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Monetary Policy, the Provision of Financial Stability and Banking Supervision

NOTE

Abstract

This note discusses why it might be desirable for a central bank to have a micro-prudential supervisory role and why a single micro-prudential supervisor might be better than a collection of national supervisors. It argues that central banks should not be macro-prudential supervisors. It describes the skills that are necessary when a central bank is the provider of financial stability and the bank supervisor, as well as the monetary policy maker. It describes the institutional features of a central bank that are necessary if providing financial stability and bank supervision are to be regarded as legitimate roles for the central bank in a democratic society. It suggests how the accountability that is necessary for carrying out these political tasks can be squared with the independence required for monetary policy.

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EXECUTIVE SUMMARY

- To ensure the stability of financial markets central banks need to act as the lender of last resort. Both a central bank's normal lending operations and especially its actions as lender of last resort can have negative fiscal consequences that are ultimately borne by the tax payers. To minimise these potential costs it is probably desirable for a central bank to supervise the financial institutions that it makes loans to.
- There are several arguments for why it is better to have a monetary union's central bank as the sole bank supervisor for the union than to have a collection of national supervisors.
- While there is an economy of scope argument for combining lender and market maker of last resort activities, micro-prudential and macro-prudential supervision in one agency, there are also reasons for keeping macro-prudential supervision outside of the central bank and, indeed, as independent from government as possible.
- If a central bank is to provide financial stability it needs microeconomists, game theorists, lawyers, legal scholars and accountants. It should talk to practitioners. Central banks who are supervisors will need to hire people with degrees in business administration and who have concentrations in finance and accounting and who have knowledge of the laws and regulations affecting the financial industry.
- The ECB's lack of accountability has damaged its legitimacy as the provider of financial stability. To be seen as the legitimate provider of both financial stability and supervision it must become more transparent.
- The solution to the problem of a monetary authority's need for independence and the provider of financial stability and banking supervisor's need for accountability is to separate the monetary authority from the rest of the central bank.

INTRODUCTION

The Eurosystem was founded as a response to bad monetary policy and attendant excess inflation in Europe and elsewhere in the 1970s and early 1980s. The belief that politicians have an incentive to use monetary policy opportunistically led to a search for an institutional arrangement that would be conducive to low and stable inflation. Legally mandating price stability and giving the central bank the autonomy to pursue this objective appeared to be the best solution to the problem of eliminating policy makers' temptation to inflate too much.¹ Thus, the Euro system was given the primary objective of price stability and it was allowed an extraordinary degree of independence to enable it to pursue this task without governmental interference.

Apparently preoccupied with concerns about inflation, the writers of the Treaty seem to have given little thought to the role of the central bank in ensuring financial stability. The liquidity, banking and sovereign debt crises that have arisen in turn since August 2007 have reminded us, however, that central banks have two roles: they should both maintain price stability and they should ensure the orderly functioning of financial markets. To conduct the latter task effectively, they need to act as the lender of last resort. Both a central bank's normal lending operations and especially its actions as lender of last resort can have negative fiscal consequences that are ultimately borne by the tax payers. To minimise these potential costs it probably desirable for a central bank to supervise the financial institutions that it makes loans to.

Unfortunately the institutional design that has been consistent with good monetary policy has given the Eurosystem far too little accountability to give it legitimacy in the much more political tasks of acting as lender of last resort and as supervisor of financial institutions. Moreover, the expertise that the central bank built up to pursue monetary policy has not proved to be adequate for ensuring financial stability and it is certainly not sufficient for supervising financial institutions.

The purpose of this note is to detail why central banks might act as micro-prudential supervisors as well as providers of financial stability and I discuss the range of expertise that is needed to pursue these tasks. I explain what the institutional requirements are if they are to pursue these tasks as well as make monetary policy. I suggest how institution designers might come up with a structure that allows both the independence necessary for monetary policy and the accountability that is essential to an unelected body providing financial stability and supervision.

¹ When excess inflation is due to a time-inconsistency problem, a benevolent government that dislikes actual inflation is enticed to create unexpected inflation to increase output or improve the fiscal situation. Central bank independence may improve matters if central bankers, either by nature or socialisation, especially dislike inflation and are less prone to such a temptation. Alternatively, if excess inflation is due to policy makers with short-term political concerns deferring painful rate increases, then central bankers who are not subject to such political pressures may act more swiftly. See Goodhart (2003) on this latter point.

