THE EUROPEAN BANKING UNION AND ROMANIA. THE IMPACT OF THE NEW EUROPEANLEGAL FRAME ON THE ROMANIAN FINANCIAL AND BANKING SYSTEM[1]

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Abstract

The paper studies from a legal and economical perspective the European Banking Union, the latest set of measures adopted by the European Union in order to assure the stability of Europe's financial and banking system and to prevent future crises. At the same time, the paper analyzes the influence this new institutional and legal mechanism could have on the Romanian financial and banking system, if our country is to take part in the European Banking Union. The paper will discuss the four European legal texts, namely the EU Regulation No 575/2013 and the three directives concerning the capital requirements for the banking system, the recovery and resolution of credit institutions and the deposit guarantee schemes, which, together, set up the European Banking Union's legal frame. Further, the paper will study the implementation and the transposition of these European provisions into national law. The study's conclusions will take into consideration the advantages and disadvantages connected to Romania's participation to the European Banking Union, by showing that, in the context of the introduction of the single currency, the participation to the Banking Union is a necessary exercise.

Keywords: *European Banking Union, European Union, Romanian financial and banking system, Eurozone crisis*

JEL Classification: *K33*

I. Introduction

The European Banking Union (EBU) represents the latest attempt of the European Union to end the crisis that continues to affect the euro area and the European project. The paper details the origins, objectives, and tools by means of which the EBU is created, while also placing the new structure in the wider context of efforts made in order to stabilize the euro area. To this end, in the first part of the paper I will review some aspects regarding the problems of the eurozone's financial system and the solutions for fighting the effects of the crisis.

The paper discusses the four European legal texts adopted by the EU Parliament and by the European Council, texts that establish the EBU, namely Regulation (EU) No 575/2013 of the EP and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, Directive 2013/36/EU of the EP 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, Directive 2014/59/EU of the EP and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, and Directive 2014/49/EU of the EP and of the Council of 16 April 2014 on deposit guarantee schemes.

At the same time, I will highlight the advantages and disadvantages that result after Romania adheres to the EBU, considering the fact that Romania is not a member of the euro area, but has accepted to be a part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, ratified in 2012. By participating in the new structure, Romania takes on the responsibility of transposing the three directives into the national legislation, the regulation being directly applicable. What I am interested in is the impact EBU has on the Romanian banking system, impact which I will analyze towards the end of this paper.

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[1] This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/142115 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain" .

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II. The economic and financial crisis in the European Union

The economic crisis has led to an increase in the number of debates on democracy and capitalism.[3] It has been argued that capitalist economy has become a danger for the states that are dependent on the actors of financial capitalism.[4] However, it has to be underlined that without state interventions financial capitalism is unable to survive. This has been proven in the initial stages of the crisis, when concepts such as *too big to (let) fail* were used to legitimize the massive injection of public funds meant to save certain credit institutions. The states acted as prisoners of financial capitalism.[5] The debate gravitated around the issue of responsibility for the effects of the crisis, in the sense that, although the actors on financial markets were directly culpable, the duty of saving the system was undertaken by the governments, which safeguarded the stability of financial systems.

Overpowered by the crisis, government officials took decisions that slipped away from democratic control, lacked the necessary legitimacy, and, consequently, lacked credibility in the eyes of the taxpayer forced to pay. The increase in speed, volume and complexity of financial transactions, as well as the digitalization and globalization of these transactions, generated new concepts, such as *the empire of speed*[6]. It has been demonstrated that, in the empire of speed, an increasing desynchronization[7] of politics from economics occurs. As a consequence, in a democratic state, the legislative and judicial powers lag behind, whereas the executive power takes advantage of the situation. The latter can act more rapidly than legislative power, whose deliberative procedures use up time financial markets do not have (anymore). Herein lies the paradox of the effects of the crisis on democracy: if decisions aimed at fighting the crisis have enormous consequences on the welfare and redistribution of incomes, it would be of paramount importance for precisely these decisions to go through the necessary procedures of democratic legitimation. Yet, in the empire of speed, any legitimation procedure ends up in being sacrificed.

In what follows, I will present a few assessments of the crisis. First, however, I need to make a preliminary remark. Mass media have used several phrases to dub the crisis: *sovereign debt crisis, eurozone crisis, the common currency crisis*. In the last two years, though, the euro has been relatively stable on international exchange markets, the euro area's public debt is, on average, lower than that of the USA or Japan, the eurozone's balance of payments is quite stable, whereas inflation in the euro area, since the launch of the common currency, has been low, of about 2% on average. Moreover, no member state of the eurozone has seriously considered giving up the euro. Hence, this crisis has been one of indebtedness, a budget crisis, or, more accurately, a structural crisis stemming from the defective architecture of the EMU (Economic and Monetary Union), prone to such phenomena.[8]

Specialized literature has identified several causes of the crisis, as follows[9]: (i) a flawed system of financial intermediation; (ii) institutional and policy weaknesses within the EMU, a suboptimal currency area; (iii) redistribution of power in world economy; (iv) existing global imbalances which the European Union seems unable to handle.

Due to the difficulties of some EU states to reimburse their debts and contract new loans, their banking systems, as well as the financial stability of the euro area, have been seriously

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[3] For a brief analysis of the causes of the crisis, see Jacques Larosière (coord.), *Report of the High Level Group on Financial Supervision in the EU*, Comisia Europeană, 25 February 2009, accesible at http://ec.europa.eu/internal_market/finances/docs/ de_ larosiere_report_en.pdf, especially Chapter I.

[4] Douglas Dowd, *Capitalism and its Economics: A Critical History*, Pluto Press, London, 2004, pp. 167 - 199.

[5] Jürgen Kocka, Wolfgang Merkel, *Demokratie und Kapitalismus: Eine neue Balance wird gesucht*, in „Neue Gesellschaft/Frankfurter Hefte" nr. 7-8/2014, pp. 4 - 7

[6] William Scheuerman, *Liberal Democracy and the Social Acceleration of Time*, Johns Hopkins University Press, 2004.

[7] Hartmut Rosa, William Scheuerman, *High Speed Society. Social Acceleration, Power, and Modernity*, Pennsylvania University Press, 2009, p. 287 and next.

