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# European Central Banking Law

## The Role of the European Central Bank and National Central Banks under European Law

Christos V. Gortsos

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*To Stuart Robinson,*
*My mentor and good friend*

# Preface

A. The present book, completed on 31 August 2019, aims to provide a comprehensive overview of European—more specifically, European Union (EU)—central banking law, a field of EU economic law which emerged in the late 1990s and has developed rapidly ever since. Sourced in both primary and secondary EU law (viz. the EU Treaties and the legal acts adopted, on the basis thereof, by EU institutions), European central banking law pertains to the rules (that form part of this EU law) governing the functions, operation, tasks and powers of the European Central Bank (ECB) and the national central banks (NCBs) of EU Member States, mostly, in the euro area. It is outside the scope of this book to discuss NCBs from the perspective of the (relevant) national rules of the Member States where they are established.

The ultimate objective is to systematically present and analyse, on the basis of a functional approach, the role of the ECB as a monetary and banking supervisory authority in the euro area. The rationale is that, although the ECB assumed responsibility for monetary policy in 1999, since 2014—as a by-product of the (ongoing) fiscal crisis in the euro area—it has also been assigned quite significant specific tasks in relation to the latter capacity. In the meantime, in the wake of the recent (2007–2009) international financial crisis, specific tasks were conferred upon it in 2011 also in relation to the macro-prudential oversight of the EU financial system. In addition, the book highlights the ECB's significant role in relation to the resolution of credit institutions, even though it is not formally responsible for final decision-making in this area, as well as (conversely) its relatively limited (albeit still important) role in respect of last-resort lending to solvent EU

credit institutions exposed to liquidity risk (an unexpected outcome to those familiar with the traditional functions of central banks).

The related tasks and powers of the ECB are presented in the light of its interaction with NCBs, which retain significant powers, albeit to variable degrees, especially to the extent that, under national law, they are designated as national supervisory and/or resolution authorities in the banking sector. This is undertaken separately for each of the three systems [European System of Central Banks (ESCB), Eurosystem and European System of Financial Supervision (ESFS)] and the two mechanisms [Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM)] participated in by the ECB and the NCBs.

Even though this book contains some elements of interdisciplinarity (reviewing to a certain extent the relevant literature on monetary economics and financial regulation), it clearly refrains from an extensive analysis in terms of political economy, a feature of excellent studies in this broad field, several of which are referenced herein. This has been a conscious choice, which definitely has the disadvantage of missing interesting insights on the dynamics of European policymaking in the field. Nevertheless, it was deemed appropriate to focus on the rules governing European central banking law and to master its complex structure. As shown in this book, the amount of legal acts which constitute the sources of this branch of EU economic law is so vast that, despite the modest approach opted for, a much lengthier study would be produced if the analysis were to be fully exhaustive in its detail (even though I trust it is complete).

B. The book is structured in four parts, containing 11 chapters:

Part I, entitled “Definition and Evolution of European Central Banking Law”, contains four chapters:

Chapter 1 briefly discusses the functions of central banks in today’s economies (Sect. 1.1) and then provides a definition of the key notion of this book (European central banking law) on the basis of the functions performed by the ECB and the NCBs (Sect. 1.2);

the subsequent Chaps. 2–4 focus on the historical evolution and the gradual development of European central banking law, by presenting the establishment of the ESCB and of the Eurosystem, the establishment of the ESFS and the establishment of the (European) Banking Union, respectively.

Part II, entitled "Institutional Architecture", is structured in two chapters:

Chapter 5 discusses the institutional aspects governing the systems and mechanisms participated in by the ECB and the NCBs, namely the ESCB/Eurosystem, the SSM, the SRM and the ESFS (Sects. 5.1–5.4, respectively);
the institutional aspects of the ECB are then discussed in particular (and in relatively more detail) in Chap. 6.

Part III, entitled "Tasks and Competences of the European Central Bank (ECB)", contains three chapters:

Chapter 7 presents the legal framework governing the single monetary policy (Sect. 7.1) and the other basic tasks of the ECB within the Eurosystem under the Treaty on the Functioning of the European Union (TFEU) (Sect. 7.2), as well as the powers of the ECB in relation to the issuance of banknotes and coins denominated in euro (Sect. 7.3);
Chap. 8 focuses on the specific (supervisory) tasks of the ECB and its cooperation with national competent authorities in the context of the SSM; and
Chap. 9 elaborates on the other specific tasks and competences of the ECB on financial stability and, in particular, its specific tasks on the macro-prudential oversight of the EU financial system in the context of the European Systemic Risk Board (a pillar of the ESFS, Sect. 9.1), its competences in the context of the SRM in relation to the resolution of credit institutions (Sect. 9.2) and, finally, its role on the 'Emergency Liquidity Assistance' mechanism in relation to last-resort lending (Sect. 9.3).

Finally, Part IV, entitled "Conclusion", contains the concluding remarks (Chap. 10) and my own assessments and proposals (Chap. 11).

C. All primary sources are duly referenced in the main text; a list thereof at the end, albeit practical for the reader, was deemed too vast; it was thus decided not to include such a list in the Annex. On the other hand, the book contains an extensive list of the secondary sources, by chapter, all of which are (mainly) referenced in the footnotes.

D. The book has benefited from comments by a great number of colleagues over an extended period of time, as well as from remarks by the

most demanding of audiences, my students (both in Greece and abroad), all of whom I want to thank collectively, but most cordially. It has also greatly benefited from my stay as Academic Visitor at Oxford University's St Antony's College in 2018, where I was affiliated to the Political Economy of Financial Markets (PEFM) Research Center and had the opportunity to conduct part of my research. In this respect, I especially wish to thank my esteemed colleagues Othon Anastasakis and Kalypso Nikolaidis.

Special thanks are extended to Christina Livada not only for her particularly useful remarks and suggestions on the manuscript, but mainly for overall continuous and great support. I also wish to warmly thank Seraina Grüenewald, Christos Hadjiemmanuil and René Repassi for their very valuable comments and remarks, Katerina Lagaria for her own very useful comments and the outstanding editing of my texts, yet again, as well as Athina Papadatou for her valuable administrative support. Any errors or omissions are my sole responsibility.

Last, but not least, special thanks are extended to my publisher, Palgrave Macmillan, for including this book in its series of "Studies in Banking and Financial Institutions", as well as to the Assistant Editor for Finance, Lucy Kidwell, for the excellent cooperation.

E. This book is dedicated to Professor Stuart Robinson, my PhD supervisor at the Graduate Institute of International Studies in the University of Geneva, back in the 1990s, and now a great friend. He was the first who introduced me to the extremely interesting field of central banking law and navigated me safely, in his own unique way, throughout my academic life.

Athens, Greece
August 2019

Christos V. Gortsos

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# Abbreviations

| | |
|---|---|
| €STR | Euro Short-Term Rate |
| ABoR | Administrative Board of Review |
| ABSPP | Asset-Backed Securities Purchase Programme |
| ABSs | Asset-Backed Securities |
| ACPR | Autorité de Contrôle Prudentiel et de Resolution |
| AEUV | Vertrag über die Arbeitsweise der Europäischen Union |
| AIF | Alternative Investment Fund |
| AIFMD | Alternative Investment Fund Managers Directive (2011/61/EU) |
| AIFMs | Alternative Investment Fund Managers |
| AL | Aggregated Liquidity |
| AML | Anti-Money Laundering |
| APPs | Asset Purchase Programmes |
| ASI | Ancillary Systems Interface |
| BaFin | BundesAnstalt für Finanzdienstleistungsaufsicht |
| BCBS | Basel Committee on Banking Supervision |
| BIC | Bank Identifier Code |
| BIS | Bank for International Settlements |
| BoE | Bank of England |
| BRRD II | Bank Recovery and Resolution Directive No II (2019/879) |
| BRRD | Bank Recovery and Resolution Directive (2014/59/EU) |
| BSC | Banking Supervision Committee |
| BU | Banking Union |
| CAI | Consolidated Account Information (Mode) |
| CBPP | Covered Bond Purchase Programme |
| CBs | Central Banks |
| CCPs | Central Counter Parties |
| CEBS | Committee of European Banking Supervisors |

| | |
|---|---|
| CEIOPS | Committee of European Insurance and Occupational Pensions Supervisors |
| CEMAC | Communauté Economique et Monétaire de l'Afrique Centrale |
| CESR | Committee of European Securities Regulators |
| CET1 | Common Equity Tier 1 |
| CFP | Colonies Françaises du Pacifique |
| CGFS | Committee on the Global Financial System |
| CIS | Conference of Insurance Supervisors |
| CIWUD | Credit Institutions Winding Up Directive (2001/24/EC) |
| CJEC | Court of Justice of the European Community |
| CJEU | Court of Justice of the European Union |
| CMGs | Crisis management groups |
| CMU | Capital Markets Union |
| COFRA | Cooperation Framework Agreement |
| CP | Commercial Paper |
| CPMI | Committee on Payments and Markets Infrastructures |
| CPSS | Committee on Payment and Settlement Systems |
| CRD I | Capital Requirements Directives No I (2006/48/EC and 2006/49/EC) |
| CRD IV | Capital Requirements Directive No IV (2013/36/EU) |
| CRD V | Capital Requirements Directive No V (2019/878) |
| CRR II | Capital Requirements Regulation No II (2019/876) |
| CRR | Capital Requirements Regulation (575/2013) |
| CSDs | Central Securities Depositories |
| CSPP | Corporate Sector Purchase Programme |
| CSSF | Commission de Surveillance du Secteur Financier |
| DGS | Deposit Guarantee Scheme |
| DGSD | Deposit Guarantee Schemes Directive (2014/49/EU) |
| DIF | Deposit Insurance Fund |
| DNB | De Nederlandsche Bank |
| DRI | Direct Recapitalisation Instrument |
| EAD | Exposure at Default |
| EBA | European Banking Authority |
| EBC | European Banking Committee |
| EBI | European Banking Institute |
| EBRD | European Bank for Reconstruction and Development |
| EBU | European Banking Union |
| EC | European Community |
| ECAF | Eurosystem credit assessment framework |
| ECB | European Central Bank |
| ECCB | Eastern Caribbean Central Bank |
| ECCU | Eastern Caribbean Currency Union |

| | |
|---|---|
| ECJ | European Court of Justice (Court of Justice of the European Union) |
| ECLI | European Case Law Identifier |
| ECOFIN | Economic and Financial Affairs Council |
| ECON | Economic and Monetary Affairs Committee (European Parliament) |
| ECOWAS | Economic Community of West African States |
| ECU | European Currency Unit |
| EDIRA | European Deposit Insurance and Resolution Authority |
| EDIS | European Deposit Insurance Scheme |
| EEA | European Economic Area |
| EEC | European Economic Community |
| EFC | Economic and Financial Committee |
| EFSF | European Financial Stability Facility |
| EFSM | European Financial Stabilisation Mechanism |
| EFTA | European Free Trade Association |
| EIB | European Investment Banking |
| EIOPA | European Insurance and Occupational Pensions Authority |
| EIOPC | European Insurance and Occupational Pensions Committee |
| ELA | Emergency Liquidity Assistance |
| EMCF | European Monetary Cooperation Fund |
| EMF | European Monetary Fund |
| EMI | European Monetary Institute |
| EMIR | European Market Infrastructure Regulation (648/2012) |
| EMS | European Monetary System |
| EMU | Economic and Monetary Union |
| EONIA | Euro OverNight Index Average |
| EP | European Parliament |
| ERL | Eurosystem Resolution Liquidity |
| ERM | Exchange Rate Mechanism |
| ESAs | European Supervisory Authorities |
| ESC | European Securities Committee |
| ESCB | European System of Central Banks |
| ESFS | European System of Financial Supervision |
| ESM | European Stability Mechanism |
| ESMA | European Securities and Markets Authority |
| ESRB | European Systemic Risk Board |
| EU | European Union |
| EUV | Vertrag über die Europäische Union |
| FCA | Financial Conduct Authority |
| FDIC | Federal Deposit Insurance Corporation |
| FESCO | Forum of the European Securities Commissions |

| | |
|---|---|
| FiCOD | Financial Conglomerates Directive (2002/87/EC) |
| FinTech | Financial Technology |
| FMA | Financial Market Authority |
| FMIs | Financial market infrastructures |
| FPC | Financial Policy Committee |
| FROB | Fondo de Restructuración Ordenada Bancaria (Spain) |
| FSAP | Financial Securities Action Plan |
| FSB | Financial Stability Board |
| GC | Governing Council |
| GdC | Groupe de Contact |
| GDP | Gross Domestic Product |
| GDPR | General Data Protection Regulation (2016/679) |
| GFSTs | Government Financial Stabilisation Tools |
| GHOS | Group of Central Bank Governors and Heads of Supervision |
| GLRA | Group Level Resolution Authority |
| GRC | GrundRechteCharta (Charta der Grundrechte der Europäischen Union) |
| G-SIB | Global Systemically Important Bank |
| G-SII | Global Systemically Important Institution |
| HICP | Harmonised Index of Consumer Prices |
| HL SSC | High Level Securities Supervisors Committee |
| IADI | International Association of Deposit Insurers |
| ICAAP | Internal Capital Adequacy Assessment Process |
| ICM | Information and Control Module |
| IFRS | International Financial Reporting Standard |
| ILAAP | Internal Liquidity Adequacy Assessment Process |
| IMF | International Monetary Fund |
| IOSCO | International Organization of Securities Commission |
| IPSs | Institutional Protection Schemes |
| ISD | Investment Services Directive (93/22/EEC) |
| ITSs | Implementing Technical Standards |
| JST | Joint Supervisory Team |
| LCR | Liquidity Coverage Ratio |
| LGD | Loss Given Default |
| LSI | Less Significant Institution |
| LTF | Legal Theory of Finance |
| LTROs | Longer-Term Refinancing Operations |
| MFIs | Monetary Financial Institutions |
| MIFID II | Markets in Financial Instruments Directive No II (2014/65/EU) |
| MMFs | Money Market Funds |
| MoU | Memorandum of Understanding |
| MREL | Minimum Requirement for (Own Funds and) Eligible Liabilities |

| | |
|---|---|
| MROs | Main Refinancing Operations |
| NCA | National Competent Authority |
| NCB | National Central Bank |
| NCWO | No Creditor Worse Off (Principle) |
| NDA | National Designated Authority |
| NPLs | Non-Performing Loans |
| NRA | National Resolution Authority |
| NSFR | Net Stable Funding Ratio |
| OCA | Optimum Currency Area |
| OECD | Organisation for Economic Co-operation and Development |
| OJ | Official Journal (of the European Union) |
| OLAF | Office de Lutte Anti-Fraude (European Anti-Fraud Office) |
| OMTs | Outright Monetary Transactions |
| O-SII | Other Systemically Important Institution |
| OTC | Over-The-Counter |
| PCIJ | Permanent Court of International Justice |
| PD | Probability of Default |
| PIA | Public Interest Assessment |
| PM | Payments Module |
| PRA | Prudential Regulation Authority |
| PSD II | Payment Systems Directive No II (2015/2366) |
| PSI | Private Sector Involvement |
| PSPP | Public Sector Purchase Programme |
| QE | Quantitative Easing |
| RTGS | Real-Time Gross Settlement |
| RTSs | Regulatory Technical Standards |
| RWAs | Risk-Weighted Assets |
| SBBSs | Sovereign Bond-Backed Securities |
| SCT Inst | SEPA Instant Credit Transfer (Scheme) |
| SDRs | Special Drawing Rights |
| SEPA | Single Euro Payments Area |
| SFTs | Securities Financing Transactions |
| SIFIs | Systemically Important Financial Institutions |
| SIPS | Systemically Important Payment Systems |
| SMEs | Small and Medium Enterprises |
| SMP | Securities Markets Programme |
| SPVs | Special Purpose Vehicles |
| SREP | Supervisory Review and Evaluation Process |
| SRF | Single Resolution Fund |
| SRM | Single Resolution Mechanism |
| SRMR II | Single Resolution Mechanism Regulation No II (2019/877) |
| SRMR | Single Resolution Mechanism Regulation (806/2014) |

| | |
|---|---|
| SRR | Special Resolution Regime |
| SSM | Single Supervisory Mechanism |
| SSMR | Single Supervisory Mechanism Regulation (1024/2013) |
| SSP | Single Shared Platform |
| SWD | Staff Working Document |
| T2S DCAs | T2S Dedicated Cash Accounts |
| T2S | TARGET2-Securities |
| TARGET | Trans-European Automated Real-Time Gross Settlement Express Transfer |
| TEC | Treaty Establishing the European Community |
| TEU | Treaty on European Union |
| TFEU | Treaty on the Functioning of the European Union |
| TIPS | TARGET Instant Payment Settlement |
| TIPS DCAs | TIPS Dedicated Cash Accounts |
| TLAC | Total Loss-Absorbing Capacity |
| TSCG | Treaty on Stability, Coordination and Governance |
| UCITS | Undertakings for Collective Investment in Transferable Securities |
| UEMOA | Union Economique et Monétaire Ouest-Africaine |
| UK | United Kingdom |

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# PART I

# Definition and Evolution of European Central Banking Law

CHAPTER 1

# The Functions of Central Banks and Definition of European Central Banking Law

## 1.1 An Overview of Central Banks' Functions

### *1.1.1 The Basic Concepts for the Analysis: Monetary System—Financial System—Payment and Settlement Systems*

*Introductory Remarks*

Central banking law is defined as the law governing the operation and competences of central banks. Central banks are public authorities, with legal personality under national law,[1] and play, in almost every jurisdiction, an extremely important role in relation to the functioning of several aspects of the economy and, in particular, to the monetary system and the financial system, including the latter's infrastructures, that is payment and settlement systems (all briefly presented just below).[2] In particular:

(1) In all cases (and traditionally), central banks have the legal monopoly (and *quasi de facto* monopoly as well) of issuing banknotes and controlling of the amount of coins in circulation produced by the government.

[1] This is not the case for the European Central Bank (the 'ECB'), the legal personality of which is based on supranational (European Union) law; see on this in Chap. 6, Sect. 6.1.2.

[2] The close links between the two systems is mainly (but not exclusively) attributable to the fact that deposits, the main source of bank financing, are concurrently the core component of money in the framework of the monetary system's operation. In this sense, the term financial system is frequently used (albeit not in this study) in a way which also covers the monetary system.

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They are also assigned the tasks of defining and implementing monetary policy in order to achieve specific, well-defined macroeconomic objectives (related but not identical is the provision of last-resort lending to solvent banks exposed to liquidity risk, which is linked to financial stability), as well as of conducting foreign exchange policy and holding, for that purpose, official foreign reserves (see Sect. 1.1.2). The contribution to financial stability and the smooth operation of payment and settlement systems, including their oversight, also rank among central banks' traditional functions. In (almost) all cases as well, but mainly after the recent (2007–2009) international (or global) financial crisis,[3] powers have been conferred upon central banks in relation to the so-called macro-prudential financial oversight as part of their contribution to financial stability (these aspects are presented in Sects. 1.1.3 and 1.1.4, respectively).

(2) In certain jurisdictions, central banks are also responsible for the authorisation and micro-prudential supervision of banks and, in some cases, of other categories of financial firms (mainly after the recent international financial crisis as well) their resolution (on this, see Sect. 1.1.3). The same applies to (specific) powers relating to the protection of consumers of financial services and the combatting of money laundering and terrorist financing through the banking/financial system (usually, not from a crime prevention perspective, but from a prudential one[4]). Finally, most recently, several central banks worldwide are responsible for the promotion of financial inclusion and financial literacy (see briefly under Sect. 1.1.5).[5]

*The Monetary System*

(1) The monetary system contains the unit of account of a state (with reference to its name and any applicable subdivisions thereof), and comprises, at an institutional level, a central bank (or similar 'monetary authority', as it is named for instance in Singapore and Saudi Arabia, or 'Reserve Bank' as it

[3] On this crisis, see Chap. 3, Sect. 3.1.2.

[4] On this aspect, see Chap. 8, Sect. 8.1.1.

[5] For a comparative overview of central banks' functions in a selected number of economically developed countries, see Central Bank Governance Group (2009), pp. 25–49 (in particular Table 2), and in more detail Central Bank Governance Group (2011). On the evolution of central banks, see also the seminal work of Goodhart (1988) and his most recent (2010). For several aspects of institutional central banking from a global point of view, see Hasan and Mester (2008) and various contributions in Conti-Brown and Lastra (2018); on the public governance of central banks, in particular, see Oritani (2010).

is called in the United States and India[6]), which enjoys the monopoly of issuing national banknotes (on the liability side of a central bank's balance sheet), controls the quantity of coins issued by the government (i.e. competent Ministry of Finance or corresponding ministry) and provides liquidity to credit institutions operating within its territory.[7]

(2) According to the 'State Theory of Money', a sovereign state is entitled to issue its own money (the money of the state) and create a (national) monetary system. This principle of 'monetary sovereignty' has been affirmed in international law. As noted, *inter alia*, by the Permanent Court of International Justice in the 1929 Serbian and Brazilian Loan Case, "it is indeed a generally accepted principle that a state is entitled to regulate its own currency."[8] In certain cases, small sovereign states have neither their own money nor a domestic monetary system. Even in the European continent, the examples are plenty: Monaco, Andora, San Marino, Liechtenstein or the Vatican State.[9] These states enter into bilateral monetary agreements with another state, according to the terms of which the money and the monetary system of the latter apply to the former as well. A distinct case is the formation of a monetary union among (usually, more or less equally sizeable) sovereign states, which decide to transfer their (national) monetary sovereignty to supranational entities issuing a single (or common) currency and operating a supranational, regional monetary system.[10]

*The Financial System*

(1) Unlike the monetary system, the content of which is straightforward (at least in terms of design), the financial system is more complicated, since it performs (at least in market economies) two functions through a complex nexus of markets and financial service providers in that system. In particular, the first function is channelling funds from the economy's positive savers to the negative savers (further discussed just below). The second function consists in enabling natural and legal persons to make payments without using cash, namely coins and banknotes; payment instruments and fund transfer services, through which this function is performed, are principally offered by banks and specialised payment institutions.[11]

[6] In some states, this function is assigned to Currency Boards; see Proctor (2012), pp. 871–876.

[7] See Proctor (2012), p. 66.

[8] PCIJ Series A, Nos. 20–21, 44.

[9] See on this also in Chap. 2, Sect. 2.4.3.

[10] This aspect, which is core to the subject of this book, is discussed in Sect. 1.2.2.

[11] See Stillhart (2002), pp. 105–121; on payments, see also further below when presenting payment and settlement systems.

(2) The first above-mentioned function of financial systems is performed via two channels: direct financing of negative savers by positive savers and indirect financing of negative savers by positive savers or financial intermediation.[12] The channel of 'direct financing' from positive to negative savers is activated through financial markets (also referred to as money and capital markets), where debt instruments and equities are issued and traded and derivatives are traded. Various categories of financial firms operate in direct financing, such as banks, to the extent that they are allowed by law to provide investment services, and 'securities firms' (or 'investment firms'), which are allowed by law to provide the entire range of investment services, including the execution of orders for the purchase or sale of financial instruments in the name, and on behalf, of their clients. 'Undertakings for collective investment in transferable securities' (the 'UCITS'; e.g. mutual funds and investment companies) also operate therein,[13] their managers having (in principle) the legal monopoly of providing financial instruments' portfolio management services on a collective basis (without being precluded from providing at least certain investment services on an individual basis as well).[14]

The second category of channelling funds from positive to negative savers is indirect financing or 'financial intermediation'. According to financial theory, this channel has emerged as a result of the (relatively high) cost of transactions in financial markets, the (relatively high) credit

[12] See, by way of mere indication, Mishkin (2007a), pp. 23–32 and 35–42, respectively. Over the past decade, a new type of funds' channelling has emerged, named 'crowdfunding'; this consists in getting a large number of natural and/or legal persons provide (relatively) small amounts of funds in order to finance a business or a project. Crowdfunding services are classified in two groups: 'crowdlending' and 'crowdinvesting; for a review of the relevant literature, see Baumann (2014) and Moritz and Block (2014).

[13] Despite being called undertakings for collective investment in transferable securities (viz. equities and bonds), these also make placements in financial derivative instruments.

[14] It is also worth noting that a type of investment vehicle, known as 'alternative investment funds' (the 'AIFs'), including 'hedge funds', has emerged over the last decades. Its operation has only recently, after the recent (2007–2009) international financial crisis, been subject to micro-prudential regulation and supervision, as a collective investment undertaking. This is an asset pool consisting of borrowed funds from (usually high-income) private and institutional investors, placed in various financial instruments, primarily derivatives, with a view to capitalising on the imperfections of the markets and operating at high leverage. With regard to the operation of hedge funds and the policy objective to regulate and supervise them as financial firms, see Garbaravicius and Dierick (2005), Chan et al. (2006), Ferguson et al. (2007), pp. 119–130 and Athanassiou (2012).

risk that investments in debt instruments and equities entail for positive savers ('risk sharing'), and information asymmetries arising in the relationship between positive and negative savers in the context of direct financing.[15] It is nonetheless true that in most financial systems indirect financing mainly through banks is more extensive than direct financing. This is true even in the United States and the United Kingdom, which are traditionally considered to have comparatively more advanced financial markets ('bank-based' vs 'market-based' systems).[16]

In order to address these problems, financial intermediaries[17] operate in the financial system. They (mainly) include banks, companies providing credit, as well as insurance (and reinsurance) companies and pension funds.[18] In the case of banking intermediation, positive savers offer their borrowed funds in the form of (bank) deposits,[19] which banks use in order to finance negative savers by providing loans and other credit facilities. In their capacity as financial intermediaries, banks perform a set of transformations: 'credit risk transformation': they assume the credit risk of the economic units they finance, transferring the risk of their own solvency to positive savers, 'size transformation': they convert liabilities of usually small nominal value (e.g. deposits) to large-value receivables (e.g. industrial loans), and 'maturity transformation': they convert short-term liabilities (e.g. sight deposits) into long-term receivables (e.g. housing loans). The ability of banks to make these transformations is concurrently the main cause of their (structural) exposure to credit risk,

[15] On this, see Mishkin (2007a), pp. 35–39 and 184–198. Specifically regarding the meaning of information asymmetry and the problems that it causes to transactions, see Rasmusen (1989), pp. 181–203 as to 'adverse selection', and pp. 133–179 as to 'moral hazard'.

[16] For more details, see Mishkin (2007a), p. 36.

[17] The term 'financial intermediaries' covers all categories of (financial) firms providing services in the financial system in the context of indirect intermediation; for a detailed presentation, see Allen and Santomero (1999), Allen (2001), Allen and Gale (2001) and Gorton and Winton (2002).

[18] The most characteristic (and in most states the larger) category of banks is 'commercial banks'. However, in various economies there are also special bank categories, such as cooperative, mortgage, development and savings banks. Such special banks (often called 'special credit organisations') are usually the outcome of the legislator's regulatory intervention, notably in developing or less developed economies.

[19] A deposit is not just a loan to the bank but also a consignment; the level of its interest rate is the best indicator of the aspect which prevails (obviously, all other parameters being equal, a comparatively higher interest rate reflects a bank's higher need to attract deposits).

interest rate income risk and liquidity risk, respectively, and, as a result, the main reason behind the need to manage these risks.[20] It is also the basis for their regulation, which is aimed at ensuring the stability of the banking system, which can be threatened due to excessive exposure to these risks.[21]

To the extent that credit intermediation is provided by non-bank unregulated entities, reference is made to the 'shadow banking system', defined as "credit intermediation involving entities and activities outside the regular banking system".[22] The Financial Stability Board (the 'FSB') defines the shadow banking system as "the system of credit intermediation that involves entities and activities outside the regular banking system".[23] In practice, shadow banking entities and activities raise funding with deposit-like characteristics, perform maturity or liquidity transformation, allow credit risk transfer or use direct or indirect leverage. Neutralising the riskiest parts of this system became a policy priority. According to the FSB Recommendations of 2011, the regulatory measures to be examined by authorities refer to five main aspects: the indirect regulation of banks' interaction with shadow banking entities, the regulatory reform of money market funds, the regulation of other shadow banking entities, such as hedge funds, the regulation of securitisation and the regulation of securities financing transactions, such as securities lending and repurchase agreements (repos).[24]

[20] In order to control their exposure to these risks, banks transfer part of their loans to special purpose vehicles (the 'SPVs') through 'asset securitisation' in the context of the 'originate and distribute' model. On the excessive extent to which several (typically large) banks used this practice, thus making it a major cause of the recent (2007–2009) international financial crisis, see Borio (2008), pp. 1–13.

[21] On the various banks' business models (such as investment banking, wholesale banking, focused retail banking and diversified retail banking), see Ayadi et al. (2012), Wehinger (2012) and the various contributions in de Haan and Bruinshhofd (2014, editors).

[22] On this, see indicatively (out of a vast existing literature) Gorton and Metrick (2010), Pozsar et al. (2010), Financial Stability Board (2011), Gerding (2011), Nijskens and Wagner (2011), Pozsar and Singh (2011), Adrian and Ashcraft (2012), Claessens et al. (2012), European Commission (2012), Kane (2014), Schwarcz (2015), Wymeersch (2017) and Alexander (2019), pp. 300–306.

[23] Financial Stability Board (2011): "Shadow Banking: Strengthening Oversight and Regulation, Recommendations", 27 October, Section 1, available at: https://www.financialstabilityboard.org/2011/10/r_111027a.

[24] Ibid., Sect. 3.2.

*Payment and Settlement Systems*

(1) 'Payment and settlement systems' are a main infrastructure of the financial system and are also of primary importance to the functioning of the monetary system (in particular, with regard to the settlement of monetary policy transactions). They include several, closely interlinked, components: payment, clearing and settlement systems, as well as securities clearing and settlement systems. In terms of definitions: a payment system is the set of instruments, services and procedures and systems that ensure the transfer of funds among its participants[25]; a clearing system is the set of procedures whereby system participants present and exchange data and/or documents relating to fund transfers to other participants at a single location, the 'clearinghouse', with a view to determining the beneficiaries of payments and the amount of each payment; and a settlement system is the system used to facilitate the settlement of funds transfers.[26] Securities clearing and settlement systems have two legs: the first is the set of procedures whereby system participants present and exchange data and/or documents relating to the transfer of securities to other participants in order to define their beneficiaries; the second leg is the set of means and procedures enabling the settlement of transactions in securities, by crediting securities to the end-beneficiaries' accounts, as well as the safekeeping of securities.[27]

[25] 'Funds transfer' means any transfer of funds conducted using all available payment instruments and order-based fund transfer services. Participants in payment systems are mostly banks (without excluding other categories of financial firms authorised to provide payment services); hence, payment systems are usually 'interbank'.

[26] See Committee on Payment and Settlement Systems (2003a): "A glossary of terms used in payments and settlement systems", Bank for International Settlements, March.

[27] See in detail Kokkola (2010), pp. 75–90 and 106–113 (for derivative financial instruments); see also Committee on Payment and Settlement Systems and IOSCO Technical Committee (2001): "Recommendations for securities settlement systems", Bank for International Settlements, November (available at: https://www.bis.org/publ/cpss46.htm), and Committee on Payment and Settlement Systems and IOSCO Technical Committee (2012): "Principles for financial markets infrastructures", Bank for International Settlements, April (available at: https://www.bis.org/publ/cpss101a.pdf). Even though most studies refer to securities clearing and settlement systems, clearing and settlement procedures also occur for derivatives, both in stock exchanges and in OTC markets (see Committee on Payment and Settlement Systems (2007): "New developments in clearing and settlement arrangements for OTC derivatives", Bank for International Settlements, March, available at: https://www.bis.org/publ/cpss77.htm).

(2) Payment systems are classified into several categories on the basis of various criteria.[28] An important distinction is made between 'systemically important payment systems' (such as large-value payment ones), that is systems in which the occurrence of a malfunction may potentially activate or spread additional malfunctions between participants or systemic malfunctions across the entire financial system,[29] and 'non-systemically important' ones, that is systems that do not have the above-mentioned potential; another is that between 'large-value' and 'small-value' payment systems (the latter also called 'retail payment systems'), on the basis of the value of funds transferred per transaction through them. As regards (clearing and) settlement systems, they are divided into two categories, depending on the manner in which the orders for the transfer of funds are to be settled: in 'net settlement systems', settlement operations are completed by offsetting and clearing all the participants' receivables at one or more discrete, predefined times during the processing day (settlement cycles)[30]; 'gross settlement systems' are those where settlement takes place separately for each payment, on an instruction-by-instruction basis, at one or more prescribed times during the processing day.[31] In the specific case of 'real-time gross settlement systems', settlement occurs not only separately for each and every payment, but also in real time and in the order that the relevant payment orders are given.[32] Such is the TARGET2 system (Trans-European Automated Real-time Gross settlement Express Transfer system) used, *inter alia*, to settle payments resulting from open market transactions in the context of implementing the single monetary policy in the euro area.[33]

[28] In addition, to these distinctions, depending on the payment instrument or service used to transfer funds, payment systems include cheque, credit transfer, direct debit, payment card and electronic money systems; depending on the netting of instructions therein, a distinction is made between bilateral and multilateral payment systems; see details in Committee on Payment and Settlement Systems (2006): "General guidance for national payment system development", Bank for International Settlements, January (available at: https://www.bis.org/publ/cpss70.htm).

[29] See Committee on Payment and Settlement Systems (2001): "Core Principles for Systemically Important Payment Systems", Bank for International Settlements, January, p. 5 (available at: https://www.bis.org/publ/cpss43.htm) and Committee on Payment and Settlement Systems and IOSCO Technical Committee (2012), op. cit., p. 12.

[30] See Committee on Payment and Settlement Systems (2003a), op. cit., p. 34.

[31] Ibid., p. 25.

[32] Ibid., p. 41 (see also Committee on Payment and Settlement Systems (1997): "Real-time Gross Settlement Systems", March, available at: https://www.bis.org/publ/cpss22.htm).

[33] This system is presented in more detail in Chap. 7, Sect. 7.2.4.

Finally, the above triple classification of clearing and settlement systems also applies to securities settlement systems. Their operational framework also includes a payments clearing and settlement system in view of the clearing and settlement of the part of the transaction that is relevant to the transfer of funds, whereby the monetary obligation generated by the purchase or sale of the securities is fulfilled and the bank accounts of the end-beneficiaries are credited with the amounts due from the transaction.

### *1.1.2 The Monetary Policy Function of Central Banks*

*'Conventional' Monetary Policy*

(1) Monetary policy encompasses all measures adopted by a central bank in order to influence the money supply, as well as, through the latter, certain financial variables (such as, for instance, loan interest rates of commercial banks), aiming at achieving specific economic policy objectives, and primarily safeguarding price stability in the economy.[34] In some states, nevertheless, the main objective of monetary policy does not only consist in maintaining price stability, but also (concurrently or secondarily) in achieving other macroeconomic goals, such as contributing to economic growth and development (thus also affecting labour market conditions).[35]

**Table 1.1** A simplified central bank balance sheet

| *Assets* | *Liabilities* |
|---|---|
| Gold | Banknotes in circulation |
| Claims on banks related to monetary policy operations ('lending facilities') | Liabilities to banks related to monetary policy operations ('deposit facility') |
| Securities issued by governments and non-financial corporates | Other liabilities |
| Other claims (in domestic or foreign currencies) | Revaluation reserves |
| Other assets | Capital and reserves |

[34] By way of mere indication, see in detail Bofinger (2001), pp. 127–161, Mishkin (2007b), Rossi (2008), pp. 217–300, as well as European Central Bank (2011a), pp. 55–62.

[35] For a comparative study of the various central bank objectives and mandates, see Central Bank Governance Group (2009), pp. 21–25 (summarised in Table 1 of that study).

(2) The definition and implementation of monetary policy is a key task of central banks conducted, in several jurisdictions, under conditions guaranteeing their independence *vis-à-vis* the political system. Safeguarding said independence is claimed to be necessary, since it constitutes the means for pursuing maintenance of price stability, allowing for definition and implementation of monetary policy without direct influence by the political system over a time period longer than the political cycle.[36]

(3) In order to implement monetary policy, central banks make use of several instruments. A key monetary policy instrument in today's economies is open market operations, which are aimed at influencing interest rates, controlling liquidity in the markets and signalling the path of monetary policy. These operations are executed upon central banks' initiative and under the conditions they set. In addition, central banks apply two standing facilities to grant and absorb liquidity to and from banks (and other eligible counterparties) outside working hours (marginal lending facility and deposit facility, respectively). Finally, they may impose on eligible counterparties an obligation to hold a percentage of their deposits in reserve with central bank accounts in order to stabilise money market rates.[37] In this respect, central banks determine specific criteria for the selection of the counterparties eligible for their monetary policy operations', as well as for the categories of assets eligible as collateral in the conduct of their credit transactions.[38]

*'Unconventional' Monetary Policy*

(1) Under the extraordinary circumstances arising from the need to bolster the banking (and, more generally, financial) system following the recent (2007–2009) international financial crisis [and, in the European

[36] On this aspect, see, by way of mere indication, Lastra (2018), with extensive further references. On the accountability and transparency of central banks' policies (established to compensate their independence), see the seminal work of Amtenbrink (1999), as well as Kaufmann and Weber (2018).

[37] On the theory and policy of monetary policy implementation before the recent international financial crisis in advanced economies, see, by way of indication, Bofinger (2001), pp. 321–368, Mishkin (2007b), pp. 161–252 and Disyatat (2008). The above-mentioned so-called conventional monetary policy instruments are discussed in more detail in Chap. 7, Sect. 7.1.2, in relation to the implementation of the single monetary policy in the euro area. For a simplified central bank balance sheet, which reflects the various monetary policy instruments, see Table 1.1.

