281513 | 38748 | 47735 | 1392465 | 1391907 | 5516 | 0,138 | 0,170 | 4,945 | 1,000 | 0,020 |
| Handelsbanken | 323793 | 24899 | 30298 | 889452 | 806327 | 924 | 0,077 | 0,094 | 2,746 | 0,907 | 0,003 |
| Swedbank | 218642 | 23203 | 18356 | 1433549 | 1084646 | 6 | 0,106 | 0,084 | 6,555 | 0,757 | 0,000 |
| UK: Barclays* | 1962640 | 259692 | 162233 | 48245411 | 22029438 | 107380 | 0,132 | 0,083 | 24,851 | 0,457 | 0,055 |
| HSBC* | 2414660 | 396151 | 351346 | 23786938 | 10100156 | 265065 | 0,164 | 0,146 | 9,851 | 0,425 | 0,110 |
| Lloyd's | 999270 | 46488 | 42661 | 6285050 | 1610301 | 54724 | 0,047 | 0,043 | 6,289 | 0,256 | 0,055 |
| Nationwide | 253252 | 2458 | 7648 | 134824 | 134788 | 13264 | 0,012 | 0,030 | 0,532 | 1,000 | 0,052 |
| RBS* | 1394038 | 208003 | 199022 | 45796929 | 18689681 | 73294 | 0,149 | 0,143 | 32,851 | 0,408 | 0,053 |
| Standard Chartered* | 583763 | 138733 | 87292 | 3970144 | 3313410 | 72429 | 0,238 | 0,150 | 5,676 | 0,835 | 0,124 |
| Denmark: Danske | 474470 | 74133 | 16520 | 6332417 | 2384005 | 8284 | 0,156 | 0,035 | 13,35 | 0,376 | 0,017 |
| Sum | 26553315 | 3446060 | 3572893 | 306231984 | 148771664 | 1720299 | | | | | |

Systemic risk indicators 2014 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS Securities | Intra-financial assets/ total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 232376 | 26660 | 61353 | 462997 | 395567 | 17598 | 0,115 | 0,123 | 1,992 | 0,854 | 0,076 |
| NL: ABN AMRO | 421311 | 93717 | 55091 | 1097406 | 512193 | 40720 | 0,222 | 0,131 | 2,605 | 0,467 | 0,097 |
| ING* | 1163853 | 108188 | 103564 | 3548041 | 1723101 | 95401 | 0,093 | 0,089 | 3,049 | 0,486 | 0,082 |
| RABOBANK | 728315 | 34512 | 45074 | 2638889 | 1151292 | 39770 | 0,047 | 0,062 | 3,632 | 0,436 | 0,055 |
| DE: Bayern LB | 275255 | 76043 | 110810 | 1551013 | 1047352 | 22374 | 0,276 | 0,403 | 5,635 | 0,675 | 0,082 |
| Commerzbank | 655686 | 162975 | 192095 | 5009289 | 2232944 | 49914 | 0,249 | 0,293 | 7,640 | 0,446 | 0,076 |
| Deutsche Bank* | 1659337 | 256613 | 192668 | 47271160 | 25169318 | 54650 | 0,155 | 0,116 | 28,488 | 0,532 | 0,033 |
| DZ Bank | 355519 | 141834 | 119363 | 856835 | 616015 | 40161 | 0,399 | 0,336 | 2,410 | 0,719 | 0,113 |
| LBBW | 289931 | 117430 | 120480 | 1140473 | 717908 | 21853 | 0,405 | 0,416 | 3,934 | 0,629 | 0,075 |
| France: Banque Postale | 223337 | 29928 | 3640 | 60329 | 60329 | 10074 | 0,134 | 0,016 | 0,270 | 1,000 | 0,045 |
| BNP Paribas* | 2252752 | 254082 | 418505 | 35228737 | 16705468 | 150522 | 0,113 | 0,186 | 15,638 | 0,474 | 0,067 |
| Credit Agricole* | 1723006 | 169966 | 191825 | 13016829 | 7971756 | 118415 | 0,099 | 0,111 | 7,556 | 0,612 | 0,069 |
| BPCE* | 1336600 | 183787 | 212805 | 10737928 | 7236791 | 42605 | 0,138 | 0,159 | 8,034 | 0,674 | 0,032 |
| Credit Mutuel | 695304 | 83508 | 50607 | 611213 | 611176 | 52757 | 0,120 | 0,073 | 0,879 | 1,000 | 0,076 |
| Societe Generale* | 1409198 | 122442 | 176916 | 18527799 | 8907562 | 65566 | 0,087 | 0,126 | 13,148 | 0,481 | 0,047 |
| Italy: Intesa Sanpaolo | 695873 | 104846 | 73098 | 2432326 | 2278423 | 52534 | 0,151 | 0,105 | 3,495 | 0,934 | 0,075 |
| Unicredit* | 1034421 | 151185 | 214723 | 2498951 | 2374838 | 103404 | 0,146 | 0,208 | 2,416 | 0,950 | 0,100 |
| Spain: Santander* | 1455593 | 137533 | 223169 | 4117354 | 2375748 | 105270 | 0,094 | 0,153 | 2,289 | 0,577 | 0,072 |
| BBVA | 723167 | 36749 | 63939 | 1778441 | 1317454 | 73255 | 0,051 | 0,088 | 2,459 | 0,741 | 0,101 |
| La Caixa | 376673 | 12730 | 25678 | 454658 | 285764 | 28754 | 0,034 | 0,068 | 1,207 | 0,623 | 0,076 |
| Sweden: Nordea* | 654515 | 105788 | 60002 | 6375089 | 6375089 | 31525 | 0,162 | 0,092 | 9,740 | 1,000 | 0,048 |
| SEB | 310460 | 35795 | 48245 | 1443082 | 693086 | 4844 | 0,115 | 0,155 | 4,647 | 0,480 | 0,016 |
| Handelsbanken | 334417 | 25768 | 44297 | 678000 | 601739 | 1245 | 0,077 | 0,132 | 2,027 | 0,888 | 0,004 |
| Swedbank | 248500 | 23541 | 23949 | 921877 | 559018 | 5 | 0,095 | 0,096 | 3,708 | 0,606 | 0,000 |
| UK: Barclays* | 1940282 | 281661 | 324974 | 38238923 | 18277934 | 120256 | 0,145 | 0,167 | 19,707 | 0,478 | 0,062 |
| HSBC* | 2679724 | 275978 | 328865 | 22476200 | 9970618 | 299071 | 0,103 | 0,128 | 8,388 | 0,444 | 0,112 |
| Lloyd's | 1107114 | 38861 | 78566 | 9335844 | 1930683 | 72529 | 0,035 | 0,071 | 8,432 | 0,201 | 0,066 |
| Nationwide | 276999 | 3894 | 8785 | 171647 | 170920 | 15226 | 0,014 | 0,032 | 0,620 | 0,996 | 0,055 |
| RBS* | 1410547 | 198054 | 203226 | 38225555 | 14506813 | 64712 | 0,140 | 0,144 | 27,099 | 0,380 | 0,046 |
| Standard* Chartered | 714448 | 161793 | 149840 | 5885031 | 4969758 | 84690 | 0,226 | 0,210 | 8,237 | 0,844 | 0,119 |
| Denmark: Danske | 494216 | 80385 | 15646 | 6284493 | 2360088 | 7862 | 0,163 | 0,032 | 12,72 | 0,375 | 0,016 |
| Sum | 27878729 | 3536246 | 3941798 | 283076409 | 144106745 | 1887562 | | | | | |