[8] Richard Corbett, *Parameters of a crisis*, in „The Future of Economic Governance in the EU", Policy Network, London, 2012, pp. 5 - 10.

[9] Daniel Dăianu, *Reforma guvernanței economice a UE: ne aflăm la un moment de răscruce?*, Centrul Român de Politici Europene, Policy Memo 17, decembrie 2010, pp. 4 - 8.

strained. The Union's intervention was necessary to redress the affected states, calm the markets, and stabilize the common currency. Thus, a significant number of banks were in great danger because, in the years before the crisis, they had given loans to southern European states, and now they found themselves in the situation of having to accept various debt reductions. At the same time, some states from Central Europe, whose banking systems are dominated by foreign banks, found themselves in danger of important capital flows because these parent banks started to withdraw huge sums from their branches.[10] The subsequent effects of this trend involved reduced crediting, fewer investments, and the beginning of a period of recession.

Although at a first glance the measures taken by European institutions seemed temporary solutions, they also considered a wider, medium- and long-term reform of the Economic and Monetary Union, since its initial architecture was obviously flawed. Hence, complex mechanisms were created, treaties and secondary legislation were modified, and new supervision methods were set up.

In other words, despite opinions according to which the solution to the crisis is not strengthening integration, but rather diminishing the euro area by keeping only the states with truly converging economies[11], the measures adopted in the past few years have allowed the European project to continue, in spite of all its unsolved problems. Evidently, EMU's reform should be regarded from a wider perspective, including the political factor, desynchronized from the economical one, as well as the European project on the whole.

The European Union was and continues to be regarded as a *sui generis* project, and so is the Economic and Monetary Union. Throughout history there has never been such a monetary union, in which sovereign states, with different levels of development, have agreed to use the same currency, administered by a single and independent central bank. The old question whether a currency without its own nation-state can survive has resurfaced with the current crisis.

But this viewpoint is wrong because it is grounded in a wrong assumption, namely that national states are and should remain fully sovereign, while international relations are based on the postulates of internal homogeneity and external independence. This model is obsolete. At present, power can no longer be monopolized, but it is vertically distributed, from local and regional to national level, from continental to global level.[12]

It follows that, at least theoretically, nothing obstructs the success of a *sui generis* economic and monetary union, provided its weak points are corrected in due time. The crisis has proven that, in the absence of adequate reforms, not only the common currency, but also the European project, are in jeopardy.

III. The European Banking Union

1. The banking union: a mere element of a fiscal union or a solution in itself?

The European Union's complex answer to the crisis was based on numerous legislative and institutional measures. However, it was obvious that the initial architecture of the Economic and Monetary Union was flawed and needed major improvements. This was one of the conclusions of the Larosière Commission Report.[13] Its authors have shown that, in order to prevent systemic risks, a structure meant to supervise the banking sector should be created, prudential coordination should be improved, and financial market regulations should be perfected.

EMU's initial minimalist structure hinged on a few erroneous assumptions. Thus, it was assumed that business cycles of Member States would synchronize spontaneously, which did not

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[10] Oana-Maria Georgescu, *România în Uniunea bancară: De ce este nevoie de o supraveghere internațională a operațiunilor bancare*, Centrul Român de Politici Europene, Policy Memo 33, februarie 2013, pp. 2-3.

[11] Strictly from an economic point of view, this argument is not necessarily wrong. See Fritz W. Scharpf, *Monetary Union, Fiscal Crisis and the Preemption of Democracy*, LSE *Europe in Question* Discussion Papers, LEQS Paper No. 36/2011.

[12] Tommaso Padoa-Schioppa, *Euro remains on the right side of history*, Financial Times, 13.05.2010, available at http://www.ft.com/intl/cms/s/0/7596170a-5ec0-11df-af86-00144feab49a.html#axzz3AwLgxDuM.

[13] Larosière, *op. cit.*, Chapters III and IV.

occur. Also erroneously, it was estimated that national mechanisms would manage to absorb possible shocks. But, faced with situations that those from Ireland or Greece, national mechanisms proved incapable of solving the problems, thus allowing or even facilitating contagion. Closely linked to these false assumptions was the idea that the public sector was the only source of instability, whereas the private sector was supposed to be essentially balanced and self-regulating. It can be demonstrated that, after the authorities lost control of the Irish and Cypriot banking systems, these were far from self-regulating.

Furthermore, the rules of the Stability and Growth Pact were weak and infringed by many of the Member States. They continued to accumulate huge deficits during periods of economic growth, the public debt of some states remaining high. This reality proves that Keynesian economical theory was misunderstood. According to Keynes, public debt accumulated during periods of recession (in order to stimulate demand) should be diminished to a sustainable level during periods of growth.

In addition, the financial integration took place in the context in which the financial-banking sector was severely unbalanced. Authorities in charge of regulation and surveillance lacked a cross-border perspective, which prevented them from identifying vulnerabilities.[14]

Another danger which EMU's initial institutional architecture cannot handle comes from the fragmentation of the single financial market alongside national borders. This fragmentation manifests itself at the level of Member States by significant differences between monetary conditions for companies and the population, as well as by restricting capital flows from center to periphery, as a result of the national perspective on the activity of surveillance.

In other words, financial stability and financial integration cannot be achieved simultaneously, if surveillance of financial markets is carried out only at national level. Economic doctrine has identified the *impossible trilemma* of national stability, integration, and surveillance, and has devised models to overcome this impossibility.[15]

Therefore, it is clear that the mechanism of transmitting the monetary policy is not functioning well, and the monetary union cannot function under circumstances such as internal capital restrictions and major differences in financial conditions among member states. The vicious circle between banks and states must be broken, and the good functioning of the mechanism of transmitting the monetary policy must be ensured.

Two possible solutions stand out: the banking union and the fiscal union. Although the measures adopted between 2010 - 2012 by the European Union represent the first steps towards a tighter fiscal union, it has been deemed that Member States currently do not have the necessary will to build a real fiscal union. Therefore, from a political point of view, at present a banking union seems less controversial and easier to implement than a fiscal one.

In this context, it is imperative to know what a fiscal union means, what it should mean, and what a banking union represents.

