

Restoring Trust and Confidence at the Institutional Level by Higher Order Control

The Case of the Formation of the European Banking Union

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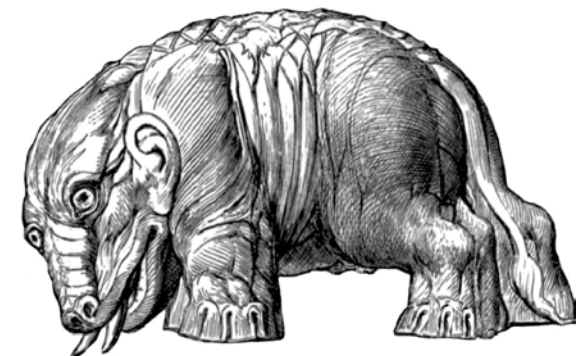
Abstract:

In 2008, the American subprime mortgage crisis turned into a financial fiasco that put the stability of the global financial system to the most severe test in decades. It was accompanied by an erosion of institutional trust and financial confidence both by private households and among financial intermediaries. In the light of the new regulations for stabilizing the European banking system the article works out the meaning and the importance of institutional trust and confidence and a need for institutionalized *guardians of impersonal trust*. It examines the introduction of these new measures of institutional control from a theoretical point of view and evaluates the results by an analysis of the regulations of the newly established European Banking Union. Referring to the long-standing history of financial market regulation we show that after the dramatic experiences of the recent trust meltdown a new and more extensive *second-order control* is needed to re-establish and maintain institutional orders of trust. The recent institutionalization of a new supervision in Europe's financial system constitutes an implementation of stronger macro-prudential surveillance and a means of reflexive second order control.

Keywords: Trust, confidence, second-order control, reflexive control, guardians of impersonal trust, financial crisis, financial system, financial market, Dodd-Frank Act, European Banking Union, supranational regulation

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1. The Current Crisis as a Matter of Confidence and Trust [1]

Some 30 years ago, the historian Reinhart Koselleck (2008, 203) stated that anybody reading a newspaper today will come upon the term “crisis”. These days, this observation seems more valid than ever. In 2008, the American subprime mortgage crisis turned into a financial crisis that put the stability of the global financial system to the most severe test in decades. Shortly thereafter, the crisis reappeared in a different guise. The intangible losses enlisted in the books of the biggest investment banks finally showed up in the balance sheets of European nation states. While by definition a crisis is regarded as a temporary interruption of a state of relative stability, it is the lasting impression of living in times of financial insecurity that coins the current collective consciousness. In September 2014, six years after Lehman Brothers filed for the biggest bankruptcy in history, Bundesbank president Weidmann confirmed that the “Euro crisis is not yet behind us” (SPON 2014). One of the striking characteristics of this sustained state of crisis is that it is frequently portrayed as a significant loss of confidence with regard to the financial system, a preferred wording by government officials legitimizing their extensive emergency measures at the peak of the crisis and the associated coverage of the mass media. A good example is the conjoint statement by Paulson, Bernanke, and Blair in October 2008 (WSJ 2009). Paulson alone uses the term “confidence” eleven times in his statement.

On the other hand, academic discussion of the crisis frequently refers to the term trust to identify a “Trust Crisis” (Sapienza/Zingales 2012) or a “Trust Meltdown” (Schatz/Vollbracht 2010; Guiso 2010; for the German discussion, that only knows the term “Vertrauen” see Baecker 2008; Beckert 2010). Consequently, confidence and trust both act as a kind of semantic seismograph detecting the immense strains that discharged in the recent financial earthquakes.

In Europe at present, these strains not only apply to the ability of nation states to meet their financial obligations but also to the corresponding solvency of some of the biggest banks of the Eurozone and even the survival of the currency as such. Obviously, these questions touch on the very foundations of the historical project of European unification and thus prove as a topic delicate enough to provoke bold reactions: In July 2012, Mario Draghi famously declared that the European Central Bank (ECB) is “ready to do whatever it takes to preserve the Euro”, adding “and believe me it will be enough”. While by 2015 the ECB followed through with its much criticized program to purchase sovereign bonds of troubled nation states worth hundreds of billions of Euros, the issue of confidence or trust remains fundamental for the Eurozone and its financial system. Against this