[38] For more details on central bank collateral frameworks and practices as part of the implementation of monetary policy, see Markets Committee (2013).

context, the subsequent (and still ongoing) fiscal crisis in the euro area], central banks all over the world adjusted their monetary policy.[39] The onset of these crises showed that the key problem of concern was not the risk of inflation, but the exact opposite: low inflation or, even, negative inflation (deflation). The fact that price levels remained persistently below the benchmark set for price stability rendered necessary for central banks to have recourse to a 'balance sheet policy' (quantitative easing), containing 'unconventional' monetary policy instruments.[40]

(2) The target of the balance sheet policy is to directly affect broader financial conditions through central bank balance sheets and is opposed to the (traditional) 'interest rate policy' aimed at affecting short-term interest rates. It comprises four elements: credit policy, foreign exchange policy, *quasi* debt-management policy and bank reserves policy. The first category, 'credit policy', consists of two pillars:

The first pillar includes all the measures to influence interbank market conditions by means of the following instruments: drastic rate cuts,[41] prolongation of certain types of open market operations, broadening the scope of assets eligible as collateral, broadening the range of eligible counterparties, as well as introduction of inter-central bank foreign exchange swap lines and easing of conditions for securities lending.

The second pillar comprises 'asset purchase programmes' (the 'APPs'), namely programmes adopted to influence non-bank credit markets through the purchase of short-term certificates of deposit and relevant commercial paper, asset-backed securities (the 'ABSs') and longer term debt securities. In particular, APPs are aimed at directly affecting the price of the corporate and/or sovereign debt securities (bonds) through central bank operations recorded on their balance sheets.[42]

[39] See, on this, Borio and Nelson (2008), Committee on the Global Financial System (2008), and the various contributions in Bank of International Settlements (2011). It is also noted in this context that, in our days, after a prolonged period of persistently low interest rates (a 'liquidity trap' situation, which is expected to last even longer), a major policy challenge is to limit the financial excesses resulting from accommodative monetary policies, by managing the resulting negative financial impact, in order to avoid repeating one of the main causes of the recent (2007–2009) international financial crisis. On the causes and consequences of persistently low interest rates, see Bean et al. (2015), with extensive further references and Blanchard and Summers (2019), pp. xxviii–xxvi.

[40] On this, see Borio and Disyatat (2009), Caruana (2011), Durré and Pill (2012) and Bernanke (2019).

[41] This includes the setting of the interest rate on the deposit facility in negative territory.

[42] For an overview, see Table 1.2.

**Table 1.2** Target and typology of central bank balance sheet policies

| | |
|---|---|
| Target | Directly affect broader financial conditions through central bank balance sheets—in opposition to the interest rate policy (affecting short-term interest rates) |
| Categories | |
| 1. Foreign exchange policy | |
| 2. *Quasi* debt-management policy | |
| 3. Bank reserves policy | |
| 4. Credit policy | 4.1 Influence on interbank market conditions<br>Prolongation of open market operations<br>Broadening of eligible collateral<br>Broadening of counterparties<br>Inter-central bank foreign exchange swap lines<br>Introduction of easing of conditions for securities lending<br>4.2 Influence on non-bank credit market ('asset purchase programmes')<br>Purchase of short-term certificates of deposit and relevant commercial paper (CP)<br>Purchase of asset-backed securities (ABSs)<br>Purchase of longer term debt securities |

### *1.1.3 Financial Stability Function(s) of Central Banks*

*Introductory Remarks—The Components of the 'Bank Safety Net'*

(1) Preserving financial stability, which may be threatened by the occurrence of systemic crises, especially in the case of exposure to 'systemic risk', is another main function of central banks.[43] It is worth noting that there is no single generally accepted definition of the term 'financial stability': while some authors define it as the opposite to the concept of 'financial instability' by referring to episodes of 'financial crises',[44] certain others define it on the basis of the various properties of a stable financial system. In that respect, Schinasi (2006) gives the following definition[45]: "Financial

[43] On systemic risk, see Schwarcz (2008) and Weber et al. (2014); on its two dimensions, see Sect. 1.1.3.3. On the role of central banks in financial stability, see the seminal works of Goodhart (1995) and Padoa-Schioppa (2003).

[44] For a generally accepted definition of this term, see Mishkin (2003), pp. 93–105; for a historical overview of recent 'systemically important' financial crises all over the world, see Caprio and Klingebiel (1996, 1999), Reinhart and Rogoff (2008), Leaven and Valencia (2008, 2012), Lowenfeld (2010), pp. 589–595 and Thiele (2014), pp. 563–569.

[45] Schinasi (2006), p. 82.

stability is a situation in which the financial system is capable of satisfactorily performing its three functions simultaneously.[46] First, the financial system is efficiently and smoothly facilitating the intertemporal allocation of resources from savers to investors and the allocation of resources generally. Second, forward-looking financial risks are being assessed and priced reasonably accurately and are being relatively well managed. Third, the financial system is in such condition that it can comfortably if not smoothly absorb financial and real economic surprises and shocks." Finally, others formulate an operational definition by introducing a framework which lays down the objectives of regulatory intervention and defines the adequate instruments to achieve them.[47]

The demand for a strengthened regulatory framework and tougher supervision in the financial system comes back stronger every time a (solvency and/or liquidity) crisis arises in one or more states; it can be a banking crisis, a foreign exchange crisis or a 'twin' crisis.[48]

(2) Ensuring the stability of the banking system, in particular, by preventing the evolution of negative externalities in the form of contagious bank failures (i.e. by preventing a chain reaction of bank failures or 'bank failure spillover effects'),[49] necessitates 'crisis prevention' and 'crisis management' measures, which comprise the 'bank safety net' and the role of central banks in this respect is important. According to Kane: "On average, across the world, the financial sector (and in particular the banking industry) is probably more closely regulated than any other segment of the private economy."[50] 'Offshore financial centres', characterised by a substantial lack of regulatory intervention in monetary and financial systems coupled with favourable corporate taxation ('tax havens'), are an exception.

[46] According to Schinasi (2006), pp. 80–82, these functions are intermediation, direct financing through markets, and operation of financial infrastructures; see also Allen and Gale (2001).

[47] On the various definitions of the term 'financial stability' see Houben et al. (2004), pp. 10–11 and 38–42 and on the third approach also Schinasi (2005). See also various contributions in von der Crone and Rochet (2014), as well as Pistor (2019), on the regulation of financial markets from the perspective of her 'Legal Theory of Finance' (the 'LTF').

[48] On this distinction, see Brakman et al. (2006), pp. 217–263 (and in particular pp. 256–258). On the objectives and the instruments of financial regulation, see Aikman et al. (2019), pp. 162–175 and Wymeersch (2019); on the role of monetary policy in the preservation of financial stability, see, by way of mere indication, Borio (2006) and Brunnenmeier (2019).

[49] From the very extensive literature on this financial policy objective, see Herring and Litan (1995), pp. 50–61. Regarding the synergies between the stability and effectiveness of the financial system, see Barth et al. (2006), pp. 307–309.

[50] Kane (1987), p. 111.

Even though the various components of this 'crisis-prevention and crisis-management system' are complementary, each has a specific contribution to the safeguarding of the banking system's stability[51]; they include:

first, the authorisation and micro-prudential supervision of banks by competent public authorities (functions performed in several jurisdictions by central banks);
in addition (and closely connected to supervision), the micro- and macro-prudential regulation of banks on the basis of rules laid down by banking legislation;
third, the macro-prudential oversight of the financial system (typically, by central banks, as also discussed below);
furthermore, specific crisis-prevention measures for troubled banks, such as 'recovery planning' (by the supervisory authorities) and 'resolution planning' (also called 'living wills'[52]), measures relating to the assessment of banks' resolvability and powers to direct removal of deficiencies or impediments thereto, 'early intervention measures', *inter alia*, through the appointment of a temporary administrator[53] and the writing-down in the nominal value and/or conversion of a bank's capital instruments into ordinary shares (prior to its resolution);
fifth, solvency crisis management measures, typically (now) in the form of resolution of failing banks, and, if those are not deemed necessary in terms of financial stability, the withdrawal of their authorisation and their winding up;
sixth, the operation of deposit guarantee systems/schemes (the 'DGSs'), which are activated once a banking licence has been withdrawn[54]; and

[51] For an overview of the components of the bank safety net, see Guttentag and Herring (1986), (1988) and Demirgüç-Kunt and Huizinga (1999). According to Guttentag and Herring (1986, p. 9), these components can be viewed as: "a series of circuit breakers designed to prevent a shock to one part of the financial system from surging through the financial network to damage the rest of the system".

[52] See Avgouleas et al. (2009), Carmassi and Herring (2013) and Amorello and Huber (2014).

[53] On the theoretical basis for this intervention, see Krimminger and Lastra (2011), pp. 58–61.

[54] DGSs will be discussed in this study only to a limited extent, since the role of central banks in their operation is usually limited to their administration. It is noted that, in rare cases (such as in the case of the Federal Deposit Insurance Corporation [the 'FDIC'] in the United States), the body responsible for the management of a DGS may also have supervisory competencies on its member banks. For an overview of the literature on the functions of DGSs, see Gortsos (2019b), pp. 4–5.

**Table 1.3** Financial policy objective: ensuring the stability of the banking system—the 'bank safety net'

| | |
|---|---|
| 1. Crisis prevention | (Structural regulations)<br>Authorisation requirements for banks<br>Micro-prudential banking regulation<br>Micro-prudential banking supervision<br>Macro-prudential policies (regulation and oversight)<br>Specific crisis-prevention measures: resolution preparation (recovery and resolution planning, intra-group financial support agreements)—early intervention measures |
| 2. Crisis management | 2.1 Management of liquidity crises<br>Lending of last resort by the central bank<br>2.2 Management of solvency crises<br>Recapitalisation of banks by public funds (state aid)<br>Resolution of banks<br>Winding up of banks<br>Operation of deposit guarantee schemes (activated for the payment of compensations in the latter case only) |

finally, last-resort lending by central banks to solvent banks exposed to temporary illiquidity (liquidity crisis management measure).[55]

(3) Of more general character are the 'structural regulations', that is those determining the range of financial services that banks (and other categories of financial firms) are allowed to provide in the financial system. The particular issue whether banks should be allowed to provide directly investment services in capital markets (and to what extent) and be direct members of the markets for the trading of securities and derivatives has been and still remains a source of dispute: while some jurisdictions apply the 'universal banking model', according to which, in principle, there are no restrictions,[56] in others, limitations are put in place.[57]

[55] This bank safety net component is usually not premised on legislative rules, but on discretionary decisions of central banks. A different issue is that certain central banks (albeit not the ECB) have a statutory authority to act as lenders of last resort. Last-resort lending, both in theory and as applied in the euro area, is discussed in detail in Chap. 9, Sect. 9.3. On the various components of the bank safety net, see Table 1.3 and on the institutional aspects relating to it, see Table 1.4.

[56] On this model, see Macey (1993), Benston (1994) and Saunders and Walter (1994); on structural regulation in general (including the universal banking model), see Alexander (2019), pp. 207–236, with extensive further references.

[57] In extremis, under US federal financial law, banks were not allowed either to provide investment services directly or to have subsidiaries that offer investment services pursuant to

**Table 1.4** Institutional aspects with regard to the preservation of the stability of the banking system

| *Policy instruments* | *Competent institution* | *Attributes of the institution* |
|---|---|---|
| Bank authorisation | Supervisory authority | Central bank or other administrative authority |
| Micro-prudential and macro-prudential regulation of banks | Legislator (including the Parliament) | General regulator |
| | Supervisory authority (in regulatory capacity) | Upon delegation |
| Micro-prudential supervision of banks | Supervisory authority | Central bank or other administrative authority |
| Macro-prudential oversight of the financial system (including the banking sector) | Central bank or monetary authority/agency | |
| Specific crisis-prevention measures and resolution of banks | Supervisory or judicial authority | On a case-by-case basis |
| | Resolution authority and resolution fund | |
| Deposit guarantee | Deposit guarantee scheme | Entity of private or public law |
| Last-resort lending | Central bank or monetary authority/agency | |
| Provision of state subsidies to banks (government 'bail-out') in form of equity participation and/or liquidity guarantees | National Ministry of Finance or other delegated governmental agency | |

(4) It should be finally noted that the adoption of banking regulations provides banks (and other categories of financial firms) with an incentive to minimise the costs to be incurred, by transferring their activity over to less regulated/unregulated services or (in an open economy) to states with a less stringent regulatory framework. This 'regulatory arbitrage' [a lesson drawn

the provisions of the 1933 "Glass-Steagall Act" (see Möschel (1978) and Lichtenstein (2010), pp. 219–224). This law was partly repealed in 1999 with the "Financial Services Modernisation Act" (widely known as 'Gramm-Leach-Bliley Act', Public Law 106-102, 113 Stat. 1338, see O' Neal (2000) and Yeager et al. (2004)). On whether the adoption of the latter Act, which also eliminated legal barriers to affiliations between banks and insurance companies, contributed to the recent (2007–2009) international financial crisis in the United States, see indicatively Grant (2010) (supporting this view), and Wallison (2009) and Norberg (2009), pp. 86–87 (arguing against it).

from economic (thereby also financial) history, since it applies irrespective of time or sector] is the premise of the ongoing 'dialogue' between regulatory/supervisory authorities and supervised entities (establishment of rules—transgression—establishment of new, stricter ones, usually with a time lag)[58] and is accentuated by technological advances and nowadays by the advent of financial technology ('FinTech'), all the more so, given the fact that supervised entities have often been ahead of regulators and supervisors. A case in point of such regulatory arbitrage has been the development of the 'shadow banking system'.[59] In addition, regulatory arbitrage between states (coupled with the tendency of certain states to adopt lax rules in order to attract more businesses to their territory, known as 'competitive deregulation' or 'competition in laxity') is the main rationale for harmonised rules at international or regional level.[60]

*Micro-prudential Banking Regulation and Supervision*

**General Remarks**

(1) As already discussed,[61] banks are exposed to various risks and predominantly to financial risks arising from their transformation functions (credit, liquidity and interest rate income risk).[62] Financial risks to which banks may be exposed also include market risks (to the extent that they operate also in capital, foreign exchange and commodities markets, such as position risk, foreign exchange risk and risk from open positions in commodities), and settlement risk. Banks may also be exposed to non-financial risks, such as operational risk (encompassing legal, cyber, conduct and model risks), political risk, reputational risk (which, as shown in the recent international financial crises, may lead to detrimental outcomes for the economy) and environmental risk.[63]

[58] On this 'regulatory dialectic', see Kane (1987), pp. 114–116.

[59] See also the analysis of Norberg (2009) in pp. 52–53.

[60] This aspect is analysed thoroughly in Kapstein (1989, 1992).

[61] See above, Sect. 1.1.1.

[62] On liquidity risk, see more details in Chap. 9, Sect. 9.3.2.

[63] On all these risks, apart from the extensive literature, reference should be made to the relevant work of the Basel Committee on Banking Supervision and the Committee on Payments and Market Infrastructures (the 'CPMI'). For a detailed definition of legal risk, see McCormick (2006); on environmental risk and the need to revise the global regulatory framework in order to include it as well, see Cambridge Institute for Sustainable Leadership and UNEP Finance Initiative (2014) and Alexander (2019), pp. 81–82 and 347–371.

Micro-prudential banking regulation seeks to enforce the safety and soundness of banks by limiting their exposure either to insolvency or to liquidity risk (which might lead to insolvency under certain circumstances) and by curbing their risk vulnerability by limiting their exposure to the risks to which they might be exposed, and increasing their capacity to absorb losses incurred in the event of such risks.[64] Hence, it serves a failure-preventing function, by preventing the failure of individual banks in order to avoid the risk of contagion and subsequent negative externalities in the financial system as a whole.[65] Micro-prudential regulations include capital adequacy ratios against banks' risk exposure,[66] liquidity ratios and a leverage ratio[67]; corporate governance rules[68]; limitation of banks' holdings in other companies (mainly outside the financial system); provisions against future exposure to risks, portfolio diversification (viz. rules on 'large exposures'); and public disclosure of information on those matters.

(2) Micro-prudential banking regulation can only be effective if coupled with micro-prudential supervision by competent authorities, with a view to assessing the quality of banks' portfolios and ascertaining compliance with the applicable regulatory framework, in order to prevent their exposure to unmanageable risk levels. This is conducted by means of regular and extraordinary assessments performed by

[64] The measures taken by banks themselves in managing the risks involved with their portfolio are aimed at the same objective. In this respect, supervisory authorities issue guidelines to banks regarding their risk exposure management.

[65] Micro-prudential banking regulation and its policy instruments (as well as its correlation with micro-prudential supervision) are discussed in detail in Barth et al. (2006), pp. 110–132 (a study published before the outbreak of the recent [2007–2009] international financial crisis). On the relationship between micro- and macro-prudential regulations, see Green (2012).

[66] On the different meanings of the 'capital' concept, including the regulatory one, see Norton (1995), pp. 3–8 and Alexander (2015). On the concept and necessity of introducing capital adequacy ratios, see indicatively Kim and Santomero (1988), Furlong and Keeley (1989), Rochet (1992), Berger et al. (1995) and Kahane (1977).

[67] On the leverage ratio, see Hildebrand (2008). On all these regulatory measures, see Aikman et al. (2019), pp. 162–175; on the definition of the ratios, see Box 1.1.

[68] The international standards on this aspect have been developed by the G20 and the OECD; see 'G20/OECD Principles of Corporate Governance' (2015) available at: https://www.oecd.org/corporate/principles-corporate-governance.htm; see also by way of mere indication Hopt (2011, (2012), and Alexander (2019), pp. 127–161.

supervisory authorities themselves, and the audit of annual accounts and other financial and organisational aspects by external auditors on behalf of supervisory authorities.[69]

**Institutional Aspects Relating to Banking Supervision**

There are several alternative approaches to the institutional structure of micro-prudential banking (and, more generally, financial) supervision[70]:

In accordance with the 'sectoral approach', a different supervisory authority is entrusted with the authorisation and micro-prudential supervision of financial firms for each of the three main sectors of the financial system (banking, capital markets and private insurance), one of which is also responsible for conducting supplementary micro-prudential supervision over financial conglomerates.[71] Under this approach, the issue arises regarding the competence for the micro-prudential supervision of banks providing investment services in terms of their compliance with rules on ensuring capital market efficiency and investor protection, given that such supervision can be carried out either by the supervisory authority responsible for the micro-prudential supervision of banks or by the capital market supervisory authority. As regards banks, the supervisory authority may be either the central bank or (another) administrative authority. Under a 'modified sectoral approach', there may be only two supervisory authorities: the first for the two main sectors of the financial system (usually the banking sector and capital markets), and the second for the insurance sector.

If the 'full integration approach' is adopted, the task of supervising all financial firms is conferred upon a single supervisory authority, which (again) may be the central bank or (another) administrative authority. Finally, under the 'functional approach', responsibilities are allocated between two supervisory authorities: the first is competent for the

[69] Micro-prudential banking supervision and its close correlation with micro-prudential regulation are discussed in detail in Blumer (1996), European Central Bank (2001), Barth et al. (2006), pp. 110–132, Arnone et al. (2007) and Thiele (2014), pp. 63–235.

[70] For an overview of these approaches, see Lastra (2006), pp. 324–328, Group of Thirty (2008) and, more recently, Central Bank Governance Group (2011) and Calvo et al. (2018). As regards the different governance practices of the financial regulatory and supervisory agencies in 103 IMF member states before the recent (2007–2009) international financial crisis, see Seelig and Novoa (2009).

[71] Typically, this competence is assigned to the authority responsible for the supervision of a group's parent company or, in the case of horizontal groups, the authority responsible for the micro-prudential supervision of the group's largest company. On the corporate structure of financial conglomerates, see by way of mere indication Herring and Carmassi (2010).

authorisation and micro-prudential supervision of financial firms, as well as for ancillary supervision of financial conglomerates, and the second is competent for checking compliance with provisions on ensuring capital market efficiency and investor protection. In this case, the former may be either the central bank or an administrative authority, and the latter is usually an administrative authority.

Under all approaches, authorities have the competence to supervise and impose sanctions but also to regulate to a certain extent[72]; hence, supervisory authorities are also regulators.

**Separation of Monetary Policy from Banking Supervision Tasks**

Although the safeguarding of financial stability has historically been a major objective of central banks and the micro-prudential supervision over banks a main task of several thereof, an ever-increasing number of countries around the world have assigned this supervision since the 1980s to independent authorities other than the central bank.[73] The rationale is that the exercise of supervisory powers by the central bank may give rise to conflicts of interest that would undermine the efficient achievement of its monetary policy objectives (mainly in terms of maintaining price stability).[74]

This trend has tended to be reversed in the aftermath of the recent international financial crisis, as a result of the relevant failures attributed to independent supervisory authorities in many states all over the world.[75] In addition to the Bank of England (the 'BoE') since 1 April 2013[76] and inter

[72] Regulatory competence may be legislatively assigned to supervisory authorities on the basis of a general procurement or on an *ad hoc* basis.

[73] See, on this, indicatively, Herring and Carmassi (2008), with extensive further references, and Central Bank Governance Group (2011). On the trend towards integrating sectoral financial supervisory authorities (for banking, capital markets and insurance/reinsurance) into a single body, see Hadjiemmanuil (2004), Wymeersch (2006) (specifically in Europe), Filipova (2007), Group of Thirty (2008), and Seelig and Novoa (2009).

[74] For an overview of this debate, see the seminal paper by Goodhart and Schoenmaker (1993), as well as Haubrich (1996), Di Noia and Di Giorgio (1999), Goodhart (2000), Gianviti (2010), pp. 480–482, Eijffinger and Nijskens (2012) and Beck and Gros (2013).

[75] See Davies and Green (2010), pp. 187–213.

[76] The Prudential Regulation Authority (the 'PRA') was established, by virtue of the UK Financial Services Act 2012, as a subsidiary of the BoE, responsible for the micro-prudential supervision of banks, building societies and credit unions, insurers and major investment firms. In addition, this Act established the Financial Conduct Authority as a conduct of business regulator and an independent Financial Policy Committee, entrusted with the objective of financial stability and macro-prudential financial oversight.

alia, the European Central Bank (ECB) has also since 2014 become another striking example of this trend. Nevertheless, the creation of 'Chinese walls' within the central bank is an essential element to ensure the adequate separation of its monetary policy and other tasks from its (new) supervisory tasks.[77]

*Macro-prudential Policies*

**Content**

Mainly after the recent (2007–2009) international financial crisis, central banks have also been assigned tasks in relation to 'financial macro-prudential policies'. This term includes the set of (mainly preventive) policies adopted and implemented to limit the financial system's exposure to 'systemic risk' arising from factors not associated with individual financial firms or individual markets and structures of the financial system, but of a more general nature.[78] These policies seek to address the two dimensions of systemic risk[79]:

The first is the 'time dimension', namely the systemic risk's evolution over time. In this context, macro-prudential policies seek to strengthen the financial system's resilience at times of economic downturn by limiting procyclicality, which can accentuate systemic risk because of the interactions developed either within the financial system or between the financial system and the real sector of the economy.[80] The objective is to 'lean against the financial cycle', since, as proven historically, failures caused by credit expansion are generated on the upside of the economic cycle but become apparent when this cycle is in a downturn. More specifically, on the upside of the economic cycle there is typically a large credit expansion, significant rises in real property, security and other asset prices, significant

[77] On this aspect, see Chap. 5, Sect. 5.2.4.

[78] See Financial Stability Board, International Monetary Fund and Bank for International Settlements (2011), section 2; on the relation between financial stability risks, monetary policy and macro-prudential policies, see Caruana (2010), Constâncio (2015), Lastra (2015), Goodhart (2018) and Liang (2019); on the relationship between micro- and macro-prudential policies, see Green (2012), Faia and Schnabel (2015) and Mülbert (2015).

[79] See Committee on the Global Financial System (2010), Annex 1, Section 2, and Financial Stability Board, International Monetary Fund and Bank for International Settlements (2011), Section 2.

[80] On the contagion channels between the financial system and the real sector of the economy, see Basel Committee on Banking Supervision (2011) and Galati and Moessner (2011), Sect. 5.2.

leveraging of banks and money and capital markets, as well as maturity mismatches of assets and liabilities in banks' balance sheet. In the absence of a proper protection of the financial system, when the economic cycle is in a downturn, problems may emerge for financial firms and they can be aggravated by the need for deleveraging; under such circumstances, the capacity to extend loans and credits is usually limited, negatively impacting on the real sector of the economy.[81]

The second dimension is the 'cross-sectional dimension', namely allocation of risk in the financial system at any given point in time. In this case, macro-prudential policies are aimed at limiting systemic risk concentration, which could result either from the concurrent exposure of multiple financial firms to risks arising from similar exposures, or from their interconnectedness, especially if they are systemically important financial institutions (the 'SIFIs'). This problem, associated with the policy objective of ensuring financial stability, is definitely not new but has become more acute during the recent crisis owing to large-scale government bail-outs of financial firms and the ensuing negative impact on public finances.[82]

**Policy Instruments**

A mix of instruments is adopted in order to meet the objective for addressing these two dimensions of systemic risk. Specifically, it is necessary to confer upon institutions (typically the central bank) the task of ensuring 'macro-prudential financial oversight', thus enabling the identification, measurement and assessment of systemic risk.[83] The objective of this oversight is to limit the distress of the financial system as a whole in order

[81] On this issue, which came to the forefront particularly in the wake of the recent international financial crisis, see Borio (2010), Committee on the Global Financial System (2010), Financial Stability Board, International Monetary Fund and Bank for International Settlements (2011), Galati and Moessner (2011), Sect. 5.1, and Gluch et al. (2013) (specifically on central banks' involvement).

[82] On the definition of SIFIs, see Huertas and Lastra (2011), pp. 255–258 (who use the term 'systemically significant financial institutions' or 'SSFIs'). The issue of the operation of SIFIs, including banks, adequate micro-prudential supervision and micro- and macro-prudential regulation of their business activities, as well as management of liquidity and solvency crisis involving such institutions (mainly with regard to their resolution) has been at the heart of academic and political debates on regulatory intervention in the financial system. By way of indication only (from a most extensive literature), see Carmassi et al. (2010), Claessens et al. (2010), European Central Bank (2010), Rajan (2010), pp. 169–176, Hofer (2014), Weber et al. (2014), pp. 152–171, as well as various Reports of the Financial Stability Board.

[83] See Financial Stability Board, International Monetary Fund and Bank for International Settlements (2011), Section 3.

to protect the overall economy against significant losses in real output. Macro-prudential analysis must therefore pay particular attention to common or correlated shocks and shocks to those segments of the financial system that trigger spillover effects; macro-prudential oversight cannot be meaningful, unless it can impact on supervision at the micro-level, whilst micro-prudential regulation and supervision cannot effectively safeguard financial stability without adequately taking account of macro-level developments.[84] Moreover, it is necessary to adopt 'macro-prudential regulations' for banks and other categories of financial firms, which are differentiated depending on the dimension of systemic risk they are called upon to address.[85]

*Management of Solvency Crises—The (Presently) Predominant Role of Banking Resolution*

(1) If insolvency problems arise[86] and a bank cannot meet capital shotfalls by resort to private sector recapitalisation, competent authorities are faced with a 'solvency crisis management trilemma'[87]: the first option is bail-out (especially of a SIFI) through public financial assistance facilities (the 'taxpayers' solution')[88]; it is noted, however, that resort to this option tends to

[84] On the content of this oversight, see Borio (2003) and Clement (2010).

[85] The policy instruments used, in particular, to achieve the objective of addressing the systemic risk's time dimension include, *inter alia*, capital buffers (such as capital conservation and countercyclical capital buffers, on the definition of which, see Box 1.1) and take 'forward-looking provisions' (see Brunnenmeier et al. (2009)), as well as prudential measures which either affect the prices of services provided by banks ['price-based prudential tools', e.g. the imposition, when the economic cycle is on the upside, of stricter risk weights for calculating the capital adequacy ratio on specific exposures (such as loans denominated in foreign exchange or mortgage loans)] or affect the quantity of services provided ('quantity-based prudential tools', such as time-variation, depending on the phase of the economic cycle, the loan-to-value ratios of mortgage loans and the debt-to-income ratios in mortgage and consumer loans). For a detailed overview, see Committee on the Global Financial System (2010), Section 3 and Galati and Moessner (2011), Section 4. For an overall review of how these measures were adopted, see Financial Stability Board, International Monetary Fund and Bank for International Settlements (2011), pp. 5–9.

[86] A bank becomes insolvent when either its liquidity is so low that it cannot repay its outstanding debt or the market value of its non-equity liabilities exceeds that of its assets.

[87] This is totally different from Schoenmaker's (2011) 'financial trilemma', stating that in an open market the objectives of financial stability, financial integration and national financial policies are incompatible; any two can be combined, but not all three.

[88] See Padoa-Schioppa (2000), pp. 24–26, as well as Nijskens and Eijffinger (2010) on the link between bail-outs and last-resort lending.

be, especially after the recent international financial crisis, the exception and is (usually) subject to strict conditions, since, in certain jurisdictions [including under European Union (EU) law], it constitutes state aid requiring prior approval by competition authorities; the second option is to withdraw the bank's authorisation, in which case the bank is placed under liquidation and the DGS to which it is affiliated is activated; finally, the third option, also a 'child' of the recent international financial crisis (like macro-prudential policies), is to resolve the bank through the competent resolution authorities.[89]

(2) The term 'resolution' encompasses all measures taken to resolve problems arising from the exposure to insolvency of financial firms and, in particular, banks (mainly, but not exclusively, SIFIs) and avoid an initiation of liquidation proceedings (thus preventing spillover effects of a bank's failure on the economy) or resort to bail-out measures. Resolution is usually referred to (correctly in the author's opinion) as a specialised regime for bank failures, since its main objectives are the preservation of financial stability, the protection of depositors (whose deposits are covered by DGSs) and the minimisation of resort to bail-out through public funds, and not the maximisation of creditor value (which is the objective of insolvency law under the application of normal insolvency proceedings).[90]

(3) In order to ward off the moral hazard in case of 'too-big-to-fail' financial institutions (including SIFIs), the failure of which would endanger the stability of the banking (and, more generally, financial) system, crisis management measures in the form of resolution actions may be put in place. 'Resolution objectives' can include (as in the example of the EU) the following: ensure the continuity of 'critical functions' of the bank under resolution, that is, activities, services or operations the discontinuance of which is likely to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or

[89] See by mere indication Avgouleas et al. (2009) and Claessens et al. (2010). On the international financial standards in this respect, see Chap. 4.

[90] See on this Psaroudakis (2014), pp. 62–71, Binder (2017), pp. 69–70 and Haentjens (2017), p. 220. Hadjiemmanuil (2014) makes use of the term 'special resolution regime (SRR) for banking institutions', with reference to Sjöberg (2014). On the concept(s) and the evolution of this crisis management measure, see Huertas and Lastra (2011), pp. 258–267, White and Yorulmazer (2014), Armour (2015) and Binder (2016), Section 2.2 and on the cross-border resolution of global banks, see Hüpkes and Devos (2010), Davies (2014), Faia and di Mauro (2015) and Avgouleas and Goodhart (2019).

group, with particular regard to the substitutability of those activities, services or operations; avoid significant adverse effects on financial stability, in particular by preventing their contagion, including to market infrastructures (i.e. payment and settlement systems), and by maintaining market discipline; protect public funds by minimising reliance on extraordinary public financial support; and, finally, protect depositors and investors covered by deposit and investment guarantee schemes respectively, as well as client funds and client assets, which are considered off-balance sheet items. Without exception, the funding necessary for resolution is provided by a separate resolution fund (financed, in principle, by bank contributions) and, on a supplementary basis, by the DGS; in other words, central banks do not provide financing.[91] A related, albeit separate, aspect is the provision of liquidity in resolution.[92]

### *1.1.4 Central Banks' Functions in Relation to Payment and Settlement Systems*

(1) Central banks perform several functions in payment and settlement systems, which (as already mentioned) constitute a key infrastructure of the financial system.[93] In particular, the first function is their management by central banks or by central banks along with other system participants (typically, banks and other categories of financial firms). Settlement of payments is usually made in accounts that system participants keep in the central bank, through which the bank accounts of those ordering the payment—or in case of direct debits, the debtors—are debited, and subsequently the bank accounts of the final beneficiaries are credited. This constitutes the second function performed by central banks in payment and settlement systems. Finally, central banks' third function is the oversight of payment and settlement systems,[94] in order

[91] On resolution financing, see Goodhart (2012), Nieto and Garcia (2012), Grünewald (2014), pp. 29–48 and Armour (2015), pp. 479–482.

[92] This aspect will be further discussed in Chap. 11, under 11.2.3.

[93] For an overview, see Committee on Payment and Settlement Systems (2003b): "Policy issues for central banks in retail payments", Bank for International Settlements, March, pp. 8–15 (available at: https://www.bis.org/publ/cpss52.htm).

[94] See Committee on Payment and Settlement Systems (2005): "Central Bank Oversight of payment and settlement systems", Bank for International Settlements, May (available at: https://www.bis.org/publ/cpss68.htm).

to safeguard their stability and efficiency, which is a major financial policy objective.[95] The conferral of this task upon central banks is a corollary of the operational synergies that exist between the tasks of conducting monetary policy, safeguarding the stability of the financial system and overseeing payment systems.

(2) The scope of the relevant power covers, first of all, large-value payment and settlement systems—given the interest in the smooth execution of monetary policy operations. With regard to small-value payment systems, its scope varies across different states and it may include low-value payment systems, systemically important small-value payment systems and systems involving *ad hoc* systemic risk.[96]

### *1.1.5 Promotion of Financial Inclusion and Literacy by Central Banks*

(1) Promoting financial inclusion and financial literacy is also a function which, in particular in the wake of the recent international financial crisis, became of interest to central banks. Financial inclusion is defined as the process of ensuring affordable, prompt and adequate access to a wide range of financial products and services, as well as proliferation of their use in all parts of society with a special focus on vulnerable groups, through the implementation of existing and innovative approaches, such as financial literacy programmes. A wide range of products and services can be incorporated in this definition, including savings, investment products, remittance and payment facilities, credit and insurance.[97] The goals of financial inclusion, which is measured on the basis of three parameters (level of credit institutions' outreach, level of usage of financial products and services, as well as quality of products and services) are the following:

[95] See Committee on Payment and Settlement Systems and IOSCO Technical Committee (2012), op. cit., Section 1; on the synergies between the stability and efficiency of payment and settlement systems, see ibid., paragraph 1.15, and Committee on Payment and Settlement Systems (2005), op. cit., paragraph 60. Settlement risk in payment systems encompasses credit and liquidity risk; see, on this Committee on Payment and Settlement Systems (2003), op. cit. On mitigating this risk, see Committee on Payment and Settlement Systems (2001): "Core Principles for Systemically Important Payment Systems", January, available at: https://www.bis.org/cpmi/publ/d43.pdf. See also Geva (2013, 2018).

[96] See Committee on Payment and Settlement Systems (2003b), op. cit. and European Central Bank (2011b); see also Chap. 7, under 7.2.3, when discussing the ECB's task of promoting the smooth functioning of payment systems in the euro area.

[97] See OECD (2005).

access for all households to a full range of financial services (including savings or deposit services, payment and transfer services, credit and insurance) at a reasonable cost; sound and safe institutions governed by clear regulation and industry performance standards; financial and institutional sustainability, to ensure continuity and certainty of investment; and competition to ensure choice and affordability for clients.

Financial literacy (education) is a means for achieving financial inclusion; it is defined as the knowledge and understanding of financial concepts and risks, and the skills, motivation and confidence to apply such knowledge and understanding in order to make effective decisions across a range of financial contexts to improve financial well-being of individuals and society and to enable participation in economic life.[98] Financial literacy enhances the confidence of users formerly excluded from the system and enables them to make informed choices by comparing available financial products from different providers and by being aware of their respective rights and obligations. It is achieved through the provision of appropriate financial education. On the other hand, financial education may also entail the risk of users making the wrong choices on available financial means, if they overestimate their abilities. This may be explained by the fact that even though financial education might enhance a user's confidence, it will not necessarily improve his/her abilities.[99] Sources of financial education include friends and family, the state, school, the media, consumer protection associations and, last but not least, central banks. It should also be noted that any effort to support financial literacy would be incomplete without a robust consumer protection framework.

(2) It has been established that financial inclusion has an impact on monetary policy.[100] It has the potential to contribute to curbing poverty and enhancing prosperity, especially in regions with a low standard of living, by making payments easier and by offering a channel for safe and legal financing, when necessary and, hence, is conducive to smooth consumption and monetary stability, which is of particular interest to central banks worldwide. More specifically an increase in financial inclusion interacts

[98] See OECD (2013), p. 144.

[99] See Ambuehl et al. (2014). The fields of 'behavioural economics' and 'behavioural finance' can also be helpful in explaining decision-making processes; see on this, by way of mere indication, Stiglitz and Walsh (2006), pp. 119–121, various contributions in Viale et al. (2018) and Zamir and Teichman (2018).

[100] See Mehrotra and Yetman (2014, 2015). On the issue whether financial inclusion can meet multiple macroeconomic goals, see Sahay et al. (2015).

with monetary policy in two ways: it helps consumers smooth their consumption over time, which may influence fundamental monetary policy choices, including the choice of targeted price index, and it encourages consumers to shift their savings away from physical assets and cash into deposits, which may have implications for monetary policy operations and the role of intermediate policy targets. Financial inclusion facilitates 'consumption smoothing', as households are able to adjust their saving and borrowing in response to interest rate changes and unexpected economic developments. Constraints on the ability to smooth consumption due to financial exclusion have been shown to affect monetary policy along several dimensions.