Systemic risk indicators 2015 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS Securities | Intra-financial assets/ total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 227942 | 27010 | 69415 | 468170 | 355157 | 19782 | 0,118 | 0,304 | 2,054 | 0,759 | 0,089 |
| NL: ABN AMRO | 464177 | 90949 | 58548 | 1248949 | 485042 | 39636 | 0,196 | 0,126 | 2,691 | 0,389 | 0,085 |
| ING* | 1097869 | 148632 | 137913 | 3811793 | 1759442 | 87000 | 0,135 | 0,126 | 3,472 | 0,462 | 0,079 |
| RABOBANK | 689820 | 27321 | 49216 | 2892704 | 1123983 | 37767 | 0,040 | 0,071 | 4,193 | 0,389 | 0,055 |
| DE: Bayern LB | 229232 | 50907 | 93559 | 1792906 | 1115967 | 27610 | 0,222 | 0,408 | 7,821 | 0,622 | 0,120 |
| Commerzbank | 535023 | 127019 | 140759 | 4600541 | 2009887 | 46203 | 0,237 | 0,263 | 8,599 | 0,437 | 0,086 |
| Deutsche Bank* | 1411887 | 237522 | 230945 | 35446760 | 20128354 | 83331 | 0,168 | 0,164 | 25,106 | 0,568 | 0,059 |
| DZ Bank | 345213 | 137572 | 125768 | 978179 | 623051 | 38671 | 0,399 | 0,364 | 2,834 | 0,637 | 0,112 |
| LBBW | 240913 | 93741 | 92826 | 1228567 | 676054 | 1813 | 0,390 | 0,385 | 5,100 | 0,550 | 0,075 |
| France: Banque Postale | 234387 | 25614 | 3442 | 71626 | 71626 | 13548 | 0,109 | 0,015 | 0,306 | 1,000 | 0,058 |
| BNP Paribas* | 1862296 | 187011 | 207370 | 28088520 | 13474063 | 154831 | 0,100 | 0,111 | 15,083 | 0,480 | 0,083 |
| Credit Agricole* | 1422901 | 174745 | 179918 | 14284079 | 8433308 | 117336 | 0,123 | 0,126 | 10,039 | 0,590 | 0,082 |
| BPCE* | 1109882 | 93175 | 133895 | 11065162 | 6962297 | 50136 | 0,084 | 0,121 | 9,970 | 0,629 | 0,045 |
| Credit Mutuel | 640785 | 115021 | 75834 | 533090 | 530046 | 57112 | 0,180 | 0,118 | 0,832 | 0,994 | 0,089 |
| Societe Generale* | 1246605 | 151299 | 183432 | 16151622 | 9527403 | 61884 | 0,121 | 0,147 | 12,956 | 0,590 | 0,050 |
| Italy: Intesa Sanpaolo | 595861 | 127357 | 74225 | 2350673 | 731236 | 55500 | 0,214 | 0,125 | 3,945 | 0,311 | 0,093 |
| Unicredit* | 975721 | 154995 | 212527 | 2484037 | 1447948 | 112699 | 0,159 | 0,218 | 2,546 | 0,583 | 0,116 |
| Spain: Santander* | 1392282 | 95917 | 155550 | 4332572 | 2300060 | 110844 | 0,069 | 0,112 | 3,112 | 0,531 | 0,080 |
| BBVA | 788370 | 72961 | 98371 | 1929415 | 893841 | 88512 | 0,093 | 0,125 | 2,447 | 0,463 | 0,112 |
| La Caixa | 336433 | 23604 | 23530 | 467313 | 300558 | 21324 | 0,070 | 0,070 | 1,389 | 0,643 | 0,063 |
| Sweden: Nordea* | 574301 | 98493 | 50284 | 7211442 | 2644322 | 34116 | 0,172 | 0,088 | 12,557 | 0,367 | 0,059 |
| SEB | 309184 | 33376 | 43190 | 1601963 | 1108213 | 5641 | 0,108 | 0,140 | 5,182 | 0,692 | 0,018 |
| Handelsbanken | 285635 | 21520 | 16526 | 440661 | 328555 | 1206 | 0,075 | 0,058 | 1,543 | 0,746 | 0,004 |
| Swedbank | 230885 | 19771 | 24642 | 694549 | 297553 | 7 | 0,086 | 0,107 | 3,009 | 0,428 | 0,000 |
| UK: Barclays* | 1419632 | 232118 | 221781 | 32322364 | 16004627 | 120057 | 0,164 | 0,156 | 22,768 | 0,495 | 0,085 |
| HSBC* | 2603612 | 225935 | 273717 | 18139122 | 9881853 | 345712 | 0,087 | 0,105 | 6,967 | 0,545 | 0,133 |
| Lloyd's | 982782 | 69210 | 88402 | 6642568 | 1729526 | 45002 | 0,070 | 0,090 | 6,759 | 0,260 | 0,046 |
| Nationwide | 292241 | 4134 | 5706 | 221151 | 217375 | 14869 | 0,014 | 0,020 | 0,757 | 0,983 | 0,051 |
| RBS* | 970343 | 155836 | 175584 | 28319101 | 12611083 | 59188 | 0,161 | 0,181 | 29,184 | 0,445 | 0,061 |
| Standard Chartered* | 675623 | 125127 | 148288 | 5587158 | 6922754 | 154138 | 0,185 | 0,219 | 8,270 | 0,835 | 0,154 |
| Denmark: Danske | 442132 | 58270 | 21610 | 4979142 | 2218452 | 6267 | 0,132 | 0,049 | 11,262 | 0,446 | 0,014 |
| Sum | 24633969 | 3206162 | 3416773 | 240385899 | 126913636 | 2011742 | | | | | |

Systemic risk indicators 2016 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS Securities | Intra-financial assets/ total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 255469 | 37461 | 83758 | 544473 | 406138 | 20692 | 0,147 | 0,328 | 2,131 | 0,746 | 0,081 |
| NL: ABN AMRO | 479926 | 93218 | 38148 | 1210412 | 374601 | 44613 | 0,194 | 0,079 | 2,522 | 0,309 | 0,093 |
| ING* | 1098266 | 149151 | 127964 | 3882232 | 1644126 | 82912 | 0,136 | 0,117 | 3,535 | 0,424 | 0,075 |
| RABOBANK | 681605 | 26004 | 57893 | 3522004 | 1407705 | 34580 | 0,038 | 0,085 | 5,167 | 0,400 | 0,051 |
| DE: Bayern LB | 227458 | 52886 | 116579 | 1076728 | 376065 | 25750 | 0,233 | 0,513 | 4,734 | 0,349 | 0,113 |
| Commerzbank | 492525 | 106847 | 120757 | 3811392 | 1689594 | 39921 | 0,217 | 0,245 | 7,738 | 0,443 | 0,081 |
| Deutsche Bank* | 1363143 | 210381 | 257684 | 35908873 | 20155651 | 52651 | 0,154 | 0,189 | 26,343 | 0,561 | 0,034 |
| DZ Bank | 443344 | 158202 | 169669 | 1161858 | 751971 | 49426 | 0,357 | 0,383 | 2,621 | 0,647 | 0,111 |
| LBBW | 253745 | 88682 | 79732 | 1530543 | 745044 | 19384 | 0,349 | 0,314 | 6,032 | 0,487 | 0,076 |
| France: Banque Postale | 236798 | 26604 | 5576 | 74822 | 74822 | 16659 | 0,112 | 0,024 | 0,316 | 1,000 | 0,070 |
| BNP Paribas* | 1879937 | 143432 | 180092 | 21550965 | 11112484 | 157686 | 0,076 | 0,096 | 11,464 | 0,516 | 0,084 |
| Credit Agricole* | 1447004 | 161811 | 139492 | 13362357 | 7635802 | 116976 | 0,112 | 0,096 | 9,234 | 0,571 | 0,081 |
| BPCE | 1163157 | 64663 | 113985 | 8915294 | 5469530 | 52659 | 0,056 | 0,098 | 7,665 | 0,613 | 0,045 |
| Credit Mutuel | 687372 | 69653 | 70801 | 456029 | 377929 | 51716 | 0,101 | 0,103 | 0,663 | 0,829 | 0,075 |
| Societe Generale* | 1227083 | 180501 | 203529 | 15487489 | 8431936 | 64127 | 0,147 | 0,166 | 12,621 | 0,544 | 0,052 |
| Italy: Intesa Sanpaolo | 634858 | 132144 | 78574 | 2478529 | 691786 | 67389 | 0,208 | 0,124 | 3,904 | 0,279 | 0,106 |
| Unicredit* | 974373 | 133774 | 193973 | 2186155 | 1296260 | 112039 | 0,132 | 0,199 | 2,244 | 0,592 | 0,115 |
| Spain: Santander* | 1402131 | 90258 | 147543 | 4462737 | 1829810 | 104557 | 0,064 | 0,105 | 3,183 | 0,410 | 0,075 |
| BBVA | 773146 | 72161 | 99424 | 2132941 | 1218737 | 58638 | 0,093 | 0,129 | 2,759 | 0,571 | 0,076 |
| La Caixa | 328169 | 11788 | 12080 | 459650 | 270218 | 18218 | 0,036 | 0,037 | 1,401 | 0,588 | 0,056 |
| Sweden: Nordea* | 558586 | 90235 | 44674 | 6779147 | 2334361 | 32295 | 0,162 | 0,080 | 12,136 | 0,3443 | 0,058 |
| SEB | 267848 | 23630 | 38152 | 1895197 | 1296563 | 4012 | 0,088 | 0,142 | 7,075 | 0,684 | 0,015 |
| Handelsbanken | 283823 | 18055 | 17947 | 410522 | 251710 | 820 | 0,063 | 0,063 | 1,446 | 0,613 | 0,003 |
| Swedbank | 221716 | 22600 | 12949 | 729934 | 323228 | 2 | 0,102 | 0,058 | 3,292 | 0,442 | 0,000 |
| UK: Barclays* | 1331970 | 216437 | 223195 | 30375197 | 15061152 | 73714 | 0,162 | 0,168 | 22,804 | 0,496 | 0,055 |
| HSBC* | 2266180 | 216116 | 245817 | 18444766 | 10466345 | 354031 | 0,095 | 0,108 | 8,139 | 0,567 | 0,156 |
| Lloyd's | 869602 | 63417 | 78606 | 4829333 | 1134512 | 66018 | 0,073 | 0,090 | 5,553 | 0,235 | 0,076 |
| Nationwide | 273641 | 3036 | 3530 | 230387 | 133005 | 10644 | 0,011 | 0,013 | 0,842 | 0,577 | 0,039 |
| RBS* | 810338 | 121681 | 150369 | 22925461 | 11567881 | 50910 | 0,150 | 0,186 | 28,291 | 0,505 | 0,063 |
| Standard Chartered* | 687145 | 124860 | 154187 | 5312930 | 3805239 | 101963 | 0,182 | 0,224 | 7,732 | 0,716 | 0,148 |
| Denmark: Danske | 456299 | 50265 | 30932 | 4266741 | 2034880 | 9513 | 0,110 | 0,068 | 9,35 | 0,477 | 0,021 |
| Sum | 24076657 | 2959953 | 3297611 | 220415098 | 114369085 | 1894515 | | | | | |