[1] This article originates from research done in the interdisciplinary project “Genesis and Persistence of Trust in Banks” at the University of Hamburg. The authors gratefully acknowledge financial support by Deutsche Bundesbank, Regional Office in Hamburg, Mecklenburg-Western Pomerania and Schleswig-Holstein

background, the formation of the European Banking Union, formally adopted in April 2014, brought about and will bring far-reaching changes in supranational regulation and the corresponding institutional landscape. One essential element of these institutional adjustments was the launching of the Single Supervisory Mechanism (SSM) in November 2014, serving as a superior vantage point of control within the European financial system assigned to the ECB. To prepare for this task, the ECB conducted a comprehensive assessment of the biggest banks of the Eurozone, led by the objective to “(b)uild confidence by assuring all stakeholders that, on completion of the identified remedial actions, banks will be soundly capitalized” (European Central Bank 2014, 2). An integral element of this assessment was the most severe stress test in the European banking sector to date which differs explicitly from all previous orders of control established in the Eurozone.

In the light of these new regulations for the European banking system our goal is to show the meaning and the importance of institutional trust. Referring to the long-standing history of financial market regulation we will show that after the dramatic experiences of the recent trust meltdown a new and more extensive “second-order control” is needed to re-establish and maintain institutional orders of trust.

Taken as specific efforts to restore confidence and trust [2] within the European financial system, this article examines the introduction of these new measures of institutional control from a theoretical point of view in order to assess whether these modifications are rather of a purely formal or administrative nature or whether they really represent a *new quality of control* [3]. Hence, it is not about a forecast if these measures will finally prove to be successful. It turns away from the crystal ball and instead uses the tools of sociological theory for an analysis and theoretical framing of the control measures currently applied within the Eurozone.

The argument is presented in six sections. As the notion of confidence and trust is often used by politicians and the media in an ambiguous way and sometimes even appears as an intellectual quagmire for political practitioners (Metlay 1999) we show in section 2 that at least in social theory a clear distinction proved to be useful. Addressing financial trust as an instance of “trust in society” (Cook 2003), we further elaborate on the “level” that trust is regarded here: as a result of institutional constellations and impersonal relations – thus sticking to a sociological macro-perspective. Since restoring trust on an institutional level within the European financial system is necessarily bound to corresponding forms of control, section 3 analyses the notion of its institutional side as

[2] See chapter 2 for a more detailed and systematic distinction of these terms.

[3] We are indebted to two anonymous reviewers who *inter alia* suggested to not only argue in a theoretical context but to be more explicit with regard to the historic novelty of our observations.

well as associated pitfalls from a theoretical angle. Section 4 states why “guardians of impersonal trust” are needed in complex institutionalized markets and explains the indispensability of reflexive control. Section 5 provides an overview on important institutional changes that were part of the recent formation of the European Banking Union and that are necessary to understand the newly implemented control measures. It is argued that institutionalizing a new supervision in Europe’s financial market is a means of “reflexive control”. A concluding and somewhat ambivalent outlook on the stability of the financial sector is finally presented in section 6.

2. From Riskless Paradise to Financial Hell: On Risk, Trust and Confidence

The primary function of financial markets is to serve the economy by settling financial needs within variable time frames for different states of the world. Therefore, financial markets can be classified as a “second order economy” (Knorr Cetina 2007, 5) that deals with (complex) credit-contracts instead of physical consumer goods; to be more precise: they are constituted by a particular kind of good – promises to pay (Baecker 2008; Knorr Cetina 2010). Hence, participating in this “promise business” immediately leads to the question if a prospective future payment might be omitted. In other words: “lenders have to decide if they trust the borrower’s promise.” (Carruthers/Kim 2011, 240)

Thus, trust in finance plays an outstanding part. As mentioned beforehand, certain preferences in the use of the terms “confidence” and “trust” can be identified with regard to the media coverage and the academic discussion of the financial crisis. Nevertheless, the utilization remains vague and interchangeably. [4] To the contrary, Luhmann (1988) suggests a theoretical outline to differentiate between confidence and trust. In his view, trust is bound to a decision that is risky; it is, so to say, a “risky advance” (Luhmann 2000, 27; own translation) [5]. To trust means to consciously choose one action over the other while being aware that this decision may result in a bad outcome and thus in regret (Luhmann 1988, 97f.). Consequently, it means to transform a profound insecurity into an actual risk, which is still more convenient than being lost in the void of unspecified uncertainty and unlimited possibilities (Bachmann 2006, 395). In other words: risk is the essential flipside of trust – no risk, no trust. But what if such risk no longer exists? Regarding the situation preceding