1. WHY SHOULD CENTRAL BANKS BE SUPERVISORS?

In this section I discuss the reasons why a central bank should have a bank supervisory role as well as some of the problems associated with this. I also discuss the benefits of having the central bank be the single bank supervisor in a monetary union. I explain why the central bank's supervisory role should be limited to micro-prudential supervision.

1.1. The lender of last resort should supervise the institutions it makes loans to

In a fear-driven outcome, depositors and wholesale creditors may believe that a bank (or other type of financial institution, or even an entire class of financial institutions) is insolvent. As a result the bank cannot borrow at all or can only borrow at far-above-market interest rates. The result is that the fear is justified and the bank is indeed insolvent, even though it would have been solvent had market participants been more sanguine. In scenarios where more than one outcome is possible the central bank has the deep pockets that enable it to function as lender of last resort and to ensure the socially preferable outcome is realized.

If the central bank is credible that it stands willing to act as lender of last resort and to lend as much as it takes to avert a run, then the run may never happen. If a run does occur and the central bank makes a loan to the threatened bank the fear may pass and the bank can return to the market as normal.

A problem with acting as lender of last resort is that it can be difficult to tell whether a threatened financial institution is illiquid but solvent or whether it is insolvent as well as illiquid. A rescue operation increases the money supply and the central bank can sterilise this increase by selling some of its other assets. If a loan is made at a penalty rate and the illiquidity proves temporary, then a solvent borrower repays, the sterilisation can be reversed and the central bank makes a profit. If the illiquid borrower turns out to be insolvent as well, then a loan is not repaid and the central bank's net worth declines. Ultimately, this burden is borne by the tax payers.

Unfortunately, financial crises can happen in a heartbeat. There may not be time for a central bank that is not also a supervisor to consult with and interpret the commentary of the relevant supervisor about the financial worthiness of a threatened financial institution. Even in its normal refinancing operations, central banks should know something about their counterparty risk and the overall riskiness of their portfolio. Thus, it can be argued that central banks should supervise any financial institution that they make routine or extraordinary loans to.²

Another argument in favour of a central bank acting as a bank supervisor is that it provides information to the central bank that is useful to it in its financial stability role. Because many of the supervised banks deal with other types of financial institutions and are sophisticated market participants, the central bank gains knowledge about the current state of and trends in different types of financial institutions and markets. It is more controversial whether acting as bank supervisor is useful for monetary policy. However, some monetary policy makers feel that that anecdotal information on regional conditions gained from their banking contacts is useful.³

² Bernanke (2007) argues that the Federal Reserve's role as bank supervisor allowed it to evaluate the collateral provided by banks requesting funds after the September 11 attacks and permitted the Fed to supply immediately the needed liquidity without undue risk.

³ See Bernanke (2007).

There are also several arguments for why it is better to have a monetary union's central bank as the sole bank supervisor for the union than to have a collection of national supervisors. First, it ensures that each bank in the union is subject to the same interpretation of the rules and degree of enforcement, which is desirable in an integrated financial market. Second, national supervisors may have a temptation to hide the extent of their own banks' problems; a single supervisor would have less incentive to hide the difficulties of a particular country's banks. Third, Bergl  f et al (2012) argue that the existence of cross-border banks in a monetary union makes multiple supervisors problematic. This is because home-country supervisors may have neither the incentive nor the ability to provide sufficient oversight of subsidiaries abroad and host country supervisors may have the incentive but, lacking information about the parent banks, not the capacity for satisfactory oversight of resident subsidiaries of foreign banks. Fourth, Garricano (2012) suggests that the main supervisory problem in the Spanish cajas debacle was the political control of the cajas and the failure of the national supervisors to stand up to the politicians even when they knew that if the cajas failed the taxpayers would lose money. The union's central bank may be less easy to intimidate.