Starting from the premise that the roots of the crisis are in the contradiction between the existence of a single supranational currency, on the one hand, and in continuing economic policies devised for and applied strictly at national level, on the other hand, it is self-evident that the European Union needs a certain form of fiscal federalism. The concept of fiscal federalism is analyzed in the *Tommaso Padoa-Schioppa Group Report*, entitled *Completing the Euro. A road map towards fiscal union in Europe.*[16] According to the report, EMU must be accompanied by a *sui generis* fiscal federalism, derived from the functional deficiencies of the common currency, respecting as much as possible the budgetary autonomy of Member States.

The authors of the report identify four action paths which should lead to the birth of *sui generis* fiscal federalism. The first regards finalizing the single market in order to make the

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[14] See the cases of the Belgian-Dutch financial group *Fortis* and of the Islandic bank *Landesbanki*, mentioned by Georgescu, *op. cit.*, p. 10.

[15] Dirk Schoenmaker, *The Financial Trilemma*, Duisenberg School of Finance, Tinbergen Institute Discussion Paper, Economics Letters, 111, 2011, pp. 57 - 59, also available at http://ideas.repec.org/p/dgr/uvatin/20110019.html.

[16] The report was drafted in 2012 by a group of European economists and is available at http://www.eng.notre-europe.eu/011-3317-Completing-the-EuroA-road-map-towards-fiscal-union-in-Europe.html.

mechanism of transmitting the monetary policy more efficient. Certain institutional adjustments are suggested for the eurozone to become a truly integrated economic space and for increasing the efficiency of monetary policy in relation to the evolution of salaries and prices in general.

Then, a cyclical stabilization fund should be established, so as to fight the negative effects of a monetary policy described as *one size fits none*.[17] This fund should be created outside the European Union's budget and placed under the direct control of national parliaments. It should operate automatically and be devised in such a way that it would not lead, on the long run, to unilateral transfers.

Thirdly, a rebalancing of rights and obligations in the eurozone is suggested, in the sense that Member States should allow a stricter budgetary supervision and agree to give up certain elements of sovereignty when they are unable to obtain financing from international markets. The guiding principle should be the following: sovereignty ends where solvability stops. In exchange, the euro area as a whole ought to ensure access to financing at adequate costs, even during periods of crisis.

Lastly, a banking union should be created. To eliminate the problems brought about by the necessity to integrate financial markets and by the national character of supervising banking systems, a surveillance authority with vast, microprudential powers, should be set up.

EBU thus appears as a component of the so-called fiscal federalism, a brick in the complex construction that would be the fiscal union, an absolutely necessary project, but one that can only be realized on the long run. The banking union represents nothing more than „*an indirect path to deepen economic and fiscal integration - meant to avoid a direct, head-on approach of the fiscal problem due to political reasons*."[18] Still, the fiscal union cannot be avoided, European fiscal integration being the next step that has to be taken if the reforms undertaken in the past few years are to succeed genuinely. In this respect, economic doctrine draws attention in particular to the fact that the fiscal union cannot be put into practice in the absence of a powerful mechanism, efficient and free of surveillance, capable to ignore pressures made by national governments and to apply corrective measures to diverse negative evolutions.[19]

The opposite opinion was also consolidated: EBU is not regarded as a feasible alternative to an ideal, yet impossible solution. It is not even regarded as a component of the fiscal union, but as *first-best option*.[20] Such an assertion is based on the idea that the banking sector bears the main responsibility for the economic and financial crisis. The banking sector took excessive risks, fueled the artificial rise in the prices of some assets, and failed to take advantage of opportunities to diversify asset classes at country level. The whole system became vulnerable to exogenous shocks.

In the above mentioned opinion, the apparent integration of the financial market during periods of economic expansion actually aggravated vulnerabilities, determining banks to profit from the cheap and abundant money offer and make excessive use of short-term financing. *„After the crisis started, it was easier for the apparently integrated financial market to disintegrate into isolated islands, having the national fiscal authorities as their only support*", shows the governor of the National Bank of Romania. This evolution would have been improbable, had the system's supervision been transnational/supranational, and had it benefitted from proper, trans- and supranational instruments.

[17] The phrase refers to the situation, almost impossible to solve, in which the European Central Bank was forced to set an interest rate that would be suitable to extremely different national economies.

[18] Daniel Dăianu, *Uniunea bancară şi chestiunea fiscală*, 21.10.2012, available at http://cursdeguvernare.ro/daniel-daianu-uniunea-bancara-si-chestiunea-fiscala.html.

[19] Stefan Vetter, *Alle Wege führen in die Fiskalunion? Optionen für mehr fiskalische Integration in der Eurozone*, Deutsche Bank/DB Research, EU-Monitor, 2013, available at http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000302608.pdf.

[20] Mugur Isărescu, *România, adoptarea euro şi Uniunea Bancară*, inaugural discourse of the Annual Scientific Conference of Romanian Academic Economists from Abroad, Faculty of Economic Sciences and Business Management, Babeş-Bolyai University Cluj-Napoca, August 2014.

In other words, if the crisis were a banking one, then it should be solved by creating a banking union, aiming to ensure financial stability and to maintain the financial system's potential to generate economic growth.

Regardless of their opinion on the banking union, economists maintain a skeptical attitude towards the „*so-called hasty approach on behalf of the European decision-making factors, which would allow certain flaws and deficiencies to surface in the elaboration and implementation of the Banking Union*". Isărescu warns that the European Union is pressed for time, having to choose between quick action, which entails some risks but is possibly efficient, and a thoroughly prepared process, but which misses the opportunity for efficient action.

The debate concerning the character of the banking union, as component of the fiscal union or as the best solution, suitable *per se* to solve the deficiencies of the EMU, is an economic debate, necessary in order to understand the legal aspects.

Simply put, the European banking union is grounded in an essential precondition, the single set of rules, and is designed as a building on three pillars. The first pillar is the single supervision mechanism, based on the transfer of the most important responsibilities regarding banking surveillance at national and European level. The second pillar is represented by the single resolution mechanism, which stipulates how to manage the bancruptcy of banks in difficulty. Finally, the third pillar is the network of harmonized bank deposit guarantee schemes, which tries to homogenize rules concerning deposit guarantees.