[4] Correspondent presuppositions lack persuasiveness. Turning to economics, Richard Swedberg (2012) identifies the tendency “to either use the term ‘confidence’ and cast it as a psychological and non-rational phenomenon, or to use the term ‘trust’ and see it in more structural and rational terms” (536). However, the frequent use of “confidence” in the coverage of the media and the statements of officials points in a different direction. It detaches from psychological phenomena and instead refers to “structural” or social qualities.

[5] Though we do not argue from a systems theory perspective in this article we adopt Luhmann’s clear and convincing conceptuality of confidence and trust.

the outbreak of the financial crisis, the later much criticized financial instruments conveyed exactly such a riskless state. The corresponding “Confessions of a Risk Manager” read as follows: “In January 2007 the world looked almost riskless. [...] We were paid to think about the downsides but it was hard to see where the problems would come from” (Economist 2008). They virtually perverted the economic idea of the calculability of risk by the suggestion of being able to eliminate all remaining risk by ever more complex calculations and elaborate forms of insuring against possible losses. As is well known now, they proved wrong. While the door to paradise remains locked by the word risk (Luhmann 1991, 26; von Lüde 2012), this only seemingly risk-free heaven eventually pushed open the doors to financial hell.

As opposed to trust, confidence means the absence of considering alternatives. Put differently, it is about leaving the house every morning without considering taking a weapon (Luhmann 1988, 97). Confidence thus appeals to universal expectations that are necessary to avoid a state of permanent uncertainty – but which may very well be disappointed, too (ibid.). This became clear in October 2008, when Ben Bernanke famously legitimized his bailout package for the banking sector worth hundreds of billions of dollars by remarking that “[i]f we don’t do this, we may not have an economy on Monday”. (NYT 2008) Hence, it is evident that reading of the term confidence – bound to an everyday assumption like “having an economy on Monday” – also plays an essential part in structuring the cohesion of finance and society in general. Yet in the (financial) media as well as in the statements of politicians a distinct differentiation of trust and confidence does not take place. As both terms are often used synonymously we decided to use them both in our title despite their theoretical differences.

As from a sociological perspective financial systems represent *institutional constellations* that consist of financial intermediaries – especially banks transmitting capital flow – and regulating organizations such as central banks, we have to explain how trust is embedded on an institutional level. Obviously, these institutional constellations account for corresponding perceptions of risk and thus catalyze forms of “institutionalized” trust. Not only has sociological theory recognized the importance of this kind of trust as an essential feature of the efficiency of modern organization (Arrow 1974) or as a cultural factor in obtaining economic prosperity (Fukuyama 1995). It has also elaborated on how to differentiate between personal trust and system (Luhmann 2000) or institutional trust as two concepts of significant relevance to comprehend of how trust eroded during the

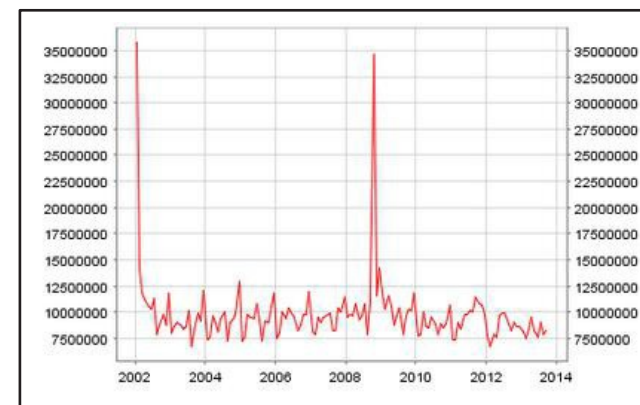
financial crisis. Moreover, this insight offers a way for better understanding the attempt of restoring institutional trust by higher order of control.