It should be noted that along with the arguments in favour of central bank supervision of financial institutions there are some arguments against. It has been suggested that if the supervisory arm of a central bank performs poorly than the competency or credibility of the monetary policy arm might be questioned. It is not clear how convincing this argument is. It has also been suggested that if banks are underperforming as a group then the monetary policy maker might be tempted to temper its commitment to price stability to assist the ailing sector. This problem can be lessened by having different groups within the central bank make monetary policy and supervise. It has also been suggested that giving a central bank yet another task could further concentrate too much power in the hands of independent and unelected policy makers. This problem might be dealt with by imposing more accountability on the central bank. A possible argument against having the central bank in a monetary union act as the sole supervisor is the suspicion that it might devote less effort to policing the banks in small periphery countries than would the national central banks of these countries. This problem can be mitigated by giving small countries sufficient voice in the supervisory decision making.⁴

1.2. The central banks supervisory role should be limited to micro-prudential supervision

There are three different types of supervision of banks (or other financial institutions). The first is supervision that protects banks' retail customers from questionable business practices. The second is micro-prudential supervision aimed at monitoring the soundness of individual financial institutions. The third is macro-prudential supervision aimed at monitoring systemic risk and the threat to the financial system as a whole. This leads to the question of whether the central bank needs to do all three types of supervision or whether it should be entrusted solely with micro-prudential supervision. I argue in favour of the latter.

The protection of retail customers entails a different type of expertise than the other two types of supervision and is difficult to see how having the central bank perform this task is likely to enhance either price or financial stability. This suggests that it ought to be done by some other government agency. While there is an economy of scope argument for combining lender and market maker of last resort activities, micro-prudential and macro-prudential supervision in one agency, there are also reasons for keeping macro-prudential

⁴ See Bergl  f et al (2012).

supervision outside of the central bank and, indeed, as independent from government as possible.

While the data necessary for macro-prudential supervision must be collected by a government or international agency, the group appointed to analyse it should at least mostly come from outside of the central bank or other parts of the governments. There are at least four reasons for this. First, making the central bank the monetary policy maker, the micro-prudential supervisor and the macro-prudential supervisor surely concentrates too much power. Second, central bankers or other government employees might not make the best macro-prudential supervisors as career concerns might stifle the incentive of a bureaucrat in a hierarchical organisation to express certain original or unpopular ideas. Third, it is important that the macro-prudential supervisors not be the micro-prudential supervisors or regulators. This is because it is often suggested that supervisors and regulators can be captured by the industry that they are supposed to mind, making them less than objective and prone to the same errors. In addition, it is useful to have an independent body to oversee the micro-prudential supervisors and the regulators who might themselves be contributing to or underestimating systemic risk. Fourth, tax payers bear the burden of macro-prudential failures and this might lead them to want a degree of political control over the agency responsible for this task that would further complicate the problem of providing the independence necessary for either good monetary policy.⁵



⁵ From this point of view the composition of the European Systemic Risk Board is a mistake.

2. WHAT ADDITIONAL SKILLS ARE NECESSARY FOR A CENTRAL BANK THAT HAS A FINANCIAL STABILITY AND SUPERVISORY ROLE?

Central banks that have been primarily focused on monetary policy, rather than on financial stability and supervision, tend to be relatively overstaffed with macroeconomists and macroeconomists are not necessarily the people best suited to ensuring market stability and they are certainly not the best people to supervise financial institutions. Both of these new roles require new skills.

2.1. Expertise needed for the provision of financial stability

If a central bank is to provide financial stability it should have theories about why asset markets become dysfunctional and about how contagion arises. It should have theories about what should determine the haircuts on the assets it accepts as collateral. It should know how to design an auction to sell illiquid assets. These tasks require a background in microeconomics and game theory. In early 2008 there were probably few senior central bankers who knew exactly what implementing FAS 157⁶ required and had a view on whether it might force big banks to underestimate the value of their assets in a crisis. Central banks with a financial stability remit need research accountants. In assessing potential sovereign defaults and debt restructurings, it is necessary to know what is politically and legally possible; central banks with a financial stability role need lawyers and legal scholars. Both staff and management at central banks should have known about credit default swaps, collateralized debt obligations and the equity tranches of mortgage-backed securities prior to 2007. If central banks cannot afford to hire practitioners, they should at least spend more time talking to them. A plus of becoming the micro-prudential supervisor is that this will happen naturally and practitioners may become willing to volunteer their expertise.