(3) There are several reasons why increased financial inclusion may also support central banks' task of safeguarding financial stability.[101]

First, consumers gaining access to the formal financial system are likely to increase aggregate savings and diversify the banks' depositor base, improving the resilience of financial firms, given the stability of deposit funding, especially when they are backed by an effective DGS. Furthermore, there is evidence that aggregate balances in the accounts of low-income customers move only gradually and are not prone to sudden month-to-month swings. This resilience can be especially relevant during crises, if low-income savers maintain their deposits when large depositors head for the exits. Indeed, during the recent international financial crisis, the fall in total deposits was slighter in economies where the degree of financial inclusion was higher in terms of bank deposits, especially for middle-income countries, even after accounting for other factors.

Second, financial inclusion, by improving firms' access to credit, can help financial firms diversify their loan portfolios, while lending to firms previously financially excluded may also lower the average credit risk of loan portfolios.

However, increased financial inclusion is no guarantee of improved financial stability; if financial inclusion is associated with excessive credit growth or the rapid expansion of unregulated parts of the financial sector, financial risks may still arise.[102]

[101] See Khan (2011), Global Partnership for Financial Inclusion (2012) and Basel Committee on Banking Supervision (2015).

[102] For a more detailed overview, based on extensive literature review, of this subject-area, see Gortsos (2016a).

## 1.2 European Central Banking Law as a Synthesis of European Monetary and Financial Law

### *1.2.1 An Introduction to the Hierarchy of Norms Under EU Law*

According to the hierarchy of norms instituted by EU law, the constituent Treaties constitute the first tier, along with the 2000 Charter of Fundamental Rights of the European Union[103] (hereinafter the 'Charter'), which has the same legal value as the EU Treaties themselves. The second tier encompasses the 'general principles of law', which can be used for the interpretation of Treaties' Articles. Regulations, Directives and Decisions adopted by EU institutions, under the powers conferred upon them, are the third tier in this hierarchy.[104]

### *1.2.2 European Monetary Law*

*Monetary Unification as the Conceptual Basis of European Monetary Law*

(1) In the monetary field, the interdependence of states arises from the fact that the national currency of one state is exchanged with the currency of other states in order to fulfil the payment leg of international transactions (commercial and/or financial[105]), on the basis of a price which is termed 'foreign exchange' parity (or rate). Potentially, public international monetary law determines the framework governing inter-state foreign exchange relations. In this context, states have a choice mainly between several options[106]: a regime of purely floating exchange rates ('free floating'); a regime of con-

[103] OJ C 202 (Consolidated version), 7.6.2016, pp. 389–405. The Charter was initially solemnly proclaimed at the Nice European Council on 7 December 2000 by the European Parliament, the Council and the Commission (OJ C 364, 18.12.2000, pp. 1–22). It is currently in force as adapted in Strasbourg, on 12 December 2007, during the Lisbon Treaty negotiations, and is supplemented by the Explanations relating to the Charter of Fundamental Rights (OJ C 303, 14.12.2007, pp. 17–35). Since the entry into force of the Lisbon Treaty, the Charter is regularly taken into consideration in the judgments of the (European) Court of Justice. See, on this, the Commission's website: https://ec.europa.eu/justice/fundamental-rights/charter/index_en.htm.

[104] See Craig and de Búrca (2015), pp. 111–120; see also Appendix of Chap. 5.

[105] From a strictly legal point of view, financial transactions are themselves commercial, since financial firms are usually commercial companies and their operations are commercial.

[106] See Eichengreen (1994), pp. 9–28.

trolled floating exchange rates in which interventions of central banks are permitted in order to influence the foreign exchange of national currencies ('managed floating')[107]; a regime of floating exchange rates within a specific fluctuation range ('target zones')[108]; a regime of fixed exchange rates in which, however, adjustment of the foreign exchange through devaluation is permitted[109]; and a regime of irrevocably fixed exchange rates, which leads to monetary unification.[110]

(2) In this context, it is also useful to make also a distinction between international and regional monetary regimes, such as the EU monetary union. Monetary union stands for the connection of two or more independent states into a single monetary area, under full freedom of movement of money, capital and payments, with the following minimum content: irrevocable fixing ('lock-in' as usually referred to) of their currencies' exchange rates, in the framework of a system of irrevocably fixed exchange rates, and establishment of a supranational central bank, competent to define and implement a single monetary (and exchange rate) policy within the single monetary area. The question on whether the convergence of certain fundamental macroeconomic indexes of the states participating in the monetary union should be prior to the irrevocable fixing of exchange rates of their currencies has been a trending topic in theory. Two diametrically opposed opinions have been formulated: according to the first approach ('coronation theory'), irrevocable fixing of exchange rates should be attempted only if a significant degree of (economic) convergence has previously been achieved between the participating states with respect to the rate of change in the general level of prices, their external debt and their macroeconomic policy and a significant convergence of growth rates among their social and economic institutions. On the contrary, according to the 'monetarist theory', a monetary union can efficiently operate even if economic performances of participating states diverge significantly and there is no explicit coordination of their fiscal policy.[111]

[107] Such is the current international monetary regime.

[108] Such a regime is the European Exchange Rate Mechanism, linking the single European currency to the currencies of certain EU member states with a derogation (see Chap. 2, Sect. 2.3.3).

[109] Such a regime was the 'Bretton Woods system' governed by the IMF, which was established in 1945 (also see Chap. 2, Sect. 2.1.1).

[110] On the legal aspects of monetary unions and their distinction from other international monetary regimes, see Proctor (2012), pp. 667–680, and 861–891 and Diatta (2007), pp. 53–86.

[111] By way of mere indication, see Padoa-Schioppa (1994), pp. 185–189.

(3) In a monetary union, it is possible to establish a 'common currency' which, after the irrevocable fixing of exchange rates, may circulate in parallel with the national currencies of participating states. However, achieving full monetary integration further requires the introduction of a single currency throughout the whole monetary area and the (simultaneous or gradual) withdrawal from circulation of banknotes and coins in the national currencies of the states participating in the monetary union.

(4) The operation of a monetary union presupposes the concurrence of institutional and operational conditions, so that the conduct of a single monetary policy is enabled. Obviously, subsidiarity, that is a partially national monetary policy, cannot exist within a single monetary area. In this respect, the existence of a supranational monetary authority, meaning a supranational central bank, from which the definition and implementation of a single monetary policy arises, is a constitutive element and a *conditio sine qua non* of their operation.[112] The European Monetary Union, discussed later, is the most striking example, while another is the Eastern Caribbean Currency Union (the 'ECCU') (albeit less complete).[113]

*A Definition of European Monetary Law*

(1) 'European monetary law' is defined as the set of primary and secondary EU economic law[114] provisions which govern the 'M' of the Economic and Monetary Union (the 'EMU') in the EU. The establishment of the European monetary union was based on Article 4(2) of the Treaty "establishing the European Community", adopted by virtue of the Treaty of Maastricht, whereby "(…) these activities (of the Member States and the Community) shall include the irrevocable fixing of exchange rates, leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange-rate policy (…)". Currently, the monetary union, the first and main element of the EMU, is embedded in the Treaty on the Functioning of the European Union (the 'TFEU').

[112] See Diatta (2007), pp. 121–127.

[113] On the ECCU, established in October 1983 for a group of eight island economies (Anguilla, Antigua and Barbuda, Commonwealth of Dominica, Grenada, Montserrat, St Kitts and Nevis, Saint Lucia, and St Vincent and the Grenadines), its common currency, the East Caribbean dollar, and the Eastern Caribbean Central Bank (the 'ECCB'), which is the relevant monetary authority, see at: https://www.eccb-centralbank.org/p/about-the-eccb. The fifteen member states of the Economic Community of West African States (ECOWAS) also decided to launch a monetary union with a single currency, the eco, as of January 2020.

[114] On the concept and content of European economic law, see indicatively Kellerhals (2006) and Schwarze (2007).

(2) With the Maastricht Treaty, Member States made the political decision to establish a European entity, the ECB, upon which they conferred several tasks, including the definition and implementation of the single monetary and (exchange-rate) policy.[115] The operation of the ECB within the European System of Central Banks (the 'ESCB'), which comprises the ECB and the national central banks (the 'NCBs') of all EU Member States, is governed by the TFEU and the Statute of the ESCB and of the ECB (the 'ESCB/ECB Statute'), which is contained in Protocol (No 4) attached to the Treaties.

It is noted that the ESCB comprises the ECB and NCBs of all EU Member States, while the term Eurosystem is defined as comprising the ECB and the NCBs of the Member States whose currency is the euro (i.e. the Member States of the euro area). Literally speaking, the single monetary and foreign exchange policies are not those of the ESCB, but of the Eurosystem. A further analysis of EU monetary law at this stage would be premature, since it would require a deeper understanding of the functioning of the EMU; this is the main objective of Chap. 2.

### *1.2.3 European Financial Law*

*Financial Integration as the Conceptual Basis of European Financial Law*

(1) The process of European financial integration has been put forward in the EU mainly during the last four decades, in stages, but at a gradually intensified pace.[116] This process, the starting point of which was the complete fragmentation of EU Member States' financial systems, is constantly evolving and aims at shaping a single financial area within the single market.[117] Financial integration between two or more sovereign states is one dimension of their microeconomic integration which, along with their macroeconomic integration, makes the whole of economic integration.[118]

[115] It is noted that the ECB was not established as a European Community (at that time) institution as it is today; on this aspect, see Chap. 2, Sect. 2.3.2.

[116] The Annual Reports of both the Commission and the ECB on European financial integration offer a systematic overview of its progress.

[117] On the fragmentation of the financial systems of EU Member States, see Avgouleas and Arner (2013) and Schoenmaker and Peek (2014).

[118] The author defines 'microeconomic integration' as the aggregation of markets (for goods and services) of sovereign states participating in the integration process, aimed at creating a common economic area. On the other hand, 'macroeconomic integration' is defined as the harmonisation/unification of the instruments used in the conduct of macro-

It also forms part of the broader process of financial internationalisation,[119] but (usually) only materialises at regional level. In the author's knowledge, there is no commonly accepted definition of financial integration in the relevant literature. In view of this, the point of reference used is the following ECB's definition[120]: "The ECB […] considers the market for a given set of financial instruments or services to be fully integrated when all potential market participants in such market are subject to a single set of rules when they decide to deal with those financial instruments or services, have equal access to this set of financial instruments or services, and are treated equally when they operate in the market. This integration can be achieved through initiatives of the market itself ('market-led process of integration'), through self-regulation, and/or through binding rules arising from intergovernmental or supranational institutions."

The establishment of the single market falls within the path of 'microeconomic integration', which stands for market integration (for the provision of goods and services, as well as the circulation of production factors) of the states participating in the integration procedure within the context of the operation of a single economic area. On the contrary, monetary union is part of 'macroeconomic integration', which stands for the harmonisation/unification of the terms of the macroeconomic policies implemented by participating states. The procedures of financial and monetary integration are characterised by significant correlation, since promoting of each one positively impacts the efficient operation of the other, resulting in positive feedback mechanisms: European monetary integration[121] could not possibly have been achieved without prior liberalisation of capital movements (the latter being also among the essential preconditions for the establishment of a single financial area); respectively, European monetary integration has essentially contributed towards further strengthening the process of European financial integration.

For the purposes of this study, financial integration is thus defined as the aggregation of the financial systems of two or more sovereign states within the framework of the operation of a single economic area, which is aimed at meeting the three above-mentioned conditions pertaining to the

economic policies of participating states with a view to implementing a single macroeconomic policy.

[119] See Herring and Litan (1995), pp. 13–48.

[120] See European Central Bank (2008), p. 6.

[121] Even though the term 'monetary integration' is often used in this context, the author deems the term 'monetary unification' as more accurate.

operation of a single financial area and pursued either (and mainly) through the regulatory framework or (to a lesser extent) by means of self-regulation and/or market-led initiatives.[122]

(2) To the extent that financial integration is pursued through the regulatory framework, two dimensions can be identified: a negative and a positive one: the materialisation of negative financial integration requires, on the one hand, the liberalisation of trade in financial services and, on the other hand, the adoption of rules to ensure free competition in the financial system, a policy objective of primary importance for the entire common economic area (i.e. not particular to the financial system only); the implementation of this dimension should be regarded as the 'necessary' condition for achieving full financial integration. On the other hand, the content of positive financial integration, which constitutes the 'sufficient' condition for achieving full financial integration, comprises, in the author's view, two levels: according to a *stricto sensu* approach, the achievement of positive integration initially requires the adoption of rules that, within a single financial area, enable meeting the objectives of regulatory intervention in the financial system, that is specific financial policy objectives. These rules must be designed so as to ensure conditions of competitive equality across all categories of financial firms operating in the single area, offering similar services and exposed to similar risks. In this context, there are three issues of key significance that need to be addressed[123]:

- the first concerns identifying the necessary financial policy objectives (goals) and the appropriate financial policy instruments in order to achieve them[124];
- the second issue concerns the level and extent of harmonisation of rules, within a single financial area, which prescribe regulatory intervention in order to meet the identified financial policy objectives: minimum or maximum in terms of extent, partial or full in terms of scope; and
- the third (related) issue concerns designating administrative authorities (and, in certain cases, schemes), which should be competent for the implementation of regulatory intervention in the financial system; in

[122] For a detailed presentation of these conditions which, once met, signify that full financial integration has been achieved, see European Central Bank (2008), pp. 64–65.

[123] For more details, see Gortsos (1996), pp. 79–89.

[124] By application of the rule established by Tinbergen (1952), the achievement of a specific set of policy objectives requires an equal number of instruments.

this respect, decisions need to be taken on two further issues: whether these authorities and schemes should remain national or become supranational, and if national, which state's authorities and schemes should be competent for foreign branches and subsidiaries) of financial firms operating in several states within the single financial area.

The undoubtedly more ambitious aspect of positive financial integration consists in the adoption of a single set of rules with respect to the provision of financial services, namely a single 'financial contracts law'. Meeting this parallel target, according to a *lato sensu* approach of positive financial integration, would require the full harmonisation of corresponding aspects of private law of participating states.[125]

*Main Aspects of European Financial Law*

**Definition, Field of Application and Sources of European Financial Law**

(1) As just mentioned, implementation of financial integration is sought either through the regulatory framework established by intergovernmental and/or supranational authorities, through self-regulation, or, finally, through market-led initiatives. In the EU, implementation of financial integration through the regulatory framework is sought (and achieved) with the adoption of the provisions of those legal acts that constitute the sources of European financial law, a subset of European economic law. Based on the definition of the concept and the two dimensions of financial integration, the author considers that European financial law can be defined, in principle, as the set of provisions of secondary EU law aimed at the achievement of the EU's negative and positive financial integration, with a view to creating a single financial area in the common market, positive financial integration relating to the achievement at EU level of specific financial policy objectives. Consequently, this concept of European (or EU) financial law, based on a functional approach, is demarcated on the basis of legal acts issued by the competent EU institutions aimed at implementing three of the EU law's basic freedoms (capital movement freedom, freedom of establishment and freedom to provide services) in relation to various categories of EU financial firms, in the context of negative financial integration, and

[125] On the evolution of European contract law in the Banking and Financial Union, see Grundmann and Sirena (2019).

adopting provisions on the implementation of specific financial policies, in the context of positive financial integration.[126]

(2) The perimeter of Member States to which the rules of the various legal acts which constitute the sources of European financial law apply is variable: in principle, these legal acts are addressed to all Member States; by way of exception, the provisions of the legal acts which constitute the legal basis of the main pillars of the Banking Union apply only to the Member States whose currency is the euro, even though Member States with a derogation may also participate therein; in this case, such legal acts apply to them as well ('eurozone +')[127]; finally, the majority of the legal acts adopted (mainly) in the form of Directives also apply to Iceland, Liechtenstein, and Norway, that is the three of the four Member states of the European Free Trade Association, which, together with the EU Member States, form the European Economic Area (the 'EEA').[128]

(3) Unlike EU monetary law, the main provisions of which are based (as already mentioned) on the Treaties, the sources of EU financial law are legal acts of EU institutions [namely the European Parliament and the (ECOFIN) Council, upon proposals of the (European) Commission and (mainly in the field of EU banking law, which one of the branches of EU financial law) under the opinion-giving influence of the ECB], which are adopted on the basis of various TFEU Articles, which pertain to the single market (by default, Article 114). The only TFEU Articles, which explicitly refer to issues relating to financial stability, are Articles 127(5) and 127(6); the former allows the ECB to issue opinions and the latter forms the legal basis for the adoption of Regulations by the Council (only).[129]

### The Impact of Public International Financial Law on the Shaping of European Financial Law

The impact of public international financial law[130] on EU financial law has been extremely significant since the 1980s. Indeed, EU financial law is

[126] For an overview of European financial institutions, see de Haan et al. (2015).

[127] On the Banking Union, see Chap. 4.

[128] Switzerland, the fourth EFTA member state, is not a member of the EEA.

[129] On these two TFEU Articles, see Chap. 3, Sect. 3.1.2 and Chap. 5, Sect. 5.2.2.

[130] Public international banking law is defined as the set of rules of international financial law, which apply exclusively to banks, whereby the following two objectives are sought: the first is to ensure the liberalisation of trade in banking services, and the second consists in ensuring the stability of the banking system, which may be disrupted as a result of the occurrence of contagious bank failures (see Gortsos (2012), p. 109). Its sources are Reports pro-

being shaped gradually, always within the limits set by the institutional framework based on the initiatives taken and the decision made by EU institutions, within the context of political conditions prevailing in each given period, but also taking into account developments in public international financial law. By way of mere indication, it is noted that, despite the autonomous development of the process of European financial integration, the content of a significant subset of the legal acts constituting the sources of EU banking law is being shaped under the influence of public international banking law, and in particular the international financial standards developed by the Basel Committee on Banking Supervision (hereinafter the 'Basel Committee', also referred to by the acronym 'BCBS')[131] and the International Association of Deposit Insurers (the 'IADI'[132]). In addition, regulatory measures adopted as a response to the recent international financial crisis[133] were taken over from the international financial reform agenda, mainly the work orchestrated by the FSB.[134]

*The Branches of European Financial Law*

**Introductory Remarks**

Considering the above and taking into account the various financial policy objectives pursued, it is the author's position that European (EU) financial law contains five separate, albeit closely linked branches: European (or EU) banking law, capital markets law, insurance law, financial conglomerates law, as well as payment and settlement systems law. The approach adopted for the definition of the individual branches of European financial law, especially as to the dimension of positive financial integration, is the functional one. Such an approach is not only suitable, but also necessary, because, if the definition was based on an institutional approach (focusing

duced by international financial fora, which contain international financial standards; on the legal nature of these standards, which constitute international soft law, see, by way of mere indication, Giovanoli (2010), pp. 34–37, Wandel (2014) and Gortsos (2019c), pp. 54–55. On the evolution of public international financial law, see Gortsos (2012), pp. 118–131.

[131] On the establishment, membership and objectives of this international financial forum, see Giovanoli (2010), pp. 25–26, Goodhart (2011), Wandel (2014), pp. 78–79, Lastra (2015), pp. 505–507 and Gortsos (2019a), pp. 109–129.

[132] On this international financial forum, see Gortsos (2016b), pp. 8–15.

[133] On this crisis, see Chap. 3, Sect. 3.1.2.

[134] On this international financial forum, see indicatively Giovanoli (2010), pp. 19–25, Nobel (2019), pp. 288–299, Thiele (2014), pp. 541–545 and Gortsos (2019a), pp. 62–64.

on the categories of financial firms coming under the individual scope of relevant provisions), there would be extensive overlapping between individual branches.[135]

'Credit institution' means any undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.[136] An 'EU credit institution' means a credit institution incorporated under the laws of a Member State of the EU or a member of the EEA. On the other hand, a 'non-EU credit institution' means a credit institution incorporated under the laws of a third country, which is not a Member State of the EU or a member of the EEA.

It is also noted that EU financial law does not include EU provisions of horizontal character, such as EU competition law, EU consumer protection law (despite the existence of sector-specific rules) and EU law on preventing the use of the financial system for criminal activities.

**European (EU) Banking Law**

(1) European banking law (hereinafter the 'EU banking law') is defined as the set of provisions of EU financial law, aimed at the following two objectives: to materialise the two basic freedoms laid down in the Treaties, that is the freedom of establishment (by setting up branches) and the freedom to provide services, with regard to EU credit institutions; and to ensure the stability of the European banking system, which may be disrupted due to the occurrence of contagious credit institutions' failures. For the achievement of the latter objective, EU banking law contains rules on the authorisation of credit institutions, the micro-prudential and macro-prudential regulation of credit institutions, the micro-prudential supervision of credit institutions, the macro-prudential oversight of the

[135] As an indication, the regime governing the operation of EU credit institutions is also affected by the rules of almost all the other branches of EU financial law (with the exception of insurance law). If the institutional approach were to be adopted, these provisions would need to be concurrently included in European banking law (alternatively defined in this case as "European law of credit institutions"), as well as in EU capital markets law, if they also apply to investment firms. Moreover, given that EU credit institutions (and all other categories of EU financial firms) are also subject to the provisions of several other legal acts constituting the sources of other branches of European economic law not included in European financial law, if the functional approach was not pursued, these provisions should also be included, for reasons of consistency, in EU banking law.

[136] This definition was originally introduced in the Council's so-called First Banking Directive (77/780/EEC) and then recurrently adopted, unchanged, in subsequent legal acts constituting the sources of EU banking law; this legal act is discussed in Chap. 3, Sect. 3.2.2.

banking (and, more generally the financial) system, the reorganisation, resolution and winding up of credit institutions, and deposit guarantee. By contrast, there are no rules on the functioning of central banks as lenders of last resort, since this function is exercised in an environment of 'constructive ambiguity'.[137]

(2) The overwhelming majority of the provisions of EU banking law apply to EU credit institutions. This branch of EU financial law also contains provisions on the establishment and operation of branches of non-EU credit institutions in Member States. Some provisions of EU banking law also apply to EU 'financial institutions', which are subsidiary undertakings of EU credit institutions. This category comprises mainly finance, leasing and factoring companies. It is noted that the term 'financial institution' is defined to mean an undertaking, other than a credit institution or an investment firm, the principal activity of which is to acquire holdings or to pursue any of the activities listed in points (2)–(12) and (15) of Annex I to one of the sources of EU banking law [the so-called Capital Requirements Directive IV (CRD IV)].[138] Accordingly, the use of this term when referring to firms active in general in the financial sector is not appropriate—in that context, the term 'financial firms' is suitable.

**The Other Branches**

EU capital markets law: EU capital markets law is the branch of European financial law containing provisions aimed at complying with four policy objectives: materialise the freedom of establishment (by setting up branches) and the freedom to provide services, with regard to EU financial firms providing services in capital markets (investment services); ensure the compensation of investors in case of suspension of operations of a firm providing investment services (credit institution or investment firm), if it is not in a position to return investors' funds or financial instruments; to ensure the stability of capital markets; ensure the protection of investors that wish to invest, or already invest, in primary and derivative financial instruments, that are either going to be listed in a regulated market (the 'primary market'), or are already being traded therein (the 'secondary market'); and, finally, ensure capital markets' integrity, efficiency and transparency. The 'closeness' of the connection between the two latter financial policy objectives can be explained by the

[137] On this aspect, see Chap. 9, Sect. 9.3.1.

[138] See Chap. 4, Sect. 4.2.2.

fact that they share, to a large extent, the same financial policy instruments, making their distinction often difficult.[139]

A considerable amount of the provisions of EU capital markets law applies to credit institutions for two reasons: first, credit institutions are entitled, since 1996, to provide the entire range of investment services and activities on an individual basis, according to the 'universal banking model'[140]; in addition, a significant number of credit institutions are listed in regulated markets and, therefore, the provisions on the regulatory obligations imposed on listed companies also apply thereto.

EU insurance law: EU insurance law is the branch of European financial law containing provisions seeking to materialise the freedom of establishment (by setting up branches) and the freedom to provide services, with regard to EU financial firms providing insurance and re-insurance services, and to safeguard the stability of the insurance sector of the financial system. Notwithstanding very few exceptions, the provisions of EU insurance law do not apply to credit institutions. This is due to the fact that, in the majority of Member States, the provision of insurance and reinsurance services is only permitted for undertakings specifically authorised for this purpose, namely insurance and reinsurance companies.

EU financial conglomerates law: EU financial conglomerates law is the branch of European financial law that contains provisions with regard to the supplementary supervision of financial conglomerates (groups combining banks, insurance companies and investment firms), in order to safeguard the stability of the financial system as regards their activity. The provisions of this branch apply to credit institutions to the extent of their participation in financial conglomerates and over and above the provisions of EU banking law on the micro-prudential supervision of credit institutions (on individual and on consolidated basis).

EU payment and settlement systems law: EU payment and settlement systems law is the branch of European financial law containing provisions seeking to safeguard the stability of payment and settlement systems, as

[139] On these policy objectives and the instruments employed to achieve them, see International Organization of Securities Commissions (2017a): "Objectives and Principles of Securities Regulation", May (available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD561.pdf) and mainly International Organization of Securities Commissions (2017b): "Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation", May (available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD562.pdf).

[140] On this model, see Benston (1994), Saunders and Walter (1994), pp. 3–9 and 84–126, Rheinholdson and Olsson (2012), Lang and Schroder (2012).

well as their efficiency. The majority of its provisions apply to credit institutions either as payment services providers, or due to their participation in payment and settlement systems, as members and/or shareholders. In the author's view, the provisions governing the regulation of securities clearing and settlement systems, which constitute the infrastructure for the functioning of capital markets, can be included in this branch, since, under the internationally prevalent terminology, the meaning of the term 'securities clearing and settlement systems' (used for the clearing and settlement of both securities and payments related to the purchase and sale of securities) falls within the meaning of the more generic term 'payment and settlement systems'.[141] Nevertheless, it is usual to include them in EU capital markets law. It is also common to consider this branch a part of monetary law.

### *1.2.4 A Synthesis: European Central Banking Law*

(1) Since November 2014, there is a stronger link between EU monetary and EU banking law, since the ECB, on top of being a single monetary authority within the Eurosystem, has also become a banking supervisory authority in the context of the Single Supervisory Mechanism (the 'SSM'), which is one of the main elements of the (European) Banking Union and was established by a Council Regulation adopted on the basis of Article 127(6) TFEU. In light of the above, it becomes evident that both EU monetary and EU financial law (and, in particular, EU banking law and some aspects of EU payment and settlement systems law) have an impact on the operation of the ECB and the NCBs in the EU. In relation to the ECB, this is all the more so after the establishment of the SSM, which, as already mentioned, is an element of EU banking law.

(2) Accordingly, under a 'synthesis' and taking into primary consideration the functions that central banks perform in the monetary, the financial, as well as the payment and settlement systems, a distinct branch of European economic law can be identified, that of 'European (or EU) central banking law'. The author defines it as the set of EU rules governing the operation of the ECB and Member State NCBs.[142] Its primary focus is EU rules, either under primary or under secondary law, and shaping the objectives, tasks and competences of such central banks, as well as their inclusion in the EU institutional framework. It also deals with the rules

[141] See Sect. 1.1.4.

[142] The author adopted this term in his recent paper referred to in the secondary sources as Gortsos (2019c).

adopted by such central banks under EU law. On the other hand, EU central banking law does not touch upon the objectives, tasks and competences of NCBs under their respective national legislation, unless this has an impact on EU law.

(3) The sources of EU central banking law, as defined above, are dispersed in various legal sources, which can be grouped in three sets. In particular:

The first set comprises the provisions of EU primary law and the legal acts of secondary law governing the monetary and other basic tasks of the ECB (within the Eurosystem), as well as the other tasks conferred on it by virtue of the TFEU and the ESCB/ECB Statute, that is in principle the provisions of EU monetary law, in force since 1 January 1999 (the establishment of the ESCB/Eurosystem is presented in Chap. 2).

The second set consists of two Regulations: Council Regulation ((EU) No 1096/2010), which conferred upon the ECB specific tasks with regard to the functioning of the European Systemic Risk Board, and Regulation of the European Parliament and of the Council ((EU) No 1093/2010) governing the European Banking Authority (the 'EBA') and the role of the ECB and the NCBs therein. Both these legal acts are sources of EU banking law (the first branch of EU financial law in general) and both constitute pillars of the European System of Financial Supervision (ESFS), which has been in operation since 1 January 2011, the establishment of which is presented in Chap. 3.

Finally, the third set of sources consists of the legal acts governing the (also) specific tasks conferred on the ECB by virtue of the SSM Regulation (SSMR), its (limited) powers under the Single Resolution Mechanism Regulation (SRMR) and the powers of NCBs within these mechanisms, that is a subset of the rules of EU banking law. Both these legal acts constitute the two main pillars of the Banking Union,[143] which has been in operation since 4 November 2014 (in relation to the SSM) and 1 January 2015 [in relation to the Single Resolution Mechanism (SRM)] and their provisions apply only to the Member States whose currency is the euro (without prejudice to the 'close cooperation' procedure under Article 7 SSMR, which has not yet been activated); the establishment of the Banking Union is presented in Chap. 4.

[143] The third main pillar of the Banking Union, the European Deposit Insurance System (the EDIS), is still not in place.

EU central banking law does not encompass the legislative acts adopted by the European Parliament and the Council, as complemented by numerous delegated and implementing acts of the Commission or of the Council, as well as by a significant number of EBA Guidelines, which govern the substantive aspects of banking authorisation, prudential regulation and resolution [Capital Requirements Regulation (CRR), CRD IV and Bank Recovery and Resolution Directive (BRRD)], as well as the Deposit Guarantee Schemes Directive. These apply to all Member States as part of the single market in banking services and are not directly linked to the operation of the ECB and NCBs; nevertheless, they are (partially) taken into account, since the application of the SSMR is based on the CRR and the CRD IV, while the application of the SRMR is based on the BRRD.[144]

This synthesis allows, *inter alia*, an in-depth study of the ECB in the context of all the above-mentioned systems and mechanisms (the ESCB/Eurosystem, which is of relevance to EU monetary law, as well as the ESFS, the SSM and the SRM, which are of relevance to EU banking law), as well as the allocation of tasks and competences between the ECB and the NCBs. In this respect, the field of study of European central banking law is broader than that of ECB law (even though, coincidentally, in both cases the acronym ECB could be used to precede law (!)).

**Box 1.1 Definition of Key Micro- and Macro-prudential Regulations**

Capital adequacy ratio: the minimum amount of regulatory own funds as a percentage of total assets and off-balance sheet exposures weighted by specific risk factors ('risk-weighted assets')

Leverage ratio: the minimum amount of regulatory own funds (usually core own funds) as a percentage of total assets and off-balance sheet exposures without weighting

Liquidity coverage ratio: the ratio of the stock of high-quality liquid assets to total net cash flows over a short period of time (e.g. the next 30 calendar days)

Net stable funding ratio: the ratio of the available amount of stable funding to a required amount of stable funding

(*continued*)

[144] On all these legal acts, see Chap. 4; on the procedure for the making of EU law, see Appendix of Chap. 5.

**Box 1.1 (continued)**

Capital conservation buffers: buffers created during times of economic growth and credit expansion in order to absorb losses generated in times of stress of the economic cycle without recourse to other regulatory capital elements for absorbing losses; they are calculated as a percentage of banks' total risk-weighted assets (according to provisions on the capital adequacy ratio)

Countercyclical capital buffers: buffers created in order to ensure that capital requirements take into account the macro-financial environment in which banks operate; such buffer requirement must be put in place when national supervisory authorities consider that excess aggregate credit growth is deemed to be associated with a build-up of systemic risk—in this context, authorities are called upon to monitor an indicator (including credit growth) that may signal a build-up of systemic risk and assess whether (and to what extent) it is excessive

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CHAPTER 2

# The Establishment of the European System of Central Banks and the Eurosystem

## 2.1 The Treaty of Maastricht as the Foundation of EMU Law

### *2.1.1 The Road Towards European Monetary Unification*

*The Political Decision to Establish a Monetary Union and the Initial Attempts*

(1) The monetary system established since 1 January 1999 in the EU (more precisely, in the majority of its Member States) has been formulated on the basis of the choices affirmed in the Treaty of Maastricht, which was signed in February 1992[1] and entered into force on 1 November 1993. These choices significantly reshaped the (then) intra-Community monetary relationships, since they involved a decision for transition from a regime of monetary policy coordination (stricter or softer, depending on the historical period), autonomously conducted by the Member States through their national central banks (NCBs), to a single monetary policy, exercised at supranational level with the establishment of the European monetary union. Under these circumstances, Member States decided to culminate the monetary unification process by relinquishing their

[1] OJ C 191, 29.7.1992, pp. 1–112; on this Treaty, see, by way of mere indication, Hahn (1993a), Cloos et al. (1994), individual contributions in O'Keeffe and Twomey (1994) (in particular, Dunnett (1994)) and Pipkorn (1994).

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monetary sovereignty,[2] replacing their national currencies with a single (and not a common) European currency, the euro, and conferring upon a new pan-European, supranational institutional entity, the European Central Bank (ECB), the power to define and implement the single monetary policy.[3]

(2) The road towards European monetary unification has been marked by several attempts until final achievement of the end objective, several decades after the foundation of the (then) European Economic Community (EEC), with the entry into force of the Treaty of Maastricht and the successful completion of the timetable set therein. The provisions of the above-mentioned Treaty can be seen as having crowned the institutional initiatives that had been undertaken, to the effect of enabling a single monetary area and preventing any negative side effects of the coexistence within a single market of several national currencies with exchange risk for the trading parties.[4] The key landmarks along this road were the following two:

The first was the establishment of the 'European currency snake' in March 1971; in order to ensure the proper functioning of the progressive narrowing of the fluctuation margins between the (then) Community currencies within this system, a European Monetary Cooperation Fund (the 'EMCF') was also established by the Council in April 1973 and operated under the administrative and technical support of the Bank for International Settlements (the 'BIS').[5]

Subsequently, the European Monetary System (the 'EMS') was launched in March 1979, which operated until 31 December 1998, that is the eve of the introduction of the euro as a single currency; an essential constitutive element of the EMS was an exchange-rate mechanism (the 'ERM').[6]

[2] On the concept of monetary sovereignty, see Mann (1986), pp. 465 ff.

[3] It is reasonable to defend the argument that, if a common currency would have been adopted, circulating in parallel with the euro, the integrity of the euro area would have been even more negatively affected by the 2010 fiscal crisis (on this crisis, see Sect. 2.4.4).

[4] Irrespective, however, of this remark, the European monetary union is not an 'optimum currency area' ('OCA'), that is a geographical region in which the introduction of a single currency would maximise economic efficiency, according to the theory developed by Mundell (1961); see on this, by way of mere indication, Mongelli (2002) and in more detail De Grauwe (2004), pp. 24–59.

[5] On this fund, see Louis (1973) and Smits (1997), pp. 17–18 (the latter also identifying its problems).

[6] On the legal basis, operation, problems and contribution of the EMS to safeguarding a (relevant) monetary stability in the Community, see Smits (1997), pp. 20–26 and Padoa-Schioppa (1994), pp. 68–85.

*International Institutional Parameters*

(1) Attention should be drawn, at this point, to two international institutional parameters. First, the exchange rates of Member States' currencies were stable until 1971, due to the participation of the Member States in the international system of stable (but adjustable) exchange rates, operating within the framework of the International Monetary Fund (the 'IMF'). The IMF is an international economic organisation of 189 Member States and belongs to the group of specialised organisations of the United Nations.[7] It was set up by virtue of an international treaty concluded at the United Nations Monetary and Financial Conference in Bretton Woods (New Hampshire, United States, widely known as the 'Bretton Woods Agreement'), which was signed in 1944 and entered into force on 27 December 1945. Its initial principal tasks consisted of monitoring the international system of fixed (but adjustable) exchange rates[8] (known as the 'Bretton Woods system'), and providing financial assistance to its Member States when faced with problems in their balance of payments, upon conditionality.[9] The IMF was thus established as both an international monetary organisation and as a lender of last resort for sovereign states.

The 'Bretton Woods system' was *de facto* abolished in December 1971 following the signing of the 'Smithsonian Agreement' by the G10. *De jure*, the system was abolished in 1978 by the second amendment of the Articles of Agreement of the IMF.[10] The instability of exchange rates, beginning in the early 1970s, with what was in reality a suspension of the US dollar convertibility into gold, along with the abolition of that system and the transition to the international system of freely floating exchange rates, currently still in force, called for the activation of mechanisms promoting monetary cooperation among Member States, reducing exchange-rate volatility and achieving monetary stability in Europe. This led to the creation of the 'currency snake', the EMCF and the ERM.

[7] This category includes 15 international organisations linked to the United Nations by special agreements; their activity covers a wide range of issues (such as monetary relations, economic development, agricultural policy, education, health, telecommunications and meteorology).

[8] Articles of Agreement (1945), Article IV.

[9] Articles of Agreement (1990), Article V ("Operations and Transactions of the Fund"); on these tasks, see Lowenfeld (2009), pp. 613–617 and 622–624, and Lastra (2015), pp. 415–422.

[10] For a review of this system and the conditions for its abolishment, see, by way of mere indication, Hooke (1981), Eichengreen (1994), pp. 50–54, Lowenfeld (2009), pp. 622–633 and Lastra (2015), pp. 412–426.