Looking back to the financial crisis at least two prominent types of loss of trust can be identified and even measured. First, it is mainly the trust on the part of private households which acts as a precondition for the proper functioning of the financial sector. How dramatic and system-threatening a situation of declining trust can be could be observed in October 2008. Shortly after Lehman Brothers filed for bankruptcy, prompting a worldwide financial panic, a trust meltdown towards the banking system could be observed within the Eurozone, initially only visible for insiders especially in central banks. Bank clients no longer trusted their banks and withdrew their money resulting in an exploding demand for 500 Euro bills over night as shown in Fig. 1 as a “distrust indicator”.

Obviously alarmed by the central bank and fearing a bank run on the following Monday the German chancellor Merkel and the minister of finance Steinbrück reassured the public on October 5 in a press conference, rapidly broadcasted on nearly all TV-stations, with a guaranty for their savings by the meanwhile famous promise that all German deposits “are safe”. Though the government guarantee for deposits lacked any legal basis and could not have been redeemed in the extreme case of a currencies collapse at least in Germany it restored trust with the consequence that savers stopped hoarding their money under their mattresses and brought it back to the banks. Yet it still took nine month before the German central bank dared to lift the veil and informed the public about these dramatic October events (Deutsche Bundesbank 2009, 57).

Second, the collapse of the interbank market is another prominent example for a trust meltdown. As these markets are among the most important in the financial system their malfunctioning is a thread to the money market and may affect the whole economy (Allen et.al 2009, 639). Though the Euro money market was the financial market segment which achieved the fastest and most complete integration after the start of the monetary union, it was also the market in which the crisis was felt immediately. This happened in 2007/2008 when banks stopped lending to each other without securities. As interbank markets are vulnerable to the perception of counterparty, the collapse of Lehman Brothers led to deterioration in market trust and “transformed the money market tensions into a full-blown crisis, as a vicious circle of increased liquidity demand and counterparty risk brought interbank trading to a virtual standstill” (ECB 2012, 66).

Fig.1: ‘Distrust Indicator’: Issued Number of Banknotes – 500 Euro Bills, Thousands of Euro



Source: ECB, Banknotes statistics, Series Key, BKN.M.U2. IS10.B.50P2.AS.F.E

3. Maintaining Confidence and Trust without Control?

Seen from the theoretical perspective as explained earlier the first example corresponds to a dramatic loss of *confidence*. Within an advanced economy households usually have no choice than being confident towards their banking system to avoid the above mentioned state of permanent uncertainty. Without a bank account it is nearly impossible to get accommodation and work (and vice versa). Nevertheless, people know from history that a single bank or even a whole banking and /or currency system may collapse.

The second example, conversely, refers to *trust*, with banks as better informed institutional actors within the money market and alternative means of decision making possibilities. In “normal times” banks do rely on the trustworthiness of other banks and entrust their excess liquidity by overnight lending thus contributing to a functioning money market. In times of crisis, however, such a decision becomes a “too risky advance” and even though it is less profitable most counterparties prefer the safe haven of the central bank [6]. So banks do have a choice while households have to be confident that there will still be a banking system tomorrow. Both aspects, the malfunctioning of the money market with its severe consequences for the whole economy as well as the “no choice option” of private households, indicate the need for institutions that guarantee for trust and confidence on an institutional level.

But how do trust and confidence emerge on this level and are adequately maintained? While personal trust is bound to individual attributes building on reputation and learned in recurrent interactions, system trust, to the contrary, is guaranteed by institutional constellations (Luhmann 2000, 64). It thus plays a pivotal role for the development of advanced financial systems based on complex and anonymous entanglements of promises to pay. For the consideration of maintaining and restoring trust on this institutional level of modern finance the question for adequate measures arises.