Systemic risk indicators 2017 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS Securities | Intra-financial assets/total exposures | Intra-financial liabilities/ total exposures | OTC Derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS/total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 274956 | 47059 | 80609 | 418935 | 265819 | 19424 | 0,171 | 0,293 | 1,524 | 0,634 | 0,070 |
| NL: ABN AMRO | 487466 | 75133 | 41434 | 1244620 | 320175 | 40232 | 0,154 | 0,085 | 2,553 | 0,257 | 0,083 |
| ING* | 1085214 | 132974 | 113912 | 3800937 | 1570874 | 71469 | 0,123 | 0,105 | 3,502 | 0,413 | 0,066 |
| RABOBANK | 619544 | 22346 | 44257 | 2910541 | 759667 | 28685 | 0,036 | 0,071 | 4,698 | 0,261 | 0,046 |
| DE: Bayern LB | 233087 | 49754 | 89108 | 1080618 | 362332 | 22363 | 0,213 | 0,382 | 4,636 | 0,335 | 0,096 |
| Commerzbank | 475579 | 76085 | 82555 | 3962698 | 1405565 | 31661 | 0,160 | 0,174 | 8,332 | 0,355 | 0,067 |
| Deutsche Bank* | 1409118 | 227571 | 279087 | 41873168 | 13426817 | 46047 | 0,161 | 0,198 | 29,716 | 0,321 | 0,032 |
| DZ Bank | 432903 | 152339 | 179465 | 1133589 | 582896 | 39008 | 0,352 | 0,415 | 2,619 | 0,514 | 0,090 |
| LBBW | 257945 | 95474 | 90557 | 1803413 | 778969 | 20427 | 0,370 | 0,351 | 6,991 | 0,432 | 0,079 |
| France: Banque Postale | 239169 | 21519 | 6782 | 74061 | 74061 | 15440 | 0,090 | 0,028 | 0,310 | 1,000 | 0,065 |
| BNP Paribas* | 1819746 | 121492 | 172401 | 20262889 | 11142529 | 123600 | 0,067 | 0,095 | 11,135 | 0,550 | 0,068 |
| Credit Agricole* | 1493620 | 166025 | 140370 | 12131159 | 6705766 | 103713 | 0,111 | 0,094 | 8,122 | 0,553 | 0,069 |
| BPCE | 1183742 | 67101 | 111572 | 5051948 | 1945612 | 53439 | 0,057 | 0,094 | 4,268 | 0,385 | 0,045 |
| Credit Mutuel | 700607 | 53058 | 59484 | 450836 | 281751 | 48859 | 0,076 | 0,085 | 0,643 | 0,625 | 0,070 |
| Societe Generale* | 1160561 | 162938 | 172911 | 15307276 | 6570634 | 55090 | 0,140 | 0,149 | 13,190 | 0,429 | 0,047 |
| Italy: Intesa Sanpaolo | 688524 | 145311 | 95747 | 2618621 | 648739 | 64917 | 0,211 | 0,139 | 3,803 | 0,248 | 0,094 |
| Unicredit* | 959035 | 147286 | 189997 | 2329744 | 1216304 | 106240 | 0,154 | 0,198 | 2,249 | 0,522 | 0,111 |
| Spain: Santander* | 1495035 | 96431 | 151209 | 4673700 | 1683574 | 120405 | 0,065 | 0,101 | 3,126 | 0,360 | 0,081 |
| BBVA | 719401 | 44588 | 72801 | 2682655 | 1103565 | 49682 | 0,062 | 0,101 | 3,229 | 0,411 | 0,069 |
| La Caixa | 350134 | 8788 | 25408 | 466889 | 280460 | 20158 | 0,025 | 0,073 | 1,313 | 0,601 | 0,058 |
| Sweden: Nordea | 543608 | 98851 | 46708 | 734434 | 205023 | 3692 | 0,182 | 0,086 | 13,298 | 0,279 | 0,067 |
| SEB | 257339 | 24386 | 31929 | 1573776 | 747561 | 3084 | 0,095 | 0,124 | 6,115 | 0,475 | 0,012 |
| Handelsbanken | 288883 | 15701 | 15607 | 419171 | 210290 | 767 | 0,054 | 0,054 | 1,451 | 0,502 | 0,003 |
| Swedbank | 217988 | 10312 | 13113 | 703596 | 311565 | 2 | 0,047 | 0,060 | 3,227 | 0,442 | 0,000 |
| UK: Barclays* | 1282327 | 167994 | 186250 | 27501451 | 11210606 | 60228 | 0,131 | 0,145 | 21,447 | 0,408 | 0,047 |
| HSBC* | 2168531 | 233563 | 221653 | 21130045 | 11204843 | 264298 | 0,108 | 0,102 | 9,744 | 0,530 | 0,122 |
| Lloyd's | 810088 | 51849 | 76174 | 4221496 | 760940 | 47449 | 0,064 | 0,094 | 5,211 | 0,180 | 0,059 |
| Nationwide | 274818 | 3342 | 2621 | 249677 | 104186 | 11946 | 0,012 | 0,010 | 0,909 | 0,417 | 0,043 |
| RBS | 776288 | 108672 | 120581 | 15748829 | 7408154 | 53339 | 0,140 | 0,155 | 20,287 | 0,470 | 0,069 |
| Standard Chartered* | 639213 | 110319 | 130355 | 5113789 | 3262583 | 92864 | 0,173 | 0,204 | 8,000 | 0,638 | 0,145 |
| Denmark: Danske | 461768 | 47487 | 33216 | 5057642 | 2129941 | 10591 | 0,103 | 0,072 | 10,952 | 0,420 | 0,022 |
| Sum | 23806237 | 2785748 | 3077873 | 206732203 | 88681801 | 1629119 | | | | | |

