# Ideal Crisis Management Mechanism for Credit Institutions and Investment Firms in the European Union


## Abstract:

The 2007-8 financial crisis brought about the most severe economic contraction since the Great Depression. Regulators on both sides of the Atlantic were taken aback and soon realized that they had no tools to deal with distressed banks and other financial services firms, failure of which could undermine financial stability not only within individual states, but also on a global scale. As a result, central banks of in particular the United States and the Eurozone became the most important actors in the fight against the unfolding crisis and *de facto* the only "governmental agencies" capable of swift and decisive measures. Their timely and vigorous reaction most likely warded off the collapse of the global financial system, though it was not without controversies. These controversies are analyzed in this dissertation in order to find out what role should central bank have during financial crisis.

Governments followed central banks with massive bank bailouts. In many countries, governments went beyond liquidity provision and nationalized their banks, which threatened their own solvency. Although the global financial system has been largely restored in the last decade, it has been achieved at huge costs, massive taxpayer-funded bailouts and surging indebtedness. Although there are not that many certainties in life, one can be sure that another financial crisis will sooner, or later come, though probably in the form and at time least expected. Before it happens, a credible crisis management framework should be put in place to reduce moral hazard and ensure that crises to come are handled properly and without resort to taxpayer money. To figure out how such crisis management framework should (or should not) look like is the primary goal of this dissertation.

Although the dissertation is primarily centered around the current European framework, its scope is broader, since financial markets are increasingly global in nature and can hardly be contained within national (or regional) borders. This dissertation shows that regulators were caught off guard in 2008, despite similar crises in the past. Accordingly, although people usually hold a firm belief that financial crises are things that happen to other people in other countries at other times since they are doing things better, are smarter and have learnt from the past mistakes, it is shown that European legislators have not learnt from all their past mistakes.

The severity of the crisis in Eurozone and only a limited success in taming it despite massive government and central bank interventions highlighted the need to accelerate integration at the institutional level. The result was a broad new quasi-federative institutional framework, the European System of Financial Supervision introduced in 2011. Although the creation of the new pan-European financial market infrastructure was a step towards the right direction, the subsequent "voluntary" Greek debt restructuring evidenced that the new framework did nothing to address the link between sovereign debt and bank solvency.

The Banking Union is the new EU institutional framework that has been developing in the last decade to prevent crises, like Eurozone went through about a decade ago, from happening again. Although some aspects are still a going concern, clear contours of the new structure can be discerned. It is a logical consequence of the fact that regulation within the EU is harmonized, so there should be an EU-level institutional framework ensuring also unified enforcement. The dissertation also assesses this new institutional framework in order to find out whether it will be enough to finally address the pains of the "old framework".