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This paper presents a holistic description and assessment of the European Union's financial services policy since the start of financial crisis in mid-2007. The decade-long sequence is divided into four themes, in broadly chronological order: the initial reaction to the 2007-08 financial shock; subsequent initiatives framed by political developments at the EU and G20 level; the banking union from mid-2012; and more recent events centred on the United Kingdom vote to exit the EU (Brexit). The analysis identifies banking union as the watershed moment, and correspondingly assesses the EU policy response as mostly inadequate in the first half and mostly effective in the second half of the period covered. Recommendations for future reforms are made in the conclusion.

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Introduction

This paper presents a holistic overview and assessment of the European Union (EU)'s financial services policy since the start of its financial [(t)-4 (h)1 (o)5 (s)-2 (e)-5 (in)0.9 (c)7 (o)-5 (un)1 (t)-4 (r)3 (ie)-5 (s)-2 (

The understanding of the crisis as home-grown and driven by the bank-sovereign vicious circle has increasingly been adopted by scholars (eg Smart, 2017; Raviv, 2017; Bayoumi, 2017). It is at odds with another narrative, which has tended to dominate the media and political discourse during most of the period covered. According to this more conventional narrative, a US-originated financial-sector tidal wave hit Europe as an external shock in 2007-09, was on its way to resolution by mid-2009, but was followed by a largely unrelated sequence of sovereign-debt crisis in the euro area starting with Greece in late 2009/early 2010 (eg Spiegel, 2014; Peet and La Guardia, 2014). But the conventional narrative of subprime crisis followed by Greek tragedy obscures the significance of euro-area banking sector fragility throughout the sequence. While superficially appealing to many, not least because it downplays the responsibility of policymakers in core euro-area countries and EU institutions, it is ultimately unhelpful to shed light on the more significant policy challenges.

The structure of the paper flows from its analytical framework, and combines chronological with thematic perspectives. Section 1 focuses on the pre-crisis build-up of risk and initial policy reactions between the summer of 2007 and the autumn of 2008, when the turmoil associated with the Lehman Brothers bankruptcy opened a new phase in terms of crisis intensity and awareness. Section 2 examines developments from November 2008 to mid-2012, a period dominated by the rise in prominence of the Group of Twenty (G20) and Financial Stability Board (FSB) at the global level, and by dramatic financial fragmentation in the euro area despite [illegible]

(MiFID) of 2004, superseding the earlier Investment Services Directive), mutual funds (three successive directives on Undertakings for the Collective Investment in transferable Securities, or UCITS), the supervision of financial conglomerates, the content of issuance prospectuses, the prevention of market abuse, and more. The 1999 legislative programme had been largely completed by mid-2007, with the exception of the directive on insurance supervision (known as Solvency II) for which the European Commission only published a proposal in July 2007, and which was adopted in 2009. As this enumeration suggests, the vast majority of applicable EU financial services legislation had taken the form of directives, which are framework laws requiring national transposition into the specific legal regime of each member state, thus typically stopping short of what has since become known as a 'single rulebook'. Regulations, which in this context refer to EU legislative acts that apply directly to market participants without a need for national transposition, were the exception prior to 2007. A significant such text was the International Accounting Standards Regulation of 2002, which mandated the use of International Financial Reporting Standards (IFRS), following an EU endorsement process, by all publicly listed companies, a major shift towards greater transparency and comparability of financial reporting whose implementation was completed in 2006. x

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The combination between, on the one hand, national financial policy autonomy and, on the other hand, enforceable mechanisms to create a single EU financial market[2], created a uniquely perverse set of incentives. First, most member states had longstanding traditions of using the domestic banking system as an instrument to channel various public policies, including the funding of the government itself, and the preferential direction of savings and credit towards favoured firms or sectors, a multifaceted cluster of practices to which economists loosely refer as 'financial repression'. Second, the market opening prompted by the EU single market and competition policies led most member states to give priority to the protection and/or promotion of their national banking 'champions' in the perceived pan-European contest for market dominance, a stance referred to as 'banking nationalism' with reference to broader patterns of economic nationalism, and often superseded prudential concerns (Véron, 2013). Taking advantage of the implicit guarantees inherent in this setting, many European banks expanded aggressively during the early 2000s, both in the Union and abroad, including by building up significant exposures in the United States and Asia. One example of such unchecked risk-taking was the expansion of ABN AMRO, a major Dutch bank, and its subsequent acquisition in 2007 through a hostile takeover by a consortium formed of the UK's Royal Bank of Scotland (RBS), Belgium's Fortis, and Spain's Santander. Santander quickly resold ABN AMRO's Italian subsidiary to Banca Monte dei Paschi di Siena (MPS) at a profit, and as a consequence the transaction was lucrative for them, but it otherwise played a material role in the subsequent failures and public rescues of RBS, Fortis, and MPS. The fact that all three banks were allowed to make this high-risk acquisition by their respective national overseers is representative of the attitude of supervisors in many member states, which effectively encouraged 'their' banks' expansion even in cases where their prudential mandate should have led them to curb it. This structural inadequacy of the supervisory framework was already observable at the time, even as it is more glaringly obvious with the benefit of hindsight.