2.2. Expertise needed for a supervisory role

A central bank that takes on a micro-prudential supervisory role also needs to expand its expertise. Micro-prudential bank supervisors must assess whether a bank is financially sound and whether it is well managed. This involves asking how much risk a bank is taking on and whether it has the resources available to manage this risk. The resources can take the form of capital, liquidity, managerial competency and internal control systems.⁷ This suggests that the central banks who are supervisors will need to hire people with degrees in business administration and who have concentrations in finance and accounting and who have knowledge of the laws and regulations affecting the financial industry. Garricano (2012) suggests that in some euro area countries, some banks have been under the control of political parties and unions. Supervisors also need to be honourable and to have the courage to stand up to them.

Ioannidou (2012) notes that hiring the large number of required supervisors in a short period of time will be difficult, as their expertise makes them attractive to the far-better-paying "*other side*". Moving supervision away from the national central banks also creates the problem of what to do with the national supervisors who expected to have their jobs for life.

⁶ Financial Accounting Standard dealing with fair value measurements.

⁷ See Ware (1996).

2.3. What about the President's expertise?

It will be possible, if expensive, for the ECB to hire a diversified staff that can handle the three separate tasks of price stability, financial stability and micro-prudential supervision. The President of the ECB (or the head of any other central bank), however, is likely to have an expertise in just one of these areas. If the President is, say, a macroeconomist then it is probable that he (or she) became a macroeconomist because he found inflation and the macro-economy interesting. Not only is he likely to lack expertise in the two other roles, he may also be less interested in them until a crisis arises. Jean-Claude Trichet appears to be an example of this. In his press conferences and Quarterly Monetary Dialogues with the European Parliament, Mr Trichet always spoke about monetary policy with enthusiasm. However, until autumn 2008 he had little to say about financial stability. For this reason, even if there remains a single President, there should be separate people responsible for each of the central bank's three areas of responsibilities. And, it might be useful if the European Parliament could regularly question each.

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3. FINANCIAL STABILITY AND BANK SUPERVISION MUST BE SEEN AS LEGITIMATE TASKS FOR THE ECB

In this section I contend that the provision of financial stability and a bank supervisory role are political tasks. For it to be palatable to the citizenry that the uniquely independent and unelected ECB undertakes these tasks, it must be seen as legitimate for it to do so. I argue that the ECB's lack of accountability has damaged its legitimacy as the provider of financial stability. To be seen as the legitimate provider of both financial stability and supervision it must become more transparent.

3.1. Providing Financial Stability and Supervision are Political Tasks

If, when acting as market-maker or lender of last resort, the central bank chooses its prices and penalty interest rates correctly, the expected increase in national or area wealth should more than compensate most of its citizenry for any additional risk. But, the central bank's actions can redistribute expected wealth and may do so in a way that is perceived by some as unfair. Moreover, in choosing its counterparties and the terms of its contracts there is the possibility that the central bank might be motivated by more than purely economic considerations. Even if the central bank policy makers always behave honourably, there is the possibility of an erroneous perception that they did not. Both the possibility of redistributing wealth in an unpopular way and of being thought corrupt introduces significant political elements into a central bank's role as provider of financial stability.

Micro-prudential banking supervision is also a highly political task. The European Commission's proposal gives vast powers to the ECB. The ECB will license and authorise credit institutions, ensure compliance with capital requirements and with provisions on leverage and liquidity. If it deems that the bank is about to breach or has breached the regulatory capital requirements, then along with the resolution authorities it can institute early intervention measures.⁸

3.2. To be seen as a legitimate provider of financial stability and supervision the ECB must be accountable

Unelected central banks that have a financial stability role and that supervise financial institutions will only be viewed as legitimate if the citizenry believes that they have both the right to do the financial stability and supervisory tasks that they take on and that they are the most appropriate institution to perform them. There are two related sources of such legitimacy: output legitimacy and input legitimacy. Output legitimacy can occur if the central bank does its assigned tasks in a satisfactory manner and does not undertake tasks that it has not been assigned, even if it can do these tasks well. Input legitimacy can arise if the citizenry approve of the way that tasks were delegated to the central bank and if the central bank is accountable.

The relatively short existence of the Eurosystem precludes a firm conclusion about its competency in providing financial stability. On the one hand, it is worrisome that ECB policymakers did not speak out about the state of Greek finances, although they must have realised by 2004 that Greece was verging on insolvency, and that they continued to accept Greek sovereign debt on the same terms as they accepted German sovereign debt. On the other hand, most economists would probably view the ECB's performance in managing the liquidity and banking sector solvency crises as being at least as good as that of the world's other major central banks. However, if the Eurosystem is perceived as reasonably

⁸ European Commission (2012).

competent at the moment, bad luck alone might cause it or any other central bank to lose this source of output legitimacy in the future. Since the Eurosystem has yet to take on a supervisory role it has no output legitimacy with regard to this task.