2. Regulation No 575/213 and Directive 2013/36/EU

After passing Regulation (EU) No 575/2013 of the EP and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, the European Union has adopted a set of prudential norms that are applicable to banks and investment firms. These norms block the danger entailed by loose regulations in a highly risky yet essential sector for the financial stability of the Union.

The document uses specialized terms, so legal and economical knowledge is needed in order to understand it. The document's preamble is extremely important for understanding the text because it provides a thorough list of motives, as well as a history of how the regulation was created and of the problems that occurred during the implementation of prior similar regulations.

According to paragraph (32) of the preamble, „*the overall objectives of this Regulation are to encourage economically useful banking activities that serve the general interest and to discourage unsustainable financial speculation without real added value. This implies a comprehensive reform of the ways savings are channelled into productive investments. In order to safeguard a sustainable and diverse banking environment in the Union, competent authorities should be empowered to impose higher capital requirements for systemically important institutions (...)*"

The main priciples and objectives of the Regulation are: (i) institutions that hold their clients' money and bonds need equivalent financial requirements to guarantee similar protection measures for those who are saving, and fair competition conditions for comparable groups of institutions; (ii) on internal markets, institutions are in direct competition, therefore requirements referring to monitoring should be equivalent throughout the Union and should take into account the different risk profiles of institutions; (iii) in order to ensure adequate solvability, it is important to establish capital requirements that would balance assets and off-balance elements according to their risk factor; (iv) it is crucial to take into consideration the diversity of EU institutions, and to offer alternative approaches to calculating capital requirements for the credit risk that has different degrees of risk sensitivity and that needs different degrees of sophistication; (v) capital requirements should be proportional to the risks they refer to.

The Regulation incorporates the suplimentary elements from the Basel III framework, basically constituting the equivalent of the dispositions from the Basel II and III frameworks [para.

(41) from the preamble]. At the same time, it must be mentioned that the normative act respects the principle of proportionality [para. (46)].

Paragraph (51) points out that „*alongside surveillance aimed at ensuring financial stability, there is a need for mechanisms designed to enhance and develop an effective surveillance and prevention of potential bubbles in order to ensure optimum allocation of capital in the light of the macro-economic challenges and objectives, in particular with respect to long term investment in the real economy.*" Thus, the European Union understands that one of the causes of the crisis was the excessive financialization of the economy, to the detriment of the real component.

Credit institutions have the obligation to provide information, and the Regulation states that the requirements regarding the publication of information are meant to offer participants in the market correct and complete data concerning the risk profile of each institution.

The leverage question is tackled in para. (90) – (96) of the preamble. According to para. (91), „*Risk-based own funds requirements are essential to ensure sufficient own funds to cover unexpected losses. However, the crisis has shown that those requirements alone are not sufficient to prevent institutions from taking an excessive and unsustainable leverage risk.*"

Basel III stipulates that the leverage effect indicator and its components will be made public starting with 1 January 2015. For the European Union, this indicator constitutes a new instrument of regulation and surveillance. Initially introduced as a suplimentary characteristic whose application is at the latitude of surveillance authorities, the indicator will become a mandatory measure starting with the year 2018.

According to para. (98), the recognition of a credit rating agency as an external credit assessment institution (ECAI) should not increase the foreclosure of a market already dominated by three main undertakings. EBA and ESCB central banks, without making the process easier or less demanding, should provide for the recognition of more credit rating agencies as ECAIs as a way to open the market to other undertakings.

Paragraphs (100) - (112) of the preamble analyze the problem of European banks which need liquid assets, noting that „*institutions should hold a diversified buffer of liquid assets that they can use to cover liquidity needs in a short term liquidity stress (...). A concentration of assets and overreliance on market liquidity creates systemic risk to the financial sector and should be avoided. A broad set of quality assets should therefore be taken into consideration during an initial observation period which will be used for the development of a definition of a liquidity coverage requirement. When making a uniform definition of liquid assets at least government bonds, and covered bonds traded on transparent markets with an ongoing turnover would be expected to be considered assets of extremely high liquidity and credit quality.*" [para. (100)].

Regarding the corporate governance of credit institutions, the document observes that „*weaknesses in corporate governance in a number of institutions have contributed to excessive and imprudent risk-taking in the banking sector which led to the failure of individual institutions and systemic problems*" [para. (113)]. As such, institutions should publicly disclose their corporate governance arrangements. Their management bodies should approve and publicly disclose a statement providing assurance to the public that these arrangements are adequate and efficient.

All these aspects have, thus, made it necessary for Regulation (EU) No 575/2013 to be adopted. It establishes „*uniform rules concerning general prudential requirements that institutions supervised under Directive 2013/36/EU shall comply with*" (art. 1).

According to article 1 of the above mentioned Regulation, general prudential requirements that EU credit institutions need to comply with concern the following five elements: „*(a) own funds requirements relating to entirely quantifiable, uniform and standardised elements of credit risk, market risk, operational risk and settlement risk; (b) requirements limiting large exposures; (c) liquidity requirements relating to entirely quantifiable, uniform and standardised elements of liquidity risk; (d) reporting requirements related to points (a), (b) and (c) and to leverage;(e) public disclosure requirements.*"

Regulation No 575/2013 has to be interpreted together with Directive 2013/36/EU, considering that, according to the Regulation, authorities will have the competencies and will apply the procedures stipulated by the that Directive. Nevertheless, the Regulation does not prevent credit institutions from having own funds that exceed the Regulation's requirements, or to apply stricter measures than those stipulated by the Regulation. In effect, the European normative act enforces certain minimal standards and requirements, obviously mandatory, but credit institutions to which the Regulation is applied can exceed them.

Art. 6 para. (1) sets the principle according to which „*institutions shall comply with the obligations laid down in Parts Two to Five and Eight on an individual basis.*" The Regulation's requirements are applied not only on an individual basis, but also on the basis of their consolidated situation. Hence, art. 11 para. (1) specifies that „*parent institutions in a Member State shall comply, to the extent and in the manner prescribed in Article 18, with the obligations laid down in Parts Two to Four and Part Seven on the basis of their consolidated situation. The parent undertakings and their subsidiaries subject to this Regulation shall set up a proper organisational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation are duly processed and forwarded* (...)."