A still valid answer is offered by Zucker’s (1986) classical study of the role that different forms of trust adopted in the historical transformation of North American Society between the 19th and 20th century. Institutional-based trust is the consequence of the establishment of formal rules and their surveillance by bureaucratic organization or intermediaries. It consequently derives from and develops within certain institutional constellations. A vivid example of how (financial) trust derives from institutional constellations is found within the German banking sector, where historical cooperative

[6] “A large volume of excess liquidity is a reflection of market segmentation, with banks preferring to park their excess liquidity with the central bank (at a loss), rather than exchange it in the market at more favourable rates” (ECB 2012, 54).

banking associations and the joint liability schemes of savings banks arguably promote the persistence of trust in banks (Gröbl/von Lüde/Fleck 2013). Like system trust (Luhmann), it is instantly available and “generalizes beyond a given transaction and beyond specific sets of exchange partners” (63). In order to generalize beyond single interactions and become part of a “world known in common” (ibid.), institutional-based trust relies on standardized legal contracts that arrange for similar experiences within identically repeated procedures. Thus, the institutionalization of trust-building capacities is essentially bound to social norms and judicial conditions that reduce risk by sanctioning deviant behavior (Bachmann 2006, 396). [7] From a historical point of view, it is precisely this mode of trust-production that became increasingly important as a social cohesive of North American society approaching the 20th century. Being confronted with the disrupting forces of internal migration, high immigration rates, and growing economic uncertainties at that time, the social world taken for granted increasingly disintegrated and with it the foundation of interpersonal trust. This, in turn, was compensated by the production of institutional-based trust, accompanied by the emergence of a respective market (55). In order to address the erosion and (possible) re-storing of trust and confidence during and in the aftermath of the financial crisis, it is the level of *institutional(-based) trust* and its supervision by control agencies that best suits our argument. The next step then is to consider possibilities to inspire this kind of trust by adequate measures of risk-reduction, i.e. control.

[7] In her analysis of the financial crisis, Herzog (2013) speaks of “Rechtsvertrauen”, which can thus be addressed as an instance of institutional(-based) trust.

4. The Tortoise and the Hare: Guardians of Impersonal Trust and the Indispensability of Reflexive Control

Taking a closer look at the conditions of how institutional trust is fostered by corresponding measures of control, so-called “guardians of impersonal trust” (Shapiro 1987) are important institutional actors. Focusing on anonymous principal-agent relationships, these guardians act as a “supporting social-control framework of procedural norms, organizational forms, and social-control specialists” (635). Essentially, Shapiro’s argument offers a trust-related interpretation of the well-known principal-agent dilemma of agents with expert knowledge and superior information seeking their own advantage. However, as much as controlling institutions do guard impersonal trust, they may as well “lie, misrepresent the safety and security of their services, ignore misdeeds, steal, self-deal, accept

bribes, and overlook their own conflicts of interest“ (645). The downside of the capability to control hence is its potential for abuse. This observation of the late 1980s aptly fits the allegations brought forward more than two decades later in the wake of the financial crisis. The manifold incentives for misuse inherent in financial market regulation are a vital issue in the discussion of adequate institutional reform (Mayntz 2012, 7).

An outstanding example of this kind of “agency” surely is the extensive balance sheet manipulation conducted by Lehman Brothers, hiding toxic assets worth about 50 billion Dollars in the first and second quarter of 2008 (Valukas 2010). As a result, measures of control and options for its abuse blur and confuse the original goal of guarding; institutions of control simultaneously show self-perpetuating and self-defeating tendencies (Shapiro 1987, 653). Consequently, the alleged guardians of impersonal trust require superior forms of control themselves; they demand a higher order of trust (648). Like the hare’s foolish over-confidence in Aesop’s fable it is the image of a “spiraling evolution of procedural norms, structural constraints, and insurance-like arrangements, each building on the former“ (649) – that breeds the inherent irony that “the more we control the institution of trust, the more dissatisfied we will be with its offerings” (652). Despite this “vicious control circle” and the numerous and immediate complaints of “overregulation” that accompany every new institutional attempt of a more efficient control of financial markets, these circumstances call attention to the fact that the tortoise will already be there when the regulating hare is arriving. Present regulation always has to bear in mind that it is a competition between unequal contestants that has to be open to future modification.

The idea of a circular approach to control, a “control of control” or second-order control was coined and developed by Heinz von Foerster (1995) in the 1970s. In search of adequate measures of control for a global financial system still suffering from a crisis of historical dimensions, cybernetic notions like these may prove effective. They not only qualify by acknowledging that control is necessarily a circular endeavor but also account for the fact that in severe crises there are states of the world not sufficiently grasped by cause-effect relationships (Esposito 2011, 193). Consequently, these approaches implicitly reject the claim of a comprehensive control of the immense complexities of global capital flows – an impression still vital in the aftermath of the current crisis. On the other hand, insofar as to trust means to engage in a “risky advance” one could even argue that a *certain amount* of risk – and thus: lack of control – serves as a necessary prerequisite that trust is

still required. Still, the question remains how changes in regulation as well as corresponding institutional adjustments may shape the risk perception so that it seems acceptable. Against this background we will now present a short overview of measures of control recently introduced to stabilize the European banking sector and discuss these in the light of our theoretical findings on trust and confidence.