(2) Second, it is noted that international cooperation among central banks took place (and still does) at the BIS, another international organisation established in 1930 by the Hague Convention and signed among six states and Switzerland[11]; its seat is located in Basel. In July 2019, shareholders of the BIS, a private company limited by shares[12] under Swiss law, were 59 NCBs and monetary authorities/agencies, including the ECB.[13] Its statutory tasks consist of the following: first, promotion of cooperation between its member central banks; second, provision of additional facilities to its members for international financial transactions (in this sense, the BIS is also a bank, since it has the power to accept deposits from central banks and international organisations and provide short-term credit to other central banks); and finally, acting as a trustee or agent with regard to international financial settlements entrusted to it under agreements with the parties concerned.[14]

*The Delors Committee Report*

### The Report's Proposals

(1) The institutional initiative that acted as a catalyst for promoting the actions with regard to European monetary unification was undoubtedly the Single European Act of 1987[15]; this was the first major revision of the Treaty of Rome, signed on 25 March 1957 by Belgium, France, Italy, Luxembourg, the Netherlands and West Germany, enacted on 1 January 1958, by virtue of which the (then) 'European Economic Community' was established. This revision laid the foundations for achieving (negative and positive) microeconomic integration in the European Community (the 'EC', as the EEC was renamed) through the

[11] The text of this Convention is available at: https://www.bis.org/about/convention-en.pdf. The initial Statutes of the BIS are available at: https://www.bis.org/about/charter-en.pdf.

[12] BIS Statutes (2016), Article 1; these Statutes, as in force, are available at: https://www.bis.org/about/statutes-en.pdf.

[13] The operation of the BIS in Switzerland is governed by the provisions of the "Headquarters Agreement" of 1987 (as currently in force). This agreement is available at: https://www.bis.org/about/headquart-en.pdf.

[14] BIS Statutes (2016), Article 3, as further specified in Articles 19–25. For an analytical study on the work of the BIS during the period 1930–1973, see Toniolo (2005). On the more recent tasks of the BIS, see Nobel (2019), pp. 300–305.

[15] OJ L 169, 29.6.1987, pp. 1–19.

creation of a single market by 1 January 1993. It then became clear that maintaining in force a multi-currency system would not allow fully capitalising on the benefits arising from the operation of the single market, especially in the financial sector.[16]

(2) In 1989, an Experts Committee was set up under the chairmanship of the (then) Commission President Jacques Delors (hence, also known as the 'Delors Committee') with the mandate to systematically record the necessary conditions for a European monetary union to be established.[17] In accomplishment of its mission, the Delors Committee submitted a Report, which recommended four main policies[18]: first, irrevocable fixing of exchange rates of Member States' currencies, fulfilling specific criteria of economic and legal convergence; second, implementation of a single monetary and a single exchange-rate policy, with a primary goal of maintaining price stability; furthermore, establishment and operation of a supranational community entity entrusted with the main duty of defining and implementing this single monetary and exchange-rate policy; and finally, the creation of a single currency, to be put in circulation in coins and banknotes, once the monetary union has been established and as soon as it is practically feasible.

**The Political Adoption of the Report's Proposals**

The Delors Committee's Report was widely accepted by the majority of the Member States.[19] As a result, the procedure for revising the Treaty of Rome was set in motion, since, even as amended by the Single European Act, it did not constitute a sufficient legal basis for the operation of a monetary union. In this context, Member States had to decide on the structure of and the arrangements governing the monetary union, and, more specifically, in respect of the following key issues: first, the structure of the institutional framework of the new monetary system and, in particular, the

[16] On the synergies between microeconomic integration and monetary unification, see Chap. 1, Sect. 1.2.3.

[17] A "Werner Committee Report" had been produced before, in 1971; however, the circumstances at the time were not appropriate for the implementation of the idea of European monetary integration. On this report, see, by way of mere indication, Smits (1997), pp. 15–17.

[18] For an assessment of the Delors Committee proposals, see Smits (1997), pp. 38–40 and Padoa-Schioppa (1994), pp. 137–149.

[19] However, the UK and Denmark were exempted from their participation in the monetary union by virtue of Protocols containing opt-out clauses; see Sect. 2.2.1.

relationship between the supranational, European central bank and the Member States' NCBs, if these were to be maintained; second, the objectives and tasks to be conferred upon the European central bank and, in case of a federal system, upon a European system of central banks; in addition, its bodies, their composition and competences, as well as the extent of its regulatory and sanctioning powers; furthermore, its independence, accountability and transparency, its corporate governance and its overall inclusion in the existing EU institutional system; and finally, the exact procedure for adopting the single currency, taking into account the fact that the main political decisions, according to what has been mentioned above with respect to the overview of the conclusions of the Delors Committee report, was the adoption of a single—and not a common—currency, as well as its gradual introduction.

### *2.1.2 The Fundamental Choices of the Treaty of Maastricht*

The implementation of the Delors Committee proposals took place in 1992 with the signing of the Treaty of Maastricht, the Articles of which relevant to the economic and monetary union (EMU) were included in the Treaty "establishing the European Community" (TEC).[20] This Treaty marked the decision of the Member States to gradually move towards a monetary union, which was to be achieved simultaneously with the economic unification of the Community. Consequently, the two fundamental choices reflected in that Treaty were the concurrent launch of the procedures of monetary and economic unification[21] and the gradual transition, in three stages, to the economic and monetary union. At the same time, the TEC reflected the choices of the Member States with respect to the above-mentioned main issues relating to the structure of and the arrangements governing the monetary union.[22]

[20] Consolidated version, OJ C 321, 29.12.2006, pp. 37–186.

[21] See Sect. 2.2.

[22] On the establishment of the EMU, see Louis (1989a, b, (1992, 2009), pp. 39–47, Hahn (1990) and (1996) and Häde (1992).

## 2.2 The Choice for the Concurrent Launch of Monetary and Economic Unification—Inherent Asymmetry

### *2.2.1 Introductory Remarks*

The decision for the establishment of a monetary and, at the same time, economic union was based on the argument that a single monetary area, which had undoubtedly been the main policy demand, should only be created, if two conditions were cumulatively fulfilled:

The first condition concerned safeguarding the participation in the single monetary area of only those Member States which will have achieved (on top of legal convergence under the provisions of the TEC) a high degree of convergence of certain essential macroeconomic indexes, both monetary and fiscal, in order for the monetary union to be sustainable and credible.[23] In order for this condition to be fulfilled, the concept of establishing a 'two-speed Community' was accepted and also reflected in the TEC with a differentiation between two categories of Member States: 'Member States without a derogation', which will have fulfilled the abovementioned convergence criteria and will, consequently, adopt the single currency, and 'Member States with a derogation', not adopting the single currency, precisely because they will not have fulfilled the respective criteria. The latter group includes also Denmark and the UK, which enjoy an opt-out status (albeit differentiated) from participation in the EMU, according to the provisions of the relevant Protocols annexed to the TEC [and, following the entry into force of the Lisbon Treaty, annexed to the Treaty of the European Union and the Treaty on the Functioning of the European Union (TFEU)].[24] It is thus obvious that the EU opted for the 'monetarist approach'[25]; in addition, the pursued economic convergence only refers to nominal values.

The second condition concerned laying down the rules to ensure, following the operation of the single monetary area, sufficient coordination of the economic policies and strict budgetary discipline of the Member

[23] TEC, Articles 108–109 and 121(1) (Articles 130–131 and 140(1) TFEU).

[24] Ibid., Article 122(1); on the conditions for joining the EMU and the position of the Members States with a derogation, see Steindorff (1996), Kerse (1997), Smits (1997), pp. 134–139 and Louis (2009), pp. 51–70 and 80–83.

[25] On this approach, see Chap. 1, Sect. 1.2.2.

States (mainly of these which will have adopted the single currency), in order to safeguard smooth operation of the monetary union and the single currency's strong value. According to the TEC, together with the monetary union and in order to support its effective operation, the action of the Member States and the Community should be oriented towards the simultaneous creation of an economic union. This choice was reflected in the fundamental provision of Article 2 TEC, according to which the mission of the Community is achieved, *inter alia*, with the establishment of an 'economic and monetary union'.[26]

### 2.2.2 Definition of the European EMU

*The Monetary Union*

(1) The establishment of the European monetary union was based on Article 4(2) TEC, whereby "(…) these activities (of the Member States and the Community) shall include the irrevocable fixing of exchange rates, leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange-rate policy (…)".[27] The procedure of monetary unification led, as a consequence, to stronger coordination of the (until then relatively independent) monetary policy of the Member States of the Community[28] aimed at irrevocably fixing nominal exchange rates among their national currencies, putting into operation appropriate mechanisms for the conduct of a single monetary (and a single exchange-rate) policy on European level and introducing a 'single currency' to replace the national currencies of the Member States fulfilling the required criteria for its adoption.[29]

(2) As already mentioned,[30] subsidiarity, that is a partially national monetary policy, cannot exist within a single monetary area[31]; consequently,

[26] By way of mere indication, see Ukrow (1999).

[27] By way of mere indication, see Häde (1999), pp. 293–305.

[28] The monetary policy of the Member States was delimited during that period by their participation in the mechanism of exchange rates of the European monetary system.

[29] For a detailed presentation of the road towards the EMU, see Bini-Smaghi et al. (1994), Steinherr (1995), Vanthoor (1996), Smits (1997), pp. 10–35, Eijffinger and de Haan (2000), pp. 3–30, De Grauwe (2004), pp. 129–147, Issing (2008), Louis (2009), pp. 9–37, Proctor (2012), pp. 681–700, and Lastra (2015), pp. 219–245.

[30] See Chap. 1, Sect. 1.2.2.

[31] From an EU legal point of view, the principle of subsidiarity does not apply to the exclusive competencies of the EU, such as the monetary policy; see also Sect. 2.3.3. On this

in the context of the operation of the EMU, the establishment of a supranational entity, competent for—at least—the definition and implementation of a single monetary policy, was deemed necessary. With the Treaty of Maastricht, the Member States made the political decision to proceed to the establishment of such a supranational entity, the ECB, upon which the Member States conferred the competences of their NCBs with respect to the definition and implementation of monetary (and exchange-rate) policy, with the primary goal of safeguarding price stability.[32]

The European Monetary Institute (the 'EMI') was established as the predecessor of the ECB at the beginning of Stage Two of EMU (1 January 1994) and was liquidated upon creation of the ECB on 1 June 1998. The EMI had legal personality, was based in Frankfurt,[33] took over the assets of the EMCF (which was liquidated on 31 December 1993) and, according to Article 1.2 of its Statute (which was included in Protocol (No) 19, annexed to the TEC), its members were the NCBs of all Member States (including the BoE). Its main task was the contribution to the shaping of the necessary conditions for the transition to Stage Three of EMU and the enhancement of cooperation among its members.[34] Its first President was the Belgian central banker Alexandre Lamfalussy[35] and then the Governor of the NCB of the Netherlands, Willem Duisenberg (who in 1998 was also appointed as the first President of the ECB).

A fundamental choice to which the Member States concluded was the establishment of the European System of Central Banks (ESCB), consisting of the ECB and the NCBs of all Member States (and not only the Member States adopting the euro). Consequently, NCBs continue to exist, although subject to limitations with regard to their degrees of freedom.[36] The ESCB and the ECB were expected to "act within the

principle (currently governed by Article 5(3) TEU), see Lienbacher (2019), pp. 103–120, Craig and de Búrca (2015), pp. 95–102 and Fabbrini (2018).

[32] TEC, Articles 4(2) and 105(1). The ECB is structured (albeit with significant differences) on the example of the central bank of Germany (Deutsche Bundesbank) and (to a lesser extent) the federal system of USA central banks (Federal Reserve System). For a detailed comparative presentation of these central banks, see Central Bank Governance Group (2009); on the relation between the ECB and the Bundesbans, see de Haan (2000).

[33] Council Decision of 29 October 1993, taken at the level of Member States' Heads of State or Government.

[34] TEC, Article 117; on the EMI, see Louis (1993, 2009), pp. 49–51.

[35] On the important contribution of Lamfalussy also in the field of EU financial law, see Chap. 3, Sect. 3.2.3.

[36] On the role of NCBs in the ESCB under the TEC, see Potacs (1993); this aspect is discussed in more detail, under the TFEU, in Chap. 5, Sect. 5.1.2.

limits of the powers conferred upon them by this Treaty and by the Statute of the ESCB and of the ECB annexed thereto".[37]

(3) Even though the NCBs of all Member States participate in the ESCB, it is noted that most provisions of primary and secondary EU monetary law were not applicable (even after enactment of the Treaty of Lisbon[38]) to the NCBs of Member States with a derogation, as these States have not adopted the euro as a single currency. Therefore, it must be pointed out that there is a difference between the two fundamental concepts of EU monetary law: the ESCB and the Eurosystem: on the one hand, the ESCB consists of the ECB and the NCBs of all Member States of the EU; on the other hand, the Eurosystem, which constitutes the main case study within the context of EU monetary law, consists of the ECB and the NCBs of Member States whose currency is the euro; respectively, the concept of 'eurozone' or 'euro area' is defined as the total number of Member States which have adopted the euro as a single European currency.

*The Economic Union*

(1) The concept of the economic union was defined in Article 4(1) TEC, according to which "for the purposes set out in Article 2, the activities of the Member States and the Community shall include (…) the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives". The concept of internal market was defined in Article 14(2) TEC, which reads as follows: "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."[39] According to this definition, the economic policy

[37] TEC, Article 8; by way of mere indication, see Häde (1999), pp. 362–363. On the legal aspects of the EMU and the ECB (with the exception of its specific tasks with regard to the prudential supervision of credit institutions, which are discussed in Chaps. 4, 5 and 8), see Hahn (1991, 1993b), Sarcinelli (1992), Mestmäcker (1994), Roth (1994), Slot (1994), Hahn and Häde (1995), Mehnert-Meland (1995), Stadler (1996), Smits (1997), Louis (1998), (2009), Zilioli and Selmayr (2000), (2001), Issing et al. (2001), various contributions in European Central Bank (2005) (including Smits 2005), Hadjiemmanuil (2006), Scheller (2006) and Lastra and Louis (2013).

[38] See Sect. 2.3.

[39] The establishment of an internal market, particularly in the field of financial services, forms a fundamental constitutive element of the monetary unification project. For an overview of this aspect, see Smits (1997), pp. 37–57, who assesses the internal market as the third constitutive element of EMU.

of the Member States (or, more specifically, dimensions other than the monetary and foreign exchange ones of their economic policies) was not 'communitised'.

A single economic policy, according to the model monetary policy (meaning that it would become an exclusive EU competence), when and if achieved, would mean that the participating Member States would no longer enjoy, in essence, any degree of freedom in the conduct of their macroeconomic policy in general. Therefore, the decision for full economic unification in such form would result in a more decisive step towards European political integration.

(2) As a consequence, upon initiation of Stage Three of EMU, on 1 January 1999, no Member State, either having adopted the single currency or not, has lost independence in the conduct of its fiscal policy. Within the framework of the new European economic governance, though, the principle of autonomy in the conduct of fiscal policy was significantly limited, though, by the institutional framework governing the operation of the economic union, which was (and still is) composed of provisions governing, on the one hand, the coordination of Member States' economic policies, and, on the other, fiscal discipline. The latter consisted of a procedure for the monitoring of excessive government deficits and the imposition of certain prohibitions imposed upon the Member States with respect to the financing of their public expenses, including the so-called no-bail-out clause not allowing their direct financing by the other Member States or by the EU. Finally, the institutional framework governing the economic union contained provisions on the so-called Community (economic) solidarity.[40] On the other hand, however, it did not contain any provisions for the management of sovereign debt crises in the euro area.[41]

It is worth noting that a Member State's non-compliance with the requirements laid down in Article 104 TEC on the excessive deficit procedure, enables the Council to decide to require that Member State to publish additional information, to be specified by the Council, before issuing

[40] TEC, Articles 99 (on economic policy coordination), 101–104 (on fiscal discipline) and 100 (on economic solidarity). On these provisions, see Italiener (1997), Taylor (1997) (dealing, in particular, with the separation of monetary and fiscal policy in Stage Three of EMU), Hahn (1998) and Buti and Sapir (1998).

[41] On the no-bail-out clause, the provisions governing economic solidarity and the lack of sovereign debt crisis management mechanisms, see also Sect. 2.4.4, when discussing the ongoing fiscal crisis in the euro area.

bonds and securities, invite the European Investment Bank (the 'EIB') to reconsider its lending policy towards it, require that Member State to make a non-interest-bearing deposit of an appropriate size with the EU until the excessive deficit has been corrected and/or to impose fines of an appropriate size.[42] It is obvious that such measures constitute a framework for corrective action, but cannot be applied as crisis management tools.

### *2.2.3 Definition of EMU Law*

Taking into account the above, the term 'European (or EU) economic and monetary law' ('EMU law') can be defined as the sum of provisions of the European institutional and regulatory framework governing the EMU. In turn, the term 'European (or EU) monetary law' is defined, as already mentioned,[43] as the set of primary and secondary EU law provisions which govern what has become known as 'the M' of the EMU. EMU law is one of the branches of EU economic law. Its sources, contrary to other fields of European economic law [such as European (or EU) financial law, including EU banking law[44]], are found both in provisions of primary EU law and in legal acts of secondary European law (see Sects. 2.3 and 2.4, respectively).

In that respect, EMU law is not identical to European central banking law, as defined in this book.[45] On the one hand, the rules governing the economic union are outside the scope of European central banking law, while, on the other hand, this includes a significant part of EU banking law.

## 2.3 Primary EU Law as a Source of EMU Law

### *2.3.1 General Overview*

The fundamental source of EMU law is primary EU law. Certain general provisions on the EMU and the ECB, albeit to a limited extent, were included in the Treaty on European Union of 1992 (the 'TEU (1992)'),[46] while the main provisions were contained in the TEC. Following the entry

[42] TEC, Article 104(11), first sub-paragraph.
[43] See Chap. 1, Sect. 1.2.2.
[44] On the sources of EU banking law, see Chaps. 3 and 4.
[45] See Chap. 1, Sect. 1.2.4.
[46] Consolidated version, OJ C 321, 29.12.2006, pp. 1–35.

into force of the Treaty of Lisbon, which was signed on 13 December 2007 and entered into force on 1 December 2009,[47] some general provisions continue to be included in the current Treaty on European Union (the 'TEU') and the main provisions, albeit broadly amended, are stipulated in the TFEU.[48] Sources of EMU law also were (and still are) various Protocols, which were annexed to the TEC or to various 1992 Treaties and currently, following the entry into force of the Lisbon Treaty, are annexed to the TEU and TFEU (jointly referred to as 'the Treaties').[49] Prevailing among these Protocols was (and still is) the Protocol on the Statute of the ESCB and the ECB. The TEU provisions which constitute sources of EMU law are presented in Sect. 2.3.2 and those of the TFEU, in Sect. 2.3.3. The structure and the procedures of amending the Statute of the ESCB and the ECB and the other Protocols are presented in Sect. 2.3.4.

### *2.3.2 The Provisions of the TEU*

The number of TEU Articles referring to the EMU is limited (albeit fundamental). In particular: Article 3(4) (which corresponds to Article 2 TEU (1992) and refers to the EU objectives) stipulates that "the Union shall establish an economic and monetary union whose currency is the euro".[50] Moreover, the Lisbon Treaty brought about a significant breakthrough in the institutional framework of the EU, with the explicit institutionalisation of the ECB by virtue of Article 13, probably the most significant institutional development in EU monetary law brought about by the Lisbon Treaty.[51] It is noted, however, that the provisions regulating the operation and the tasks of the ECB and the ESCB are included in the TFEU and not in the TEU, in contrast to the corresponding regime of the European Parliament, the European Council, the Council, the Commission

[47] Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Aai0033; for details on the text and a commentary of this Treaty, see Fischer (2008).

[48] OJ C 202 (Consolidated version), 7.6.2016, pp. 1–45 and 47–200, respectively.

[49] According to Article 51 TEU (Article 311 TEC), the Protocols annexed to the Treaties form an integral part thereof and, consequently, their provisions fall within primary EU law.

[50] According to the author's opinion, the last part of this provision ("whose currency is the euro") is not absolutely precise, given that the euro is the currency of specific Member States (viz. those defined as the Member States whose currency is the euro) and not of the EU or the EMU.

[51] TEU, Article 13(1), second sub-paragraph, point (6) (Treaty of Lisbon, Article 1(14)); see, on this, Snyder (2011), pp. 702–703.

and the Court of Justice of the European Union (or European Court of Justice, hereinafter the 'ECJ', also referred to (more precisely) as 'CJEU').[52]

Lastly, Article 48(6) (second sub-paragraph), which refers to one of the simplified procedures for amending the Treaties, provides that the European Council may adopt a decision amending all or part of the provisions of Part Three of the TFEU, where most of the fundamental provisions on EMU are stipulated,[53] deciding by unanimity after consulting the European Parliament and the Commission, and also the ECB in the case of "institutional changes in the monetary area". On the basis of this procedure, the new Article 136(3) TFEU was introduced in 2011 (the only TFEU amendment amidst the ongoing euro area fiscal crisis) by means of European Council Decision 2011/199/EU.[54]

### *2.3.3 The Provisions of the TFEU*

*Fundamental Articles*

The Lisbon Treaty brought about amendments, of larger or smaller extent and importance, on many TEC provisions concerning the EMU, while others were repealed.[55] The new provisions are included in the TFEU. In particular, the field of monetary policy for the 'Member States whose currency is the euro', as the Member States without a derogation were renamed,[56] is one of the exclusive EU competences.[57] On the contrary, the field of coordination of economic policies falls within neither the EU's exclusive competences nor its shared competences with the Member States; it is regulated by Article 5(1), which reads as follows: "The Member States shall coordinate their economic policies within the Union. To this end, the Council shall adopt measures, in particular broad guidelines for these policies. Specific provisions shall apply to those Member States whose currency is the euro."[58]

In addition, of particular importance is Article 119, which provides (in its two paragraphs, respectively) a definition of both the economic policy

[52] Ibid., Articles 14–17 and 19, respectively; on this, see Snyder (2011), p. 702.

[53] See Sect. 2.3.3.

[54] OJ L 91, 6.4.2011, pp. 1–2.

[55] Treaty of Lisbon, Article 2(1).

[56] Ibid., Article 2(2), point (i).

[57] TFEU, Article 3(1), point (c). On Article 3 TFEU, see Pelka (2019).

[58] The same provision is found in Article 2(3) TFEU; on this, see Snyder (2011), p. 701.

and the economic union and underscores the fundamental differences in their design (emphasis added in bold): "For the purposes set out in Article 3 of the [TEU], the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition."

"Concurrently with the foregoing, and as provided in the Treaties and in accordance with the procedures set out therein, these activities shall include a single currency, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Union, in accordance with the principle of an open market economy with free competition."[59]

*The Main Corpus of the TFEU on the EMU and the ECB*

(1) The critical mass of provisions is included in Articles 119–144, which fall within the TFEU's Title VIII ('Economic and Monetary Policy') of Part Three ('Union Policies and Internal Actions'). More specifically:

Chapters 1 and 2 (entitled 'economic policy' and 'monetary policy', respectively) contain the main provisions of the two legs of the EMU; the first includes Articles 120–126 on the economic union (which actually reflect without major amendments those stipulated in Articles 98–104 TEC[60]) and the second Articles 127–132 on the monetary union (actually reflecting without major amendments as well those stipulated in Articles 105–110 TEC.[61] Furthermore, a new Article 133 was inserted in Chap. 2 on measures for the use of the euro.[62] In this respect, it is noted that upon the start of Stage Three of EMU on 1 January 1999, the Eurosystem was endowed with four 'basic tasks': the definition and implementation of the

[59] For an analysis of this Article, see Hatje (2019); on Article 3 TEU, see Becker (2019).

[60] For an analysis of these Articles, see, by way of mere indication, Hattenberger (2019).

[61] Treaty of Lisbon, Article 2(91)–(97), and Annex, Correspondence Table B. It is noted, however, that the individual paragraphs of Article 111 TEC were placed in the TFEU as follows: paragraph 4 in Chap. 4, as Article 138 TFEU, and paragraphs 1–3 and 5 in the (new) Part Five of the Treaty on the Functioning of the European Union ("The Union's external action"), in Title V ("International Agreements") as Article 219.

[62] On this Article, see further in Sect. 2.4.3.

monetary policy of the EU,[63] the conduct of foreign exchange operations consistent with Article 219 TFEU, the holding and management of Member States' official foreign reserves and the promotion of the smooth operation of payment systems.[64] The ECB also has been endowed with other tasks, as laid down in Article 127(6) TFEU on certain aspects relating to the prudential supervision of (*inter alia*) credit institutions and Article 128 TFEU on the issuance of banknotes and coins denominated in euro.[65]

With regard to the distinction between basic and non-basic tasks, the author subscribes to the comment made in Lastra and Louis (2013): "Though this distinction is not always clear in our opinion, it is enshrined in the Treaties and, therefore, has legal consequences",[66] noting, however, that the basic tasks have been conferred upon the ESCB/Eurosystem, while the specific and other tasks are those of the ECB.

Chapter 3 (entitled 'institutional provisions') governs the Economic and Financial Committee (the 'EFC'), as well as the Council's and the Member States' respective powers to act in case of (potential) 'inertia' of the Commission (Articles 134–135, respectively).[67] The new Chap. 4 (entitled 'provisions specific to Member States whose currency is the euro') includes two new Articles, on the special regulatory power of the Council for the proper functioning of the EMU[68] and with respect to the establishment of the Eurogroup, that is the meetings between Ministers for Finance and Economic Affairs of Member States whose currency is the euro (Articles 136–137, respectively).[69] A newly placed Article on the establishment of common EU positions on matters of particular interest for the EMU and

[63] The first indent of Article 127(2) TFEU refers to the "monetary policy of the Union". Since, however, this paragraph applies only to the Member States whose currency is the euro (ibid., Article 139(2), point (c)), the phrase 'monetary policy of the euro area' is obviously more accurate.

[64] Ibid., Article 127(2); on all these tasks, which are analysed in Chap. 7, Sects. 7.1 and 7.2, see indicatively Smits (1997), pp. 193–202, Papathanassiou (2001), pp. 15–28, Louis (2009), pp. 152–162, and Lastra and Louis (2013), pp. 79–81.

[65] These tasks are analysed in Chaps. 8 and 7.3, respectively.

[66] Lastra and Louis (2013), p. 79. The main legal consequence is that any reference in a legal act to the ECB's basic tasks pertains to those listed in Article 127(2) TFEU.

[67] It is noted that resort to Article 135 has never been made until now.

[68] This Article is also discussed in Sect. 2.4.3.

[69] On the related Protocol annexed to the Treaties, see further in Sect. 2.3.4. In the author's opinion, even though the Eurogroup does not belong to the EU institutions, it does not lack any institutional character under EU law.

ensuring unified representation within international financial institutions and conferences is also included in this chapter (Article 138, which corresponds to Article 111(4) TEC, extensively amended).

Finally, Chap. 5 (entitled 'transitional provisions') contains the only provisions referring to the Member States with a derogation still in force (Articles 139–144); the provisions of Chap. 4 TEC on the transition in Stage Three were repealed.[70] Article 142 TFEU (Article 124(1) TEC) provides that each Member State with a derogation must treat its exchange-rate policy as a matter of common interest, taking into account the experience acquired in cooperation within the framework of the ERM. This is the basis for the new Exchange Rate Mechanism (ERM II), which replaced, as of 1 January 1999, the EMS (on the basis of a Resolution of the European Council of Amsterdam of 16 June 1997). The procedures for the operation of this mechanism, which provides the framework to manage the exchange rates between EU currencies, are laid down in an Agreement between the ECB and the NCBs of the Member States with a derogation. Even though participation therein is voluntary, it still is one of the convergence criteria for entry to the euro area.[71]

(2) The new Article 282[72] together with Articles 283–284 TFEU (which correspond to Articles 112–113 TEC) contain the main institutional provisions governing the ECB. Articles 283–284 were moved to Part Six ("Institutional and Financial Provisions"), Title I ("Institutional Provisions"), Chapter 1 ("Institutions") in order to form the critical mass of provisions governing the ECB as an institution.[73]

[70] In particular, repealed were: Articles 116 with respect to the three Stages of EMU, 117(1), 117(2), point (6) and 117(3)–(9) on the EMI, 118 on the European Currency Unit (the 'ECU'), 121(2)–(4) on the alternative initiation procedures of the third EMU stage, 122(1), 122(2), first sub-paragraph and 122(3)–(6) with respect to the Member States with a derogation, 123(1)–(2) and (4) with respect to the actions that should be undertaken immediately after the decision on the date of initiation of the third EMU stage, and 124(2) with respect to the exchange-rate policy of Member States with a derogation. For details, see Snyder (2011), pp. 702–703.

[71] For updates on participation in this mechanism, see at: https://www.ecb.europa.eu/ecb/legal/107663/1350/html/index.en.html.

[72] This Article, which currently includes all the main institutional provisions of the ESCB and the ECB, incorporated some paragraphs of Articles 105 and 107 TEC.

[73] For a systematic summary of all these TFEU Articles, see the correlation Table 2.1.

**Table 2.1** The system of the main provisions of the TFEU on the EMU

| Part Three ("Union Policies and Internal Actions"), Title VIII ("Economic and Monetary Policy")—Articles 119–144 | | |
|---|---|---|
| Chapters and Articles in the TFEU | Articles in the TEC | Content |
| Chapter 1: Articles 120–126 | Articles 98–104 | Main provisions on the economic union |
| Chapter 2: Articles 127–132 | Articles 105–110 | Main provisions on the monetary union |
| Chapter 2: Article 133 | | New: adoption by the European Parliament and the Council of measures necessary for the use of the euro |
| Chapter 3: Articles 134–135 | Articles 114–115 | Institutional provisions on the EFC and on powers granted to the Council and to Member States |
| Chapter 4: Articles 136–137 | | New: provisions specific to Member States whose currency is the euro—special regulatory powers of the Council for the proper functioning of the EMU and establishment of the Eurogroup |
| Chapter 4: Article 138 | Article 111(4) | Establishment of common EU positions on matters of particular interest for the EMU and ensuring the unified representation within international financial institutions and conferences |
| Chapter 5: Articles 139–144 | Articles 121(1), 122(2), second sentence, 123(5), 123(3), 117(2), first five indents, 124(1) and 119–120 | Transitional provisions |
| Part Six ("Institutional and Financial Provisions"), Title I ("Institutional Provisions"), Chapter 1 ("Institutions") | | |
| Article 282 | | New: main institutional provisions governing the ECB |
| Articles 283–284 | Articles 112–113 | Main institutional provisions governing the ECB |

*Other Articles*

In addition to the above-mentioned, of particular importance are also the TFEU provisions regulating the review of the legality of the ECB's acts by the ECJ, disputes which concern the ESCB and are subject to the ECJ's jurisdiction, the non-contractual liability of the ECB and its servants, as

well as the ECB privileges and immunities.[74] Furthermore, in the case of capital movements to or from third countries, which cause or threaten to cause serious difficulties for the operation of EMU due to exceptional circumstances, the Council may adopt safeguard measures with regard to these countries only after consulting the ECB.[75] Finally, the other institutions, as well as the EU bodies, offices and agencies have the right of access to ECB documents (as well as to those of the ECJ and the EIB) when exercising their administrative tasks. According to a new TFEU provision, the ECB also has the right of access to documents of the other EU institutions, bodies and agencies when exercising its administrative tasks.[76]

### *2.3.4 Protocols and Declarations*

*The Protocol on the Statute of the ESCB and of the ECB*

**Structure**

The organisation and functioning of the ESCB were established, on top of the TEC, in the Statute of the ESCB and of the ECB, which was included in the identically entitled Protocol (No 18) annexed thereto[77]; its content was based on the draft Statute submitted in 1990 by the Committee of Central Banks Governors.[78] The Lisbon Treaty brought about some minor amendments with respect to the Statute's provisions.[79] The Statute, as

[74] TFEU, Articles 263, 265–267 and 277 (corresponding to Articles 230, 232–234 and 241 TEC), 271 (corresponding to Article 237 TEC), 340, third sub-paragraph (corresponding to Article 288, third sub-paragraph TEC) and 343, second sub-paragraph (corresponding to Article 291, second sub-paragraph TEC); several of these aspects are discussed in more detail in Chap. 6; on Articles 266–277, 271 and 277 (not further discussed), see Borchardt (2010), Schwarze and Voet van Vormizeele (2019) and Schwarze and Wunderlich (2019).

[75] Ibid., Article 66 (corresponding to Article 59 TEC).

[76] Ibid., Article 15(3), first–fourth (new) sub-paragraphs; see Zerdick (2010), pp. 353–356 and, in more detail, Görlitz and Schoo (2019), pp. 496–517. The right to access documents of the European Parliament, the Council and the Commission was also established in Article 255 TEC, without reference to the ECB (see Görlitz and Schoo (2019), pp. 494–496).

[77] TEC, Article 107(4).

[78] See Smits (1997), p. 91, explaining the reason why certain TEC Articles are repeated *verbatim* in the Statute.

[79] In this respect, it is noted that Articles 37, 50 and 51, which contained provisions that ceased to apply after the beginning of Stage Three of EMU (a fact that led to a necessary renumbering), were repealed, while Article 10.6 was incorporated as Article 40(2).

**Table 2.2** Structure of the ESCB/ECB Statute

| *Chapters* | *Articles* | *Content* |
|---|---|---|
| Chapter I | Article 1 | Constitution of the ESCB |
| Chapter II | Articles 2–6 | Objectives and tasks of the ESCB |
| Chapter III | Articles 7–16 | Organisation of the ESCB |
| Chapter IV | Articles 17–24 | Monetary functions and operations of the ESCB |
| Chapter V | Article 25 | Conferral upon the ECB of specific tasks relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertaking |
| Chapter VI | Articles 26–33 | Financial provisions of the ESCB |
| Chapter VII | Articles 34–39 | General provisions of the ESCB, including provisions on the legal acts of the ECB |
| Chapter VIII | Articles 40–41 | Simplified procedure for amendment of the provisions of the Statute and the 'complementary legislation' of the Council |
| Chapter IX | Articles 42–50 | Transitional and certain other provisions on the ESCB |

currently in force, is contained in Protocol (No 4)[80] annexed to the Treaties (the 'ESCB/ECB Statute').[81]

Its provisions are included in 50 articles, categorised in 9 chapters.[82]

**Procedures for Amendment**

(1) Pursuant to Article 48 TEU (1992), the Statute's Articles could be amended as any other Article of the TEU (1992), the TEC and all (other) Protocols; the amendments came into force following their ratification by all Member States according to their respective constitutional rules.[83] That was without prejudice to the specific, simplified procedures established in Article 10.6 ESCB/ECB Statute,[84] concerning the amendment of Article 10.2 on voting rights in the GC, and Articles 107(5) TEC and Article 41 ESCB/ECB Statute concerning the amendment of some other Statutes' Articles by the European Parliament and the Council either upon a Recommendation

[80] OJ C 202 (Consolidated version), 7.6.2016, pp. 230–250.

[81] Treaty of Lisbon, Protocols, B. Protocols annexed to the Treaty of Lisbon, Protocol No 1: Article 1, A. Horizontal amendments, par. 1–6 and 8, Article 1, B. Special amendments, par. 11 and Annex, Correspondence Table A.

[82] The Articles contained in the Chapters of this Protocol, which are also of primary importance to European central banking law and their majority will be presented in detail below, are presented in summary in Table 2.2.

[83] TEU (1992), Article 48; see, on this, Cremer (1999), pp. 242–246.

[84] This Article was added with the Treaty of Nice (OJ C 80, 10.3.2001, pp. 1–87).

from the ECB and after consulting the Commission, or upon a proposal from the Commission and after consulting the ECB.[85] On the basis of Article 10.6, the Council, meeting in the composition of the Heads of State or Government, adopted on 21 March 2003 Decision 2003/223/EC "on an amendment to Article 10.2 ESCB/ECB Statute",[86] which governs decision-making processes within the ECB Governing Council (the 'GC').

(2) Since 2009, the Statute's Articles continue to be amendable, in principle, as those of the Treaties and all the other Protocols in accordance with Article 48 TEU.[87] The above-mentioned simplified amendment procedures also remained in force[88]; nevertheless, apart from the necessary renumbering,[89] the procedure for the amendment of Article 10.2 has been substantially modified.[90]

*Other Protocols*

(1) After the entry into force of the Treaty of Lisbon, the following Protocols, which were annexed to the TEC and remained in force upon the beginning of Stage Three of EMU,[91] pertain to the EMU (annexed to the Treaties)[92]:

[85] These Articles are 5.1–5.3 (on the collection of statistical information), 17–18, 19.1, 22, 23 and 24 (on the monetary functions and operations of the Eurosystem, with the exception of Article 21 on operations with public entities), 26 (on the financial accounts of the ECB and the NCBs), 32.2–32.3, 32.4 and 32.6 (on the majority of the aspects relating to the allocation of NCBs' monetary income), 33.1, point (a) [on the variable amount (determined by the GC) of the ECB's net profit to be transferred to the general reserve fund] and 36 (on the ECB's staff). On this procedure, see Smits (1997), p. 115 (under I).

[86] OJ L 83, 1.4.2003, pp. 66–68.

[87] On this Article, see Boss (2010) and Herrnfeld (2019).

[88] Treaty of Lisbon, Protocols, B. Protocols which are annexed to the Treaty of Lisbon. Protocol No 1, Article 1, B. Special amendments, par. 11, point (ka), sub-point (ii). In the TFEU, this aspect is governed by Article 129(3); see on this Wutscher (2019), pp. 2067–2068.

[89] Article 41 was renumbered to Article 40.1 and Article 10.6 to Article 40.2 (which from a systemic standpoint was reasonable).

[90] More specifically, the Decision on amendment is taken unanimously, albeit by the European Council and not by the Council of the Heads of State or Government, which was repealed by the Lisbon Treaty; the amendments come into force following their approval by Member States according to their respective national constitutional rules (as is also the case upon application of Article 48 TEU); decision-making requires as a necessary preceding condition either an ECB Recommendation (the relevant decision taken unanimously by its GC (ESCB/ECB Statute, Article 40.3) and consultation with the Commission or a Commission proposal and consultation with the ECB; the European Parliament must also be consulted.