Art. 13 para. (1) lays down the obligation for EU parent institutions to comply with disclosure requirements, specified in part eight, also on a consolidated basis.

Art. 18 is important, and it is entitled *Methods of prudential consolidation*. According to para. (1), „*the institutions that are required to comply with the requirements referred to in Section 1 on the basis of their consolidated situation shall carry out a full consolidation of all institutions and financial institutions that are its subsidiaries or, where relevant, the subsidiaries of the same parent financial holding company or mixed parent financial holding company*."

According to art. 19 para. (1), certain entities are exempt from the application of prudential consolidation. Thus, „*an institution, financial institution or an ancillary services undertaking which is a subsidiary or an undertaking in which a participation is held, need not to be included in the consolidation where the total amount of assets and off-balance sheet items of the undertaking concerned is less than the smaller of the following two amounts: (a) EUR 10 million; (b) 1 % of the total amount of assets and off-balance sheet items of the parent undertaking or the undertaking that holds the participation.*"

Directive 2013/36/EU of the EP 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 brings necessary additions to the provisions of Regulation No 575/2013. The Directive includes those individual measures that were supposed to be established by competent authorities after a continuous supervision process.

Directive 2013/36/EU represents the essential instrument for the achievement of the internal market from the point of view of both the freedom of establishment and the freedom to provide financial services in the field of credit institutions, taking into consideration that the smooth operation of the internal market requires not only legal rules but also close and regular cooperation and significantly enhanced convergence of regulatory and supervisory practices between the competent authorities of the Member States.

The EBU concept is mentioned in para. (9) of the preamble, which shows that the first step towards a banking union is represented by the single supervision mechanism. The principle on which the banking union is founded is laid down as follows: „(…) *any introduction of common intervention mechanisms in the event of a crisis should be preceded by common controls to reduce the likelihood that such intervention mechanisms will have to be used*". The document shows that the integration of the financial framework could be further enhanced through the setting up of a single resolution mechanism, including appropriate and effective backstop arrangements to ensure that bank resolution decisions are taken swiftly, impartially and in the best interests of all concerned. Such a mechanism was established by Directive 2013/36/EU.

Para. (10) of the preamble details the European Central Bank's role, indicating that „*the conferral of supervisory tasks on the European Central Bank (ECB) for some of the Member States should be consistent with the framework of the European System of Financial Supervision set up in 2010 and its underlying objective to develop the single rulebook and enhance convergence of* *supervisory practices across the Union as a whole. The ECB should carry out its tasks subject to and in compliance with any relevant primary and secondary Union law* (...)"

In order to protect savings and to create equal conditions of competition between credit institutions, measures to coordinate the supervision of credit institutions should apply to all of them. Due regard should, however, be given to the objective differences in their statutes and aims as laid down in national law. [para. (12)].

The Directive sets the rule according to which, in order to ensure a well-functioning internal market, transparent, predictable and harmonised supervisory practices and decisions are necessary for conducting business and steering cross-border groups of credit institutions. The scope of measures should therefore be as broad as possible, covering all institutions whose business is to receive repayable funds from the public, whether in the form of deposits or in other forms such as the continuing issue of bonds and other comparable securities and to grant credits for their own account.

It is appropriate to effect harmonisation which is necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Union and the application of the principle of home Member State prudential supervision.

Paragraphs (29) – (32) deal with the issue of information exchange among competent authorities, para. (33) attributing auditors the obligation of promptly notifying the competent authorities whenever they come across certain acts that might significantly affect the financial situation or the administrative and accounting structure of a particular institution.

Likewise, paragraphs (34) – (107) cover other objectives of the legislative undertaking I have analyzed, and provide ways of interpreting the Directive by explaining the reasons why certain situations are regulated, whereas others are left totally to the competency of Member States, and yet others are laid down by Regulation No 575/2013.

The provisions of Directive 2013/36/EU have been included in national legislation by passing Government Emergency Ordinance No 113/2013, regarding some budgetary measures, and the modification and completion of Government Emergency Ordinance No 99/2006 regarding credit institutions and capital requirements.

3. Directive 2014/59/EU of the European Parliament and of the Council

When drafting the new framework regarding the recovery and resolution of credit institutions, the European Parliament started from the premise that „*the financial crisis has shown that there is a significant lack of adequate tools at Union level to deal effectively with unsound or failing credit institutions and investment firms ('institutions'). Such tools are needed, in particular, to prevent insolvency or, when insolvency occurs, to minimise negative repercussions by preserving the systematically important functions of the institution concerned. During the crisis, those challenges were a major factor that forced Member States to save institutions using taxpayers' money* (...)." The European Union admits that what happened during the first few years of the crisis, when important financial and banking institutions from the USA and Europe were saved with public money, represents a situation which must be avoided in the future.

Moreover, the financial crisis affected the access to funding of a large proportion of credit institutions. To avoid failure, with consequences for the overall economy, such a crisis necessitates measures aiming to secure access to funding under equivalent conditions for all credit institutions that are otherwise solvent. Such measures involve liquidity support from central banks and guarantees from Member States for securities issued by solvent credit institutions.

Union financial markets are highly integrated and interconnected with many institutions operating extensively beyond national borders. The failure of a cross-border institution is likely to affect the stability of financial markets in the different Member States in which it operates. The inability of Member States to seize control of a failing institution and resolve it in a way that effectively prevents broader systemic damage can undermine Member States' mutual trust and the credibility of the internal market in the field of financial services. The stability of financial markets is, therefore, an essential condition for the establishment and functioning of the internal market, the Directive's preamble concludes.

Directive 2014/59/EU tries to change the current reality that resolution procedures of institutions are not harmonized at European level. Some member states apply the same procedures to institutions and other insolvent companies; these procedures are sometimes adapted to credit institutions as well. In Romania, for example, Law No 85/2014 regarding procedures of insolvency prevention and insolvency, regulates in Chapter III of Title II (art. 204 – 241) the bancruptcy of credit institutions and establishes suplimentary norms to those generally applicable in the case of companies' insolvency. There are big differences among Member States as far as the fund and the procedures applicable to insolvent credit institutions are concerned.