Systemic risk indicators 2018 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS securities | Intra-financial assets/ total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 267962 | 47504 | 63527 | 416792 | 264952 | 5719 | 0,155 | 0,237 | 1,555 | 0,636 | 0,021 |
| NL: ABN AMRO | 481832 | 65317 | 28935 | 2464401 | 1382806 | 41146 | 0,136 | 0,060 | 5,115 | 0,561 | 0,085 |
| ING* | 1167968 | 124218 | 131865 | 3625195 | 1376338 | 76121 | 0,106 | 0,113 | 3,104 | 0,380 | 0,065 |
| RABOBANK | 610102 | 23436 | 45621 | 3406823 | 803060 | 18711 | 0,038 | 0,075 | 5,58 | 0,235 | 0,031 |
| DE: Bayern LB | 241355 | 49889 | 87970 | 856459 | 333063 | 24575 | 0,207 | 0,364 | 3,549 | 0,389 | 0,102 |
| Commerzbank | 491115 | 79042 | 83564 | 4416856 | 1277116 | 25545 | 0,161 | 0,170 | 8,993 | 0,289 | 0,052 |
| Deutsche Bank* | 1286322 | 177865 | 199029 | 35232505 | 13566439 | 46070 | 0,138 | 0,155 | 22,390 | 0,385 | 0,036 |
| DZ Bank | 442618 | 159074 | 172965 | 1304735 | 588328 | 18080 | 0,359 | 0,391 | 2,948 | 0,451 | 0,041 |
| LBBW | 264168 | 95072 | 98317 | 2588895 | 823779 | 19487 | 0,359 | 0,372 | 9,800 | 0,318 | 0,074 |
| France: Banque Postale | 255899 | 22197 | 7067 | 87035 | 87035 | 13864 | 0,087 | 0,028 | 0,340 | 1,000 | 0,054 |
| BNP Paribas* | 1879908 | 133983 | 190015 | 20734716 | 12318358 | 59398 | 0,071 | 0,101 | 11,030 | 0,594 | 0,032 |
| Credit Agricole* | 1610996 | 161300 | 155857 | 9739340 | 4931769 | 55870 | 0,100 | 0,097 | 6,046 | 0,506 | 0,035 |
| BPCE | 1189083 | 75714 | 111929 | 4753562 | 2282871 | 40151 | 0,064 | 0,094 | 3,998 | 0,480 | 0,034 |
| Credit Mutuel | 744848 | 56897 | 60678 | 686229 | 480881 | 42169 | 0,076 | 0,081 | 0,921 | 0,701 | 0,057 |
| Societe Generale* | 1219284 | 160711 | 228799 | 13190777 | 6703915 | 49986 | 0,131 | 0,188 | 10,818 | 0,508 | 0,041 |
| Italy: Intesa Sanpaolo | 682434 | 140514 | 107461 | 2454742 | 630500 | 63319 | 0,206 | 0,157 | 3,597 | 0,257 | 0,093 |
| Unicredit* | 1001573 | 175632 | 233193 | 2632666 | 1521145 | 90037 | 0,175 | 0,233 | 2,629 | 0,578 | 0,090 |
| Spain: Santander* | 1523092 | 85126 | 147612 | 5786567 | 1788391 | 106186 | 0,056 | 0,097 | 3,799 | 0,437 | 0,070 |
| BBVA | 714311 | 55108 | 67345 | 3378884 | 1476259 | 42019 | 0,077 | 0,094 | 4,730 | 0,434 | 0,059 |
| La Caixa | 350942 | 18079 | 15119 | 504445 | 277659 | 21888 | 0,052 | 0,043 | 1,437 | 0,550 | 0,062 |
| Sweden: Nordea | 532584 | 96463 | 49143 | 6453355 | 1992576 | 33569 | 0,181 | 0,092 | 12,117 | 0,309 | 0,063 |
| SEB | 276126 | 26295 | 32380 | 1786628 | 789331 | 1710 | 0,095 | 0,117 | 6,470 | 0,442 | 0,006 |
| Handelsbanken | 294950 | 17188 | 16493 | 414529 | 186856 | 743 | 0,058 | 0,056 | 1,405 | 0,451 | 0,003 |
| Swedbank | 220340 | 8797 | 13133 | 676534 | 380366 | 0 | 0,040 | 0,060 | 3,070 | 0,562 | 0 |
| UK: Barclays* | 1291118 | 166892 | 180172 | 31744985 | 11355216 | 58418 | 0,129 | 0,140 | 24,587 | 0,358 | 0,045 |
| HSBC* | 2313302 | 216663 | 242377 | 27933268 | 12265425 | 289714 | 0,094 | 0,105 | 12,075 | 0,439 | 0,125 |
| Lloyd's | 806620 | 61037 | 87909 | 6744549 | 758535 | 27741 | 0,076 | 0,109 | 8,361 | 0,112 | 0,034 |
| Nationwide | 250753 | 3453 | 3629 | 315116 | 86730 | 14797 | 0,014 | 0,014 | 1,257 | 0,275 | 0,059 |
| RBS | 731025 | 145778 | 114728 | 13786941 | 7133020 | 50970 | 0,199 | 0,157 | 18,860 | 0,517 | 0,070 |
| Standard Chartered* | 700945 | 123585 | 139954 | 6316958 | 3266407 | 110902 | 0,176 | 0,200 | 9,012 | 0,517 | 0,158 |
| Denmark: Danske | 440928 | 47257 | 39697 | 5948736 | 2052964 | 9946 | 0,107 | 0,090 | 13,491 | 0,345 | 0,023 |
| Sum | 24284503 | 2820086 | 3156483 | 220383223 | 93182090 | 1458851 | | | | | |

Systemic risk indicators 2019 (amounts in mln €, ratios * 100%)

| Bank | Total exposure | Intra-financial assets | Intra-financial liabilities | OTC derivatives | bilateral OTC derivatives | AFS Securities | Intra-financial assets/total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 275228 | 58664 | 56445 | 508328 | 304556 | 5714 | 0,213 | 0,205 | 1,847 | 0,599 | 0,021 |
| NL: ABN AMRO | 484826 | 64728 | 28580 | 1438013 | 275542 | 44406 | 0,133 | 0,059 | 2,966 | 0,192 | 0,092 |
| ING* | 1190776 | 145169 | 130521 | 3833443 | 1275960 | 78897 | 0,122 | 0,110 | 3,219 | 0,332 | 0,066 |
| RABOBANK | 612465 | 21825 | 48614 | 3564604 | 807705 | 13299 | 0,036 | 0,079 | 5,820 | 0,227 | 0,022 |
| DE: Bayern LB | 243396 | 47724 | 82929 | 727180 | 301196 | 23050 | 0,196 | 0,341 | 2,988 | 0,414 | 0,095 |
| Commerzbank | 499197 | 61935 | 74898 | 7286131 | 1240156 | 30343 | 0,124 | 0,150 | 14,596 | 0,170 | 0,061 |
| Deutsche Bank* | 1177917 | 134257 | 160854 | 31827441 | 12810804 | 40477 | 0,114 | 0,137 | 27,020 | 0,403 | 0,034 |
| DZ Bank | 467605 | 174241 | 185859 | 1300078 | 557978 | 27058 | 0,373 | 0,397 | 2,780 | 0,429 | 0,058 |
| LBBW | 277821 | 114051 | 103991 | 2931011 | 961690 | 25045 | 0,411 | 0,374 | 10,550 | 0,328 | 0,090 |
| France: Banque Postale | 285323 | 21630 | 15680 | 119622 | 119622 | 12825 | 0,076 | 0,055 | 0,419 | 1,000 | 0,045 |
| BNP Paribas* | 1971546 | 154631 | 197549 | 20486182 | 12660182 | 56000 | 0,078 | 0,100 | 10,391 | 0,617 | 0,028 |
| Credit Agricole* | 1676552 | 168305 | 167808 | 13857174 | 5056940 | 50354 | 0,100 | 0,100 | 8,265 | 0,365 | 0,030 |
| BPCE* | 1251870 | 81616 | 115201 | 5050637 | 2310237 | 44682 | 0,065 | 0,092 | 4,034 | 0,457 | 0,036 |
| Credit Mutuel | 769543 | 58887 | 66812 | 800875 | 538884 | 43102 | 0,077 | 0,087 | 1,041 | 0,673 | 0,056 |
| Societe Generale* | 1210479 | 179964 | 242188 | 14256191 | 6151985 | 53235 | 0,149 | 0,200 | 11,777 | 0,432 | 0,044 |
| Italy: Intesa Sanpaolo | 693221 | 149444 | 101313 | 2362218 | 642471 | 75679 | 0,216 | 0,146 | 3,408 | 0,272 | 0,109 |
| Unicredit* | 1026433 | 206165 | 249507 | 3366720 | 1150941 | 81235 | 0,201 | 0,243 | 3,280 | 0,342 | 0,079 |
| Spain: Santander* | 1578629 | 94246 | 157067 | 5949149 | 1866117 | 106359 | 0,060 | 0,099 | 3,775 | 0,314 | 0,067 |
| BBVA | 738935 | 58487 | 68078 | 3706618 | 1450969 | 45888 | 0,079 | 0,092 | 5,016 | 0,391 | 0,062 |
| La Caixa | 348007 | 14575 | 11839 | 493613 | 274523 | 18371 | 0,042 | 0,034 | 1,418 | 0,556 | 0,053 |
| Now Finland: Nordea | 539240 | 85662 | 38759 | 6431272 | 1816503 | 29779 | 0,159 | 0,072 | 11,927 | 0,282 | 0,055 |
| SEB | 299388 | 33242 | 27202 | 1992029 | 733588 | 1554 | 0,111 | 0,091 | 6,655 | 0,368 | 0,005 |
| Handelsbanken | 297041 | 15888 | 14823 | 393216 | 156644 | 732 | 0,053 | 0,050 | 1,324 | 0,398 | 0,002 |
| Swedbank | 227081 | 9942 | 18371 | 478687 | 370983 | 0 | 0,043 | 0,081 | 2,109 | 0,775 | 0,000 |
| UK: Barclays* | 1339173 | 190750 | 183877 | 33895980 | 11840267 | 76682 | 0,142 | 0,137 | 25,310 | 0,349 | 0,057 |
| HSBC* | 2470085 | 219288 | 245974 | 23372279 | 12190743 | 309507 | 0,089 | 0,100 | 9,462 | 0,522 | 0,125 |
| Lloyd's | 837044 | 67206 | 84520 | 8147725 | 839058 | 29491 | 0,080 | 0,101 | 9,734 | 0,103 | 0,035 |
| Nationwide | 303774 | 3792 | 2445 | 354618 | 92598 | 17055 | 0,012 | 0,008 | 1,167 | 0,261 | 0,056 |
| RBS | 767054 | 97802 | 123648 | 15827197 | 7493050 | 56812 | 0,128 | 0,161 | 20,633 | 0,473 | 0,074 |
| Standard Chartered* | 756906 | 125913 | 158628 | 6758083 | 3831595 | 128791 | 0,166 | 0,210 | 8,929 | 0,567 | 0,170 |
| Denmark: Danske | 451765 | 54604 | 39598 | 7800727 | 2145815 | 14445 | 0,121 | 0,088 | 17,267 | 0,275 | 0,032 |
| i) sum ii) avg ratio | 25068320 | 2914633 | 3203578 | 229317041 | 92269302 | 1540867 | | | | | |