5. Institutionalizing a New Supervision in Europe's Financial Market as a Means of Reflexive Control

In reaction to the recent crisis, a range of different ideas and approaches for the control and stabilization of financial structures has been proposed, discussed, rejected, and finally ratified on both sides of the Atlantic. In the USA the Dodd-Frank Act, signed by President Obama in 2010, constitutes an extensively modified regulation regime and also a landmark in the attempt to restore confidence in the US financial sector. In Europe on the other hand, the crisis-reactions were rather slow. The institutional reforms of the banking sector, including the transfer of national responsibilities to the European level, no longer represent a frequently requested "radical" but instead demonstrate "incremental institutional change" (Mayntz 2012). Finally, the formation of the European Banking Union was formally acknowledged in April 2014. Some of the most important innovations encompass the launching of the Single Rulebook, a "unified regulatory framework for the EU financial sector" (EBA) including the reform measures of Basel III as mandatory guidelines. What is more, the Single Resolution Mechanism (European Commission 2014) contains rules for the orderly handling of insolvencies of financial institutions. A further measure to increase confidence is the insurance of deposits of European savers up to 100 000 Euros, accompanied by the adoption of the bail-in principle as a reaction to the much criticized bail-outs during the recent crisis. From now on, creditors and shareholders of a financial institution are held responsible in the case of its failing. This not only aims at altering the recently reinforced expectation that the state will finally act as a lender of last resort. It also creates incentives for an additional surveillance by investors and owners themselves with respect to the potential risk of "their" institution. The overall goal is thus to calm private investors and eventually guide their risk perception concerning future investment-decisions. [8]

[8] This also points to a micro-sociological perspective on trust. In the case of Germany, risk aversion represents a distinct feature of private investment behavior. It guides decisions by acting as some kind of unconscious cultural heritage (von Lüde 2012; von Lüde/von Scheve 2012).

However, the European Banking Union not only comprises extensive reform in regulation. It also establishes higher-order observation and control on a supranational level. Regarding the corresponding institutional changes, this manifests in the foundation of the European System of Financial Supervision (ESFS) in September 2010 and the introduction of three specialized European Supervisory Authorities (ESAs) in 2011, namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), further accompanied by the adoption of the European Systemic Risk Board (ESRB). These institutional innovations were in turn complemented by launching the Single Supervisory Mechanism (SSM) in November 2014, assigning additional supervisory power to the European Central Bank. [9]

From a theoretical angle, this rearrangement of the European institutional landscape corresponds to the introduction of new “guardians of impersonal trust” (Shapiro), serving the purpose of an “enhanced and harmonized financial supervision within the EU Single Market” (BaFin 2014). At the same time, a shift within the approach to control systemic risk on a European scale is evident. Formerly, national banking supervision relied on the assumption that the approved solvency of its single banks in sum would also guarantee for the stability of the banking system as a whole. We interpret this especially micro-prudential supervision as a *first-order control*, because systemic risks were at least undervalued or underestimated. The German central bank comes to the same conclusion in its monthly report as of March 2015: Because the micro-prudential supervision neglects the repercussions of developments at the level of individual institutions on the entire financial system, it cannot guarantee for the stability of the whole system alone (Deutsche Bundesbank 2015, 46).

Accordingly, the problem of systemic risk was neglected in terms of overall supranational effects. This approach then became gradually substituted by the acknowledgement of substantial macroprudential supervision on a European scale. The previous constellation of institutions is complemented on a supranational level, consequently enforcing standards of systemic risk-protection within a position of superior supervision. We can thus identify an instance of reflexive or second-order control (Fleck/von Lüde 2015).