Central banks can also achieve output legitimacy by not taking on tasks that have not been assigned to them. Providing direct subsidies to counterparties by buying their assets or accepting their assets as collateral at a higher than fair value is equivalent to making a fiscal transfer and this is not generally seen as an appropriate action for a central bank. The Eurosystem's foray into the sovereign debt markets after May 2010 is widely viewed as something that the Eurosystem was not only not assigned to do, but was something it was specifically *not* supposed to do. While it appears to be mostly understood that it was necessary and done under duress it did not enhance the legitimacy of the Eurosystem. Other acts of voluntary outright fiscal subsidisation such as the national central bank of Luxembourg's long-standing policy of allowing Icelandic banks to borrow from it using each other's debt as collateral and the unlimited one-year fixed rate liquidity provision of June 2009 which may have been a transfer of about EUR 1 billion from taxpayers to delighted banks have also tarnished the institution's output legitimacy.

The Federal Reserve Act of 1913 came into being largely as a response to a series of financial crises and being the lender or market maker of last resort as well as a micro-prudential supervisor is generally perceived as legitimate roles for the Federal Reserve. Unfortunately, there is much less of a perception that they are legitimate roles for the Eurosystem. The European Monetary Union came into being after unfortunate experiences with monetary policy in the 1970s and 1980s. Thus, the Treaty, which might have reinforced the input legitimacy of the Eurosystem in its financial stability and supervisory roles, focuses almost entirely on monetary policy. What little it has to say about a financial stability or bank supervision role for the central bank is vague and ambiguous. The ECB, therefore, has little input legitimacy in these roles from the manner of its birth.

After five years of crisis fighting, there is political support for a banking union with a single supervisory authority. Furthermore, the ECB is the only obvious candidate for the supervisor as the European Banking Authority, headquartered in London is an EU institution rather than a euro Area institution. Consequently, on 12 September 2012 The European Commission proposed a single system of supervision for euro area banks led by the ECB. Should this proposal be agreed it has the potential to ensure some input legitimacy for the ECB in its supervisory role.

Unfortunately two major problems undermine this input legitimacy. First, it would be preferable to have all EU nations join the system, but those EU nations that are not euro area Member States and that choose to join will likely resent not having voting rights. Second, there is conflict over the extent of the ECB's supervision. Clearly the ECB must be able to supervise all systemically important institutions. However, the experience of Spain shows that it should eventually supervise or at least oversee the supervision of small and medium-sized banks as well. The idea is disagreeable to Germany which would like to continue its rather questionable supervision of its own small and medium-sized banks.

With regard to its financial stability and bank supervisory roles, the ECB has little input legitimacy through the manner its creation. It has lost output legitimacy in its financial stability role by taking on tasks that were not in its remit. The output legitimacy it has gained by its competency can always be lost by chance. With regard to its bank supervisory role it may acquire some input legitimacy if agreement is reached on banking union but with no experience it has no output legitimacy. Thus if the ECB is to be perceived as having legitimacy in its financial stability and bank supervisory roles it must attain input legitimacy by being perceived as accountable.

3.3. How can the ECB be seen as accountable?

It is typical to view a central bank as accountable if it is transparent in the sense that the public is able to observe or be provided with the relevant information about the central bank's actions and decision-making processes and if the central bank explains and justifies its actions and if it is possible to punish central bank policy makers who engage in bad or incompetent behaviour. Unfortunately, from the point of view of being seen as legitimate, the Eurosystem's unusual degree of independence means that it is virtually impossible to punish its policy makers for bad or incompetent behaviour. Therefore, if the Eurosystem is to be seen as accountable it must be seen as transparent.

With regard to monetary policy, the ECB is famously impenetrable and with regard to financial stability the ECB is even more opaque. We do not know what prices the ECB uses for the marketable securities it accepts as collateral when they have not been recently traded. We do not know how the ECB computes the haircuts it imposes on securities used as collateral.