Systemic risk indicators 2020 (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intrafinancial assets | Intrafinancial liabilities | OTC derivatives | Bilateral OTC derivatives | AFS securities | Intra-financial assets/ total exposures | Intra-financial liabilities/ total exposures | OTC derivatives/ total exposures | bilaterally cleared OTC Derivatives/ OTC Derivatives | AFS securities/ total exposures |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Belgium: KBC | 302167 | 78787 | 49052 | 542596 | 268087 | 5689 | 0,261 | 0,162 | 1,796 | 0,494 | 0,019 |
| NL: ABN | 431044 | 61646 | 32920 | 1448060 | 225818 | 46567 | 0,143 | 0,076 | 3,359 | 0,156 | 0,108 |
| ING | 1105642 | 130845 | 132816 | 3644768 | 1171285 | 85427 | 0,118 | 0,120 | 3,297 | 0,321 | 0,077 |
| RABOBANK | 560983 | 22852 | 43238 | 4588925 | 811084 | 15317 | 0,041 | 0,077 | 8,180 | 0,177 | 0,027 |
| DE: Bayern LB | 276865 | 50615 | 83334 | 614140 | 285147 | 20905 | 0,182 | 0,301 | 2,218 | 0,464 | 0,076 |
| Commerzbank | 542940 | 60813 | 74876 | 6621173 | 1116665 | 42252 | 0,112 | 0,138 | 12,195 | 0,169 | 0,078 |
| Deutsche Bank | 1171279 | 125407 | 160950 | 31226503 | 10905348 | 49502 | 0,107 | 0,137 | 26,660 | 0,349 | 0,042 |
| DZ Bank | 497839 | 191445 | 213429 | 1300189 | 514614 | 27058 | 0,385 | 0,429 | 2,612 | 0,396 | 0,054 |
| LBBW | 295660 | 104960 | 94986 | 4084794 | 842126 | 31039 | 0,355 | 0,321 | 13,816 | 0,206 | 0,105 |
| France: Banque Postale | 323494 | 22364 | 21255 | 135212 | 135212 | 13896 | 0,069 | 0,066 | 0,418 | 1,000 | 0,043 |
| BNP Paribas | 2266866 | 164849 | 215329 | 20503304 | 12386710 | 61116 | 0,073 | 0,095 | 9,045 | 0,604 | 0,027 |
| Credit Agricole | 1861851 | 184342 | 184316 | 16234393 | 5378793 | 51581 | 0,099 | 0,099 | 8,719 | 0,331 | 0,027 |
| BPCE | 1374354 | 71956 | 116021 | 6129632 | 2161497 | 49766 | 0,052 | 0,084 | 4,460 | 0,353 | 0,036 |
| Credit Mutuel | 856533 | 59560 | 68657 | 564633 | 298045 | 48124 | 0,070 | 0,080 | 0,659 | 0,528 | 0,056 |
| Societe Generale | 1283601 | 170421 | 258343 | 14817826 | 5487173 | 51979 | 0,133 | 0,201 | 11,544 | 0,370 | 0,040 |
| Italy: Intesa Sanpaolo | 892263 | 152763 | 76424 | 2713150 | 559266 | 61849 | 0,171 | 0,086 | 3,041 | 0,206 | 0,069 |
| Unicredit | 1075629 | 214554 | 225222 | 3880366 | 1078129 | 72690 | 0,199 | 0,209 | 3,608 | 0,278 | 0,068 |
| Spain: Santander | 1556279 | 82493 | 136617 | 5665379 | 1710800 | 97294 | 0,053 | 0,088 | 3,640 | 0,302 | 0,063 |
| BBVA | 771742 | 64591 | 72553 | 3892741 | 1049033 | 54403 | 0,084 | 0,094 | 5,044 | 0,269 | 0,070 |
| La Caixa | 409551 | 16118 | 11621 | 556900 | 280697 | 19309 | 0,039 | 0,028 | 1,360 | 0,504 | 0,047 |
| Now Finland: Nordea | 539240 | 85662 | 38759 | 6488526 | 1610352 | 33727 | 0,159 | 0,072 | 12,032 | 0,248 | 0,063 |
| Sweden: SEB | 331835 | 35854 | 39258 | 2898273 | 1541345 | 1380 | 0,108 | 0,118 | 8,734 | 0,532 | 0,004 |
| Handelsbanken | 307115 | 13320 | 15626 | 356325 | 132551 | 903 | 0,043 | 0,051 | 1,169 | 0,372 | 0,003 |
| Swedbank | 253728 | 13627 | 24790 | 337416 | 332614 | 0 | 0,054 | 0,098 | 1,330 | 0,986 | 0 |
| Denmark: Danske | 487885 | 55847 | 42219 | 7147720 | 2145815 | 14445 | 0,114 | 0,087 | 14,650 | 0,300 | 0,030 |
| Sum | 19776385 | 2235691 | 2432611 | 146392944 | 52428206 | 956218 | | | | | |

Systemic risk indicators 2020 UK GSIBs (amounts in mln €, ratios * 100%)

| Bank | Total exposures | Intrafinancial assets | Intrafinancial liabilities | OTC Derivatives | Bilateral OTC Derivatives | AFS Securities |
|---|---|---|---|---|---|---|
| UK: Barclays | 1429857 | 172153 | 201275 | 31818115 | 11569910 | 87406 |
| HSBC | n/a | n/a | n/a | n/a | n/a | n/a |
| Lloyd's | 833112 | 68259 | 74039 | 8445351 | 766358 | 30703 |
| Nationwide | n/a | n/a | n/a | n/a | n/a | n/a |
| RBS | 789309 | 71693 | 121756 | 14474489 | 6254463 | 49601 |
| Standard Chartered | 733891 | 115440 | 167729 | 6868298 | 4257432 | 117912 |