[91] Treaty of Lisbon, Protocols, B. Protocols annexed to the Treaty of Lisbon, Protocol No 1, Article 1: A. Horizontal amendments, par. 1–8, and B. Special amendments, on a case by case basis in the respective points.

[92] OJ C 202 (Consolidated version), 7.6.2016, pp. 265, 266–272, 279–280, 281–282, 284–286, 287, 288 and 289, respectively.

the first two (Protocols (No 6) and (No 7) on the location of the seats of the institutions and of certain bodies, offices, agencies and departments of the EU and on the EU privileges and immunities, respectively) refer to institutional aspects of, *inter alia*, the ECB[93]; Protocols (No 12) and (No 13) refer to the excessive deficit procedure (part of the economic union) and the convergence criteria. The other four Protocols are country specific: Protocol (No 15) on certain provisions relating to the UK established the latter's right to opt out of Stage Three of EMU and defining, in case of exercising this right, its special regime among Member States with a derogation; Protocol (No 16) on certain provisions relating to Denmark established the latter's right to opt out of Stage Three of EMU and providing that, in case of exercising this right, its regime is equivalent to the one of the other Member States with a derogation; Protocol (No 17) on Denmark provides that Article 14 ESCB/ECB Statute does not affect the right of its central bank to fulfil its existing duties on territories not belonging to the EU; and Protocol (No 18) on France stipulates the reservation of its privilege to issue coins in its overseas territories according to the provisions of its national legislation, and its exclusive competence for determining the exchange rate of the franc of French Colonies of the Pacific (Colonies Françaises du Pacifique, 'CFP franc').[94]

(2) New is Protocol (No 14) on the Eurogroup,[95] which provides that the Ministers of the Member States whose currency is the euro meet informally, when necessary, in order to discuss questions related to the specific responsibilities they share with regard to the euro; the Commission and the ECB (upon invitation) also take part in the meetings.[96] On the other hand, three Protocols of 1992, the provisions of which were rendered inapplicable after the beginning of that Stage, were repealed with the Lisbon Treaty[97]: Protocol (No 19) on the Statute of the EMI, Protocol (No 23) on Portugal, which conferred upon the country, on a temporary basis, the power to retain the facilitation granted towards the autonomous areas of Azores and Madeira to use the no-interest credit facilitation provided by the central bank of Portugal, according to Portuguese law, and Protocol (No 24) on the transition to Stage Three of EMU.

[93] On these aspects, see Chap. 6, Sect. 6.1.2.

[94] On this Protocol, see also Sect. 2.4.3.

[95] OJ C 202 (Consolidated version), 7.6.2016, p. 283.

[96] For a summary of all these Protocols, see Table 2.3.

[97] Treaty of Lisbon, Protocols, B. Protocols annexed to the Treaty of Lisbon, Protocol No 1, Article 1, B. Special amendments, par. 9, points (c)–(e).

**Table 2.3** Protocols annexed to the treaties of relevance to the EMU

| *Protocol number* | *Subject* |
|---|---|
| Of general application | |
| Protocol (No 4) | On the Statute of the ESCB and of the ECB |
| Protocol (No 6) | On the location of the seats of the institutions and of certain bodies, offices, agencies and departments of the EU |
| Protocol (No 7) | On the privileges and immunities of the EU |
| Protocol (No 12) | On the excessive deficit procedure |
| Protocol (No 13) | On the convergence criteria |
| Protocol (No 13) | On the Eurogroup |
| Country-specific | |
| Protocol (No 15) | On certain provisions relating to the UK |
| Protocol (No 16) | On certain provisions relating to Denmark |
| Protocol (No 17) | On Denmark |
| Protocol (No 18) | On France |

*Declarations*

For the sake of completeness, a mere reference is also made to three relevant Declarations annexed to the Final Act of the Intergovernmental Conference, which adopted the Lisbon Treaty: Declarations (No 30) on Article 126 TFEU, (No 52) by certain Member States on the EU symbols (including the euro) and (No 58) by the Republic of Latvia, the Republic of Hungary and the Republic of Malta on the spelling of the name of the single currency in the Treaties.

## 2.4 Legal Acts of Secondary European Law as Sources of the EMU Law—Intergovernmental Agreements

### *2.4.1 General Overview*

(1) EMU law is also shaped through a series of legal acts of secondary European law. One of the most significant institutional amendments introduced in European law by means of the Treaty of Maastricht was the assignment to the ECB of the autonomous power to issue legal instruments, including legally binding ones, to enable it to effectively exercise, within the framework of its operational independence, the duties assigned to it and to the ESCB. The law of the monetary union continues, after the entry into force of the Lisbon Treaty, to be shaped to a large extent (within

the limits set by the Treaties and the ESCB/ECB Statute) by such ECB legal instruments, that is Regulations, Decisions, Recommendations and Opinions, by virtue of the TFEU, and Guidelines, Instructions and internal Decisions, by virtue of the Statute.[98]

The regulatory power of the ECB and its operational independence were, nevertheless, delineated through Article 107(6) TEC (repeated *verbatim* in Article 42 ESCB/ECB Statute), according to which, as far as the implementation of certain provisions of the Statute of the ESCB and of the ECB is specifically concerned, it was deemed necessary to establish an obligation for the Council (and not the ECB) to issue relevant legal acts. This choice was the outcome of the political decision for 'intergovernmental supervision' over the activity of the ECB to be exercised by the Council. The relevant provisions were carried over in the TFEU (on this aspect, see Sect. 2.4.2).

(2) It is also noted that the (then) Community institutions were empowered to issue a series of legal acts, which mainly concerned the implementation of specific TEC provisions with respect to the economic union, the transition to Stage Three of EMU and the introduction of the euro. Similar provisions are also found in the TFEU with regard to the regulatory powers of EU institutions (see Sect. 2.4.3).

### *2.4.2 The 'Complementary Legislation' of the Council*

(1) Under the TEC, the Council was required (as just mentioned) to adopt, immediately after the decision on the beginning of Stage Three of EMU, by qualified majority and with the participation of representatives of all Member States, provisions in relation to specific Articles of the ESCB/ECB Statute.[99] This procedure remained in force under the Treaty of Lisbon[100] and is now stipulated in Articles 129(4) TFEU and 41 ESCB/ECB Statute, without any significant amendment as to the procedural conditions. The European Parliament continues to have a mere opinion-issuing role, as under the above-mentioned simplified amendment proce-

[98] These legal instruments are discussed in Chap. 6, Sect. 6.3.1.

[99] TEC, Article 123(1), first sub-paragraph, first point and Statute, Article 42. Article 107 was not included in the list of Articles of Article 122(3) TEC, which were not applicable to Member States with a derogation; it was also applicable to the UK (Protocol (No 25), paragraphs 5 and 7).

[100] Treaty of Lisbon, Article 2(93)(c) (for Article 107(6) TEC) and Protocols B. Protocols, annexed to the Treaty of Lisbon, Protocol No 1, Article 1, B. Special amendments, par. 11, point (kb) (for Article 42 ESCB/ECB Statute).

dure of Article 10.2 ESCB/ECB Statute. Hence, this legislation is correctly referred to as the Council's 'complementary legislation'.

(2) The subject matters for which the adoption of this legislation was deemed necessary were the following[101]:

first, determination of the terms and conditions under which ECB must be consulted when asked by the national authorities of the Member States on any draft legislative provision in its fields of competence;

second, with respect to the provision of statistical information to the ECB in order to fulfil its relevant task, the definition of natural and legal persons subject to reporting requirements, confidentiality regime of the information transferred and the appropriate provisions for enforcement;

third, with respect to the imposition by the ECB on the credit institutions established in Member States of the euro area of the obligation to hold minimum reserves, as a means of single monetary policy implementation, the determination of the basis for these reserves, the maximum permissible ratios between those reserves and their basis, and also the appropriate sanctions in case of non-compliance;

fourth, the determination of the range of complementary operational methods of monetary control which might be used by the ECB, provided that these methods impose obligations on third parties;

furthermore, in relation to the ECB capital, the determination of limits and conditions for its increase by the GC, as well as the approval of the rules concerning the statistical data to be provided by the Commission for the determination of the key for subscription thereof;

in addition, the determination of the limits and conditions under which the ECB may ask from the NCBs of the Member States without a derogation the payment of foreign reserve assets, beyond the (initial) limit of 50 billion euros; and

finally, the determination of limits and conditions under which the ECB is entitled to impose fines and periodic penalty payments on undertakings for failure to comply with the obligations under its Regulations and Decisions.[102]

[101] ESCB/ECB Statute, Articles 4, point (a), second case, 5.4, 19.2, 20 (second sub-paragraph), 28.1 (second sub-paragraph), 29.2, 30.4 and 34.3, respectively; the majority of the legal acts adopted by the Council are discussed in the following chapters of this book, as appropriate (mainly, in Chap. 6).

[102] For a comparative presentation of the simplified procedures for the amendment of provisions of the ESCB/ECB Statute (under its Articles 40.1 and 40.2; see Sect. 2.3.4) and the procedure for the adoption of the complementary legislation by the Council (under Articles 129(4) TFEU and 41 ESCB/ECB Statute) and on a summary of the legal acts adopted by the Council under the complementary legislation, see Tables 2.4 and 2.5.

**Table 2.4** Comparative presentation of the simplified procedures for amending provisions of the ESCB/ECB Statute and the procedure for the adoption of complementary legislation by the council

| | *Simplified amendment procedure of Articles of the Statute* | *Special simplified amendment procedure under Article 10.2 of the Statute* | *Complementary legislation* |
|---|---|---|---|
| Legal basis | TFEU, Article 129(3) and Statute, Article 40.1 | Statute, Article 40.2 | TFEU, Article 129(4) |
| Institution issuing the legal act | European Parliament and Council | European Council | Council |
| Required majority in the Council | Qualified majority | Unanimity | Qualified majority |
| Opinion of the European Parliament | – | √ | √ |
| Commission's contribution | Proposal—consultation (interchangeably with ECB) | Recommendation or Consultation (interchangeably with ECB) | Proposal or Consultation (interchangeably with the ECB) |
| ECB's contribution | Consultation—Recommendation (interchangeably with the Commission) | Consultation or Recommendation (interchangeably with the Commission) | Consultation or Recommendation (interchangeably with the Commission) |

**Table 2.5** Legal acts adopted by the Council under the 'complementary legislation'

| *Statute's Article* | *Subject matter* | *Council's legal act* | *Further reference in this book* |
|---|---|---|---|
| 4 | Terms and conditions under which ECB provides Opinions | Decision 98/415/EC | Chapter 3, Sect. 3.1.2 |
| 5.4 | Persons required to provide the ECB with statistical information and enforcement rules | Regulation (EC) 2533/98 (as in force) | Chapter 7, Sect. 7.1.2 |

(*continued*)

**Table 2.5** (continued)

| *Statute's Article* | *Subject matter* | *Council's legal act* | *Further reference in this book* |
|---|---|---|---|
| 19.2 | Various aspects relating to the imposition by the ECB on the credit institutions established in Member States of the euro area of the obligation to hold minimum reserves | Regulation (EC) 2531/98 (as in force) | Chapter 7, Sect. 7.1.2 |
| 20 | Range of complementary operational methods of monetary control which might be used by the ECB | – | |
| 28.1 | Limits and conditions for the GC to increase the ECB's capital | Regulation (EC) 1009/2000 | Chapter 6, Section 6.4.1 |
| 29.2 | Approval of the rules concerning the statistical data that the Commission is required to provide for the determination of the key for subscription of the ECB's capital | Decision 98/382/EC | Chapter 6, Section 6.4.1 |
| 30.4 | Limits and conditions under which the ECB may ask from the NCBs of the Member States without a derogation the payment of foreign reserve assets, beyond the (initial) limit of 50 billion euros | Regulation (EC) 1010/2000 | Chapter 7, Section 7.2.2 |
| 34.3 | Limits and conditions for the ECB to impose fines and periodic penalty payments on undertakings for failure to comply with the obligations under its Regulations and Decisions | Regulation (EC) 2532/98 | Chapter 6, Section 6.3.2 |

### *2.4.3 Other Legal Acts of Secondary European Law*

*Legal Acts by Virtue of the TEC*

On the basis of several TEC provisions, the Council was called to adopt a series of other legal acts, mainly referring to the following subject matters:

First, the adoption of secondary law by the Council in the form of Regulations was required for the implementation of specific TEC provisions governing the economic union. In that respect, on 13 December

1993, it adopted two Regulations specifying the definitions for the application of the prohibitions referred to in Articles 104, 104a and 104b TEC. These were followed by two Regulations of 7 July 1997 concerning the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies and the speeding up and clarification of the implementation of the excessive deficit procedure.[103] The 1997 Regulations, together with a relevant European Council Resolution of 17 June 1997 constitute the so-called Stability and Growth Pact and are currently applicable, as repeatedly amended.[104]

Furthermore, in December 1998, the Council adopted two Decisions with respect to its composition and Statute.[105]

[103] Regulations (EC) 3603/93 and 3604/93 (OJ L 332, 31.12.1993, pp. 1–3 and 4–6, respectively) and Regulations (EC) 1466/97 and 1467/97 (OJ L 209, 2.8.1997, pp. 1–5 and 6–11, respectively); the first two legal acts were adopted on the basis of Article 103(2) TEC, the third on the basis of Article 99(5) and the fourth on the basis of Article 104(14). In the first three cases, the Council was required to decide on the basis of the cooperation procedure of Article 252 TEC; in the latter, it was required to decide by a qualified majority, upon proposal of the Commission and after consulting the European Parliament.

[104] The Resolution is available at: https://publications.europa.eu/en/publication-detail/-/publication/1409c2d7-2549-4e85-99a0-b262887b3a7b. An often repeated error is that the Pact sets the reference limits which are not to be exceeded within the framework of the excessive budgetary deficit procedure. However, the procedure was established in the TEC (and currently in the TFEU), the provisions of which were specified by Regulation 1467/97 included within the Pact, while the reference limits were provided for in Protocol (No 20), which formed an integral part thereof (i.e. primary law). As a result, any amendment of such limits requires a TFEU amendment. In addition, the amendment of the reference limits included (anymore) in Protocol (No 12) requires a unanimous Council Decision (TFEU, Article 126(14), second sub-paragraph). The same applies for the amendment of the provisions of Regulation 1467/97. It is also noted that the establishment of this prerequisite of a unanimous Council decision on the amendment (of the convergence criteria and) of the reference limits with respect to budgetary discipline was the main argument of the German Federal Constitutional Court, when it confirmed the constitutionality of the Treaty of Maastricht provisions (Cases 2 BvR 2134/92, 2 BvR 2159/92, Judgment of October 12, 1993, available at: https://iow.eui.eu/wp-content/uploads/sites/18/2013/04/06-Von-Bogdandy-German-Federal-Constitutional-Court.pdf); see on this, Meessen (1993), Wegen and Kuner (1994) and Wiegandt (1995). On the content of the Pact, see, by way of mere indication, Lastra and Louis (2013), pp. 55–71.

[105] Council Decisions 98/743/EC of 21 December 1998 and 1999/8/EC of 31 December 1998 (OJ L 358, 31.12.1998, pp. 109–110 and OJ L 5, 9.1.1999, p. 71, respectively), adopted on the basis of Article 114(3) (first sentence) TEC (currently Article 134 TFEU) and Article 209 TEC (Article 242 TFEU). The Statute is currently in force as amended by Council Decisions 2003/476/EC of 18 June 2003 (OJ L 158, 27.6.2003, pp. 58–60) and 2012/245/EU of 26 April 2012 (OJ L 121, 8.5.2012, pp. 22–24).

Finally and of particular importance was the secondary law adopted (in 1997 and 1998) for the transition to Stage Three of EMU and the introduction of the euro.[106] Related to these two aspects were also three Decisions taken by the Council, on 31 December 1998, with respect to the position to be taken by the (then) Community regarding agreements concerning the monetary relations with the Principality of Monaco, the Republic of San Marino and the Vatican City, which before the transition were using as their national currency that of a Member State which adopted the euro (viz. France—in the first case, and Italy—in the second)[107]; on the basis of these Decisions, these countries were allowed to use, as of 1 January 1999, the euro as their national currency and, as of 1 January 2002, to give legal tender status to coins and banknotes denominated in euro. The same was stipulated for the French territorial communities (collectivités territoriales) of Saint-Pierre-et-Miquelon and Mayotte, which are part of France but not of the EU.[108]

[106] The legal acts governing the introduction of the euro were Council Regulations (EC) 1103/97 of 17 June 1997 and 974/98 of 3 May 1998 (OJ L 162, 19.6.1997, pp. 1–3 and OJ L 139, 11.5.1999, pp. 1–5, respectively); the former was adopted on the basis of Article 308 TEC and the latter on the basis of Article 123(4). On these two legal acts, see Gortsos (1998), Wiegand (1998), Louis (2000) and Wahlig (2000); on the particular issue concerning the continuity of contracts in the transition to Stage Three, see also Wölker (1996). On the changeover to the euro, see also Yeowart (1995), Bamford (1997), Dunnett (1996), (1997), Goodhart (1997) and Wittelsberger (1997).

[107] Council Decisions 1999/96/EC, 1999/97/EC and 1999/98/EC, OJ L 30, 4.2.1999, pp. 31–32, 33–34 and 35–36, respectively; on the basis of these Decisions, France and Italy concluded in 2001 the necessary agreements with the countries in question.

[108] Council Decision 1999/95/EC, OJ L 30, 4.2.1999, pp. 29–30. The same does not hold for other French overseas territories, such as New Caledonia, French Polynesia and Wallis and Futuna (see also the above-mentioned Protocol (No 18) on France), in relation to Italy for its exclave in Switzerland Campione d'Italia (which uses the Swiss franc, while in the case of the German exclave in Switzerland Büssingen am Hochrhein use is made of the euro), as well as for some overseas territories of the Netherlands. It is also noted that, by virtue of Council Decision 98/683/EC of 23 November 1998 concerning exchange-rate matters relating to the CFA Franc and the Comorian Franc (OJ L 320, 28.11.1998, pp. 58–59), France was allowed to continue (and did so) the implementation of its monetary agreements with the West African Economic and Monetary Union (well-known with the French acronym 'UEMOA'), the Economic and Monetary Union of Central Africa ('CEMAC') and Comores, which guarantee the convertibility of the CFA and Comorian francs into the French franc at a fixed parity. Similar arrangements were made in relation to the Cape Verde escudo by virtue of Council Decision 98/744/EC of 21 December 1998 (OJ L 358, 31.12.1998, pp. 111–112).

*Legal Acts by Virtue of the TFEU*

(1) The (just) above-mentioned TEC provisions with respect to the economic union, conferring upon the Council the power to issue secondary law, remained in force under the Lisbon Treaty with a partial amendment of the procedural conditions; hence, according to the TFEU, the Council has the power to amend adopted Regulations. Furthermore, new provisions were also established, conferring upon EU institutions the power to issue legal acts of secondary law. More specifically, on the basis of Article 133 TFEU, the European Parliament and the Council, deciding with the ordinary legislative procedure laid down in Article 294,[109] may adopt measures necessary for the use of the euro as the single currency, after consultation with the ECB and without prejudice to the competences of the latter. In addition, by virtue of Article 136(1) TFEU, the Council may adopt measures addressed to Member States whose currency is the euro, in order to contribute to the smooth functioning of the EMU.[110]

(2) It is also noted that, during the period following the entry into force of the Lisbon Treaty, Article 127(6) TFEU on the conferral upon the ECB of specific tasks relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertaking was activated twice. By virtue of this Article, the Council adopted Regulations (EU) No 1096/2010 "conferring specific tasks upon the [ECB] concerning the functioning of the European Systemic Risk Board" and 1024/2013 "conferring specific tasks on the [ECB] concerning policies relating to the prudential supervision of credit institutions".[111]

On the basis of the above-mentioned, the euro is the national currency not only of the Member States which have met the convergence criteria (currently 19), but also of the above-mentioned European countries and the French territorial communities.

[109] On this, see the Appendix to Chap. 6.

[110] By mere indication, this Article (in conjunction with Article 121(6)), formed the legal basis of Regulations (EU) No 1174/2011 of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, pp. 8–11), 472/2013 of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, and 473/2013 of the same date on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OL L140, 27.5.2013, pp. 1–10 and 11–23, respectively).

[111] These legal acts, which are of significant importance in the context of this book, are discussed in detail in Chaps. 3, 4 and 5.

### 2.4.4 *Intergovernmental Agreements as 'Children' of the Ongoing Fiscal Crisis in the Euro Area*

(1) As already mentioned,[112] the institutional framework governing the economic union before the (ongoing) fiscal (and sovereign debt) crisis in the euro area did not contain any provisions for the management of such crises.[113] In view, however, of the urgency to deal with the fiscal crisis to which Greece was first exposed in April 2010 and the need to provide financial support to this Member State, which could no longer refinance its debt in international capital markets, it became necessary to establish, for the first time, a mechanism for the management of such crises, given also the fact that, as also already mentioned, the 'no-bail-out clause' under Article 125(1) TFEU did not allow the direct refinancing of Member States' debt by the other Member States or the EU.[114] Within this context and in order to restore conditions of confidence for the euro area in international capital markets, the Council decided to establish the first mechanism, named "European Financial Stabilisation Mechanism" (the 'EFSM'), of 60 billion euros, by virtue of Council Regulation (EU) No 407/2010 of 11 May 2010.[115] This was adopted on the basis of Article 122(2) TFEU, that is on the basis of the principle of EU economic solidarity; it was based on the consideration that the unprecedented global financial crisis and economic downturn had seriously damaged economic growth and financial stability and provoked a strong deterioration in the

[112] See Sect. 2.2.2.

[113] For an evaluation of this crisis and the related policy responses, see, by way of mere indication, Belke (2010), Eichengreen et al. (2011), pp. 47–64, Athanassiou (2011), Aizenman (2012), Caminal (2012), Stephanou (2013), de Grauwe (2013), Hadjiemmanuil (2015), pp. 6–10, d'Arvisenet (2015), Zimmermann (2015), Hadjiemmanuil (2019) and Honohan (2019), pp. 73–96. On the institutional aspects and implications of the crisis and the "New Economic Constitutionalism in Europe", see Gerapetritis (2019).

[114] During the first, emergency period of the Greek crisis and in order to deal with the spillover effects to other Member States (and, in particular, its credit institutions, since many of them were holding in their banking and trading books significant amounts of Greek government bonds) from a (highly potential at that time) haircut of Greek debt and given (as just mentioned) the absence of any sovereign debt crisis management mechanisms, the Eurogroup, the European Council and the Commission's President announced on 11 April an initial financial support package, jointly with the IMF, of 30 billion euros (see at: https://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113686.pdf, which on 10 May was extended to 110 billion (see at: https://consilium.europa.eu/uedocs/cmsUpload/100502-%20Eurogroup_statement.pdf).

[115] OJ L 118, 12.5.2010, pp. 1–4.

deficit and debt positions of the Member States and its deepening had led to a severe deterioration of the borrowing conditions of several Member States beyond what can be explained by economic fundamentals. Accordingly, by addressing this exceptional situation—which was beyond the control of the Member States—as a matter of urgency, it was deemed necessary to put in place immediately an EU stabilisation mechanism to preserve its financial stability.[116]

(2) Given that the provision of funding on the basis of this TFU Article was, more than evidently, a last-resort solution which could not be sustainable, immediately after the adoption of that Regulation, in June 2010, the Member States of the euro area signed an intergovernmental agreement outside the EU framework which established the "European Financial Stability Facility" (the 'EFSF').[117] Use of this mechanism was immediately made by Greece and then by Ireland (during the same year), Portugal (in April 2011) and subsequently (in 2013) Cyprus.

The establishment of a permanent mechanism by the Member States of the Eurozone was the next (reasonable and absolutely necessary) step, which, nevertheless, required the amendment of the TFEU. In that respect, with the Decision 2011/199/EU of the European Council of 25 March 2011,[118] these Member States effected the first (and hitherto sole) amendment of the TFEU with the introduction of a new paragraph 3 to Article 136. On that (solid legal) basis, on 2 February 2012, the Intergovernmental Treaty was signed establishing the "European Stability Mechanism" (the 'ESM') as an international financial institution which succeeded the EFSF.[119] That Treaty was concluded (again) outside the EU framework and became operational in October 2012.

(3) Finally, on 1 January 2013 the intergovernmental "Treaty on Stability, Coordination and Governance in the [EMU]" (the 'TSCG') entered into force, which was formally concluded on 2 March 2012 by all Member States

[116] Council Regulation 407/2010, recitals (3)–(5).

[117] The EFSF was a special purpose vehicle established under the laws of Luxembourg; its statutory objective was to issue bonds and other debt securities in capital markets in order to raise the funds necessary for the provision of loans to Member States, which were facing fiscal problems and could not refinance their debt in capital markets. Its work is presented on its website at: https://www.efsf.europa.eu.

[118] OJ L 91, 6.4.2011, pp. 1–2.

[119] The consolidated version of the ESM Treaty is available at: https://www.esm.europa.eu/legal-documents/esm-treaty; on the pending proposals for the enhancement of the ESM's role, see Chap. 4, Sect. 4.3.3.

(with the exception of the UK and the Czech Republic) (also known as the 'Fiscal Pact').[120] Its objective is to further enhance the commitment made by the Member States of the euro area[121] to comply with the provisions governing fiscal discipline by application of the 'balanced budget rule' and by anchoring, as well, in their domestic legal orders the commitment to support the proposals of the Council and the Commission at every stage of the excessive deficit procedure (under Article 126 TFEU).[122]

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[120] Available at: https://www.consilium.europa.eu/media/20383/st00tscg26-el-12.pdf. On this Treaty, see Craig (2012) and de Streel (2014).

[121] Only the provisions of Article 14 are applicable to Member States with a derogation.

[122] On several institutional developments relating to improving the economic union, see, by way of mere indication, the Van Rompuy Report (2012) (discussed in more detail in Chap. 4, Sect. 4.1.1) and Stephanou (2013); on the current economic governance in the euro area and proposals for its enhancement, see, by way of mere indication, Fabbrini (2016).

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CHAPTER 3

# The Establishment of the European System of Financial Supervision

## 3.1 The EU Treaties' Provisions on Financial Stability: Introductory Overview

### *3.1.1 The Conditions Before the Maastricht Treaty*

(1) The founding Treaties establishing the EEC did not contain any single rule explicitly referring to the banking (and, in general, the financial) system and its stability. Despite the significant initiatives taken in the mid-1980s (especially after the implementation of the Commission's 1985 White Paper 'on Completing the Internal Market', which identified the legislative measures needed to complete the internal market) to establish a single market for banking services, in terms of both negative and positive integration, this aspect was not modified. The 1985 White Paper was followed in 1986 by the Single European Act. In order to facilitate the establishment of a common market, it introduced the principle of qualified majority voting (rather than unanimity) in the Council for almost all relevant legal acts, thus paving the way for a higher degree of harmonisation of national legislative and administrative measures, including those pertaining to the financial system.

(2) The legal acts of this period which constituted the sources of EU banking law (discussed in more detail in Sect. 3.2) were based on the following principles: first, the conditions for the authorisation and the main aspects relating to the micro-prudential supervision of credit institutions were, at a

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minimum level, harmonised across the (then) European Community, but it was national competent authorities (the 'NCAs'), which were responsible for authorising credit institutions and supervising the latter's compliance with micro-prudential regulations, which were harmonised as well[1]; second, this same 'principle of decentralised management' with regard to the institutions competent for the preservation of stability in the banking system[2] also applied to deposit guarantee schemes (DGSs), the operation of these schemes was harmonised as well at a minimum level, but in case of activation of the payout procedure, it was (and still is) national DGSs which were called upon to compensate depositors for their covered deposits; finally, last-resort lending to solvent but illiquid credit institutions was provided by the NCBs of the Member State in which they were incorporated.

### 3.1.2 The Conditions After the Maastricht Treaty and Before the Lisbon Treaty

*Initial Remarks*

(1) The Treaty of Maastricht (and then the entry into operation of the EMU on 1 January 1999) did not bring about any substantial change in the choice of EU institutions with regard to the authorities that were competent for the authorisation and prudential supervision of credit institutions (in any Member State) and, more generally, safeguarding the stability of the EU financial system. Hence, contrary to the applicable regime on the definition and implementation of the single monetary and exchange-rate policy in the euro area, assigned to the European level (as mentioned in Chap. 2), and despite the fact that several aspects of the bank safety net

[1] Authorisation requirements serve a screening function, aimed at preventing market entry by natural or legal persons whose management could lead to heavy losses in a bank and impair the reputation of the banking system as a whole (see Guttentag and Herring (1988), pp. 12–13). They also assure that the banking firm has sufficient financial resources to finance its initial investments and withstand temporary losses. Under EU banking law, standard requirements imposed in the context of the licensing procedure are the following: a minimum initial capital requirement (this is the first function of bank capital, the second being its loss-buffer function, pursued by the imposition of capital adequacy requirements); requirements on the organisational structure of the bank; specific fit-and-proper criteria for major shareholders and similar criteria for bank management (the 'four-eyes principle').

[2] This principle is different from the principle of decentralisation under EU law, specifying the role of national authorities in relation to an EU institution to which specific powers have been transferred for the exercise of exclusive competences (see Chap. 5, Sect. 5.1.2).

were already harmonised (albeit at a minimum level and partially), the ECB had not been promoted to a supranational supervisory authority of the EU financial system or even of one of its branches. Padoa-Schioppa (2004) referred to this state of affairs as 'European regulation with national supervision'.[3] In the same vein, Lastra (2006) characteristically noted: "There is an inevitable tension in the current EU structure: a national mandate in prudential supervision, combined with a single European currency and a European mandate in the completion of the single market in financial services."[4]

(2) In addition, the ECB did not assume the role of the lender of last resort for any solvent credit institution incorporated in a euro area Member State and exposed to illiquidity. Its role was (and still is) confined to the approval of relevant decisions taken by the NCBs—members of the Eurosystem, in accordance with Article 14.4 ESCB/ECB Statute.[5]

*In Particular: The General Clause of Article 105(5) TEC*

**Introductory Remarks**

According to Article 105(5) TEC, repeated *verbatim* in Article 3.3 ESCB/ECB Statute, the ESCB's task was rather vague and restricted to 'contributing' to the smooth conduct of policies by NCAs relating to prudential supervision of credit institutions and the stability of the financial system. This TEC provision, which was applicable since the start of Stage Three of EMU,[6] has been the corollary of strong objections on the part of several Member States that did not wish for the ECB to be promoted to a supervisory authority, by substituting (in full or in part) the competences of NCAs. This group of Member States included those in which the central bank was not the competent authority for prudential supervision of credit institutions (such as Germany and Austria), as well as those arguing that assigning supervisory competences to the ECB could put at risk its primary objective, that is to safeguard price stability in the euro area.[7] As a consequence, the

[3] Padoa-Schioppa (2004), p. 121.

[4] Lastra (2006), p. 298. For a summary of the various proposals with regard to the creation of supranational financial supervisory authorities in the EU, see also Hadjiemmanuil (2006), pp. 818–828.

[5] For more details on this Article, see Chap. 9, Sect. 9.3.

[6] TEC, Article 116(3), second sentence.

[7] On the historical evolution of this provision, see Smits (1997), pp. 334–338 and Padoa-Schioppa (2000).

authorisation and conduct of prudential supervision on EU credit institutions (and other categories of EU financial firms) still fell, even after the start of Stage Three of EMU, within the powers of NCAs [this did not run counter to (the just above-mentioned) Article 14.4 ESCB/ECB Statute].

Nevertheless, Article 105(6) TEC contained an enabling clause, according to which the Council could assign to the ECB 'specific tasks' with regard to the prudential supervision of credit institutions, which had not been activated.[8]

**Instruments for Implementation of the ESCB Task**

In order to execute its task under Article 105(5) TEC, the ESCB had a broad range of instruments, founded on the provisions of the TFEU and the ESCB/ECB Statute[9]:

The first instrument at the ESCB's disposal was based on Article 25.1 ESCB/ECB Statute, which reads as follows: "The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Union legislation relating to the prudential supervision of credit institutions and to the stability of the financial system." On the basis of this provision,[10] the competence to be consulted and provide Opinions was exclusively granted to the ECB and did not extend to the NCB members of the ESCB. In addition, the recipients of the ECB's advice and Opinions were (only) the Council, the Commission and the NCAs and only in relation to EU legislation on prudential supervision of credit institutions and the stability of the financial system and not the relevant legislation of Member States. This competence could be performed either by an intervention of the ECB on its own initiative ('offer advice') or upon request of the above-mentioned authorities ('be consulted'). Finally, the competence to give advice and be consulted is restricted to 'the scope and implementation of' EU legislation, not extending to its interpretation (an exclusive competence of the ECJ).[11]

[8] This Article, carried over almost *verbatim* in the TFEU as Article 127(6), is discussed in more detail in Chap. 5, Sect. 5.2.2.

[9] The content and scope of application of this Article, see Smits (1997, pp. 338–355, 2005), and Psaroudakis (2018), pp. 134–137.

[10] It is noted that this provision applied (and still applies) to all Member States (Article 42.1 ESCB/ECB Statute, as in force), including the UK (Protocol No 15, paragraph 7).

[11] According to Smits (1997), p. 344, the ECB's advisory role also extends to other aspects of the single market's operation, such as, for instance, legislation on the prevention of the use of the financial system for the purpose of money laundering.

In addition, the ECB was given the power to provide Opinions on issues relating to the policies on prudential supervision of credit institutions and the stability of the financial system, either upon request or on its own initiative under Article 105(4) TEC (carried over *verbatim* in Article 4 ESCB/ECB Statute),[12] within the limits and under the conditions set out in Council Decision 98/415/EC of 29 June 1998.[13] Recourse to this provision was possible mainly for cases not covered by Article 25.1 ESCB/ECB Statute, that is offering opinions to EU institutions other than the Council and the Commission (e.g. the European Parliament and the ECJ), and offering opinions that do not concern EU legislation, but national legislation of Member States.[14]

Finally, the ESCB's task could be discharged by the collection from the ECB of relevant statistics in accordance with Article 5 ESCB/ECB Statute,[15] as well as by the participation of the ECB and the NCBs in international organisations and fora, responsible for matters relating to prudential supervision of credit institutions and the stability of the financial system and/or through cooperation with other central banks within the framework of the international cooperation of the ECB and the NCBs in accordance with Article 6.2 ESCB/ECB Statute.[16] Recourse to this Article has repeatedly been made by the ECB during the recent (2007–2009) international financial crisis.[17]

**The (No Material) Impact of the Lisbon Treaty**

(1) The Treaty of Lisbon did not amend the above-mentioned TEC provisions; they are currently contained (subject to only minor modifications to the legislative procedure) in Article 127(4)–(6) TFEU.[18] The related

[12] During Stage Two of EMU, relevant competences were assigned to the EMI under Article 117(6) TEC.

[13] OJ L 189, 3.7.1998, pp. 42–43; on the duty to consult the ECB (currently under Article 127(4) TFEU) and the Opinions submitted by the ECB, see Lambrinoc (2009).

[14] See Smits (1997), pp. 339–343 and Andenas and Hadjiemmanuil (1997), pp. 398–399; see also, in particular, the argumentation in Smits (1997, pp. 339–350) on whether Article 25.1 ESCB/ECB Statute constitutes or not the only instrument for the implementation of the task created by means of Articles 105(5) TEC and 3.3 ESCB/ECB Statute.

[15] Recommendations and Opinions are non-binding ECB legal instruments (see Chap. 6, Sect. 6.3.1).

[16] On this, see Smits (1997), pp. 347–348. It should be pointed out, however, that the legal basis for all opinions offered by the ECB bar none, either on its own initiative or upon request, is Article 127(4) TFEU and not of Article 25.1 ESCB/ECB Statute, in line with the above. See, in this regard, the ECB's website, at: www.ecb.int/ecb/legal/opinions/htm/inex.en.html.

[17] See Smits (2010).

[18] Article 127(5) TFEU does not apply to Member States with a derogation (Article 139(2), point 3 TFEU, and ESCB/ECB Statute, Article 42.1, respectively), including to the

provisions of the ESCB/ECB Statute are also still applicable, unchanged. Accordingly, until November 2014, when the Banking Union started operating,[19] the authorisation and prudential supervision of credit institutions was an exclusive competence of NCAs. The regime governing last-resort lending in the Eurozone also remained unchanged.

(2) These institutional arrangements were not amended as a result of the recent (2007–2009) international (or global) financial crisis either. This crisis was triggered by events in the financial system of the United States, spilled over to the world economy seriously affecting the stability of the financial system in several other states around the globe, had a serious negative impact on the real economy worldwide and also negatively affected confidence in the financial system at a large scale.[20] It is potentially a manifest example supporting the view (which this author fully adopts) that the causes of a major financial crisis are not (and cannot be) one-dimensional; they are a function of a combination of market, supervisory, regulatory and macroeconomic failures.[21] In the words of Honohan (1997)[22]: "Systemic failures in the financial system are typically complex and they differ one from the other. In order to understand the processes involved it is necessary

UK (Protocol (No 15), paragraphs 4 and 7); the other provisions apply to all Member States (see also Chap. 5, Sect. 5.1.2).

[19] This aspect is discussed analytically in Chap. 4.