It is interesting to compare the transparency of the Eurosystem with that of the Federal Reserve System. In its operation of the Securities Markets Programme, the ECB appears to believe that it is allowed to sell a security at any price to any eligible counterparty and it never has to say who the counterparty was, how it was selected or how much they paid. In contrast, section 1109(c) of the Dodd-Frank Act requires the Fed to publicly reveal the details of its emergency lending between December 2007 and July 2010. In December 2010 the Fed provided detailed information about this lending on its website, including the identity of the counterparty, the size of the transaction and the terms. The Dodd-Frank Act exempted borrowing from the discount window during the crisis but mandated disclosure of loans made after 21 July 2010 with a two-year lag. In March 2011 the Supreme Court forced the Fed to disclose data on emergency discount window borrowing.

The Eurosystem's obsessive secrecy in its roles as provider of price stability and financial stability threatens its legitimacy. This threatens its credibility and its reputation as an institution. This will hamper its future ability to both make monetary policy and to provide financial stability. It could also threaten the credibility and reputation of all other European Union governance institutions, including the European Parliament. It certainly threatens its legitimacy as a micro-prudential supervisor. The Eurosystem should become more transparent.

4. WHERE DOES THIS LEAVE MONETARY POLICY?

If one can design a central bank from scratch it seems possible to protect the independence of monetary policy without threatening the legitimacy of the central bank in its other roles. This can be done by recognising that monetary policy, narrowly defined, is a technical task best done by people with technical expertise and that these people – as a group – do not have to have other responsibilities within the central bank.

The provision of financial stability and micro-prudential bank supervision should be done by a Financial Stability Group and a Supervision Group, each with their own chair. These committees should have a mandate to make risky decisions that might redistribute wealth and, consequently, they should be held accountable. The Financial Stability Group should be required to specify its collateral policies and how it decides them and to say how it chooses its counterparties. With an appropriate lag it should provide the details of its transactions. The Supervision Group should display a similar level of transparency. The chairmen of both groups should regularly testify before the parliament or other appropriate legislative body. Ideally, it should be possible to fire members who are incompetent.

Ideally, the Monetary Policy Committee (MPC) should be affiliated with but distinct from the central bank and charged *solely* with choosing policy interest rates or conducting quantitative easing if necessary. This will allow it to – but not the rest of the central bank – to have the needed independence to pursue monetary policy. It would also satisfy German Finance Minister Wolfgang Schäuble's desire for a Chinese Wall.

Also, ideally, the intersection of the groups should be small but not empty; the chairman of the Financial Stability Group should probably also be the head of the central bank. The MPC – which is charge with what is almost a purely technical and non-political task -- need not be chaired by the head of the central bank and it need not and probably should not be populated primarily by employees of the central bank. This committee should have a point inflation target that is consistent with price stability and be given operational independence. Its members should serve fixed terms and dismissal from the committee should only be on grounds of gross misconduct. Accountability is satisfied if it publishes individual votes and its unattributed minutes. Efficiency is promoted if the MPC is a far smaller group than the Governing Council. In addition, as with other technical jobs, such as brain surgery or flying passenger planes, it is usually better to hire the best people rather than the best people of a specific nationality.⁹

Within the confines of the Treaty, it appears difficult to force upon the Eurosystem the accountability needed for its financial stability and bank supervisory roles. However, nothing precludes the Eurosystem from becoming more transparent voluntarily. The European Parliament might assist matters in devoting more of their Quarterly Monetary Dialogue (renamed Quarterly Testimony) to the ECB's more political tasks.

⁹ An example of a country with an arrangement close to this is Iceland. Since 2008 monetary policy has been made by a committee that is distinct from the central bank and is charged solely with choosing policy interest rates and commenting on financial stability. It is made up of five members, two of whom are external. The first (acting) governor and one external have been foreigners.

5. CONCLUSION

It is probably desirable for the ECB to supervise the financial institutions that the Eurosystem might be called upon to make loans to. This is a political task and requires the institution responsible for it to be transparent, a quality that apparently does not come naturally to policy makers at the Eurosystem. It requires a different type of expertise than does monetary policy or the provision of financial stability, but while expensive this should not present a serious hurdle.

While making the ECB the single micro-prudential supervisor is desirable, the most important ingredient in any serious EU banking reform is a single bank resolution regime that is compatible with that of the United States and other major financial centres. If banks cannot be allowed to fail without serious systemic implications, no change in supervision or regulation will ensure EU financial stability.

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