# Appendix 5. Excerpts from Garcia et al.

Table 3: Summary statistics

| G-SIBs (13 banks) | P10 | P25 | P50 | P75 | P90 | StDev | Mean | Obs |
|---|---|---|---|---|---|---|---|---|
| *Matched indicators (basis points)* | | | | | | | | |
| Assets under custody | 6 | 12 | 54 | 148 | 393 | 158 | 124 | 286 |
| Cross-jurisdictional claims | 67 | 176 | 261 | 512 | 627 | 213 | 328 | 286 |
| Cross-jurisdictional liabilities | 71 | 181 | 267 | 509 | 679 | 217 | 329 | 286 |
| Intra-financial assets | 225 | 262 | 447 | 787 | 921 | 295 | 513 | 286 |
| Intra-financial liabilities | 164 | 243 | 333 | 631 | 821 | 248 | 435 | 286 |
| Level 3 assets | 42 | 62 | 125 | 293 | 481 | 164 | 199 | 286 |
| Notional amount of OTC derivat. | 67 | 97 | 157 | 436 | 660 | 234 | 284 | 286 |
| Securities outstanding | 68 | 122 | 165 | 198 | 221 | 52 | 157 | 286 |
| Total exposures | 91 | 131 | 161 | 199 | 293 | 67 | 173 | 286 |
| Trading & AFS securities | 249 | 306 | 443 | 621 | 936 | 341 | 533 | 286 |
| Overall G-SIB score | 149 | 161 | 224 | 387 | 503 | 139 | 274 | 286 |

Table 8: Banks' year-end contraction at indicator level

| | Dependent variable: *Δ indicator score* | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Cross-j. claims | Cross-j. liabilities | Intra-fin. assets | Intra-fin. liabilities | Securit. outst. | OTC derivat. | Level 3 assets | Trading & AFS sec. | Assets under custody |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| Q4 | −4.39*** | −4.35*** | −14.62*** | −13.18*** | −2.49*** | −2.45** | −4.77*** | −11.20*** | −1.61* |
| | (1.51) | (1.66) | (3.53) | (3.16) | (0.53) | (1.01) | (1.54) | (3.10) | (0.88) |
| RepB × Q4 | −4.47*** | −3.64*** | −11.02*** | −13.92*** | −2.06*** | −2.15** | −2.36 | −7.59*** | 0.04 |
| | (1.12) | (0.95) | (2.59) | (2.60) | (0.55) | (0.98) | (1.62) | (1.84) | (0.42) |
| G-SIB × Q4 | −10.81* | −12.28* | −53.90** | −34.58** | 1.30 | −26.19*** | 0.16 | −16.42 | −4.82 |
| | (6.05) | (6.85) | (21.82) | (15.89) | (1.11) | (8.92) | (4.03) | (18.25) | (4.87) |
| R2 | 0.08 | 0.09 | 0.18 | 0.17 | 0.07 | 0.05 | 0.03 | 0.08 | 0.02 |
| Obs. | 2,895 | 2,895 | 2,895 | 2,895 | 2,895 | 2,895 | 2,895 | 2,895 | 2,392 |
| Banks | 148 | 148 | 148 | 148 | 148 | 148 | 148 | 148 | 131 |

*/**/*** indicates statistical significance at the 10/5/1% level. Coefficient estimates based on equation (2) with robust standard errors, clustered by bank, in parentheses. All regressions include time-varying bank controls (non-performing loans ratio, return on equity, short-term wholesale funding ratio, CET1 ratio, and log total assets) as well as bank fixed effects and quarter fixed effects. Regressions based on excluding time-varying bank controls in order to include the entire sample of 166 banks yield very similar results (available upon request from the authors).

# Appendix 6. Legal excerpts

## 6.1 Excerpt describing the priority claim of Covered Bonds in Article 27 (4) SRM regulation

4. The scope of the bail-in tool referred to in paragraph 3 of this Article shall not prevent, where appropriate, the exercise of the bail-in powers to any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured or to any amount of a deposit that exceeds the coverage level provided for in Article 6 of Directive 2014/49/EU.

The Board shall ensure that all secured assets relating to a covered bond cover pool remain unaffected, segregated and with enough funding.

Without prejudice to the large exposure rules in Regulation (EU) No 575/2013 and Directive 2013/36/EU, and in order to provide for the resolvability of entities and groups, the Board shall instruct the national resolution authorities to limit, in accordance with Article 10(11)(b) of this Regulation, the extent to which other institutions hold liabilities eligible for a bail-in tool, save for liabilities that are held at entities that are part of the same group.

## 6.2 Excerpt of Directive 2019/2162/EU describing the preferential features of Covered Bonds in header §17

(17) Covered bonds have specific structural features that aim to protect investors at all times. Those features include the requirement that investors in covered bonds have a claim not only against the issuer but also against assets in the cover pool. Those structural product-related requirements differ from the prudential requirements applicable to a credit institution issuing covered bonds. The former should not focus on ensuring the prudential health of the issuing institution, but should rather aim to protect investors by imposing specific requirements on the covered bond itself. In addition to the specific requirement to use high-quality cover assets, it is also appropriate to regulate the general requirements with regard to the features of the cover pool, in order to further strengthen investor protection. Those requirements should include specific rules that aim to protect the cover pool, such as rules on the segregation of the cover assets. Segregation can be achieved in different ways, such as on the balance sheet, by means of a special purpose vehicle or by other means. Nonetheless, the purpose of the segregation of cover assets is to put them legally beyond the reach of creditors other than covered bond investors.

## 6.3 Excerpt of Directive 2019/2162/EU describing waivers on securitisation requirements in header §20

(20) Article 129 of Regulation (EU) No 575/2013 sets out a number of conditions that covered bonds collateralised by securitisation entities are to meet. One of those conditions concerns the extent to which that type of cover asset can be used and limits the use of such structures to 10 % of the amount of the outstanding covered bonds. That condition can be waived by competent authorities in accordance with Regulation (EU) No 575/2013. The Commission's review of the appropriateness of that waiver concluded that the possibility of using securitisation instruments or covered bonds as cover assets for issuing covered bonds should be allowed only with regard to other covered bonds ('intragroup pooled covered bond structures'), and should be allowed without limit by reference to the amount of outstanding covered bonds. To guarantee an optimum level of transparency, cover pools for externally issued covered bonds should not contain internally issued covered bonds from different credit institutions within the same group. Moreover, as the use of intragroup pooled covered bond structures provides an exemption from the limits on credit institution exposures that are laid down in Article 129 of Regulation (EU) No 575/2013, internally and externally issued covered bonds should be required to qualify for credit quality step 1 at the moment of issue or, in the event of a subsequent change in credit quality step and subject to the approval of the competent authorities, credit quality step 2. Where the internally or externally issued covered bonds cease to meet that requirement, the internally issued covered bonds no longer qualify as eligible assets under Article 129 of Regulation (EU) No 575/2013 and, as a consequence, the externally issued covered bonds from the relevant cover pool do not benefit from the exemption in Article 129(1b) of that Regulation.

Where those internally issued covered bonds no longer comply with the relevant credit quality step requirement, they should, however, be eligible cover assets for the purpose of this Directive, provided that they comply with all the requirements laid down in this Directive, and the externally issued covered bonds collateralised by those internally issued covered bonds or other assets that comply with this Directive should therefore also be able to use the label 'European Covered Bond'. Member States should have the option of allowing the use of such structures. It follows that, for that option to be effectively available to credit institutions belonging to a group located in different Member States, all relevant Member States should have exercised that option and transposed the relevant provision in their law.

6.4 Excerpt of Article 17 of Directive 2019/2162/EU describing 'dual recourse' and 'bankruptcy remoteness' for CBs with extendable maturity

*Article 17*

**Conditions for extendable maturity structures**

1. Member States may allow for the issue of covered bonds with extendable maturity structures where investor protection is ensured by at least the following:

(a) the maturity can only be extended subject to objective triggers specified in national law, and not at the discretion of the credit institution issuing the covered bonds;

(b) the maturity extension triggers are specified in the contractual terms and conditions of the covered bond;

(c) the information provided to investors about the maturity structure is sufficient to enable them to determine the risk of the covered bond, and includes a detailed description of:

(i) the maturity extension triggers;

(ii) the consequences for a maturity extension of the insolvency or resolution of the credit institution issuing the covered bonds;

(iii) the role of the competent authorities designated pursuant to Article 18(2) and, where relevant, of the special administrator with regard to the maturity extension;

(d) the final maturity date of the covered bond is at all times determinable;

(e) in the event of the insolvency or resolution of the credit institution issuing the covered bonds, maturity extensions do not affect the ranking of covered bond investors or invert the sequencing of the covered bond programme's original maturity schedule;

(f) the maturity extension does not change the structural features of the covered bonds regarding dual recourse as referred to in Article 4 and bankruptcy remoteness as referred to in Article 5.