[20] On the causes of this particular crisis, see, by means of mere indication (out of a vast existing literature), European Central Bank (2008), Kiff and Mills (2007), Borio (2008), pp. 1–13, Calomiris (2008), Eichengreen (2008), Gorton (2009, 2010), Swoboda (2008), Goodhart (2009), pp. 2–29, Norberg (2009), Lastra and Wood (2010), pp. 537–545, Posner (2010), pp. 13–245, Rajan (2010), Tirole (2010), pp. 11–47, Gortsos (2012), pp. 127–129, and Scott (2014). For a comparison of the recent crisis with the international financial crisis of 1931 (in terms of causes and regulatory reaction), see Moessner and Allen (2010). The author uses the term 'recent' (and not 'current') to denote that this crisis lasted from 2007 to 2009 and came to an ending. This is without prejudice either to the fact that the financial systems of certain states remain vulnerable as a result of this crisis, or that in certain cases (especially in the euro area periphery) the current malfunctioning of the banking system is a corollary of the ongoing fiscal crisis in the Eurozone, which occurred, at least to some extent, as a result of the international financial crisis (see Chap. 2, Sect. 2.4.4). For a most recent assessment of the impact of this crisis and the related policy implications, see Blanchard and Summers (2019).

[21] On the related "financial instability hypothesis" of Minsky (1992, 2008, Chapter 8, pp. 194–196, and Chapters 9–10), which has been at the heart of academic discussions after the eruption of that crisis, see Krugman (2012), pp. 41–53 and (in more technical terms) Ferri (2019), pp. 177–194.

[22] Honohan (1997), Sect. 1.1.

to schematize and simplify, but extreme reductionism is misleading." Norberg (2009) therefore rightfully talks of a 'perfect financial storm'.

The existence of market failures justifies regulatory intervention in the economy; the main market failures observed in the financial system concern information asymmetries and conditions favouring negative externalities (i.e. spillover effects). By contrast, the financial system is not a natural monopoly.[23] Nevertheless, regulatory interventions can sometimes fail too ('regulatory failures'), while failures may also occur on the part of supervisory authorities ('supervisory failures'). In this context, Norberg correctly remarks the following: "It is pointless to compare the real-life market economy, in all its imperfection, with an ideal image of how hypothetical, perfect authorities would govern the economy. It goes without saying that we must compare it with the real, imperfect authorities that we actually have."[24] Two examples are representative:

First, regulations do not always serve in the best way the purpose of their implementation, *inter alia*, due to the lack of an appropriate risk–benefit analysis.[25] Some recent examples:

(i) Capital adequacy rules, which (rightly) seek to strengthen banks' capacity to absorb losses arising from unexpected (credit, interest rate, foreign exchange and operational) risks undertaken as part of their business, exacerbate 'procyclicality', namely by encouraging banks to grant more loans during economic upturns and to be more hesitant in their credit activity at times of recession.[26]

(ii) The implementation of certain rules for the protection of consumers of financial services results, in the author's view, in high costs (in some cases higher than benefits), always taking into account the moral hazard to which consumers may be exposed. In addition, some other rules in this field provide consumers with rights which they cannot easily make use of (the typical case of 'over-information').

[23] See Gorton (1988), p. 5–7. On negative externalities and information asymmetries, see Mercuro and Medema (2006), pp. 60–67, Stiglitz and Walsh (2006), pp. 239–255 and in more detail Ippolito (2005), pp. 153–379.

[24] See Norberg (2009), p. 134.

[25] On regulatory failures, see the contribution of Kroszner in Kroszner and Shiller (2011).

[26] See on this Committee on the Global Financial System (2010), Sect. 2.1. This is the main element of the 'time dimension' of systemic risk, which necessitates the adoption of macro-prudential policies.

Second, with regard to supervisory failure, it has been rightfully argued that supervisory or other competent authorities are chronically unable to restructure banks before their net worth has been depleted. Guttentag and Herring (1987) identify three reasons for this slow response[27]: the 'recognition lag' is a lag between the time the bank has become unviable and the authorities recognise this; the 'reaction lag' extends from the time the authorities recognise the non-viability of the bank until they decide to terminate it; the 'implementation lag' is the period between the time the authorities initiate the procedure on closing down an unviable bank and the moment when the bank actually terminates its operations.

In the context of this discussion, it is also crucial to take into account the circumstances under which rules are being adopted. Contrary to the predominant 'public interest approach', according to which regulatory intervention in the banking (and, more generally, financial) system is aimed at answering specific policy demands, the 'public choice theory approach' shows that regulatory intervention is the outcome of the actions of politicians, bureaucrats and lobby groups involved in the policy-making process for their own self-interest. The latter approach raises, *inter alia*, the issue of the influence of companies affected by regulatory intervention rules on those who adopt them ('regulatory capture').[28]

(iii) The crisis' consequence, especially after the failure of the US investment bank Lehman Brothers Inc.,[29] was that many banks and other financial firms around the world (including 'systemically important' ones) were not able to absorb the losses from their risk exposure.[30] This resulted, *inter alia*, in negative effects on the real economy, and obliged several governments (especially in the United States and the EU) to adopt rescue packages and recovery plans[31] in order to support or even bail out individual

[27] Guttentag and Herring (1987), pp. 48–50.

[28] On this aspect, see Igan and Lambert (2019).

[29] See Claessens et al. (2010), pp. 42–46 and in more detail Wiggins, Piontek and Metrick (2019).

[30] Notable cases were those of the Swiss bank UBS (see by way of mere indication, Thévenoz (2010) Zulauf and Eggen (2013), pp. 117–118, Abegg et al. (2017), pp. 91–94, and Nobel (2019), pp. 451–465), the US-based insurance company AIG, the Belgium-based bank Fortis and the Dexia Bank (whose holding company was also seated in Belgium; see Claessens et al. (2010), pp. 46–51).

[31] For an assessment of these measures in the EU, see Panetta et al. (2009), Gortsos (2009), Petrovic and Tutsch (2009) and De Meester (2010).

banks (and, in some cases, the entire banking system[32]). Such governmental interventions weighed on state budgets and, in some cases, created serious fiscal imbalances, some of which evolved to fiscal crises,[33] which, in turn, spread to become new financial crises.[34]

## 3.2 The Evolution of EU Banking Law Before the Establishment of the Banking Union: A Brief Overview

### *3.2.1 Introductory Remarks*

In the context of a short overview of the evolution of EU banking (and, in general, financial) law, the following four periods can be identified: the first period from the beginning of the functioning of the EEC until 1988; the second period of the establishment of the single financial area; the third period of consolidation of the single financial area (1999–2007), extending from the beginning of the functioning of the EMU until the onset of the recent (2007–2009) international financial crisis; and, finally, the current fourth period since 2008.[35]

### *3.2.2 The First and the Second Periods*

(1) During the first period in the evolution of EU banking law (1958–1988), developments were slow and piecemeal. The most important legal act of this period was Council Directive 77/780/EEC of 12 December 1977 "on the coordination of the laws, regulations and

[32] The most striking example in this case is Iceland; see Claessens et al. (2010), pp. 51–53, Zeissler et al. (2014a) and Norberg (2009), pp. 94–98.

[33] The most striking example is that of Ireland. With a sole exception, all Irish credit institutions were exposed to insolvency after the financial crisis and needed to be recapitalised; on the Irish crisis, see Eichengreen (2015), Zeissler et al. (2014b) (in comparison to the Icelandic crisis), Hadjiemmanuil (2019), pp. 51–58 and Honohan (2019), pp. 312–338.

[34] For more details, see Committee on the Global Financial System (2011).

[35] For a brief overview of the evolution of European financial law, see Dermine (2003), pp. 33–50 (only with respect to EU banking law), Blair et al. (2009), pp. 98–102, Hadjiemmanuil (2006), pp. 786–804, Tridimas (2011), Jung and Bishof (2015) and Gortsos (2016, 2017b). On the various phases in the evolution of EU banking law before the establishment of the EBU, see Sousi-Roubi (1995), Schnyder (2005), Gortsos (2010b) and Tridimas (2011).

administrative provisions relating to the taking up and pursuit of the business of credit institutions", known as the 'First Banking Directive'.[36] This legal act laid down the conditions, on the basis of the minimum harmonisation principle, for the granting and withdrawal of credit institutions' licenses by NCAs, as well as the conditions for the granting of licenses by NCAs to branches of credit institutions incorporated either in other Member States, on the basis of the national treatment principle, or in third countries; it also established procedures for the cooperation between NCAs and the exchange of information among them and with supervisory authorities of third countries.[37] In addition, Council Directive 83/350/EEC of 13 June 1983 "on the supervision of credit institutions on a consolidated basis"[38] was the first legal act of EU banking law, the content of which was shaped under the influence of the related work of the Basel Committee (notably the 1983 Report "Principles for the supervision of banks' foreign establishments", known as the 'Revised Basel Concordat').[39]

(2) After the amendments of the (founding) Treaties in 1986 by the Single European Act, the process of financial integration in the banking sector through legislation gained momentum with a view to establishing a single banking area within the single financial area. The legal acts of EU banking law during the second period of its evolution (1988–1998) are found in Directives and were governed by three principles: decentralised management (resort to national authorities and schemes), mutual recognition, as well as minimum and partial harmonisation. In particular:

As early as in 1989, the Council adopted Directive 89/646/EEC, which substantially amended the First Banking Directive, known as the 'Second Banking Directive'.[40] This legal act laid down the groundwork for the exercise by EU credit institutions of the freedoms to provide services and establish branches in other Member States, by virtue of the principle of mutual recognition of the license granted to them by their home Member State competent (supervisory) authority (the 'single license', which does not hold for subsidiaries). In addition, it further specified (as compared to the First Banking Directive) the conditions for the granting and withdrawal of bank licences by home Member State NCAs, laid down

[36] OJ L 322, 17.12.1977, pp. 30–37.

[37] Directive 77/780/EEC, Articles 3, 8, 4, 9, 7 and 12, respectively.

[38] OJ L 193, 18.7.1983, pp. 18–20.

[39] On the original Basel Concordat of 1975, the 1983 Report and its subsequent supplements, see Gortsos (2012), pp. 238–250.

[40] OJ L 386, 30.12.1989, pp. 1–13.

the conditions for credit institutions to carry out their activities under the single license and established a concrete procedure with regard to the licensing of EU credit institutions being subsidiaries of non-EU parent companies.[41]

Concurrently, the Council adopted two Directives which transposed into EU banking law the 1988 Basel Committee's Report on the "International convergence of capital measurement and capital standards", known as 'Basel I'[42]: Directive 89/647/EEC "on a solvency ratio for credit institutions",[43] and Directive 89/299/EEC "on the own funds of credit institutions".[44] These legal acts laid down rules with regard to the calculation of credit institutions' minimum capital requirement of 8% as to their exposure to credit (and country) risk, and the elements eligible for use as regulatory 'own funds' in order to meet this requirement.[45]

In 1996, the regulatory framework on credit institutions' capital adequacy was enhanced with the adoption of Council Directive 93/6/EEC "on the capital adequacy of investment firms and credit institutions", which laid down rules with regard to their exposure to market risks (i.e. position risk, foreign exchange risk, settlement risk, counterparty risk and risks arising from large exposures in the trading book).[46] In parallel, the Council also adopted Directive 93/22/EEC "on investment services in the securities field" (the 'ISD'),[47] which laid down the conditions for the establishment of a single EU capital markets area and introduced for investment firms the same principles governing credit institutions under the Second Banking Directive. *Inter alia*, by virtue of Article 15(3), that Directive established the 'universal banking model', by prohibiting Member States,

[41] Directive 89/646/EEC, Articles 18, 4–5 and 17, 10–12 and 7, respectively.

[42] Basel Committee on Banking Supervision (1988), July (available at: https://www.bis.org/publ/bcbsc111.htm). During the period 1991–1995, 'Basel I' was amended on five occasions in terms of individual technical points, which prompted tantamount amendments of EU Directives 89/299/EEC and 89/647/EEC. On the 'Basel I' framework, see Hausmann (1995), pp. 141–152 and 229–247, Norton (1995), pp. 171–241, and Gortsos (2012), pp. 250–252.

[43] OJ L 386, 30.12.1989, pp. 14–22.

[44] OJ L 124, 5.5.1989, pp. 16–20.

[45] It is worth noting that this 8% capital adequacy requirement applies, in principle, also under the current regulatory framework.

[46] OJ L 141, 11.6.1993, pp. 1–26. This Directive was based on the relevant proposals of the Basel Committee, which were finalised in January 1996 upon adoption of its Report entitled "Amendment to the Capital Accord to incorporate market risks".

[47] OJ L 141, 11.6.1993, pp. 27–46.

since 1996, to impose on EU credit institutions limitations with regard to the direct provision of investment services.[48]

Finally, Directive 94/19/EC "on deposit guarantee schemes"[49] was the first legal act of EU banking (and, in general, financial) law adopted under the co-decision procedure between the European Parliament and the Council under Article 251 TEC. This legal act introduced the principle of mutual recognition with regard to such schemes,[50] and harmonised, at the minimum level, certain aspects of their functioning, such as the level and the extent of deposit coverage, the procedure for compensating depositors once a participating credit institution's deposits have become 'unavailable' and depositors' information requirements.

### *3.2.3 The Third Period: The Period of Consolidation of the Single Financial Area (1999–2007)*

*Institutional Developments*

**Adoption of the 'Lamfalussy Process'**

(1) The third period starts with the introduction of the euro on 1 January 1999, as part of Stage Three of EMU, which triggered the deepening of European financial integration. The adoption of measures to speed up procedures towards a single European capital market, where numerous gaps had been identified, as well as important delays in the law-making process, became a priority after the launch of the euro.[51] In view of the above, the ECOFIN Council, in its session of 17 July 2000, decided to set up a seven-member committee made up of prominent personalities of the financial

[48] See Mauerhofer (1998), p. 92; on this model, see Chap. 1, Sect. 1.1.3.

[49] OJ L 135, 31.5.1994, pp. 5–14; for a brief overview of this legal act, see Arnaboldi (2014), pp. 53–58 and Kleftouri (2015), pp. 64–75.

[50] Accordingly, deposits taken by an EU credit institution through its branches established in other Member States were (and still are) covered by the DGS of its home Member State.

[51] Already since 1999, when the euro was introduced, the creation of a single capital market became a top priority among EU institutions. The rationale behind it was that, within a single currency environment, conditions had greatly improved for further consolidation of national capital markets, with the elimination of currency risk for investments, as well as enhanced price transparency which enabled investors to compare the performance of listed companies on the basis of one single currency unit denominator, and, as a result, markets would become more liquid. Regarding the impact of the introduction of the euro on European capital markets, see Galati and Tsatsaronis (2003) and Freixas et al. (2004).

**Table 3.1** The Lamfalussy process

| | *Level 1* | *Level 2* | *Level 3* |
|---|---|---|---|
| Type of legal act | Basic legal act | Implementing measures | Recommendations/ Guidelines |
| Legislator | European Parliament/Council | European Commission | CEBS/CESR/ CEIOPS |
| Supporting mechanism | EBC/ESC/EIOPC (as advisory committees) | 1. EBC/ESC/EIOPC (as advisory and regulatory committees)<br>2. CEBS/CESR/CEIOPS (as advisory committees) | |

sector, known as the Committee of Wise Men or the 'Lamfalussy Committee' (named after its chairman, Baron Alexandre Lamfalussy).[52] On 15 February 2001, the Committee submitted the "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets" (the 'Lamfalussy Report'),[53] Chapter I of which included an analysis of the reasons necessitating the amendment of the (then applicable) procedure on issuing legal acts of EU capital markets law.[54]

(2) The Committee's proposals, presented in Chapter II,[55] were the adoption of a conceptual framework of overarching principles, the establishment of a special procedure comprising four levels for the issuance by EU bodies of legislative acts on EU securities markets, and the implementation of their provisions by Member States (the 'Lamfalussy process'), as well the setting up of an Inter-Institutional Monitoring Group and the 2004 process review. On a political level, the Lamfalussy Report was immediately, fully and unreservedly adopted by the Council, at its Stockholm meeting on 23 March 2001, as well as by the Stockholm European Council on 23–24 March, which also issued a relevant Resolution "on more effective securities

[52] As mentioned in Chap. 2, among his other capacities in the international and European financial system, Lamfalussy served as Chairman of the EMI throughout its operation.

[53] Both the initial report of 9 November 2000 and the final report are included in a single document, available at: https://ec.europa.eu/internal_market/securities/lamfalussy/index_en.htm.

[54] Lamfalussy Report (2001), pp. 9–18; see also Table 3.1.

[55] Ibid., pp. 19–42.

**Table 3.2** Cooperation of national banking supervisory authorities at European level: from informal fora to 'European (*quasi-*)Supervisory Authorities'

| | *Banking* | *Capital markets* | *Insurance, reinsurance and pension funds* |
|---|---|---|---|
| Before adoption of the Lamfalussy process: informal (except BSC) | GdC (Groupe de Contact, 1972) and BSC (Banking Supervision Committee, European Central Bank, 1998)[a] | HLSSC (High Level Securities Supervisors Committee, 1985) and FESCO (Forum of European Securities Commissions, 1997) | CIS (Conference of Insurance Supervisors, 1957) |
| After adoption of the Lamfalussy process: institutionalised | CEBS (Committee of European Banking Supervisors, 2004), and BSC[a] | CESR (Committee of European Securities Regulators, 2001) | CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors, 2004) |
| After establishment of the ESFS: institutionalised | EBA (European Banking Authority, 2011) and BSC[a] | ESMA (European Securities and Markets Authority, 2011) | EIOPA (European Insurance and Occupational Pensions Authority, 2011) |

[a]Within the context of the ESCB, with the representation of national central banks (NCBs) from across the EU (both Member States that have adopted the euro as their currency and Member States with a derogation).

market regulation in the European Union".[56] The Commission reacted promptly and on 6 June 2001 issued two Decisions establishing the two committees proposed in the Lamfalussy Report, namely[57] the European Securities Committee (the 'ESC') and the Committee of European Securities Regulators (the 'CESR'),[58] which became operative on 7 June 2001.[59]

[56] See at: https://europa.eu.int/comm/internal_market/en/finances/mobil/01-memo105.htm, https://europa.eu.int/european_council/conclusions/index_en.htm and https://ue.eu.int/ueDocs?cms_Data/docs/pressData/en/ec/00100-r1.%20ann-r1.en1.html, respectively.

[57] On these Committees, see Avgerinos (2003), pp. 95–98, and Ferran (2004), pp. 75–84.

[58] Commission Decisions 2001/528/EC and 2001/527/EC (OJ L 191, 13.7.2001, pp. 45–46 and 43–44, respectively).

[59] Cooperation between national supervisory/regulatory authorities in this field was informally established in 1985 within the "High Level Securities Supervisors Committee" and was further strengthened in 1997 within the "Forum of European Securities Commissions" ('FESCO') (see European Commission (2000), pp. 33–35 and 41–43) and Table 3.2).

**Extension of the Lamfalussy Process to European Banking and Insurance Law**

(1) Considering that the contribution of the Lamfalussy process to shaping EU capital markets law was positive, the ECOFIN Council deemed it would be advisable to extend its implementation to other branches of European financial law, and notably banking law, insurance law and the law applying to undertakings for collective investment in transferable securities (UCITS). Accordingly, on 5 November 2003, the Commission submitted a package of measures into six decisions, extending the Lamfalussy process. For the banking sector, the two (new) committees created were the European Banking Committee (the 'EBC'), which entered into operation on 13 April 2005, and the "Committee of European Banking Supervisors" (the 'CEBS'), which became operative on 1 January 2004.[60] Moreover, two new committees in the insurance, reinsurance and occupational pensions sectors were created: the European Insurance and Occupational Pensions Committee (the 'EIOPC'), which also entered into operation on 13 April 2005, and the Committee of European Insurance and Occupational Pensions Supervisors (the 'CEIOPS'), which became operative on 24 November 2003.[61] Finally, the duties of the two committees in the sector of transferable securities (viz. the ESC and the CESR) were extended to UCITS.[62]

(2) The Lamfalussy process was not a novelty in the law-making process under EU financial law, but contained proposals in order to enhance the role of the Commission in adopting implementing measures. At the same time, enhanced cooperation between NCAs in the financial sector was

[60] Commission Decision 2004/5/EC (OJ L 3, 7.1.2004, pp. 28–29); cooperation between national banking supervisory authorities was informally established in 1972 within the "Groupe de Contact" and was further strengthened in 1998 within the "Banking Supervision Committee" (see European Commission (2000), pp. 11–16).

[61] Commission Decisions 2004/9/EC and 2004/6/EC (OJ L 3, 7.1.2004, pp. 34–35 and 30–31, respectively); cooperation among Member States' insurance supervisory authorities was informally established in 1957 within the "Conference of Insurance Supervisors of the Member States of the European Communities" (see European Commission (2000), pp. 27–29).

[62] Commission Decisions 2004/7/EC and 2004/8/EC (OJ L 3, 7.1.2004, p. 32 and 33, respectively), amending Decisions 2001/527/EC and 2001/528/EC. In 2009, its Decisions establishing the CESR, the CEBS and the CEIOPS were repealed and replaced by Decisions 2009/77/EC, 2009/78/EC and 2009/79/EC, respectively (OJ L 25, 29.1.2009, pp. 18–32).

institutionalised, even though, contrary to what applied to monetary policy, the institutional structure of the European financial sector's supervision continued to be governed by fragmentation.[63]

*Regulatory Developments: The Two Benchmark Initiatives*

**The 1999 'Financial Services Action Plan'**

(1) The first benchmark initiative was the so-called 1999 Financial Services Action Plan (the 'FSAP'), a Commission Communication entitled "Financial Services: Building a framework for action".[64] The FSAP was based on the existing set of principles pertaining to financial regulation and supervision (decentralised management, mutual recognition, as well as minimum and partial harmonisation) and laid down all the legislative measures, in the fields of European financial, company and taxation law, which the Commission deemed necessary for the acceleration of the financial integration process after the introduction of the euro as a single currency. The main pillars of this Program were four. The first was enhancing EU capital markets' integration, the second was shaping open and safe markets for retail transactions, the third was putting in place an efficient framework on micro-prudential supervision and regulation of financial firms and the fourth was paving the way, for the first time, for the harmonisation of taxation in the financial sector.[65]

(2) In relation to EU banking law, of particular importance was the third pillar concerning an efficient framework on the micro-prudential supervision and regulation of financial firms, including credit institutions. In this respect (and in chronological order), the European Parliament and the Council adopted two legal acts:

First, on 4 April 2001, Directive 2001/24/EC "on the reorganisation and winding up of credit institutions"[66] was adopted, which was pending

[63] On the Lamfalussy process, see Ferran (2004), pp. 61–74 and 99–107, Lastra (2006), pp. 334–341, Hadjiemmanuil (2006), pp. 815–818 and Sousi-Roubi (2007), pp. 24–29; for a summary, see also Table 3.1.

[64] COM/1999/232 final.

[65] This led to the adoption of Directive 2003/48/EC "on taxation of savings income in the form of interest payments" (OJ L 157, 26.6.2003, pp. 38–48).

[66] OJ L 125, 5.5.2001, pp. 15–23. 'Winding up proceedings' means collective proceedings opened and monitored by a Member State's administrative or judicial authorities with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure (Directive 2001/24/

since 1987. This legal act (the only of that period still in force) was the first (and to the author's knowledge still only) legal act of EU banking (and, in general, financial) law introducing the principle of mutual recognition without providing for a minimum harmonisation of national measures.[67]

In addition, on the basis of the 2004 Basel Committee's Report "Basel II: International Convergence of Capital Measurement and Capital Standards, A Revised Framework", known as 'Basel II',[68] the European Parliament and the Council adopted on 14 June 2006 two legal acts, commonly known as 'Capital Requirements Directives I' (or 'CRD I'),[69] which repealed the Second Banking Directive[70]: It is also worth noting that in the field of the supplementary supervision of financial conglomerates, including (usually) credit institutions, Directive 2002/87/EC[71] was adopted (the 'FICOD') on the basis of the proposals submitted by the Joint Forum.[72]

EC, Article 2, ninth point). On the other hand, 'reorganisation measures' means measures intended to preserve or restore the financial situation of a credit institution or an investment firm and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims, as well as application of the resolution tools and exercise of the resolution powers provided for in the BRRD (ibid., Article 2, seventh point, as amended by Article 117, point (2) BRRD); on this legal act, see Chap. 4, Sect. 4.3.2.

[67] This Directive is analysed in Peters (2011) and Wessels (2017), who uses the abbreviation 'CIWUD' (Credit Institutions Winding-Up Directive).

[68] Basel Committee on Banking Supervision (2004), June (available at: https://www.bis.org/publ/bcbs107.htm). On this framework, see the various contributions in Wiegand (2006) (and in particular Sigrist (2006)), Macht (2007), Gleeson (2010) and Gortsos (2012), pp. 252–253; on its cyclical implications, see Kashyap and Stein (2004), Jarrow (2007), Heid (2007) and Drumond (2009).

[69] Directives 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and 2006/49/EC on the capital adequacy of investment firms and credit institutions (OJ L 177, 30.6.2006, pp. 1–200 and 201–255, respectively). In 2007, certain articles of the first directive, mainly on the evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector, were amended by Directive 2007/44/EC of the European Parliament and of the Council (the 'Qualifying Holdings Directive', OJ L 247, 21.9.2007, pp. 1–16).

[70] This was in force as codified by Directive 2000/12/EC (OJ L 126, 26.5.2000, pp. 1–59).

[71] OJ L 35, 11.2.2003, pp. 1–27.

[72] This Directive is analysed in Gortsos (2017a); on the Joint Forum, another international financial forum, see Gortsos (2019), pp. 100–102.

**The 2005 White Paper 'Financial Services Policy 2005–2010'**

The second benchmark initiative of this period was the Commission's 2005 White Paper 'Financial Services Policy 2005–2010' (the 'Post-FSAP'). This document outlined the Commission's financial services policy for the said period with a view to the further regulation-driven deepening of European financial integration.[73] It was published well before the evaluation of the efficiency of the measures which were adopted under the FSAP was completed (and despite a widespread consensus on the need for a 'regulatory pause', necessary in order to digest the regulatory storm of the previous years). The Post-FSAP was based on four pillars: dynamic integration of the single financial area, preservation of sound regulatory and supervisory procedures, taking up of a limited amount of new legislative initiatives and upgrading of the EU role in the shaping of international financial law. Despite its proposals for improvements in a wide range of issues, it continued to rely on the (above-mentioned) existing set of principles pertaining to financial regulation and supervision and did not contain any proposals on modifying the architecture of EU banking law. Nevertheless, the progress towards its implementation was interrupted abruptly in 2007, when the international financial crisis broke out, and rendered necessary, *inter alia*, a more comprehensive readjustment of European banking and in general financial law.

### *3.2.4 The (Current) Fourth Period*

In the author's opinion, the current period in the evolution of EU banking law contains two phases, linked to the two major crises which erupted since 2007 and definitely affected, *inter alia*, the stability of the European financial system and public confidence therein. In particular:

(1) Apart from the regulatory developments which have taken place, the first phase of the current period was marked by the publication of the Report of the 'de Larosière Group', which laid down the foundations for reshaping (and further deepening the institutionalisation of) arrangements at European level, established by the Lamfalussy Report, with regard to the financial system's micro-prudential supervision, and establishing for the first time a European framework for the financial system's macro-

[73] COM/2005/629 final.

prudential oversight.[74] For the most part, regulatory measures adopted as a regulatory response to the recent (2007–2009) international financial crisis were taken over from the international financial reform agenda, mainly the work orchestrated by the FSB and soft law rules adopted by the Basel Committee. In this respect:

First, the Basel Committee's initiatives for the review of the international framework on micro- and macro-prudential banking regulation were the basis for the adoption, in 2013, by the European Parliament and the Council of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.[75]

Second, the impact of the work of the FSB was considerable; in particular, its 2011 Report on "Key Attributes of Effective Resolution Regimes for Financial Institutions" definitely influenced the initiatives for creating an EU legal framework for the resolution of credit institutions and investment firms. This led to the adoption, in 2014, by the European Parliament and the Council of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.[76] In addition, the FSB's initiatives with regard to the regulation of the shadow banking system triggered EU regulatory developments as well.[77]

(2) The second phase contains the legal acts adopted as a reaction to the ongoing fiscal crisis in the euro area, which became manifest in 2010. The main by-product of this response, as regards financial law, was the establishment of the Banking Union.[78]

[74] These developments are presented in more detail in Sect. 3.3.

[75] These two legal acts, which are an integral element of the Banking Union (hence a by-product of the ongoing fiscal crisis in the euro area), are presented in Chap. 4, Sect. 4.2.2.

[76] This Report and this Directive are discussed in Chap. 4, Sect. 4.3.2.

[77] On 4 September 2013, the Commission adopted a Communication on "Shadow Banking—Addressing New Sources of Risk in the Financial Sector", setting out its roadmap to limit the emergence of risks in the unregulated or less regulated financial system, particularly risks of systemic nature through the shadow banking sector's interconnectedness with the banking system through contagion risk (COM/2013/614 final). On the basis of this communication, several legislative acts have been adopted (the study of which is outside the reach of this book).

[78] This is discussed in more detail in Chap. 4.

## 3.3 The Establishment of the European System of Financial Supervision as a 'Child' of the Recent (2007–2009) International Financial Crisis

### 3.3.1 *The* De Larosière Report *as the Basis for Establishing the ESFS*

(1) As already mentioned,[79] the recent (2007–2009) international financial crisis did not prompt any modification in the Treaties. Nevertheless, and taking into account that the academic debate on the creation of supranational supervisory authorities for the European financial system can be basically traced back to the mid-2000s, the prospect of establishing pan-European financial supervisory authorities was put forward at the political level in 2009 in the wake of that crisis. Its scale and intensity have shown, as one should reasonably expect, the need to review the then existing EU financial regulatory and supervisory framework. It is noted, however, that the European Parliament had already taken several initiatives to that end, calling on various occasions for a European body to be directly responsible for certain supervisory tasks over financial institutions, starting with its Resolutions of 13 April 2000 "on the Commission Communication on implementing the framework for financial markets: Action Plan" and of 21 November 2002 "on prudential supervision rules in the European Union".[80]

(2) The Commission assigned the task of investigating the appropriate means to attain the objective of readjusting the provisions of the applicable European financial law pertaining to the supervision of EU financial firms to a special, high-level, group of experts, chaired by France's former central banker Jacques de Larosière,[81] known as the High-Level Group on Financial Supervision in the EU. The Group submitted its Report (*De Larosière Report*) on 25 February 2009.[82] Apart from analysing the causes of the recent financial crisis, this Report included proposals (in the form of recommendations) on the improvements to the existing regulatory framework

[79] See Sect. 3.1.

[80] OJ C 40, 7.2.2001, p. 453 and OJ C 25 E, 29.1.2004, p. 394, respectively.

[81] Jacques de Larosière served as Managing Director of the IMF (1978–1987), Governor of the Central Bank of France (Banque de France, 1987–1993), and President of the European Bank for Reconstruction and Development (EBRD, 1993–1998).

[82] The Report is available at: https://ec.europa.eu/commission_barroso/president/pdf/statement _20090225_en.pdf. For an overview, see Ferrarini and Chiodini (2009), Gortsos (2010a) and Louis (2010).

that were deemed necessary in order to strengthen existing rules, and to fill all the regulatory gaps that had been identified due to the crisis. In addition, it addressed the readjustment of the supervisory framework in the European financial system, coming to the conclusion that it was neither necessary nor feasible, in the near future, to set up supranational supervisory authorities at European level[83]; nevertheless, it emphasised that micro-prudential supervision of financial firms, including credit institutions, should not be assigned to the ECB in any case.[84] It also included a proposal on the eventuality of moving, in the long term, towards a system which would rely only on two Authorities, mainly following a 'functional approach' to the institutional architecture of the financial system's micro-prudential supervision (still also in use in several Member States).[85]

The Report also contained proposals on a 'European system of crisis management' as part of the 'European system of supervision and crisis management', which introduced a series of initiatives mainly concerning the rules under which financial crises should be managed[86] and can be viewed as a preliminary step to the resolution regime adopted within the framework of the Banking Union.[87]

(3) On the basis of the proposal of the *De Larosière Report* that, for the short-term horizon, a 'European System of Financial Supervision' (ESFS) should be established,[88] the institutional reaction of EU institutions to the international financial crisis, with a view to enhancing financial stability, was the establishment of the 'European System of Financial Supervision' (the 'ESFS'). The ESFS, which entered into operation on 1 January 2011

[83] *De Larosière Report* (2009), Chapter I, paragraphs 6–37 and Chapter II, paragraphs 38–218.

[84] Ibid., paragraphs 171 and 172, first sentence.

[85] Ibid., Chapter III, Section V.

[86] Ibid., Chapter II, Section VI ("Crisis Management and Resolution"), paragraphs 125–143.

[87] The BU is discussed in Chap. 4. In the author's view, the term 'European system of supervision and crisis management' was used in an effort to demonstrate the close correlation, at European level, of financial supervision, the rules on exercising such supervision (i.e. prudential regulation) and crisis management mechanisms. Paragraph 192 (second to fifth sentences) makes the following remark: "Regulation, supervision and crisis management/resolution arrangements are intertwined. They form a continuum. There is no point in converging supervisory practices, if the principal financial regulations remain fragmented. And it will be impossible to revamp the organisation of European supervision without clarity as to how a crisis, should it break out, will be managed and resolved by competent authorities."

[88] *De Larosière Report* (2009), paragraphs 194–214.

and still applies to all EU Member States and not only to those of the euro area, consists of two pillars: the three European Supervisory Authorities and the European Systemic Risk Board (see Sects. 3.3.2 and 3.3.3, respectively).

### 3.3.2 *The European Supervisory Authorities as the First Pillar of the ESFS*

(1) The first pillar of the ESFS comprises the three so-called European Supervisory Authorities (the 'ESAs'), which were established by virtue of the following Regulations of the European Parliament and of the Council of 24 November 2010: the European Banking Authority (the 'EBA') by virtue of Regulation (EU) No 1093/2010 (the 'EBA Regulation'); the European Insurance and Occupational Pensions Authority (the 'EIOPA') by virtue of Regulation (EU) No 1094/2010 (the 'EIOPA Regulation'); and the European Securities and Markets Authority (the 'ESMA') by virtue of Regulation (EU) No 1095/2010 "establishing a European Supervisory Authority (European Securities and Markets Authority)(…)" (the 'ESMA Regulation').[89] The ESAs succeeded, since 1 January 2011, the above-mentioned[90] three Committees (CEBS, CESR and CEIOPS), which were set up following recommendations contained in the 2001 'Lamfalussy Report'.[91] The EBA Regulation was substantially amended by Regulation (EU) No 1022/2013 of 22 October 2013 due to the conferral of specific supervisory tasks to the ECB within the SSM.[92]

(2) The creation of the ESFS did not, literally speaking, lead to the creation of supranational supervisory authorities of the financial system at EU level. The ESAs are mainly regulatory authorities composed of national supervisory authorities, one of their main tasks being to contribute to the "establishment of high-quality common regulatory and supervisory standards and practices", that is to the development of the 'single rulebook' (the establishment of the BU and, in particular, of its first main pillar, the SSM, being an exception). Nevertheless, in the cases laid down in Articles

[89] OJ L 331, 15.12.2010, pp. 12–47, 48–83 and 84–119, respectively.

[90] See Sect. 3.2.3.

[91] As regards the reasons that led to this approach being adopted (even though there were proposals for the unification of the ESAs), see Louis (2010), p. 154.

[92] See Chap. 4, Sect. 4.2.1.

17–19 of their founding regulations, all three ESAs have the right to substitute NCAs if the latter fail to comply with the Commission's formal opinions or ESA decisions (indirect supervisory tasks). In addition, and by way of exception, the ESMA has direct supervisory powers over credit rating agencies under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009[93] (as in force) and trade repositories under Regulation (EU) No 648/2012 of the same institutions of 4 July 2012 (the 'EMIR')[94] (as in force).[95]

(3) The Joint Committee is a joint body of the ESAs, governed by Articles 54–57 of their founding regulations. It is primarily composed of their Chairpersons[96] (Article 55(1)) and serves as a forum to ensure cross-sectoral consistency between them on issue areas where tasks and powers have been conferred on all of them, notably financial conglomerates; accounting and auditing; micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities for financial stability; retail investment products; measures on combating money laundering and information exchange with the ESRB and developing the relationship between the ESRB and the ESAs.[97]

### *3.3.3 The European Systemic Risk Board as the Second Pillar of the ESFS*

(1) The second pillar of the ESFS is the 'European Systemic Risk Board' (the 'ESRB'), established in accordance with Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 "on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board"[98] (the 'ESRB Regulation'). On the basis of this Regulation, which entered into force on 1 January 2011 and is currently under amendment as well,[99] the

[93] OJ L 302, 17.11.2009, pp. 1–31. On this legal act, see by way of mere indication Moloney (2014), pp. 637–682, and Veil (2017) (both with extensive further references).

[94] OJ L 201, 27.7.2012, pp. 1–59. On this legal act, see Aditya (2013), Ferrarini and Saguato (2013, 2014), Provino (2015) and Sethe et al. (2017, Hrsg.).

[95] The role of the EBA is further discussed in Chap. 5, Sect. 5.4.1.

[96] EBA/ESMA/EIOPA Regulations, Article 55(1).

[97] Ibid., Article 54(2).

[98] OJ L 331, 15.12.2010, pp. 1–11.

[99] COM(2017) 538 final (20.9.2017).

macro-prudential oversight of the European financial system became the first (and single until 2014) component of the 'Europeanised bank safety net'. Each Member State should also designate (and all have complied with) an authority entrusted with the conduct of macro-prudential policy in national legislation, as set out in the ESRB Recommendation of 22 December 2011 "on the macroprudential mandate of national authorities" (ESRB/2011/3).[100] This power has been conferred upon NCBs.