After the initial shock of July/August 2007, the relevant authorities in Europe stayed in almost continuous denial of the seriousness of the situation and of the magnitude of the risks. The Bank of England went as far as refusing to provide liquidity to struggling banks in its jurisdiction, citing concerns about moral hazard, until this wholly unsuitable stance precipitated the collapse of Northern Rock in September 2007 and the first bank run in the UK since the 1860s. More pervasively, authorities in most member states painted the turmoil as temporary and entirely driven by US-based assets that were dubbed 'toxic', implying that the rest of the banks' balance sheets should be considered safe. As for the toxic assets themselves, there long lingered a pretence that the price fall of entire asset classes was mostly linked to liquidity constraints, exacerbated with fair value or 'mark-to-market' accounting standards (which were duly, and entirely unfairly as it turned out, scapegoated for the market volatility), and would thus eventually rebound. At the EU level, there was no significant legislative response other than the delivery of pre-crisis projects, such as Solvency II as mentioned above. The commissioner in charge of financial services, Charlie McCreevy, had heralded a non-interventionist stance to financial regulation and was wrong-footed by the crisis. More generally, European leaders found it much more appealing to blame the United States and its market-driven, supposedly short-termist system for what was depicted as an exogeneous shock, than to reflect soberly on their own banking sectors' home-grown risks.

[2] In particular, the competition-policy arm of the European Commission, known as DG COMP, started in the late 1990s to forcefully dismantle policy barriers against intra-EU cross-border mergers and acquisitions involving banks, as well as explicit government guarantees on specific banks.

When a new cycle of financial dislocation started with renewed violence in September 2008, with the US nationalisation of Fannie Mae and Freddie Mac followed in short order by the bankruptcy of Lehman Brothers and the hasty public rescue of AIG, European policymakers were caught unaware. The initial reactions were almost entirely uncoordinated, such as the Irish gove

then widely described as crisis accelerators through ill-timed 'procyclical' downgrades (a charge which, with hindsight, appears rather pointless)[3]; at hedge funds and private equity investors, long

shortly afterwards, eg Allied Irish Banks in November 2010 or Spain's Bankia in April 2012. In the end, these stress tests only served to underline the dysfunction of the EU and especially euro-area supervisory framework, and the incentives for national banking supervisors to hide and deny problems in banks under their purview, generally driven by banking nationalism under the ever-less-convincing excuse of forbearance to safeguard financial stability.

A more promising though still insufficiently ambitious initiative was the commissioning in late 2008 by European Commission President José Manuel Barroso of a report on EU financial regulation, which was promptly delivered by a high-powered expert group chaired by former French central banker (and former IMF Managing Director) Jacques de Larosière in February 2009. The Larosière Report (European Commission, 2009) articulated the vision of an EU financial 'single rulebook', implying fuller harmonisation of applicable rules and a shift from directives to regulations (in the latter's EU legislative sense). Concretely, it advocated the transformation of the three Lamfalussy Committees (CESR, CEBS and CEIOPS) into more authoritative 'European Supervisory Authorities', namely the European Securities and Markets Authority (ESMA), European Banking Authority (EBA), and European Insurance and Occupational Pensions Authority (EIOPA), respectively located in Paris, London and Frankfurt like their Committee predecessors. A European Systemic Risk Board (ESRB) was also recommended to monitor 'macro-prudential' issues and make recommendations accordingly, to be hosted by the ECB in Frankfurt. After member states endorsed these proposals in May 2009 and the corresponding legislation was eventually enacted in November 2010, the three ESAs were officially established on 1 January 2011 as agencies of the European Union, with a mandate that included the drafting of sub-legislative 'technical standards' (akin to regulations issued by federal agencies in the US), with binding effect them is subject to endorsement (or modification) by the European Commission; a cte(S)1 ())-4 (,-6 s)-2 (s)-2 (i1r1)-4 (,

increasingly internalising the possibility of a break-up which thus appeared on its way to become a self-fulfilling prophecy. Greece defaulted on its sovereign debt in March 2012, too late for this to resolve its debt sustainability challenge, and immediately required a further round of massive financial assistance from the euro area and the IMF. By the spring of 2012, it had become glaringly obvious that the course of euro area policy had become unsustainable.