Even if Regulation No 575/2013 and Directive 2013/36/EU helped consolidate capital reserves and liquidities, by improving macroprudential policy instruments and the resistence of credit institutions to tensions, it is impossible to elaborate a framework of regulation and surveillance that would allow the respective institutions to always stay away from difficult situations. The states should have adequate instruments of recovery and resolution in order to handle both systemic and individual crises.

De plano, the European Union is not opposed to the temporary nationalization of a failing credit institution. As a last resort, for the resolution of an institution, public instruments of financial stabilization can be used, „*including temporary public ownership.*" In this case, it is essential for restructuring to be made in such a way that „*taxpayers are the beneficiaries of any surplus that may result from the restructuring of an institution that is put back on a safe footing by the authorities.*"

For all these reasons, the norms that regulate the resolution of credit institutions are subject to some minimal common provisions. This is the role of Directive 2014/59/EU. In order to ensure consistency with existing Union legislation in the area of financial services as well as the greatest possible level of financial stability across the spectrum of institutions, the resolution regime should apply to institutions subject to the prudential requirements laid down in Regulation (EU) No 575/2013 of the European Parliament and of the Council and Directive 2013/36/EU of the European Parliament and of the Council.

Considering that the resolution instruments and competencies laid down by the Directive could affect the rights of shareholders and creditors, such as the right to property or the right to equal treatment, the Directive lays down the principle of public interest: resolution measures will only be taken when it is in the best public interest.

An important objective that the resolution procedure should take into account is assuring financial stability and reducing to a minimum the negative economic and social effects in the Member State or States where the financial or banking institution or group carry out their activities.

Institutions will elaborate recovery plans, will bring them up to date regularly, and will determine the necessary measures for restabilizing their financial position after a serious deterioration. The plans must be detailed, based on realistic hypotheses, and applicable in critical scenarios.

An important regulation is laid down in para. (39) from the preamble. Thus, „*during the recovery and early intervention phases laid down in this Directive, shareholders should retain full responsibility and control of the institution except when a temporary administrator has been appointed by the competent authority. They should no longer retain such a responsibility once the institution has been put under resolution.*"

The aim of the Directive is to provide national authorities with a harmonized set of instruments and competencies for resolution, in case an institution is susceptible to be fail. These competencies should be put into practice according to some common conditions and objectives, as well as according to some general principles.

As a rule, any institution in difficulty should be able to leave the market, regardless of its size or degree of interconnectedness, without causing systemic disturbances. The Directive lays down the subsidiary nature of resolution. According to para. (46), the winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied.

Resolution measures must comply with a series of principles, including the principle that shareholders and creditors bear an appropriate share of the losses, that the management should in principle be replaced, that the costs of the resolution of the institution are minimised, and that creditors of the same class are treated in an equitable manner. In particular, where creditors within the same class are treated differently in the context of resolution action, such distinctions should be justified in the public interest and should be neither directly nor indirectly discriminatory.

The Directive does not leave out the purpose of protecting the right of shareholders and creditors. Thus, because interference with property rights should not be disproportionate, affected shareholders and creditors should not incur greater losses than those which they would have incurred if the institution had been wound up at the time that the resolution decision was taken.

An important goal of the European normative act is to sustain market confidence and minimise contagion. According to para. (53), „*rapid and coordinated action is necessary to sustain market confidence and minimise contagion. Once an institution is deemed to be failing or likely to fail and there is no reasonable prospect that any alternative private sector or supervisory action would prevent the failure of the institution within a reasonable timeframe, resolution authorities should not delay in taking appropriate and coordinated resolution action in the public interest* (...).”

Para. (55) lays down the regulation according to which the resolution tools should be applied before any public sector injection of capital or equivalent extraordinary public financial support to an institution. This, however, should not impede the use of funds from the deposit guarantee schemes or resolution funds in order to absorb losses that would have otherwise been suffered by covered depositors or discretionarily excluded creditors.

The resolution tools are enumerated in para. (59). These should include the sale of the business or shares of the institution under resolution, the setting up of a bridge institution, the separation of the performing assets from the impaired or under-performing assets of the failing institution, and the bail-in of the shareholders and creditors of the failing institution.

Para. (76) of the preamble lays down the interdiction to finance resolution mechanisms by means from their general budget.

Resolution authorities should have all the necessary legal powers that, in different combinations, may be exercised when applying the resolution tools. According to para. (84), these powers should include the power to transfer shares in, or assets, rights or liabilities of, a failing institution to another entity such as another institution or a bridge institution, the power to write down or cancel shares, or write down or convert liabilities of a failing institution, the power to replace the management and the power to impose a temporary moratorium on the payment of claims.

In accordance with art. 47 of the European Union Charter of Fundamental Rights, the parties in question have the right to a fair trial and to an effective appeal regarding the measures that affect them. Consequently, the decisions taken by the resolution authorities should ensure the right to an effective remedy. Since it aims to cover situations of extreme urgency, and since the suspension of any decision of the resolution authorities might impede the continuity of critical functions of the credit institution in question, the Directive establishes the presumption that its suspension would be against the public interest. The right of appeal should not result in the automatic suspension of the effects of the challenged decision. No right of appeal should affect any subsequent administrative act or transaction concluded on the basis of an annulled decision. Remedies for a wrongful decision should therefore be limited to the award of compensation for the damages suffered by the affected persons. [para. (91)].

Given that crisis management measures may be required to be taken urgently due to serious financial stability risks in the Member State and the Union, any procedure under national law relating to the application for ex-antejudicial approval of a crisis management measure and the court’s consideration of such an application should be swift. Given the requirement for a crisis management measure to be taken urgently, the court should give its decision within 24 hours and Member States should ensure that the relevant authority can take its decision immediately after the court has given its approval. This is without prejudice to the right that interested parties might have in making an application to the court to set aside the decision for a limited period after the resolution authority has taken the crisis management measure.

Para. (103) of the preamble deals with the financing of resolution procedures. Notwithstanding the role of central banks in providing liquidity to the financial system even in times of stress, it is important that Member States set up financing arrangements to avoid that the funds needed for such purposes come from the national budgets. Hence, financial industry, as a whole, should be the one that finances the stabilisation of the financial system.