(2) Even though, as already mentioned,[101] a key conclusion of the *De Larosière Report* was that, at least in the near future, the setting up of supranational supervisory authorities at the European level was neither necessary nor feasible and, in any case, the micro-prudential supervision of credit institutions should not be assigned to the ECB, it pointed out that specific tasks concerning the macro-prudential oversight of the financial system should be conferred upon it.[102] Subsequently, in connection to the operation of the ESRB, specific tasks have been conferred on the ECB pursuant to Council Regulation (EU) No 1096/2010 of 17 November 2010.[103] Accordingly, the ECB became a part of the ESFS upon its establishment.[104]

### *3.3.4 The Legal Basis of the Regulations on the ESFS*

The legal basis for the Regulations establishing the ESAs and the ESRB is Article 114 TFEU.[105] On the other hand, the legal basis for Council Regulation (EU) No 1096/2010 is the enabling clause of Article 127(6) TFEU (repeated almost *verbatim* in Article 25.2 ESCB/ECB Statute), which was activated for the first time in this case. According to recital (9): "As it is the task of the ESRB to cover all aspects and areas of financial stability, the ECB should involve national central banks and supervisors to provide their specific expertise. The option to confer specific tasks concerning policies relating to prudential supervision upon the ECB provided for by the Treaty on the Functioning of the European Union should therefore be exercised, by conferring on the ECB the task of ensuring the Secretariat to the ESRB." The second time that this TFEU Article was

[100] OJ C 41, 14.2.2012, pp. 1–4; see Recommendation B, paragraph 1.

[101] See Sect. 3.3.1.

[102] *De Larosière Report* (2009), paragraph 172, second sentence, and paragraphs 173–182.

[103] OJ L 331, 15.12.2010, pp. 162–164.

[104] The role of the ESRB is further discussed in Chap. 5, Sect. 5.4.2.

[105] Regarding this choice, see Louis (2010), p. 149; in relation to the EBA Regulation, see also its recital (17). Article 114 TFEU is detailed in Herrnfeld (2019).

activated was in 2013, when it was used as a legal basis for adopting Council Regulation (EU) No 1024/2013, the 'SSM Regulation', which is the main legal source of the first pillar of the Banking Union.[106]

## 3.4 A General Remark on the Importance of Robust Institutions and Policies

(1) A careful look into the literature on international banking crises since 1970 shows that it would be overly optimistic to rule out the eventuality of future banking crises.[107] This is not due to a destructive trend inherent within the system and also not (only) due to a Minsky-type financial instability hypothesis[108] (to the extent that this applies). It is, in the author's opinion, mainly due to two factors:

The first factor concerns a systematic failure to appropriately design the necessary measures for the system's protection, in order to predict probable crises adequately; this failure is due to several factors and is beyond the scope of this book. In any event, it is no coincidence that institutions and rules in the banking (and, more generally, financial) system are often the 'children of crises'.

The second factor relates to the reflex following the onset of a crisis, which consists in taking hasty and often piecemeal and excessive regulatory measures, without taking into due account the negative effects of their application, having as a sound (or pretextual) legal basis the need to immediately restore trust in the banking system. Within this framework, it is noted that complacency as a result of the event (and appropriate promotion) of the establishment of new institutions and/or the adoption of new rules may lead to a short-sighted approach to reality and exacerbate the above-mentioned issue of designing effective long-term policies. Equally problematic is, however, the eventuality of the new institutional and/or regulatory framework shortly proving inadequate (given that it was the result of emergency circumstances), and thus necessitating readjustment. This would result in heightened uncertainty in terms of the adequacy of interventions, both aggravating trust on the part of depositors, investors and borrowers and increasing the operational cost of banks (which is rolled

[106] See Chap. 4, Sect. 4.2.1; Article 127(6) TFEU is analysed in Chap. 5, Sect. 5.2.2.

[107] See Leaven and Valencia (2008) and Reinhart and Rogoff (2008); see also Caprio and Klingebiel (1996, 1999), as well as Thiele (2014), pp. 563–569.

[108] See Sect. 3.1.2.

over to either the consumers or shareholders and leads to squandering of funds) without on the other hand (sufficiently) achieving the substantial protection of systemic stability.

(2) It is also noted that, at times of (solvency and/or liquidity) crisis, the primary and overriding concern is, rightly, taking management measures in order to immediately mitigate the adverse effects of the crisis. Such measures, encompassing *inter alia* (as mentioned above) the interventions of central banks as lenders of last resort, but also as monetary authorities (by means of non-standard monetary policy measures), and government ownership for insolvent banks are not used under 'normal' circumstances of a financial system and are necessary in the short-run, but do not represent solutions for the medium-term protection of such banks, after the circumstances of their operation are normalised. In addition, however, they cannot be permanent, because this would go against the provisions of applicable law regarding the prohibition (in principle) of state aid in several jurisdictions, including the EU Member States, in which the main factor to be taken into account is the fundamental principle of EU law on the operation of a single market with free competition. This final remark is made in light of the government-financed bank bailout or rescue packages adopted for the consolidation of the banking system and restoration of liquidity in the economy adopted in the aftermath of the recent (2007–2009) international financial crisis in several EU Member States (as well as by many other countries around the world), which resulted in the (albeit temporary) government ownership of technically insolvent, but (usually) viable banks. The government's stake in the share capital of banks, along with all other relevant measures (such as the provision of guarantees to banks), are considered to constitute state aid and require prior approval of the competition authorities.

(3) In closing, the most relevant factor is not (at least not merely) the quantity of regulations, even though, at times of crisis, there is always an unwarranted risk of overregulation—regulatory intervention and the concomitant supervision in every segment of economic and social activity usually overshoots its purpose.[109] The quality and targeting of regulatory

[109] This is a reasonable reaction on the part of the intervening body to—at least—appease society as a whole, and common in areas such as air transport, in case of accidents, healthcare, in case of epidemics, or in the financial system, in case of financial firm insolvencies. In due course, 'excessive' intervention measures tend to become lax, inert or are transgressed by the market itself. In this context and in realistic terms, expectations regarding current policy

interventions,[110] effective micro-prudential financial supervision, the existence of adequate early warning systems, reliable sanctioning mechanisms and adequate crisis management mechanisms, the institutional, personal, financial and operational independence of supervisory authorities (following the model of central banks as bodies which design and implement monetary policy), while concurrently safeguarding proper accountability, their appropriate staffing in order to ensure the quality of the micro-prudential supervision exercised, the efficient and unobstructed exercise of their sanctioning powers and the existence of an appropriate framework on their responsibility *vis-à-vis* depositors, as well as supervised banks and their shareholders[111] are equally important. Both in the short- and, mainly, in the long run, all the above will ultimately boost savers' and investors' confidence in the financial system, which is a key objective.[112]

Better (legal, political, social and economic) institutions have an important impact on economic performance.[113] As a result, to the extent that these institutions pertain to the financial system, there is a higher degree of financial development[114] and, subsequently, stronger economic growth (the 'legal view' on financial development and growth).[115] The financial systems of several states were not exposed (at least primarily), or were less significantly exposed, to the recent (2007–2009) international financial crisis, not only because they were equipped with a strong institutional and regulatory framework but also because micro-prudential supervision of their banking system was, admittedly, suitable. To illustrate this, it is worth noting the wording of paragraph 151 of the 2009 Report drawn up by the de Larosière High-Level Group,[116] tasked with identifying the causes of the crisis: "The supervisory objective of maintaining financial stability must take into account an important constraint which is to allow the financial industry to perform its allocative economic function with the

initiatives should be to minimise the eventuality of future crises of the magnitude and extent that we are experiencing today, and not to eliminate financial crises completely.

[110] See on this Herring and Santomero (2000).

[111] On this distinction, see Rini (2008), pp. 61–68.

[112] See on this Swoboda (2008).

[113] See on this the seminal work of North (1990, 1991), and Williamson (2000); see also, by way of mere indication, Joskow (2008) for a general review of new institutional economics.

[114] This has been established empirically by La Porta et al. (1997, 1998).

[115] See on this Levine (1998) and Aron (2000).

[116] See Sect. 3.3.1.

greatest possible efficiency, and thereby contribute to sustainable economic growth. Supervision should aim to encourage the smooth functioning of markets and the development of a competitive industry. Poor supervisory organisation or unduly intrusive supervisory rules and practices will translate into costs for the financial sector and, in turn, for customers, taxpayers and the wider economy. Therefore, supervision should be carried-out as effectively as possible and at the lowest possible cost."

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CHAPTER 4

# The Establishment of the (European) Banking Union

## 4.1 The Birth of the Banking Union as a Response to the Ongoing Fiscal Crisis in the Euro Area

### *4.1.1 The Political Decisions of June 2012 and the Commission's Initiatives*

(1) Amidst the ongoing fiscal crisis in the euro area, which became manifest in 2010, the initiative to create the (European) Banking Union [hereinafter the 'BU', also referred to frequently by this author as well as the 'EBU'] was introduced in the Report submitted on 26 June 2012 by the (then) President of the European Council, Herman Van Rompuy, entitled "Towards a Genuine Economic and Monetary Union" (the so-called Van Rompuy Report).[1] One of the four elements of this report was the creation of "an integrated financial framework".[2] The creation of the BU was tabled immediately afterwards, at the Euro Area Summit of 29 June 2012, which included a phrase summarising the main rationale behind this initiative in its statement: "We affirm that it is imperative to break the vicious circle between

[1] Available at: https://www.consilium.europa.eu/media/33785/131201.pdf.

[2] The other three elements were setting up an integrated budgetary framework ('European Fiscal Union'), an integrated economic policy framework ('European Economic Union') and a democratic legitimacy and accountability framework ('European Political Union').

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banks and sovereigns."[3] The European Summit which was held concurrently on 28 and 29 June invited the President of the European Council to develop, in close collaboration with José Manuel Barroso, President of the Commission, Jean-Claude Juncker, President of the Eurogroup and Mario Draghi, President of the European Central Bank (ECB), a specific and time-bound roadmap for the achievement of a genuine Economic and Monetary Union (EMU), in accordance with the Van Rompuy Report. This roadmap took the form of a Report, entitled "Towards a Genuine Economic and Monetary Union" (the 'Four Presidents' Report), published on 5 December 2012.[4]

(2) Against this political background, the Commission issued on 12 September 2012 an announcement regarding "A Roadmap for a Banking Union", a proposal for a Council Regulation "conferring specific tasks on the [ECB] concerning policies relating to the prudential supervision of credit institutions", and a proposal for a Regulation of the European Parliament and of the Council "amending [the EBA] Regulation (…) as regards its interaction with [the above-mentioned] Council Regulation (…)".[5] In its Announcement the Commission called on the European Parliament and the Council to reach agreement by end-2012 on the two above-mentioned Regulation proposals, as a first step towards the creation of the BU. It also called upon them to approve, also by end-2012, the proposals for the Regulations and Directives on amending the applicable regulatory framework on micro-prudential banking regulation, and setting up a new regulatory framework on macro-prudential banking regulation, establishing pan-European rules on the recovery and resolution of unviable credit institutions (and investment firms), and amending the existing regulatory framework on deposit guarantee schemes (DGSs). Finally, it should examine, in the medium term, how to shape the conditions for the establishment of a supranational entity for the resolution of unviable credit institutions, a supranational resolution fund for covering

[3] Euro Area Summit Statement, 29 June 2012, first paragraph, first sentence, available at: https://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf. For a historical perspective on the 'vicious circles' (also called 'vicious cycles', 'diabolic loops' or 'doom loops') between the banking sector and sovereign bond markets, see Mitchener (2014).

[4] Available at: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf.

[5] COM(2012) 510 final, 511 final and 512 final, respectively.

funding gaps, provided that a decision were to be made in favour of the resolution of an unviable credit institution, and a supranational deposit guarantee scheme, allowing the completion of the BU.

(3) On the basis of this political agenda, the establishment of the BU should create a 'Europeanised bank safety net' consisting of three main pillars:[6] first, a Single Supervisory Mechanism (SSM) exclusively for the banking sector (i.e. not for the insurance and securities sectors) and mainly for credit institutions incorporated in euro area Member States, with regard to their micro-prudential supervision (the 'first pillar'); second, a Single Resolution Mechanism (SRM) for unviable credit institutions (also mainly incorporated in euro area Member States) and a Single Resolution Fund (SRF), provided that a decision were to be made on the resolution of such credit institutions (the 'second pillar'); and third, a single deposit guarantee scheme, which coupled with the Single Resolution Board (a part of the SRM), could form a 'European Deposit Insurance and Resolution Authority' (EDIRA) (the 'third pillar').

(4) These pillars should be premised on a 'single rulebook'[7] containing substantive rules on all previous aspects as part of the single market for financial services[8] and developed either by the EU institutions [legislative acts under Article 289 Treaty on the Functioning of the European Union TFEU)] or by the EU institutions with the direct involvement of and contribution of the EBA (delegated and implementing acts in accordance with Articles 290–291 TFEU).[9]

[6] For arguments for or against establishing the Banking Union, see indicatively (out of a vast existing literature) Eijffinger and Nijskens (2012), Louis (2012), Beck (2012), Bofinger et al. (2012), Carmassi et al. (2012), House of Lords (2012), Pisani-Ferry et al. (2012), Schoenmaker (2012), Sibert (2012), Wyplosz (2012), Goyal et al. (2013) and Herring (2013). On various aspects of the functioning of the BU, see also the contributions in Allen et al. (2013, 2014, 2015).

[7] This term is used to refer to the total harmonisation of rules pertaining to the prudential regulation and supervision of financial firms and was first introduced in June 2009, when the European Council called for the establishment of a "European single rulebook applicable to all financial institutions in the Single Market" (11225/2/09 REV 2, paragraph 20, available at: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/108622.pdf). For a detailed analysis on the single rulebook, see Lefterov (2015).

[8] On the link between the BU and the single market, see Lastra (2013), Binder (2016), pp. 13–15, and Alexander (2016), pp. 258–260.

[9] On Articles 289–291 TFEU, see Appendix of Chap. 5.

### 4.1.2 *Legislative Actions—The New Institutional and Regulatory Framework*

*The First Wave of Measures*

(1) The most significant institutional and regulatory developments towards establishing the BU took place during 2013–2014. Taking into account the normal response time of European institutions, these legislative measures were taken, based on proposals by the Commission, in an exceptionally short amount of time. Except for the single deposit insurance scheme, the other components are in place.[10] It is noted that the BU agenda does not include, so far at least, the centralisation of last-resort lending, which Lastra and Goodhart (2015) correctly consider to be the "missing fourth pillar of the banking union", since the role of the ECB within the "Emergency Liquidity Assistance Mechanism" is still limited.[11]

(2) The pillars of the BU, notably the new EU mechanisms and funds, are "children" of the ongoing fiscal crisis in the euro area and are designed to apply mainly (albeit not exclusively) to the euro-area Member States.[12] On the other hand, the legislative acts which constitute the main corpus of the single rulebook are "children" of the recent international financial crisis. In particular, those on the prudential regulation and supervision of credit institutions and on DGSs repealed pre-existing legislation in those two issue areas, while that on the resolution of credit institutions introduced for the first time such a regime—all of them under the influence,

[10] For a general overview and assessment of the legal framework on the BU, see indicatively Binder (2013), Moloney (2014), various contributions in Castaneda et al. (2015, editors), Lastra (2015), pp. 355–382, the contributions of the co-authors in Binder and Gortsos (2016) and individual contributions in Busch and Ferrarini (2015, editors) and Chiti and Santoro (2019, editors). On the specific aspect of how the BU framework also impacts on private law relationships (duties), see Grundmann (2015). On extending the framework governing single supervision and resolution also to systemically important non-bank EU financial institutions, see Busch and van Rijn (2017) and (in relation to resolution) Binder (2019).

[11] Lastra and Goodhart (2015), p. 16. The three main pillars of the BU and the related single rulebook are presented, in turn, in Sects. 4.2–4.4. Table 4.1 summarises the key legal sources thereof and Table 4.2 the addressees of and the dates by which the main provisions are applicable. Table 4.3 presents the content of EU banking law before and after the establishment of the BU, denoting the elements of continuity and change. On the ELA, see Chap. 9, Sect. 9.3.

[12] On the potential application of the BU on Member States with a derogation under the so-called close cooperation procedure, see Chap. 5, Sect. 5.2.5.

**Table 4.1** The key legal sources of the Banking Union

| | *Prudential supervision and regulation of credit institutions* | *Resolution of non-viable credit institutions* | *Deposit guarantee schemes* |
|---|---|---|---|
| European 'Single Mechanisms' | Single Supervisory Mechanism: Council Regulation (EU) No 1024/2013 ('SSM Regulation') ECB Regulation (EU) No 468/2014 ('SSM Framework Regulation') Other ECB legal acts | Single Resolution Mechanism and Fund: Regulation (EU) No 806/2014 of the European Parliament and of the Council ('SRM Regulation'), and Commission's delegated and implementing acts Intergovernmental Agreement (2014) ('SRF') | Proposal for a Regulation of the European Parliament and of the Council "amending Regulation EU No 806/2014 in order to establish an 'EDIS'" |
| Harmonisation of substantive rules ('single rulebook') | Regulation (EU) No 575/2013 of the European Parliament and of the Council ('CRR'), and Commission's delegated and implementing acts Directive 2013/36/EU of the European Parliament and of the Council ('CRD IV'), and Commission's delegated and implementing acts | Directive 2014/59/EU of the European Parliament and of the Council ('BRRD'), and Commission's delegated and implementing acts | Directive 2014/49/EU of the European Parliament and of the Council, and a Commission's delegated act ('DGSD') |

to a higher or lower degree, from developments in public international banking law after that crisis.[13] The single rulebook, adopted by the European Parliament and the EcoFin Council and further fleshed out by the Commission and the EBA, is applicable across all EU Member States; it forms part of the single market for financial services and is based on a 'total harmonisation approach'.

[13] See Chap. 3, Sect. 3.2.3.

**Table 4.2** Addressees of and date by which the main provisions of the key legal sources pertaining to the Banking Union are applicable

| *Legal act* | *Addressees* | *Date of start of (full) application* |
|---|---|---|
| A. Authorisation—prudential supervision—prudential regulation | | |
| Regulation (EU) No 1024/2013 ('SSM Regulation') | 19+ Member States | 4 November 2014 |
| ECB 'SSM Framework Regulation' | 19+ Member States | 15 May 2014 |
| Regulation 575/2013 ('CRR') | 28 Member States | 1 January 2014 |
| Directive 2013/36/EU ('CRD IV') | 28 Member States | 1 January 2014 |
| B. Recovery and resolution | | |
| Regulation (EU) No 806/2014 ('SRM Regulation') | 19+ Member States | 1 January 2016 |
| Intergovernmental Agreement on the 'SRF' | 19+ Member States | 1 January 2016 (upon ratification by contracting parties) |
| Directive 2014/59/EU ('BRRD') | 28 Member States | 1 January 2015 |
| C. Deposit guarantee | | |
| Directive 2014/49/EU on deposit guarantee schemes | 28 Member States | 4 July 2015 |

*The Commission's Most Recent Reform Agenda: A General Overview*

(1) The legal framework governing the BU and (mainly) the underlying single rulebook is currently under (partial) amendment. On 23 November 2016, the Commission tabled, on the basis of its Communication of 24 November 2015 "Towards the completion of the Banking Union",[14] a legislative 'banking package' concerning the amendment of several aspects of the SRMR, the Bank Recovery and Resolution Directive (BRRD), the Capital Requirements Regulation (CRR) and the Capital Requirements Directive No IV (CRD IV) with a view to reducing risks in the financial system and further strengthening the resilience of EU credit institutions. The components of this package have gradually already been adopted and are briefly presented below, as appropriate.

(2) The Commission Communication of 11 October 2017 "On completing the Banking Union",[15] which is broadly based on the conclusions of its Reflection Paper "on the deepening of the economic and monetary

[14] COM(2015) 587 final.
[15] COM(2017) 592 final.

**Table 4.3** European (EU) banking law before and after the Banking Union: Elements of continuity and change

| *Financial policy instruments* | *Institutions/rules* | |
|---|---|---|
| A. Prudential requirements | | |
| | Until 31 December 2013 | By 2014 (gradually) (italics denote change or new element) |
| 1. Authorisation and micro-prudential supervision of credit institutions | National supervisory authorities<br>Minimum harmonisation of rules (Directive 2006/48/EC) | Single Supervisory Mechanism ('SSM Regulation') (for euro area +)<br>NCAs (for Member States with a derogation)<br>Single rulebook ('CRD IV') (for all Member States) |
| 2. Micro- and macro-prudential regulation of credit institutions | Minimum harmonisation of rules (Directives 2006/48/EC and 2006/49/EC) | Single rulebook ('CRR' and 'CRD IV') (for all Member States) |
| 3. Evaluation of recovery plans | – | Single Supervisory Mechanism ('SSM Regulation') (for euro area +)<br>NCAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |
| 4. Resolution planning | – | Single Resolution Mechanism ('SRM Regulation') (for euro area +)<br>NRAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |
| 5. Macro-prudential oversight of the financial system | European Systemic Risk Board | European Systemic Risk Board |
| B. Crisis prevention | | |
| | Until 31 December 2013 | By 2014 (gradually) (italics denote change or new element) |
| 1. Adoption of 'alternative measures' within the framework of recovery plan evaluation | – | Single Supervisory Mechanism ('SSM Regulation') (for euro area +)<br>NCAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |

(*continued*)

**Table 4.3** (continued)

| *Financial policy instruments* | *Institutions/rules* | |
|---|---|---|
| 2. Repair or removal of impediments to resolvability | – | Single Resolution Mechanism ('SRM Regulation') (for euro area +)<br>NRAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |
| 3. Early intervention—special administrator | – | Single Supervisory Mechanism ('SSM Regulation') (for euro area +)<br>NCAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |
| 4. Write-down and conversion (without bail-in) | – | Single Resolution Mechanism ('SRM Regulation') (for euro area +)<br>NRAs (for Member States with a derogation)<br>Single rulebook ('BRRD') |
| C. Crisis management | | |
| | Until 31 December 2013 | By 2014 (gradually) (italics denote change or new element) |
| 1. Reorganisation of credit institutions | National authorities (Directive 2001/24/EC)<br>No harmonisation of rules | National authorities (Directive 2001/24/EC)<br>No harmonisation of rules |
| 2. Winding up of credit institutions | National authorities (Directive 2001/24/EC)<br>No harmonisation of rules | National authorities (Directive 2001/24/EC)<br>No harmonisation of rules |
| 3. Deposit guarantee schemes | National schemes<br>Minimum harmonisation of rules (Directive 94/19/EC) | From national schemes to the EDIS (proposal)<br>Single rulebook (Directive 2014/49/EU) (for all Member States) |
| 4. Resolution of credit institutions | – | Single Resolution Mechanism ('SRM Regulation') (for euro area +)<br>NRAs (for Member States with a derogation)<br>Single Resolution Fund (Intergovernmental Agreement) (for euro area +)<br>Single rulebook ('BRRD') (for all Member States) |

(*continued*)

**Table 4.3** (continued)

| *Financial policy instruments* | *Institutions/rules* | |
|---|---|---|
| 5. Provision of state subsidies to systemically important credit institutions | Member States<br>Indirectly the ESM | Member States<br>Indirectly the ESM<br>Directly the ESM ('DRI') |
| 6. Last-resort lending to solvent but illiquid credit institutions | National central banks [Emergency Liquidity Assistance (ELA) in the euro area] | National central banks [Emergency Liquidity Assistance (ELA) in the euro area] |

**Table 4.4** Key Reports and Commission Communications relating to the Banking Union

| *Date* | *Report/communication* |
|---|---|
| 26 June 2012 | 'Van Rompuy' Report "Towards a Genuine Economic and Monetary Union" |
| 5 December 2012 | 'Four Presidents' Report "Towards a Genuine Economic and Monetary Union" |
| 22 June 2015 | 'Five Presidents' Report' "Completing Europe's Economic and Monetary Union" |
| 21 October 2015 | Commission Communication "On steps towards Completing Economic and Monetary Union" |
| 24 November 2015 | Commission Communication "Towards the completion of the Banking Union" (the basis of the 2016 legislative 'banking package') |
| 31 May 2017 | Commission Reflection Paper "on the deepening of the economic and monetary union" of 31 May 2017 (the 'EMU reflection paper') |
| 20 September 2017 | Commission Communication "Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment" |
| 11 October 2017 | Commission Communication "On completing the Banking Union" |
| 6 December 2017 | Commission Communication "Further steps towards completing Europe's Economic and Monetary Union: A roadmap" |

union" of 31 May 2017[16] (the 'EMU reflection paper') (as well as in previous documents submitted by the Council and by the Commission), laid down in this respect the following six priorities, which can be categorised in two groups.

[16] Available at: https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en.

The first group contains 'risk reduction' measures, including the following: the (quick) adoption of the 2016 legislative 'banking package', the creation of sovereign bond-backed securities (the 'SBBSs'), the undertaking of actions to address non-performing loans, in accordance with the Council Action Plan "on Non-Performing Loans" of July 2017,[17] and the sustained attempt to ensure high-quality supervision (see the concluding remarks). The initiative to introduce the 'SBBSs' can be viewed as a by-product of the need to overcome in a smooth manner a major 'regulatory failure' linked to the provisions of the CRR, which stipulate, in relation to the calculation of capital requirements for credit risk (mainly under the 'standardised approach',[18] still used by several less sophisticated credit institutions), that claims on Member State governments, if denominated in the local currency, have a 0% risk weight.[19] In this respect, on 24 May 2018 the Commission submitted a Proposal for a Regulation of the European Parliament and the Council on sovereign bond-backed securities[20] aiming to establish a "general framework" for SBBSs in the EU.

[17] Its conclusions are available at: https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans. The Commission's proposals are laid down in pp. 17–18 of its Communication of 11 October 2017. Developments on this field are constant; for a detailed overview, see Montanaro (2019).

[18] For the calculation of their capital requirements in accordance with the (alternative) 'internal ratings-based approach', credit institutions must take into account four specific parameters for each exposure: a borrower's probability of default (the 'PD'); loss given default (the 'LGD'), which refers to the calculation of a bank's (average) expected loss per claim (a function of accepted collateral) in the event of a borrower's inability to meet liabilities (a concept which incorporates capital losses, loss of interest income and operating expenses); exposure at default (the 'EAD'); and the loan contract's maturity (see Gleeson (2010), pp. 75–77).

[19] For an analytical study of this case, see European Systemic Risk Board (2015). On the same aspect from a global point of view, see the discussion paper of the Basel Committee of 7 December 2017 on the "Regulatory treatment of sovereign exposures" (available at: https://www.bis.org/bcbs/publ/d425.htm). The experience from the 'voluntary' haircut on Greek government bonds under the Private Sector Involvement (the 'PSI'), which resulted in Greek credit institutions suffering extremely severe losses from their participation therein to the extent that their capital basis was depleted, has shown that these provisions are not appropriate. They provide credit institutions with perverse incentives when including government bonds in their portfolios, especially in their banking books (on the key terms of the PSI following the 26 October 2011 Euro Summit, see Gortsos (2013), pp. 166–169, more analytically Zettelmeyer et al., Gulati (2013) and Buchheit (2016)) and Hadjiemmanuil (2019), pp. 73–77. Nevertheless, any (even adequate) increase of risk weights might lead to a distortion of capital markets, given the volumes of higher risk government bonds involved.

[20] COM(2018) 839 final. The text of the Commission's Staff Working Document "Impact Assessment" (SWD(2018) 252 final, 24.5.2018) is available at: https://ec.europa.eu/info/

The second group comprises two 'risk sharing' measures (the adoption and implementation of which was deemed to have to follow the efficient application of the risk reduction ones), and in particular the establishment of the European Deposit Insurance Scheme (EDIS) (see Sect. 4.4.1) and the creation of a 'common backstop' to the (Single Resolution) Board for the SRF (Sect. 4.3.3).[21]

(3) The priority character of the above-mentioned actions was further reinforced in the Commission Communication of 6 December 2017 "Further steps towards completing Europe's Economic and Monetary Union: A roadmap",[22] which outlines the comprehensive package of six proposals to strengthen the EMU—including the BU and the Capital Markets Union (the 'CMU'),[23] which constitute the two pillars of the 'Financial Union'. *Inter alia*, this package also included a proposal for a Council Regulation on the establishment of the European Monetary Fund, which was initially considered to be the basis for the 'common backstop'.

*In Particular: Increasing the Quality of Supervision*

(1) Notwithstanding its overall positive assessment of the work of the SSM with regard to the micro-prudential supervision of credit institutions in the euro area,[24] the Commission also submitted on 20 September 2017 a Communication on "Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment".[25] This was coupled by four Proposals for three Regulations and one Directive of the European Parliament and of the Council for the amendment of the Regulations

law/ better-regulation/initiatives/ares-2018-400473. This proposal is analysed in Gortsos (2018), with extensive further references.

[21] All these initiatives were without prejudice to other regulatory developments designed for the enhancement of financial stability and affecting the operation of EU credit institutions, such as the new international accounting standard 'IFRS 9' on the classification and measurement of financial instruments, whose application started on 1 January 2018. On this accounting standard and its implications for financial stability, see European Systemic Risk Board (2017).

[22] COM (2017) 821 final, 6.12.1017, pp. 11–12.

[23] On the CMU, see by way of mere indication Dixon (2014), Ringe (2015), Véron and Wolff (2015), the individual contributions in Busch et al. (2018, editors) and Lannoo and Thomadakis (2019).

[24] Commission Communication (11.10.2017), Section 7, first paragraph.

[25] COM(2017) 542 final.

governing the European Supervisory Authorities and the European Systemic Risk Board, of several legal acts constituting the sources of EU capital markets law,[26] the objective of which is to ensure stronger and more integrated financial supervision across the EU by improving their mandates, governance and funding. In addition, there are proposals to enhance the micro-prudential supervision of investment firms, especially in view of the fact that, due to the existing potential for regulatory arbitrage, some large investment firms (in certain cases, part of complex banking groups) carry out investment banking services which are outside the reach of the existing regulatory/supervisory framework and raise concerns of financial stability.[27]

Of particular institutional importance (even though outside the reach of this book) are also the proposals to develop the European Securities and Markets Authority into a 'Single Capital Markets Supervisor', by extending its direct supervision to selected capital market sectors, beyond those of credit rating agencies and trade repositories.[28] This initiative is linked with the creation of the CMU.

(2) With regard to this aspect and notwithstanding the rationale underlying the current regulatory reform, the author notes that legal certainty and efficiency dictate a 'regulatory pause' (even though current and forthcoming developments signal the opposite). Taking into account, in particular, the difficulties arising from the appropriate application and interpretation of several provisions of the extensive new regulatory framework in the BU era (CRR and the national legislation having incorporated the CRD IV and the BRRD), the steady state should be reached soon and not be distorted by a new wave of regulations before the recent ones have been fully and adequately absorbed.[29] In any case, it is the author's strong belief that the preservation of systemic stability is not a linearly positive function of extensive and extremely detailed micro- and macro-prudential regulations, such as those contained in the Basel III regulatory framework and in the CRR.

[26] Available at: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-536_en.

[27] Commission Communication (11.10.2017), Section 7, second paragraph.

[28] Commission Communication (20.09.2017), pp. 9–10.

[29] This argument is further developed in Gortsos (2015b).

## 4.2 The First Main Pillar: Authorisation, Prudential Regulation and Prudential Supervision of Credit Institutions

### *4.2.1 The Legal Acts Governing the SSM*

(1) Council Regulation (EU) No 1024/2013 (the 'SSMR') "conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions" is the main legal source of the SSM. It was adopted by the Council on 15 October 2013 (within 14 months from the submission of the Commission's proposal), was published in the Official Journal (the 'OJ') on 29 October 2013 and entered into force on 3 November 2013. The SSMR confers on the ECB specific tasks "concerning policies relating to the prudential supervision of credit institutions" (a phrase taken over *verbatim* from Article 127(6) TFEU) with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State and to preventing regulatory arbitrage, fully taking into account and caring for the unity and integrity of the internal market based on equal treatment of credit institutions.[30] Obviously, this ECB objective is different from the primary objective of the European System of Central Banks under the TFEU, that is maintaining price stability. The eventuality of conflicts of interest arising from concurrently pursuing these two objectives was the reason behind the introduction of 'Chinese walls' separating the ECB's monetary and supervisory functions (in accordance with Article 25 SSMR).[31]

(2) In the prospect of conferring supervisory tasks upon the ECB, it was deemed necessary to introduce amendments to certain provisions of the EBA Regulation in order to bring the EBA's functions in line with the ECB's function as a supervisory authority over credit institutions. The above-mentioned circumstances encouraged the adoption by the European Parliament and the Council of Regulation (EU) No 1022/2013 of 22 October 2013 "amending Regulation (EU) No 1093/2010 establishing the European Supervisory Authority (…) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013".[32] This Regulation, adopted on the basis of Article

[30] SSMR, Article 1, first sub-paragraph.

[31] On these aspects, see Chap. 5, Sects. 5.1.1 and 5.2.4.

[32] OJ L 287, 29.10.2013, pp. 5–14.

114 TFEU, was drafted in parallel and adopted concurrently with the SSMR (hence the term 'twin' Regulations) and amends the EBA Regulation on several aspects.

(3) In consultation with the National Competent Authorities (NCAs) of participating Member States and on the basis of a proposal from the Supervisory Board, the ECB was required to adopt and make public a framework to organise the practical modalities of implementation of Article 6 SSMR. On the basis of this Article, the ECB adopted on 16 April 2014 Regulation (EU) No 468/2014 "establishing the framework for cooperation within the SSM between the [ECB] and [NCAs] and with national designated authorities ('SSM Framework Regulation') (ECB/2014/17)".[33] The subject matter and purpose of this Regulation is to lay down rules on several aspects and primarily a framework to organise the practical arrangements for implementing Article 6 on cooperation within the SSM.[34]

(4) The institutional and regulatory framework pertaining to the SSM is further specified in other ECB legal acts, containing provisions on the detailed operational arrangements for the implementation of the tasks conferred upon the ECB by the SSMR. These legal acts can be classified into two categories: the first contains the legal acts pertaining to the operation of the three bodies established within the ECB pursuant to the SSMR (i.e. the Supervisory Board, the Administrative Board of Review and the Mediation Panel);[35] the second category contains the ECB legal acts pertaining to various other aspects of the SSM, that is identifying the credit institutions subject to the comprehensive assessment, the close cooperation procedure, the ECB powers to impose sanctions, the provision to the ECB of supervisory data reported to the NCAs by supervised entities, the implementation of the separation between the monetary and supervision functions of the ECB, and supervisory fees.[36]

(5) On the basis of Article 20(8)–(9) SSMR, an Interinstitutional Agreement between the European Parliament and the ECB was also signed in October 2013 "on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the [SSM]".[37] In addition, in

[33] OJ L 141, 14.5.2014, pp. 1–50.

[34] SSM Framework Regulation, Article 1(1); see also Article 6(7) SSMR.

[35] On these bodies, see Chap. 6, Sect. 6.2.2.

[36] For a systematic overview of the ECB legal acts adopted in the (initial) period 2014–2015, see Gortsos (2015a), pp. 77–80 and 82–83.

[37] OJ L 320, 30.11.2013, pp. 1–6.

December 2013, the Council and the ECB signed a Memorandum of Understanding (the 'MoU') "on the cooperation on procedures related to the [SSM]", which entered into force on 12 December 2013.[38]

### *4.2.2 The Single Rulebook*

*General Overview*

(1) The authorisation, prudential regulation and micro-prudential supervision of credit institutions in the EU (and not only in the euro area) are governed by two legal acts of the European Parliament and of the Council of 26 June 2013: Regulation (EU) No 575/2013 "on prudential requirements for credit institutions and investment firms (…)" ('Capital Requirements Regulation' or 'CRR')[39] and Directive 2013/36/EU "on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (…)"[40] ('Capital Requirements Directive IV'[41] or 'CRD IV'). Adopted on the basis of Articles 114 and 53(1) TFEU,[42] respectively, in force since 1 January 2014 and applying equally to credit institutions and investment firms (jointly referred to as 'institutions'), these legal acts set the framework governing the following aspects: first, access to activity of the business of institutions (granting and withdrawal of authorisation, as well as acquisition and disposal of qualifying holdings), and exercise of the right of establishment and the freedom to provide services in the single market; second, relations to third countries; third, prudential supervision of institutions, both on a solo and on a consolidated basis, including the Supervisory Review and Evaluation Process (the 'SREP');[43] and fourth, micro- and (for the first time) macro-prudential

[38] The main provisions of all these acts are presented in Chap. 5, Sect. 5.2.

[39] OJ L 176, 27.6.2013, pp. 1–337. This legislative act is in force as repeatedly amended and mainly in 2017 by two Regulations of the European Parliament and of the Council: Regulation (EU) 2017/2395 of 12 December 2017 mainly as regards the mitigation of the impact of the introduction of IFRS 9 on own funds (OJ L 345, 27.12.2017, pp. 27–33) and Regulation (EU) 2017/2401 of 12 December 2017 mainly on the treatment of securitisation positions (OJ L 347, 12.2.2017, pp. 1–34). In May 2019, it has been further amended (see later).

[40] OJ L 176, 27.6.2013, pp. 338–436. In May 2019, this legislative act has also been amended.

[41] In fact, this is a misnomer for the Directive, which addresses several other prudential aspects rather than merely capital requirements.

[42] Article 53 TFEU is analysed in Schlag (2019).