Additionally, this means of control puts into practice a special kind of observation. In times of increased insecurity banks assess potential risk mainly by observing and thus relying on what the other banks “think” (Luhmann 1991). It is precisely this mode of financial second-order observation

[9] Initially, the ESFS was conceived as a combination of macroprudential supervision by the ESRB on a European level as well as additional micro-prudential supervision of financial institutions by national authorities (BaFin 2014). However, this division of supervisory labor displayed significant shortcomings during the pertaining European debt crisis (notably the Cypriot economic crisis in 2012). As a result, the Single Supervisory Mechanism (SSM) was introduced, following the idea of a “uniform supervisory scheme” that comprises the biggest banks of the Eurozone (ibid.).

that is difficult to control, because the reference to the initial objects of observation is lost (Esposito 2013, 3). Referring to the SSM, this is counteracted by a kind of superior supervision that not only “overlooks” the second-order observations of the financial institutions, but that also investigates the reliability of banks by referring to their capital base, thus realizing a direct, object-bound first-order observation (9). Still, it is a privileged point of observation whose introduction increases complexity within the financial system. In practice, this increased complexity may result in tangible consequences and annoy the risk management departments of banks in terms of new obligations to fulfill. From a theoretical perspective, increased complexity nevertheless is the key to all problems that contain more than one solution (Baecker 1999, 33) – and also for “second-order dangers” (Holzer/Millo 2005) typically arising in financial markets as a result of the widespread utilization of financial instruments that promote a misleading perception of a seemingly perfectly rational and risk-free future.

In preparation to launching the Single Supervisory Mechanism in November 2014, the ECB conducted a comprehensive assessment of the biggest 130 banks from 19 participating countries of the Eurozone, including some voluntary participants from the outside as well, covering around 80 percent of total SSM banking assets. The assessment comprised of two essential steps of evaluation. At first, an asset quality review (AQR) performed an extensive assessment of the accuracy of the carrying value of the respective banks assets. Intended as a bank-related “thorough health check” (ECB, 2), the asset quality review also served as a preliminary for the associated stress test that in turn represented a “forward-looking examination of the resilience of banks’ solvency to two hypothetical scenarios” (3). These macroeconomic scenarios, a baseline scenario and an adverse scenario respectively, projected different economic developments covering a time horizon of three years up to 2016. While the baseline scenario meant to reflect the most plausible scenario and thus extended the European Commission winter forecast (37), the adverse scenario **[10]** captured the prevailing view of current risks facing the European financial system, as identified by the European Systemic Risk Board.

Regarding the targeted capitalization rate, the banks were required to maintain a minimum capital ratio of 8 percent for the baseline scenario while the adverse scenario required a minimum ratio of 5.5 percent (3, 33). After comparing the projected solvency ratios against these defined thresholds, the comprehensive assessment identified an overall capital shortfall of about 25 billion Euros across

[10] The economic development of the adverse scenario manifest itself in an average “deviation of euro area GDP from its baseline level by -1.9% in 2014, -5.1% in 2015, and -6.6% in 2016. The euro area unemployment is higher than its baseline level, by 0.3 percentage points in 2014, by 1.2 percentage points in 2015, and by 2.2 percentage points in 2016” (ECB 2014, 37). Under the adverse scenario, the banks’ aggregate available capital was projected to be depleted by about 220 billion Euros or 22 percent of the capital held by the participating banks while their risk weighted assets were projected to increase by about 860 billion Euros by 2016 (5f.).

the 25 participating banks (6). This capital shortfall has to be regarded in context of capital already raised by the participating banks. Since the beginning of the global crisis in 2008 the participating banks already raised capital in excess of 200 billion Euros until 2014. Since then, another 60 billion have been raised but were not considered within the results of the comprehensive assessment (ECB 2014, 8). Here, if not before, it becomes clear that the new rules already had significant influence on the behavior and expectations of the European banks.

6. Conclusion: The Future Financial Stability is Safe, or is it?

Focusing on two of the essential dimensions that constitute the coordinate system of finance, the crisis of 2008 can be interpreted as “an implosion of the future and of trust” (Esposito 2011, 6). This erosion of institutional trust and financial confidence was the result of an outlook into a future that confronts all possible actions with absolutized risk. To restore trust and confidence and to prepare for its new supervisory duties, far-reaching institutional adjustments were conducted on a European scale aiming at the improvement of the financial resources of banks compared to the status quo ante and thus guaranteeing for the stability of the future financial system.