3. Banking union

The idea of shifting the main instruments of banking sector policy from the national to the European level long predates the financial crisis. On the face of it, this shift, now widely referred to as banking union, is a logical consequence of the European Union's longstanding policy of creating a single market for banking services. But because of the significance of financial repression and banking nationalism in most member states, banking sector policy had remained predominantly national even after the shock of the 2007-08 financial crisis, as described above. It took the severe financial contagion, fragmentation and dislocation of 2011 and early 2012 to force an acceptance by political leaders of the necessity of banking union, and even then, only in a limited form and covering only the euro area. Still, the inception of banking union is increasingly seen as the most structurally significant EU policy initiative in the past decade, and the summit of June 28-29, 2012 when it was decided, as the most significant in the long sequence of European crisis summits (eg Draghi, 2013; Van Rompuy, 2014; Hollande, 2016; Smart, 2017).

The decision of June 29, 2012 was a recognition by euro-area leaders of the need to radically change investors' expectations about the area by taking an action that would be viewed as a credible commitment to hang together. By that time, the bank-sovereign vicious circle was generally understood to be at the core of the current phase of crisis. Action on the fiscal side, eg by pooling the ability to raise tax, make expenditures, and/or issue debt securities ('fiscal union'), had been ruled out as politically unfeasible, at least in the short term and given widespread negative perceptions about the fiscal behaviour Tw 25.11 0 Td 0 Tw 4.26 0in(r Tw 25.1By)Tjm b7 (p)(v)2 (e)-5 (n)1 0 Twtnnnboegvica2(p)1 (e) (s)-u

improvement (ECA, 2017). It passed its first operational test in early June 2017 with the orderly resolution of Banco Popular, Spain's sixth-largest bank whose operations were swiftly taken over by Banco Santander, even though this case has also given rise to multiple lawsuits. The BRRD principle of senior bond bail-in, however, has not yet been fully established, and was circumvented by the Italian authorities in the liquidation of two medium-sized banks, Banca Popolare di Vicenza and Veneto Banca, also in June 2017. These are only early steps in what promises to be a long sequence of discovery before the new European model of bank crisis management and resolution achieves a high degree of consistency and predictabilits4.1 (e)fC6(a)-6 (([c)-3 (o5 (i)5 (10 cs 0 0.091j-20.946 -1.217 Td( )Tj23 (o5 (i 0.091j-2[

appears to favour an expansion of the role of ESMA, both generally (European Commission, 2017) and specifically in the case of CCPs[19].

Conclusion: achievements, missing pieces and next steps

The European Union's financial services policy since the crisis started in 2007 has involved both great shortcomings and great achievements. As this paper has argued, the turmoil has revealed massive supervisory failures which in turn stemmed largely from an inadequate architecture for financial supervision. The response to the core problem of banking sector fragility has been disastrously slow, particularly in the euro area, with the first half-decade of crisis (mid-2007 to mid-2012) essentially wasted with dilatory measures. After the breakthrough inception of banking union in mid-2012, the process of repair and restructuring has been painfully protracted. Even so, the establishment of the SSM, and to a lesser extent also those of the ESAs and SRM, represent radical change, with already significant and positive impact on the structures of the European financial sector. This structural change has been implemented remarkably quickly, and is more comprehensive than any comparable episode in the long history of banking sector policy integration in the United States (Gelpern and Véron, 2018). The aim of a single financial rulebook remains largely aspirational, but significant progress has been made in its direction, for example in bank capital and derivatives regulation. The future impact of these reforms is likely to be even more visible yet, particularly if cross-border bank acquisitions pick up in the next few years. Overall, a measure of guarded optimism is in order as to the European Union's ability to face the next challenges as its financial system continues to evolve.

The most obvious current piece of unfinished work is the banking union. *"Completing banking union"*, an expression frequently used by euro-area policymakers at the time of writing, can mean at least three different things depending of context. First, it could mean delivering on the stated aim of banking

sovereign concentration charges (SCCs), namely a regulatory instrument to disincentivise concentrated euro-area sovereign exposures of euro-area banks. There is an increasing recognition that the combination of well-designed EDIS and SCCs (together with the acknowledgement of a backstop role of the ESM to both the SRF and EDIS)

(BCBS, 2014). Particularly in the global context created by the Trump administration in the United States,

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