Member States shall transpose Directive 2014/59/EU until 31 December 2014, and shall apply these measures starting with 1 January 2015, excepting Section 5 of Chapter IV of Title IV, applicable starting with 1 January 2016.

4. Directive 2014/49/UE of the European Parliament and of the Council

The last normative act that enforces the framework for banking regulation and supervision is Directive 2014/49/UE of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes. This Directive poses the least challenges.

According to para. (3) of the preamble, „*the Directive constitutes an essential instrument for the achievement of the internal market from the point of view of both the freedom of establishment and the freedom to provide financial services in the field of credit institutions, while increasing the stability of the banking system and the protection of depositors. In view of the costs of the failure of a credit institution to the economy as a whole and its adverse impact on financial stability and the confidence of depositors, it is desirable not only to make provision for reimbursing depositors but also to allow Member States sufficient flexibility to enable DGSs to carry out measures to reduce the likelihood of future claims against DGSs* (...).”

Considering that Directive 94/19/EC of the EP and Council of 30 May 1994 regarding deposit guarantee schemes was based on the principle of minimum harmonization, currently in the EU there are very different deposit guarantee schemes. Directive 2014/49/UE lays down common requirements which ensure uniform protection of depositors, together with the same degree of scheme stability. At the same time, common requirements will eliminate market distortions, the Directive thus contributing to finalizing the internal market.

According to the European legislative body, depositors will benefit from significantly improved access to DGSs, thanks to a broadened and clarified scope of coverage, faster repayment periods, improved information and robust funding requirements. This will improve consumer confidence in financial stability throughout the internal market.

Directive 2014/49/UE lays down the obligation of each credit institution to become member of a deposit guarantee scheme. However, each Member State which accepts subsidiaries of a parent credit institution from a third country, has the right to decide how to apply the Directive to these subsidiaries.

According to para. (12), it should be recognised that there are institutional protection schemes (IPS) which protect the credit institution itself and which, in particular, ensure its liquidity and solvency. Where such a scheme is separate from a DGS, its additional safeguard role should be taken into account when determining the contributions of its members to the DGS.

Each credit institution should be part of a DGS recognised under this Directive, thereby ensuring a high level of consumer protection and a level playing field between credit institutions, and preventing regulatory arbitrage. A DGS should be able to provide that protection at any time. The key task of a DGS is to protect depositors against the consequences of the insolvency of a credit institution. DGSs should be able to provide that protection in various ways. DGSs should primarily be used to repay depositors pursuant to this Directive (the ‘paybox’ function). [para. (13) - (14)].

Paragraphs (14) - (17) give more details on the ways in which the schemes should offer the above mentioned protection. Firstly, guarantee schemes should be used in order to repay depositors pursuant to this Directive (the 'paybox' function). Then, DGSs should also assist in the financing of the resolution of credit institutions in accordance with Directive 2014/59/EU. Thirdly, it should also be possible, where permitted under national law, for a DGS to go beyond a pure reimbursement function and to use the available financial means in order to prevent the failure of a credit institution with a view to avoiding the costs of reimbursing depositors and other adverse impacts. Those measures should, however, be carried out within a clearly defined framework and should in any event comply with State aid rules. Among other things, DGSs should also have appropriate systems and procedures in place for selecting and implementing such measures and monitoring affiliated risks. Finally, DGSs should also be able to take the form of an IPS. The competent authorities should be able to recognise IPS as DGSs if they fulfil all criteria laid down in the Directive.

According to art. (1) para. (1), „*this Directive lays down rules and procedures relating to the establishment and the functioning of deposit guarantee schemes (DGSs)*". According to para. (2) of the same article, the Directive applies to: „*(a) statutory DGSs; (b) contractual DGSs that are officially recognised as DGSs in accordance with Article 4(2); (c) institutional protection schemes that are officially recognised as DGSs in accordance with Article 4(2); (d) credit institutions affiliated to the schemes referred to in points (a), (b) or (c) of this paragraph*."

In accordance with art. 4 para. (1), each Member State shall ensure that within its territory one or more DGSs are introduced and officially recognised. This shall not preclude the merger of DGSs of different Member States or the establishment of cross-border DGSs.

According to art. 4 para. (4), „*if a credit institution does not comply with the obligations incumbent on it as a member of a DGS, the competent authorities shall be notified immediately and, in cooperation with the DGS, shall promptly take all appropriate measures including if necessary the imposition of penalties to ensure that the credit institution complies with its obligations*." If the measures taken under the above mentioned paragraph fail to secure compliance on the part of the credit institution, the DGS may, subject to national law and the express consent of the competent authorities, give not less than one month's notice of its intention to exclude the credit institution from membership of the DGS. Deposits made before the expiry of that notice period shall continue to be fully covered by the DGS. If, on expiry of that notice period, the credit institution has not complied with its obligations, the DGS shall exclude the credit institution.

Art. 5 examines the eligibility of deposits. Hence, according to para. (1), the following shall be excluded from any repayment by a DGS: (a) subject to Article 7(3) of this Directive, deposits made by other credit institutions on their own behalf and for their own account; (b) own funds as defined in point (118) of Article 4(1) of Regulation (EU) No 575/2013; (c) deposits arising out of transactions in connection with which there has been a criminal conviction for money laundering as defined in Article 1(2) of Directive 2005/60/EC; (d) deposits by financial institutions as defined in point (26) of Article 4(1) of Regulation (EU) No 575/2013; (e) deposits by investment firms as defined in point (1) of Article 4(1) of Directive 2004/39/EC; (f) deposits the holder of which has never been identified pursuant to Article 9(1) of Directive 2005/60/EC, when they have become unavailable; (g) deposits by insurance undertakings and by reinsurance undertakings as referred to in Article 13(1) to (6) of Directive 2009/138/EC of the European Parliament and of the Council (1); (h) deposits by collective investment undertakings; (i) deposits by pension and retirement funds; (j) deposits by public authorities; (k) debt securities issued by a credit institution and liabilities arising out of own acceptances and promissory notes.

By way of derogation from paragraph 1 of Article 5, Member States may ensure that the following are included up to the coverage level laid down in Article 6(1): (a) deposits held by personal pension schemes and occupational pension schemes of small or medium-sized enterprises; (b) deposits held by local authorities with an annual budget of up to EUR 500 000.