Taking a closer look at these new structures for the control of financial risk, it is clear that prior to the crisis the focus was on micro-prudential supervision, based on the conviction that the respective stability of each single bank would also guarantee the stability of the whole banking system. We interpret this especially micro-prudential supervision as a *first-order control*, because systemic risks were at least undervalued or underestimated. The introduction of a *reflexive control structure* on an institutional level can be seen as the specific outcome of the new mechanisms adopted within the EU. We called this new macro-prudential supervision and the accompanying creation of new “guardians of impersonal trust” – like the EBA and ESRB – a *second-order control*, as henceforth the control focus is on systemic risks that each individual bank would not reflect because of their own considerations of manageable and calculable risk levels.

The results of the stress test, as far as they are known until spring 2015, have also shown that financial intermediaries like the largest German private bank react in advance to the control with even massive and expensive capital measures for their shareholders. As banks try to omit failing in the stress test it is evident that the new demanding control mechanisms already yield announcement

effects. Advanced control structures therefore include concomitant change in expectations which already contribute to stabilize the system. As it is one of the explicit goals of the Banking Union (and the Dodd-Frank Act) to release the state of its role of lender of last resort and to shift the default risks to creditors and owners, those will have a significantly increased self-interest that their bank and thus their own capital is better protected against any potential risks.

Still, it remains unclear if these new institutional measures of control will prove to be successful in restoring trust and confidence within the European financial system. We should not have any illusions: Even anticipatory systemic control strategies do not guarantee to fully detect second order dangers. This is due to the fact that the replication of perfectly rational and effective security strategies of single actors can cause a number of aggregate effects that undermine their own (safety) assumptions (Holzer/Millo 2005) thus exposing market actors to the reflexive and cumulative effects of their own actions as well as to the activities of others.

And not to forget: Even though the stability of the banking sector is a significant part of the money market the OTC transactions are far less controlled although the transactions are of a size and complexity that hugely exceeds the latter. In an article in the Financial Times on 16 March 2015 the swap market alone was estimated at \$700tn. "It's more expensive to trade [than before the financial crisis] but I'm still trading the way I was in September 2008. I don't think anything has changed," said the global head of trading at a US investment company with nearly \$300bn of assets under management (FT 2015).

Timothy Geithner, witnessing the global crisis as the president of the Federal Reserve Bank of New York and as the U.S. Secretary of the Treasury respectively, is well aware of not forgetting about the unexpected. Commenting on recent modifications in US financial regulation he declares: "You can design a system, and I think we have, that allows you to be indifferent in most states of the world: the five-year flood, the 15-year flood, the 30-year flood, maybe even the 50-year flood. [...] But there are constellations of storms, of panics, of fires that are so bad that it's very hard to imagine that you could be indifferent to the failure of the financial system" (NYTM 2014). Given these warnings even the new measures of control and corresponding guardians of impersonal trust may be swept away and we can, broadly referring to the mythology of political theory (introduced by Thomas Hobbes), witness just another case of a finance-driven version of the everlasting struggle between a Leviathan being not able to control the potentially chaotic tendencies Behemoth stands for.

While we refrain from the task of prediction here, Robert K. Merton nonetheless offers a highly optimistic perspective. Elaborating on his idea of the Self-Fulfilling Prophecy, he addresses the institutional adjustments undertaken in the wake of the Great Depression. Following Merton, they resulted in an immediate halt of the countless insolvencies of banks at that time and were able to calm private investors: “Perhaps money panics have not been institutionally exorcized by legislation. Nevertheless, millions of depositors no longer have occasion to give way to panic-motivated runs on banks simply because deliberate institutional change has removed the grounds for panic” (Merton 1968, 489).

At least, theoretical considerations offer a less optimistic outlook. While trust can immediately turn into distrust or even “suggests” to distrust itself, to regain trust can only be achieved gradually; it resembles a cumbersome way uphill towards a more complex social order (Luhmann 1984, 180; own translation). Even though the warranty for savers in Germany had such a soothing effect, just like Merton has described it for the Great Recession, given Geithners gloomy forecast of storms, fires and panics it only remains a matter of time until the next financial crisis will happen.

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