2. Member States which allow the issue of covered bonds with extendable maturity structures shall notify EBA accordingly.

6.5 Excerpt of Article 8 of Regulation 2017/2402, imposing a ban on resecuritisation

*Article 8*

**Ban on resecuritisation**

1. The underlying exposures used in a securitisation shall not include securitisation positions.

By way of derogation, the first subparagraph shall not apply to:

(a) any securitisation the securities of which were issued before 1 January 2019; and

(b) any securitisation, to be used for legitimate purposes as set out in paragraph 3, the securities of which were issued on or following 1 January 2019.

2. A competent authority designated pursuant to Article 29(2), (3) or (4), as applicable, may grant permission to an entity under its supervision to include securitisation positions as underlying exposures in a securitisation where that competent authority deems the use of a resecuritisation to be for legitimate purposes as set out in paragraph 3 of this Article.

Where such supervised entity is a credit institution or an investment firm as defined in points (1) and (2) of Article 4(1) of Regulation (EU) No 575/2013, the competent authority referred to in the first subparagraph of this paragraph shall consult with the resolution authority and any other authority relevant for that entity before granting permission for the inclusion of securitisation positions as underlying exposures in a securitisation. Such consultation shall last no longer than 60 days from the date on which the competent authority notifies the resolution authority, and any other authority relevant for that entity, of the need for consultation.

Where the consultation results in a decision to grant permission for the use of securitisation positions as underlying exposures in a securitisation, the competent authority shall notify ESMA thereof.

3. For the purposes of this Article, the following shall be deemed to be legitimate purposes:

(a) the facilitation of the winding-up of a credit institution, an investment firm or a financial institution;

(b) ensuring the viability as a going concern of a credit institution, an investment firm or a financial institution in order to avoid its winding-up; or

(c) where the underlying exposures are non-performing, the preservation of the interests of investors.

6.6 Excerpt displaying the response of Eurostat towards Dutch MP Mr. Omtzigt on 16 September 2014 concerning the interpretation of put option agreements and compliance with ESA

Ref. Ares(2014)3026697 - 16/09/2014

EUROPEAN COMMISSION
EUROSTAT

The Director-General

Luxembourg,
ESTAT/DG/WR/D3/JV/PL/eb/D(2014)3304947

Mr Pieter Omtzigt
Member of Parliament for the Dutch
Christian Democratic Party CDA
Tweede Kamer der Staten-Generaal
Plein 2 – PO Box 20018
NL - 2500 EA The Hague
THE NETHERLANDS

Excerpt from www.lawlesslatvia.com

**Subject: Parex Bank and the EBRD**

Dear Mr Omtzigt,

Thank you for your letter of 26.08.2014.

Eurostat is aware of the put option provisions included in the shareholders agreements concerning Parex Bank, and its successor companies, between the government of Latvia and the EBRD. It has the relevant documents and has been informed by the Latvian authorities that these are to be considered confidential.

The put option provisions allow the EBRD to sell its relevant shareholdings back to the Privatisation Agency (which is classified within the general government sector of Latvia) under certain conditions, which include sale of Citadele Bank by the Privatisation Agency.

The mentioned provisions do not meet the definiton of financial derivatives in the European System of Accounts (ESA 95; paragraphs 5.65 to 5.68) and are considered as guarantees. Guarantees are treated as contingent liabilities under ESA95 (paragraphs 5.05, 7.12 (c) and 7.22) and therefore no government liability is to be recorded in the Latvian statistical data.

It may be worth noting that any future call on this guarantee would be recorded as a government expenditure, thereby increasing the Latvian government deficit at that time.

The statistical treatment of this issue under the newly introduced European System of Accounts (ESA 2010) remains the same.

Yours sincerely,

Walter Radermacher

European Commission, 2920 Luxembourg, LUXEMBOURG - Tel. +352 43011
Office: BECH A4/078 - Tel. direct line +352 4301-31748
http://ec.europa.eu/eurostat

6.7 Excerpt of Eurostat report confirming the fraudulent transaction between LPA and the EBRD (p. 31)

*an undertaking. The transfer of undertaking took place on 1 August 2010. Citadele, the Latvian Privatisation Agency (LPA) and the European Bank for Reconstruction and Development (EBRD) signed an agreement on 30 July 2010, whereby the EBRD took a shareholding of 25 % of share capital plus 1 voting share. 75% minus 1 share was owned by the LPA. Following a tender process, the Latvian government decided to sell its 75% stake in Citadele to Ripplewood Advisors LLC and an international group of investors. EBRD retained its 25% minus one share stake in Citadele. Privatisation was concluded in April 2015."*[35]

LPA and EBRD concluded a put option agreement (embedded in the *Parex Bank* shares purchase contract signed between the mentioned parties) in April 2009, which forms part of the *Parex Bank* shares purchase contract, followed by minor amendments in July 2009, July 2010 and November 2012. With this put option agreement the LPA guaranteed to the EBRD its investment in *Parex Bank*. Eurostat concluded together with the CSB in 2015 that this put option is not a financial derivative instrument in national accounts (i.e., it is not a marketable instrument) and therefore it should be recorded as a guarantee in national accounts. The activation of the put option (i.e. call of the guarantee in national accounts) is related to the privatisation of the *Citadele Bank*, which is the "good bank" after the split of *Parex Bank* in 2010. The privatisation was concluded in 2015.

The provisional amount of 74 MEUR was specified in the equity sale contract, which was subject to change depending on the *Citadele Bank*'s financial result for 2014. There is a payable in the amount of 88.14 MEUR in the 2014 accounts of the LPA, which led to recording a guarantee call (deficit increasing capital transfer) in 2014 (instead of 2015). The recording of the capital transfer of 88.14 MEUR to EBRD had the following formulation: the starting point was the put option price of 114.3 MEUR, which is the amount to be paid by LPA on the historical investment of EBRD (93 MEUR notional + 21.3 MEUR interest). For 1.26 MEUR, the put option was partially settled in 2012, which leaves 112.9 MEUR still to be settled between LPA and EBRD. However, LPA has to pay ERBD only the amount which is not covered by the value of EBRD 25% ownership of *Citadele Bank* (CB) shares, which is calculated as 24.9 MEUR taking into account that the sales price of 75% of PA shares in CB was 74.7 MEUR. Therefore the full amount of impact on B.9 was recorded as 88.14 MEUR = 114.3 -1.26 – 24.9.

*Discussion and methodological analysis*

Eurostat agrees that 88.14 MEUR corresponds to the government obligation to EBRD, taking into account the original obligation (114.3MEUR) (including interest accrued), minus repayments (1.3 MEUR), minus 25% of the share held by EBRD in *Citadele*. Against this obligation the government acquires 75% of *Citadele* at 74.7 MEUR. As a result the loss is only 13.5MEUR. According to the rules, the capital transfer on a call representing 88.2 MEUR of liabilities against an acquisition on assets of 74.7 MEUR is a capital transfer of 13.5 MEUR. Government sold *Citadele* for 74.7 MEUR after a few months, which provides a good estimate of its value.

Eurostat agrees that there is a payable in the Privatization Agency accounts in 2014 of 88.2 MEUR. But the put call will have a deficit impact or not depending on whether an effective claim is acquired, whose value can be reasonably estimated. In this case, it seems there is an effective claim since the equity was sold within a few months to

6.8 Excerpt of letter from John Christmas to Mario Draghi of 2013

Mr. Mario Draghi, President of The European Central Bank
Kaiserstrasse 29, Frankfurt am Main, 60311, Deutschland

RE: EBRD helping falsify financial statements of Latvia and Lithuania

Dear Mr. Draghi,

I am the exiled whistleblower from Parex Bank of Latvia. Parex was an offshore bank for Russia, Ukraine, Belarus, and Central Asia. According to the Director of Transparency International Latvia, Parex "symbolizes the corruption related ills we have in Latvia."

The only investigation was done by the United States in 2007, resulting in a $185 million bribery settlement with Daimler. The related fraud at Parex can be confirmed in an hour, however Latvian officials did nothing for years until the "statute of limitations" expired.