According to art. 6 para. (1), the coverage level for the aggregate deposits of each depositor is EUR 100 000 in the event of deposits being unavailable. For ensuring equity and social protection, certain deposits are protected above EUR 100 000 for at least three months and no longer than 12 months after the amount has been credited or from the moment when such deposits become legally transferable.

Repayments are made in any of the following: (a) the currency of the Member State where the DGS is located; (b) the currency of the Member State where the account holder is resident; (c) euro; (d) the currency of the account; (e) the currency of the Member State where the account is located.

Finally, art. 20 para. (1) and para. 2 stipulates that Member States shall transpose Directive 2014/49/EU into internal legislation by 31 May 2016.

IV. A few Conclusions. Romania and the European Banking Union

Heretofore in this paper I have made a brief and, obviously, incomplete presentation of the four normative acts that lay the judicial grounds for harmonizing the banking regulation and supervision framework, for managing the bancruptcy of banks, and for harmonizing and centralizing the guarantee of bank deposits. This single set of regulations represents a precondition for the good functioning of the EBU. The four normative acts must be enforced in all Member States.

This single set of regulations will eliminate jurisdictional arbitrage in the field, will reduce EU financial stability risks, will consolidate the principle of competitive neutrality, and will ensure that the same activity has the same risk and is subjected to the same regulations. Lastly, it will consolidate the single market and make the banking sector more efficient.

In the fields where the three directives will be applied, stricter national regulations will be allowed, where appropriate. Thus, stricter capital requirements are allowed for mortgage loans, if there is the risk of asset price bubbles. Should competent authorities identify higher risks, they will have the right to impose additional requirements.

Based on the single set of regulations, the EBU will enforce a single supervisory mechanism where the European Central Bank and national banking supervisory authorities will function as a system. Thus, ECB will directly supervise systemically important banks, the rest being within the national authorities' range of supervision. However, the procedures will coincide and will previously have been approved by ECB's Supervisory Board. All the data concerning supervisory activities will be transmitted to ECB, which will at any time have the power to decide to directly supervise any bank or gorup of banks considered a potential source of systemic risk.

Such being the case, the single supervisory mechanism should restore investors' and depositors' confidence in the financial and banking system, since under-performing assets will not be hidden in other jurisdictions anymore, and by identifying and monitoring international financial exposures and connections, systemic risks should diminish.

In addition, the existence of a transnational surveillance authority should prevent the fragmentation of European financial markets, thus contributing to the finalization of the internal market. With this aim in mind, adequacy requirements of assets and liabilities are eliminated at national level, capital flow within the EMU is made easier and, very importantly, there is a return to the good functioning of the transmission mechanism of monetary policy, whose malfunctioning was rightfully presented as cause and, at the same time, symptom of the eurozone's crisis.

However, certain problems result from the architecture of the single supervisory mechanism. For instance, voluntary participation of states outside the euro area might lead to a new type of fragmentation of the single market. Then, it also remains to be seen how EBU member states, but which are outside the euro area, will participate in decision-taking processes, considering they have full membership in ECB's Supervisory Board, but not in the Governing Council.

Moreover, ECB runs a reputational risk, which it tries to manage by completely separating the monetary policy function from the supervision function, by throughly evaluating the banks under its direct responsibility before putting into practice the single supervisory mechanism[21], and

[21] The evaluation is being finalized at the time I am writing this paper (October 2014).

also by hiring the specialized staff necessary for strengthening its institutional capacity and for the good functioning of the supervision.

We should not overlook the problem of provisions from the single set of regulations which seem to be in conflict with the principle of ECB's independence, principle that can be found in constitutive treaties.

Regarding the single resolution mechanism for banking crises, it is evident that creating a European resolution mechanism is justified, considering the transnational consequences of a banking crisis. Such crises should be managed impartially and efficiently in order to minimize the negative consequences on the economy and to avoid as much as possible the use of public funds.

The principles on which the single resolution mechanism for banking crises is based are simple. First of all, a functional market economy presupposes leaving the market in the event of failure. Secondly, the resolution's cost should be covered first and foremost by shareholders and creditors. Using public money should be a last resort measure and it should be accompanied by measures meant to ensure fiscal neutrality on a medium term. In order to avoid conflicts, the mechanism must be managed by the single resolution authority and not by the ECB. It should replicate the institutional and geographic coverage area of the single supervisory mechanism.

The single deposit guarantee scheme is kept, although it was surrounded by major controversies concerning the necessity and concrete form of constructing this component. But, it was agreed to cover national guarantee schemes at a harmonized sum of 100.000 EUR/depositor/ credit institution, and to simplify reimbursement procedures by reducing payment terms and improving ways of financing.

As far as Romania is concerned, we need to know from these initial stages whether our country should participate in the European Banking Union, or it should remain outside until we adopt the single currency, event which also makes Romania a EBU member.

Prima facie, several arguments can already be enumerated in favor of Romania joining the EBU. Firstly, considering that banks from the euro area hold three quarters of the banking assets and two thirds of its capital, joining the EBU seems a natural choice. Secondly, it is preferrable to participate from within to the construction of a mechanism to which Romania must adhere anyway sooner or later, so that it can benefit early on from firsthand information about the decisions in this field. Thirdly, belonging to the EBU would eliminate or at least diminish deleveraging stimulants which foreign banks present in Romania have operated during the past few years, in most cases for strictly conjectural reasons.[22] Fourthly, jurisdictional arbitrage will be eliminated, and possible distortions will be avoided among competitors. Finally, the high costs of nonparticipation should be analyzed, namely increased vulnerability to contagion effects and the absence of cross-border, effective and impartial coordination during the resolution process of a possible banking crisis.

It seems obvious that, similar to Romania's participation to the European Union, in the financial-banking sector and monetary policy as well, the national interest might be better served if certain prerogatives of national sovereignty would be given up at the right time. Becoming a part of the EBU could consolidate Romania's stability, could strengthen confidence in the banking sector, and could contribute to the growth of sustainable crediting and of the economy by and large.

Romania's participation to the European Banking Union could be one of the exercises necessary for the successful adoption of the single currency. Under no circumstances could it jeopardize this next big step for Romanian economy and society.

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