The Latvian government nationalized Parex in 2008 and bailed it out with billions of euros borrowed from the IMF, the European Union, and bond investors. Latvia did not prosecute the people who looted the assets of Parex, but instead covered-up the looting with a "sale" of Parex stock to the European Bank for Reconstruction and Development (EBRD) which later was revealed to be a reversible and therefore temporary and illegal deception.

The fraud is explained on Youtube. The "LatviavEBRD" videos have a quarter-million views compared with the EBRD's own videos which have a few hundred views. Also, an independent journalist Mauro Caterina produced a video about the fraud.

More recently, a Lithuanian journalist claimed the EBRD's 2013 bailout of Ukio Bank (under Bank of Lithuania administration) was fraudulent. He was afraid for his safety and never published an article. Ukio was similar to Parex. They were both connected with the money laundering in the Sergei Magnitsky case.

A pattern has emerged. The EBRD is covering-up frauds to sneak countries with corrupt governments into the Eurozone. The victims include all taxpayers in the 64 nations supporting the EBRD plus especially taxpayers in Latvia and Lithuania.

The integrity of the Eurozone is at risk if this problem is ignored. I fear a repeat of when Goldman Sachs helped Greece to hide debt so it could issue bonds that later defaulted. I hope the ECB and hundreds of other letter recipients will confront the EBRD.

Thank you for your service to Europe.

Excerpt from www.lawlesslatvia.com

John Christmas, LatviavEBRD, latviavebrd@gmail.com
Via Leonina 38, #275, Roma, 00184, Italia

6.9 Excerpts from Follow the Money on Nomura in relation to Parex restructuring in 2010, see next page too

Alles wat telt van 9 tot 5



DIENESTA VAJADZĪBĀM

aktīvus, lai atspoguļotu to ilgtermiņa ekonomisko vērtību. Šāda pārvērtēšana novestu pie papildus zaudējumiem un nepieciešamības palielināt kapitālu pašlekošajā AS "Parex banka"

- pašlekošajā AS "Parex banka" paliek reputācijas no bijušiem akcionāriem / subordinētā kapitāla turētājiem
- neatbilst ERAB interesēm, ERAB nepiekristu restrukturizācijai un izmantotu akciju "put – opciju" saskaņā ar Akcionāru līgumu, t.i., valstij būtu jāatpērk ERAB akcijas → 'state must repurchase EBRD shares'

→ EBRD

→ put option

Excerpt from Follow the Money

Nemot vērā abu restrukturizācijas priekšlikumu salīdzinājumu, Konsultanta viedoklis, kas tika akceptēts arī Darba grupā, ir, ka, realizējot AS "Parex banka" restrukturizācijas modeli - "Jaunās bankas nodalīšana", varētu tikt sasniegti konsultāciju pakalpojumu līgumā ar Konsultantu un Ministru kabineta lēmumos noteiktie restrukturizācijas stratēģiskie mērķi, t.i.:

1) tiktu nodrošināta AS "Parex banka" restrukturizācijas rezultātā izveidoto

Alles wat telt van 9 tot 5

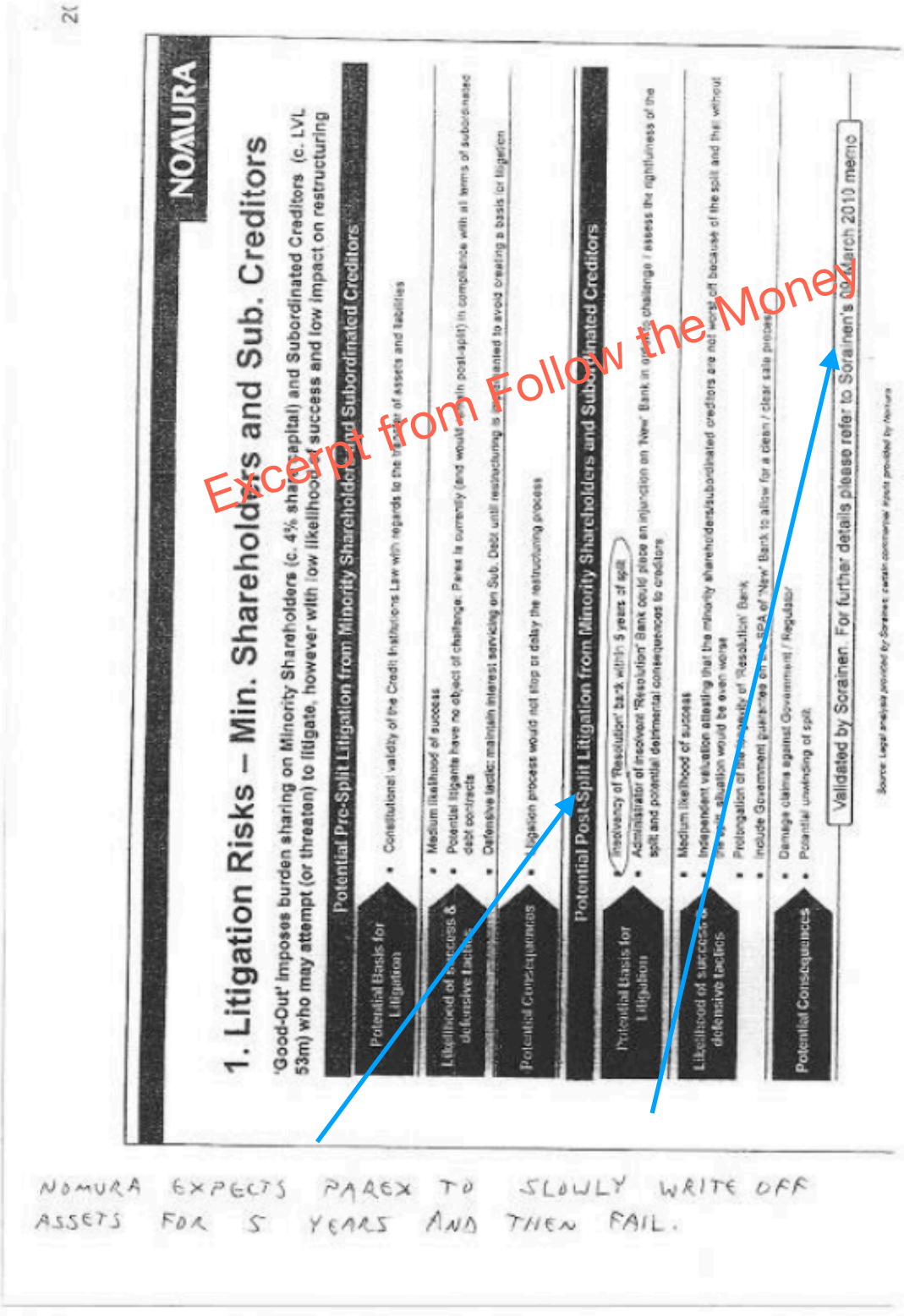
## Evolution of Government Position

- The Treasury is expected to receive a total CF of LVL 648mn by 2017 – Discounted value of this is LVL 454mn (using Treasu
- Additionally the Treasury is expected to capitalise LVL 104mn of its deposit in the New Bank
- The 2014E BV of New Bank is LVL 170mn - vs opening equity of LVL 104mn – no dividends or (additional) capital increases
- Equity in Resolution Bank (legacy Parex) expected to be fully absorbed by losses – no residual value
- New Bank fully able to support interest payments and principal repayment of Subordinated debt from Parex/EBRD
- Bank of Latvia fully repaid in 2012
- Guarantee for syndicate loans remain until repayment in May 2011 but is not foreseen to be required

| | |
|---|---|
| Treasury cash flow received | 647,989 |
| *Interest* | 111,212 |
| *Principal* | 536,765 |
| Discounted value of treasury repayment (using cost of Treasury funding to Parex 6-10%)[1] | 453,783 |
| 2014 balance New Bank | - |
| PV 2014 balance New Bank | - |
| Capitalised treasury | 103,825 |
| 2014E BV New Bank (100%) | 170,378 |
| equity value Resolution Bank | - |
| Compensation of EBRD | |
| 22 % Resolution Bank 2014E BV | 38,184 |
| *Compensation for nominal investment* | 57,569 |

Excerpt from Follow the Money

Usurious interest rate




925
Alles wat telt van 9 tot 5

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