[43] CRD IV, Articles 8–27, 33–46, 47–48 and 49–117, respectively.

regulation of institutions.[44] Micro-prudential regulations, which are part of the so-called Pillar 1 of regulatory framework, include capital adequacy ratios against exposure to risks associated with the conduct of their business, liquidity ratios and a leverage ratio, corporate governance rules, limitation of credit institutions' holdings in companies outside the financial system and rules on 'large exposures'; 'Pillar 2' refers to the SREP and 'Pillar 3' to the public disclosure of information on those matters. Macro-prudential regulations include the imposition on institutions to build up capital buffers.[45]

(2) An integral part of the single rulebook are also the delegated and implementing acts (predominantly) adopted by the Commission, on the basis of the power conferred thereon under specific Articles of the CRR and the CRD IV in accordance with Articles 290–291 TFEU; their majority is based on draft technical regulatory and implementing standards developed by the EBA. Included in the single rulebook are also Guidelines adopted by the EBA, either on the basis of specific provisions of the CRR and the CRD IV or on its own initiative pursuant to Article 16 EBA Regulation.[46]

*The Impact of Public International Banking Law*

The rules of the CRR and of the CRD IV on the SREP and the micro- and macro-prudential regulation of credit institutions reflect to a large extent the framework developed in 2010 [immediately after the recent (2007–2009) international financial crisis] by the Basel Committee in this field (the 'Basel III regulatory framework').[47]

[44] CRR and CRD IV, Articles 128–142 (on capital buffers).

[45] On the SREP, see more details in Chap. 8, Sect. 8.2.3 and on the macro-prudential capital buffers Chap. 8, Sect. 8.1.3.

[46] All these draft technical standards and Guidelines adopted by the EBA are available at: https://eba.europa.eu/regulation-and-policy/single-rulebook; the related Q&As are available at: https://eba.europa.eu/single-rule-book-qa. The making of delegated and implementing acts and EBA Guidelines is briefly presented in Appendix of Chap. 5.

[47] The Basel III framework consists of three Reports: "Basel III: A global regulatory framework for more resilient banks and banking systems" (available at: https://www.bis.org/publ/ bcbs189.htm), "Basel III: The Liquidity Coverage Ratio [LCR] and liquidity risk monitoring tools" (at: https://www.bis.org/publ/bcbs238.htm), and "Basel III: The net stable funding ratio [NSFR]" (at: https://www.bis.org/publ/bcbs295.htm). On this framework and its evolution, see Gortsos (2012), pp. 250–281, McNamara et al. (2014a) and (2014b) and Bodellini (2019).

*Adoption of the 2016 'Banking Package'*

The above-mentioned 2016 'banking package'[48] provided for the amendment of the CRR and the CRD IV as well. The amendments to the CRR are included in Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019[49] and refer to the following: the leverage and the net stable funding ratios, requirements for own funds and eligible liabilities, counterparty credit and market risks, exposures to central counterparties and collective investment undertakings, large exposures and reporting and disclosure requirements (the 'CRR II'). On the other hand, the amendments to the CRD IV are included in Directive (EU) 2019/878 of the same institutions and of the same date and refer to exempted entities, financial holding companies and mixed financial holding companies, remuneration, supervisory measures and powers, as well as capital conservation measures[50] (the 'CRD V').

The vast majority of the proposals on the amendment of the CRR and the CRD IV are broadly based on aspects of the "Basel III regulatory framework", which were not included in these legislative acts at the time of their adoption (in 2013). It is noted, however, that the Basel Committee's framework has been amended again after the endorsement, on 7 December 2017, from its oversight body, the Group of Central Bank Governors and Heads of Supervision of the Report entitled "Basel III: Finalising post-crisis reforms"[51] (also referred to as the "Basel IV regulatory framework", even though the Basel Committee tends to view it as a Complement to "Basel III"). Accordingly, it is expected that in the near future, the Commission will submit new proposals for further amendments to these EU legislative acts.

[48] See Sect. 4.1.2.

[49] OJ 150, 7.6.2019, pp. 1–225. The consolidated version of the CRR contains 814(!) pages.

[50] OJ 150, 7.6.2019, pp. 253–295.

[51] Available at: https://www.bis.org/bcbs/publ/d424.htm. The EBA already conducted and published an ad hoc cumulative impact assessment of this new regulatory reform package for the EU banking system (available at: https://www.eba.europa.eu/documents/10180/1720738/Ad+Hoc+Cumulative+Impact+Assessment+of+the+Basel+reform+package.pdf).

### *4.2.3 The Relationship Between the SSMR and the Single Rulebook*

For the purpose of carrying out its tasks under the SSMR and with the objective of ensuring high standards of supervision, the ECB must apply all relevant legal acts which constitute sources of European (EU) banking law, that is the CRR and the CRD IV, as well as the delegated and implementing acts of the Commission adopted on the basis of these legislative acts. The said EU law is composed of Directives or Regulations. To the extent that national legislation is either transposing those Directives or implementing Member States' options available under those Regulations,[52] the ECB is called upon to apply not only uniform EU law but also national law, which may vary among participating Member States.

## 4.3 The Second Main Pillar: Resolution of Credit Institutions

### *4.3.1 The SRM and the SRF*

(1) In 2014, a Single Resolution Mechanism (SRM) and a Single Resolution Fund (SRF) were established on the basis of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 "establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (...)" (the 'SRMR').[53] This legislative act was adopted on the basis of Article 114 TFEU and (with some exceptions) is applicable (mainly) since 1 January 2016.[54] Its adoption was a necessary complement to the SSMR, as it would constitute a paradox if credit institutions were directly supervised (by the ECB) at European level, but, in the event of a need for resolution (upon determination by the ECB—or the Single Resolution Board (SRB)—that a credit institution is failing or likely to fail), the relevant decision were to be made at national level.[55] The SRM, supported by the SRF, constitutes the second main pillar of the BU.[56]

[52] SSMR, Article 4(3), first sub-paragraph.

[53] OJ L 225, 30.7.2014, pp. 1–90.

[54] SRMR, Article 99(2).

[55] See also recital (14) SRMR; on this aspect, see details in Chap. 9, Sect. 9.2.3.

[56] The main provisions of this legislative act, which was amended in May 2019 (see Sect. 4.3.2), are presented in Chap. 5 (Sect. 5.3).

(2) The SRF is also governed by the Intergovernmental Agreement (No 8457/14) "on the transfer and mutualisation of contributions to the Single Resolution Fund" (the 'SRF Agreement').[57] The SRF Agreement is an instrument of public international law and, as such, the rights and obligations laid down therein are subject to the principle of reciprocity, that is the equivalent performance of those rights and obligations by all Contracting Parties;[58] it must be applied and interpreted by them in conformity with the Treaties and with EU law, and in particular with Article 4(3) TEU[59] and EU banking law concerning resolution, that is the BRRD[60] and the SRMR.

Under this Agreement, which is also applicable from 1 January 2016,[61] complements and supports the SRMR which established the SRF[62] and applies to the Contracting Parties whose institutions are subject to the SSM and the SRM, these parties committed to transfer the contributions raised at national level to the SRF in accordance with the BRRD and the SRMR. In addition, they must allocate the nationally raised contributions to the different SRF 'compartments', corresponding to each of them during a transitional period of eight years in accordance with the abovementioned legal acts. The use of these compartments is subject to a 'progressive mutualisation', meaning that they will cease to exist at the end of the transitional period in order to secure the effectiveness of the operations and functioning of the SRF.[63]

(3) The SRF should reach a target level of at least 1% of the amount of 'covered deposits' of all credit institutions authorised in all participating Member States (about 55 billion euros).[64] In principle, it is financed by the participating institutions' *ex ante* contributions, while the EU budget

[57] Available at: https://register.consilium.Europa.eu/content/out?lang=EN&typ=ENTRY&i=SMPL&DOC_ID=ST%208457%202014%20COR%201.

[58] The only Member States which are not Contracting Parties to the Agreement, which is subject to ratification, approval or acceptance by its signatories under their respective constitutional requirements, are Sweden and the UK.

[59] This Article provides that Member States must, *inter alia*, facilitate the achievement of the EU's tasks and refrain from any measure which could jeopardise the attainment of its objectives; see on this indicatively Lenz (2010), pp. 19–20 and, in detail, Hatje (2019), pp. 69–91.

[60] See Sect. 4.3.2.

[61] SRF Agreement, Article 12.

[62] SRMR, Articles 1, second sub-paragraph, second sentence and 67(1), first sentence.

[63] SRF Agreement, Article 1.

[64] Ibid., Article 1(1), point (b), with reference to Article 68 SRMR.

or the national budgets may not be held liable for expenses or losses incurred by the SRF.[65] The *ex post* financing (i.e. raising of extraordinary *ex post* contributions from institutions, voluntary borrowing between resolution financing arrangements and alternative funding means) is governed by Articles 71–74 SRMR.[66]

### *4.3.2 The Single Rulebook*

*General Overview*

(1) The single rulebook on banking resolution is governed by Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014 "establishing a framework for the recovery and resolution of credit institutions and investment firms"[67] (the 'Bank Recovery and Resolution Directive' or 'BRRD').[68] The BRRD, which as the CRR and the CRD IV also applies to investment firms (also jointly referred to therein as 'institutions'), was adopted on the basis of Article 114 TFEU and is applicable (with some exceptions) since 1 January 2015 to all Member States.[69] It was the first time that harmonised rules were adopted at the EU level in this field, as opposed to the fields of authorisation, micro-prudential supervision and micro-prudential regulation of credit institutions (macro-prudential regulation under the CRR and the CRD IV is another innovative element), as well as deposit guarantee schemes, for which a regulatory framework has been in place since the late-1980s and mid-1990s, respectively.

(2) The BRRD lays down a comprehensive framework of substantive rules on the resolution of credit institutions (and investment firms) and contains provisions pertaining to three main aspects (its pillars): the first pillar contains the so-called preparatory measures, including recovery planning, resolution planning and intra-group financial support agreements (Articles 4–26); the second pillar refers to the 'early intervention measures', including the appointment of a special administrator (Articles

[65] SRMR, Articles 70 and 67(2), respectively.

[66] On the SRF Agreement, see by way of mere indication Fabbrini (2014), Burke (2015), Hadjiemmanuil (2014), pp. 26–29, Zavvos and Kaltsouni (2015), pp. 36–49, Wolfers and Voland (2018) and Gortsos (2019b), pp. 99–106 and 263–271.

[67] OJ L 173, 12.6.2014, pp. 190–348.

[68] For an analytical commentary, see Haentjens (2017) and the various contributions in World Bank (2017) (in particular Freudenthaler (2017) on its scope); see also Huber and Merc (2014), Thole (2014) and Ventoruzzo and Sandrelli (2019).

[69] BRRD, Article 130(1), second sub-paragraph.

27–30); and the third pillar covers the 'resolution tools and powers' (the most extensively regulated aspect, Articles 31–86).[70] All these measures are divided into two categories: 'crisis prevention' and 'crisis management': 'crisis-prevention measure' means the exercise of powers to direct removal of deficiencies or impediments to recoverability, the exercise of powers to address or remove impediments to resolvability, the application of an early intervention measure, the appointment of a temporary administrator or the exercise of the write-down or conversion powers; on the other hand, 'crisis management measure' means a resolution action or the appointment of either a special manager (in accordance with Article 35) or a person as provided for in Articles 51(2) or 72(1).[71]

(3) For the above purpose, four 'resolution tools' are available: the sale of business tool, the bridge institution tool, the asset separation tool, and the bail-in tool.[72] 'Sale of business tool' means the mechanism for effecting a transfer by a resolution authority of instruments of ownership issued by a bank under resolution, or assets, rights or liabilities of an institution under resolution, to another bank that is not a bridge institution, while 'bridge institution tool' is the mechanism for transferring instruments of ownership issued by a bank under resolution, or assets, rights or liabilities of an institution under resolution, to a bridge institution. In both these cases, the authorisation of the bank under resolution is withdrawn and the bank is placed under liquidation (hence, they are called 'gone-concern' resolution tools). Nevertheless, its deposits up to the level of their coverage under the DGS are previously transferred either to another bank or to the bridge institution; hence, DGSs are not activated. On the other hand, 'going-concern' resolution tools are the 'asset separation tool', meaning the mechanism for effecting a transfer of assets, rights or liabilities of a bank under resolution to an 'asset management vehicle' and the 'bail-in tool', which is defined as the mechanism for effecting the exercise of the write-down and conversion powers in relation to liabilities (including deposits up to the level of their coverage under the DGS) of a bank under resolution.[73]

[70] Ibid., Articles 4–26, 27–30 and 31–86, respectively.

[71] Ibid., Article 2(1), points (101) and (102), respectively.

[72] These resolution tools are defined (in a similar way) in Articles 3(1), points (30)–(33) SRMR and 2(1), points (55), (57)–(58) and (60) BRRD and are governed by Articles 24–27 SRMR and 37–44 BRRD. For an overview, see Haentjens (2017), pp. 230–255, Binder, J.-H. (2019) and Gortsos (2019b), pp. 193–203.

[73] On the bail-in instrument, see by way of mere indication Coffee (2010), Huertas (2012), Goodhart and Avgouleas (2014), Joosen (2014), Hadjiemmanuil (2014) and (2019), Avgouleas and Goodhart (2015), Krahnen and Moretti (2015) and Tröger (2015) and (2017).

(4) As in the case of the CRR and the CRD IV, the single rulebook consists also of Commission delegated and implementing acts. These are adopted on the basis of the power conferred upon it in specific Articles of the BRRD in accordance with Articles 290–291 TFEU and (mainly) are based on draft technical regulatory and implementing standards developed by the EBA in accordance with Articles 10–14 and 15 EBA Regulation. In this case as well, the single rulebook also encompasses EBA Guidelines adopted either on the basis of specific provisions of the BRRD or on its own initiative in accordance with Article 16 EBA Regulation.[74]

*The Impact of Public International Banking Law*

As in the case of the CRR and the CRD IV, the impact of public international law on the BRRD was considerable as well. In particular, its content was heavily influenced by the 2011 Financial Stability Board (FSB) Report entitled “Key Attributes of Effective Resolution Regimes for Financial Institutions”.[75] On 15 October 2014, the FSB adopted additional guidance documents elaborating on specific Key Attributes relating to information sharing for resolution purposes and sector-specific guidance, setting out how they should be applied for insurers, financial market infrastructures (the ‘FMIs’) and the protection of client assets in resolution; these documents have been incorporated as annexes into the 2014 version of the Key Attributes, which did not modify the text of the above-mentioned 2011 Key Attributes.[76] Finally, in October 2016, the FSB adopted the “Key Attributes Assessment Methodology for the Banking

[74] Along with the CRR and the CRD IV, the draft technical standards and Guidelines adopted by the EBA are available at its website.

[75] Available at: https://www.financialstabilityboard.org/publications/r_111104cc.htm. These Key Attributes laid down the core elements considered to be necessary for an effective regime governing the resolution of any type of financial institutions that could be systemic in failure, and in particular: the scope of application, the resolution authority, the resolution powers, set-off, netting, collateralisation and segregation of client assets, safeguards, funding of firms in resolution, legal framework conditions for cross-border cooperation, crisis management groups (‘CMGs’), institution-specific cross-border cooperation agreements, resolvability assessments, recovery and resolution planning, and access to information and information sharing. For an overview, see Grünewald (2014), pp. 79–80 and Kleftouri (2015), pp. 160–165.

[76] Available at: https://www.financialstabilityboard.org/2014/10/r_141015.

Sector", which lay down essential criteria guiding the assessment of national bank resolution frameworks' compliance with the key attributes.[77]

Of specific importance in the application of resolution tools is the 'no creditor worse off principle' (the 'NCWO' principle), according to which creditors should be worse off in a resolution than they would be in liquidation. This principle, specified in Section 5 (mainly Sect. 5.3) of the 2011 FSB "Key Attributes of Effective Resolution Regimes for Financial Institutions", is regarded as the cornerstone of resolution regimes. It provides the following: "Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard)". Under this principle, *inter alia*, deposits covered by DGSs are not bail-inable.[78]

### 4.3.3 Recent Modifications and Pending Amendments

*The Impact of the 2016 'Banking Package' on the SRMR and the BRRD*

In accordance with the above-mentioned 2016 "banking package", the Proposal for a Directive of the European Parliament and of the Council "amending [the BRRD] as regards the ranking of unsecured debt instruments in insolvency hierarchy",[79] which provides for the amendment of Article 108 BRRD, was adopted on 12 December 2017 (Directive (EU) 2017/2399).[80] In addition, a combined legislative proposal referred to the amendment of both the SRMR and the BRRD, reviewing the minimum requirement for own funds and eligible liabilities (the 'MREL') and implement in the EU legal framework the total loss-absorbing capacity (the 'TLAC') standard of the FSB.[81] This led to the adoption on 20 May 2019 and publication on 7 June 2019 of two legislative acts: Regulation

[77] Available at: https://www.fsb.org/2016/10/key-attributes-assessment-methodology-for-the-banking-sector.

[78] On the NCWO principle and its application under EU resolution law, see (by way of mere indication) Grünewald (2014), pp. 92–93, Wojcik (2015), de Serière and van der Houwen (2016), Grünewald (2017), pp. 302–307, and Haentjens (2017), pp. 272–274. See also the 2016 FSB "Key Attributes Assessment Methodology for the Banking Sector", pp. 38–39.

[79] COM(2016) 853 final.

[80] OJ L 345, 27.1.2.2017, pp. 96–101.

[81] COM(2016) 851/2 final and 852/2 final, respectively.

(EU) 2019/877 of the European Parliament and of the Council "amending the SRMR as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms"[82] (the 'SRMR II') and Directive (EU) 2019/879 of the same institutions "amending the BRRD on loss-absorbing and recapitalisation capacity of credit institutions and investment firms (…)"[83] (the 'BRRD II').

It is noted that, from an operational point of view, the harmonised minimum level of the TLAC standard for global systemically important institutions (the 'G-SIIs') (referred to as 'TLAC minimum requirement') will be introduced in the EU through the CRR II.[84] On the other hand, the 'institution-specific add-on' for G-SIIs and the 'institution-specific requirement' for non-G-SIIs will be addressed through the targeted amendments to the BRRD and the SRMR (BRRD II and SRMR II, respectively). This institution-specific add-on will be imposed when the TLAC minimum requirement is not sufficient to absorb losses and recapitalise a G-SII under the preferred resolution strategy.[85]

*Towards a 'Common Backstop' to the (Single Resolution) Board for the SRF*

**An Overview**

(1) One of the elements of the comprehensive package of measures proposed by the Commission in its Communication of 6 December 2017 to strengthen the EMU[86] was the proposal for a Council Regulation "on the establishment of the European Monetary Fund" (the 'EMF' and the 'EMF Regulation'). This proposal was submitted on 12 December 2017[87] and was to be adopted on the basis of Article 352 TFEU. In its Annex, this proposal contains the EMF's Statute.[88] The objective of the EMF, a successor to the European Securities and Market (ESM) would be to contribute to safeguarding financial stability in the euro area and its participating Member States. In order to achieve this objective, it was proposed that the EMF should be assigned two tasks: first, to mobilise funding and provide

[82] OJ 150, 7.6.2019, pp. 226–252.

[83] OJ 150, 7.6.2019, pp. 296–344.

[84] See Sect. 4.2.2; on the definition of G-SIIs, see Chap. 8, Sect. 8.1.3.

[85] For a brief overview of the TLAC and of the new framework, see Gortsos (2019b), pp. 175–179.

[86] See Sect. 4.1.2.

[87] COM(2017) 827 final, 6.12.2017.

[88] EMF Regulation, Article 1(2) and recital (18).

stability support under strict policy conditions, appropriate to the chosen financial assistance instrument, to the benefit of its Members experiencing, or threatened by, severe financing problems (including), *inter alia*, the provision of direct public financial assistance to credit institutions through the Direct Recapitalisation Instrument (the 'DRI');[89] and second, to provide credit lines or setting guarantees in support of the Board (the 'common backstop').[90]

(2) Any progress on the adoption of this legal act is halted. Nevertheless, in the Euro Summit meeting, of 29 June 2018, agreement was reached that the common backstop should be activated and be provided by a more strengthened ESM.[91] Taking also into consideration the relative urgency of the situation, the Summit noted that the Eurogroup should prepare the terms of reference of the common backstop and agree on a term sheet for further developing the ESM by December 2018.[92] The Euro Summit meeting of 14 December 2018 agreed then on endorsing the terms of reference for the operationalisation of the common backstop, as developed by the Eurogroup, on condition that "sufficient progress has been made in risk reduction". It also endorsed the term sheet elaborated by the Eurogroup on the reform of the ESM.[93] The latest Euro Summit meeting, of 21 June 2019, noted the broad agreement reached by the latter on the revision of the ESM Treaty, stating its expectation that it will continue its work so as to allow for a final agreement in December 2019.[94] Under the current political agenda, the common backstop will thus be provided by an enhanced ESM;[95] the establishment of the EMF is not envisaged.

[89] Ibid., Article 19(1), second sentence; on this instrument, see later.

[90] For a systematic presentation and an assessment of the proposed legal framework on the EMF, see Louis (2017) and (2018), pp. 23–27, as well as Gortsos (2017) and in particular pp. 28–31 and 53 on the common backstop. On the case for establishing a common backstop, see Schoenmaker (2014) and (2017) and Schlosser (2017).

[91] The text of this Statement is available at: https://www.consilium.europa.eu/media/35999/29-euro-summit-statement-en.pdf.

[92] Euro Summit meeting (29 June 2018), Statement, point 2.

[93] Euro Summit meeting (14 December 2018), Statement, points 1 and 2. The terms of reference are annexed to the Statement of the Eurogroup's report of 4 December 2018 (available at: https://www.consilium.europa.eu/media/37268/tor-backstop_041218_final_clean.pdf); the term sheet is annexed to the Statement as well and available at: https://www.consilium.europa.eu/media/37267/esm-term-sheet-041218_final_clean.pdf.

[94] Euro Summit meeting (21 June 2019), Statement, point 1, first bullet (available at: https://www.consilium.europa.eu/media/39968/20190621-euro-summit-statement.pdf).

[95] On this aspect, see also the Assessments and Conclusions, Sect. 2.3, when discussing liquidity in resolution in the context of the euro area. On the ECB's role in supporting the ESM, see Zilioli and Athanassiou (2018), pp. 649–650 and O'Gorman (2019), pp. 246–251.

**In Particular: The Direct Recapitalisation Instrument**

(1) On 10 June 2014, the euro-area Member States reached a preliminary agreement on a new ESM instrument, the 'Direct Recapitalisation Instrument' (DRI). This instrument entered fully into operation on 8 December 2014, after the requisite national procedures were completed by the euro-area Member States, by means of a unanimous Resolution of the ESM Board of Governors.[96] On the same day, the ESM Board of Directors adopted a detailed Guideline on the modalities, including, *inter alia*, the eligibility criteria for the requesting ESM Member and the institution concerned, and the allocation of specific tasks to the Managing Director of the ESM, the Commission, the ECB and, wherever appropriate, the IMF, for providing financial assistance in the form of DRI.[97]

(2) The aim of the DRI is safeguarding financial stability in the euro area as a whole and in each individual Member State, by catering for those specific cases in which an ESM Member is confronted with severe financial disturbances that cannot be remedied without significantly jeopardising fiscal sustainability given the heightened risk of contagion from the financial sector to the sovereign. Thus, such financial assistance must seek to remove this contagion risk, thereby mitigating the effect of a vicious circle between a fragile financial sector and a deteriorating creditworthiness of the sovereign. The DRI is available (mainly) to systemically relevant credit institutions that are unable to meet the capital requirements established by the ECB in its capacity as single supervisor within the SSM, and obtain sufficient capital from private sources, if a bail-in cannot adequately meet the anticipated capital shortfall.[98] A burden-sharing scheme determines the contributions of the requesting ESM Member and the ESM[99] to be granted under strict conditionality, accompanied by an MoU addressing both the sources of difficulties in the financial sector and, where appropriate, the overall economic situation of the requesting ESM Member.

[96] Available at: https://www.esm.europa.eu/pdf/Establishment%20of%20the%20instrument%20for%20the%20direct%20recapitalisation%20of%20insti%20.pdf.

[97] Available at: https://www.esm.europa.eu/pdf/20141208%20Guideline%20on%20Financial%20Assistance%20for%20the%20Direct%20Recapitalisation%20of%20Institutions.pdf; on this instrument, see details in Hadjiemmanuil (2014), pp. 29–34 and Vovolinis (2015).

[98] BRRD, Articles 43–62.

[99] See, on this, European Stability Mechanism (2014).

(3) As to the implementation of the DRI, the ESM Board of Governors must establish, through a unanimous Resolution, a subsidiary body to undertake the recapitalisation operations. In order to enable external investors to participate in the recapitalisation alongside the ESM, the Board may also establish sub-entities dedicated to the financing, implementation and ownership of capital instruments related to the recapitalisation process.[100]

### *4.3.4 The Relationship Between the SRMR and the Single Rulebook*

(1) Under EU financial law, it is the BRRD that lays down the substantive rules pertaining to resolution planning with regard to early intervention in and resolution action taken in relation to credit institutions of designated entities and groups. The SRMR is consistent with the BRRD and adapts its rules and principles to the specificities of the SRM and ensures that appropriate funding is available to the latter.[101] In addition, the SRMR is based on the BRRD and makes such a continuous reference to its provisions (as the reader of this book will realise) that the analysis of the latter is indispensable for the understanding of the former. It is noted that several aspects covered by the BRRD are not, for various reasons, addressed in the SRMR, including mainly the following:[102] recovery planning,[103] intra-group financial support,[104] government financial stabilisation tools ('GFSTs'),[105] resolution powers, cross-border group resolution[106] and the ranking of deposits in insolvency hierarchy.

(2) On the relationship between the two legal acts, Article 5(1) SRMR provides that if, in accordance with the SRMR, the Board performs tasks and exercises powers which, under the BRRD, are to be performed or exercised by National Resolution Authority (NRAs), for the application of

[100] In principle, the DRI must be conducted against the acquisition of common shares satisfying the Common Equity Tier 1 (the 'CET1') requirements laid down in Articles 28–29 CRR.

[101] SRMR, recital (18), first and second sentences.

[102] BRRD, Articles 5–9, 19–26, 56–58, 63–72, 87–92 and 108, respectively.

[103] On this aspect, see more details in Chap. 8, Sect. 8.1.2.

[104] On this arrangement, see Haentjens (2017), pp. 210–213.

[105] On this form of state aid and the conditions under which it can be provided in accordance with Articles 37(10) and 56–58 BRRD, see Gortsos (2016b), Haentjens (2017), pp. 252–254 and Huber (2017).

[106] On these two aspects, see Haentjens (2017), pp. 256–272 and 285–296, respectively.

both the SRMR and the BRRD, the Board is considered to be the 'relevant national resolution authority' or, in the case of a cross-border group resolution, the 'relevant group-level resolution authority'.[107]

## 4.4 The (Still Pending) Third Main Pillar: Deposit Guarantee

### *4.4.1 The (Single) European Deposit Insurance Scheme*

*An Overview on the Basis of the Commission's 2015 Proposal for a Regulation*

(1) Unlike the SSM and the SRM, which are already operational, the third main pillar of the BU, that is a European Deposit Insurance Scheme (the 'EDIS'), has not yet been put in place. In political terms, its creation was first presented in the June 2012 'Van Rompuy Report', which paved the way for the decisions of the Euro Area Summit and the European Summit of 28–29 June on building the BU, and then in the December 2012 'Four Presidents' Report'.[108] The need for the EDIS was further discussed in the so-called Five Presidents' Report, of 22 June 2015, "Completing Europe's Economic and Monetary Union". According to that Report, which was included in the framework of the proposals on the creation of an (EU) 'Financial Union',[109] and a follow-up Commission Communication of 21 October 2015 "On steps towards Completing Economic and Monetary Union",[110] the EDIS would increase the resilience against future crises, since a condition for a truly single banking system is for confidence in the safety of bank deposits to be the same across the EU, irrespective of the Member State in which a credit institution operates. It is also more likely to be fiscally neutral over time than national DGSs, since risks will be spread more widely and private contributions will be raised over a larger pool of financial firms.

(2) Immediately afterwards, on 24 November 2015, the Commission submitted a proposal for a Regulation of the European Parliament and of

[107] SRMR, Article 5(1) (the definition of the two terms is given in Article 3(1), points (4) and (27), respectively). On this aspect, see more details in Gortsos (forthcoming).

[108] On both these reports, see Sect. 4.1.1.

[109] Available at: https://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf.

[110] COM(2015) 600 final.

the Council "amending Regulation (EU) No 806/2014 in order to establish a European Deposit Insurance Scheme"[111] (the 'proposed SRMR'). This proposal envisages the establishment of the EDIS through an amendment of the SRMR without any modification of the rules on the functioning of the SRM. According to this proposal, the EDIS will be established by the (amended) SRMR (the SRM's founding regulation) gradually, in three successive stages: reinsurance, co-insurance and full insurance. In all three stages, it will provide funding to and cover losses of 'participating DGSs',[112] with the level of funding provided and the share of loss covered increasing gradually.

(3) For the purposes of the EDIS, the SRMR will apply to all participating DGSs and to all credit institutions affiliated to them.[113] The cover to be provided by the EDIS will be limited to the mandatory functions of DGSs under the DGS Directive (2014/49/EU), that is payouts to depositors and contributions to resolution.[114] The EDIS will be administered by the Single Resolution Board (the 'Board', to be renamed "Single Resolution and Deposit Insurance Board") in cooperation with the participating DGSs; it will be supported by a Deposit Insurance Fund (the 'DIF') to be also set up from the outset as part of the EDIS, directly financed by risk-adjusted contributions made by credit institutions.[115] Accordingly, the Board will become responsible for the administration of both the SRM and the EDIS. In addition, it will administer two funds: the SRF and the DIF. Specific safeguards against incorrect or unwarranted access to the EDIS by participating DGSs have also been proposed for all three stages, in order to ensure that only those having observed their obligations in relation to the limitation of risk at EDIS level may benefit from its protection.[116]

(4) On the basis of this proposal, the process of the adoption of which is still halted, the three stages in the evolution of the EDIS should be as

[111] Available at: https://ec.europa.eu/finance/general-policy/docs/banking-union/european-deposit-insurance-scheme/151124-proposal_en.pdf.

[112] 'Participating DGSs' means DGSs, which are introduced and officially recognised in a participating Member State (proposed SRMR, Article 3(1), point (55)).

[113] Ibid., Article 2(2), first sub-paragraph.

[114] On this Directive and on these functions, see Sect. 4.4.2.

[115] Proposed SRMR, Article 1(2), second sub-paragraph.

[116] Ibid., Articles 41i and 41j. On various aspects of this proposal, see Gros (2015), Carmassi et al. (2018), Brescia Morra (2019) and in details Gortsos (2019c). On the adequacy of Article 114 TFEU as the legal basis for the establishment of the EDIS, see Herdegen (2016).

follows:[117] during the first 'reinsurance phase', national DGSs would have access to EDIS funds only when all their own resources would be exhausted, subject to appropriate limits and safeguards against abuse; EDIS funds would provide additional funds to a national DGS only up to a certain level and the latter would access the EDIS only when justified. Use of EDIS funds would be closely monitored, and any such funds found to have been received inappropriately by a national DGS would have to be fully reimbursed. The EDIS would then become a progressively mutualised system (the 'co-insurance phase'), still subject to appropriate limits and safeguards against abuse; during this phase, a national DGS would not be required to exhaust its own funds before accessing EDIS funds and the EDIS would be available to contribute a share of the costs from the moment when the DGS would have been activated and depositors were to be reimbursed, leading to a higher degree of risk sharing between national DGSs through the EDIS. The share to be contributed by the EDIS would start at a level of 20% and gradually increase to 80% over a four-year period. The EDIS should fully insure national DGSs as of 2024 (the 'full insurance phase'), that is the same year when the SRF and the requirements of the DGS Directive will be fully phased in; the mechanism would be equal to that in the co-insurance stage, with the EDIS covering, albeit, in this case, a share of 100%.

*Current Developments*
(1) The progress on adopting the Regulation establishing the EDIS on the basis of the 2015 Commission's proposal has been slow, predominantly because the previous adoption of the above-mentioned risk reduction measures is considered as a *conditio sine qua non*. Nevertheless, the Commission identified in its EMU reflection paper the establishment of the EDIS (ideally by 2019, with a view to be in place and fully operational by 2025) as a key outstanding component for completing the BU.[118] In this respect, in its above-mentioned Communication of 11 October 2017 concerning the completion of all parts of the BU by 2018, the Commission submitted a compromise solution, proposing a more gradual introduction of the EDIS compared with the original proposal in only two phases. In particular, during the more limited 'reinsurance stage', the EDIS would only provide liquidity coverage to national DGSs, temporarily providing the means to ensure full payouts if a credit institution's deposits were to become

[117] Ibid., Articles 41a–41c, 41d–41g and 41h, respectively.
[118] EMU reflection paper (2017), pp. 19–20.

unavailable. National DGSs would need to pay back this support, ensuring that any losses would continue to be covered at national level; during the following 'co-insurance stage', the EDIS would also progressively cover losses; nevertheless, the migration to this phase should be conditional on progress achieved in reducing risks.

(2) The above-mentioned Euro Summit meeting of 14 December 2018 did not make any explicit reference to the progress of negotiations on the EDIS. Nevertheless, according to the "Eurogroup report to Leaders on EMU deepening", of 4 December 2018,[119] work has started on a roadmap for launching political negotiations on the EDIS in line with the mandate from the June 2018 Euro Summit. In addition, the establishment of a high-level working group was decided to work on the next steps and report to the Euro Summit of June 2019. The latest Euro Summit meeting, of 21 June 2019, on the other hand, was silent on this subject, even though the risk reduction measures had been adopted a month ago. Its statement concluded with a general remark: "We look forward to the continuation of the technical work on the further strengthening of the Banking Union."[120] Nevertheless, the establishment of the EDIS (and the DIF) is not envisaged before 2020.

### *4.4.2 The Single Rulebook*

*General Overview*

(1) The operation of national DGSs is governed by Directive 2014/49/EU of the European Parliament and of the Council "on deposit guarantee schemes"[121] (the 'DGSD'), which was adopted on 16 April 2014 as part of the single rulebook and repealed Directive 94/19/EC since 3 July 2015.[122] Its legal basis being Article 53(1) TFEU, it lays down rules and procedures on the establishment and functioning of national DGSs in Member States.[123] According to this legal act, 'deposit guarantee scheme' (DGS) means a DGS introduced and officially recognised by a Member State. This covers 'statutory DGSs' set up by law and usually administered by a public entity, 'contractual DGSs' to the extent that they are officially

[119] The text of this report's statement is available at: https://www.consilium.europa.eu/en/press/press-releases/2018/12/04/eurogroup-report-to-leaders-on-emu-deepening/pdf.

[120] Euro Summit meeting (21 June 2019), Statement, point 2.

[121] OJ L 173, 12.6.2014, pp. 149–178.

[122] DGSD, Article 21; on Directive 94/19/EC, see above in Chap. 3, Sect. 3.2.2.

[123] Ibid., Article 1(1).

recognised as DGSs, by complying with the requirements imposed by the DGSD, as well as 'institutional protection schemes' (the 'IPSs'), also to the extent that they are officially recognised as such.[124]

(2) The DGSD substantially modified certain aspects of Directive 94/19/EC, while concurrently containing several innovative elements. In particular,[125] as to the elements of continuity, it is noted that DGSs remain national, even though the merger of DGSs or the establishment of cross-border DGSs is not ruled out. Member States are not liable for the funding adequacy of their DGSs (their responsibility being confined to the establishment and official recognition of at least one DGS in their territory, the 'mandatory membership rule' for credit institutions and the fact that DGSs are activated when a credit institution's deposits become 'unavailable'). In addition, the main function of DGSs, the 'payout (or paybox) function',[126] has been retained but ranks first among four functions that DGSs may serve. It is noted in this respect that DGSs may be called upon to contribute to the financing of the resolution of unviable credit institutions as well.[127] On the other hand, elements of change include (*inter alia*) the rules adopted on the supervision of DGSs by designated authorities with regard to their operation, the introduction of provisions pertaining to the financing of DGSs (in that respect *ex ante* financing is the rule, while *ex post* financing arrangements are also prescribed and regulated), the fixing of the level of coverage at 100,000 euros per depositor per credit institution (minimum and maximum) and the gradual reduction of the repayment period from twenty to seven working days at the latest by the end of 2023.

(3) Unlike the above-mentioned cases of the CRR, the CRD IV and the BRRD, the DGSD provides for the adoption by the Commission of

[124] Ibid., Article 2(1), point (1), with reference to Article 1(2), points (a)–(c). 'IPS' means an agreement meeting the requirements laid down in Article 113(7) CRR (ibid., Article 2(1), point (2)). On these three types of DGSs under the DGSD (including an analysis of this CRR Article), see Gortsos (2014), pp. 37–40.

[125] This legal act is analysed in Gortsos (2014).

[126] This traditionally primary function of DGSs is to serve as a 'paybox' for depositors, guaranteeing the default-free character of deposits in the event of a bank failure. In this respect, DGSs pursue two objectives: protecting retail depositors and acting as a buffer in the event of a banking crisis and contributing to safeguarding the stability of the banking system (being part of the bank safety net), thus curbing the likelihood of banking panics. For an overview of banking panic models, see Calomiris and Gorton (1990).

[127] See on this Gortsos (2019a), with extensive further references.

only one delegated act (no implementing acts are envisaged in this case).[128] In addition, it provides for the adoption by the EBA of Guidelines in accordance with Article 16 EBA Regulation.

*The Impact of Public International Banking Law*

The impact of public international financial law on the content of the DGSD is less important than in the case of the CRR, the CRD IV and the BRRD, since the majority of the principles contained in the "IADI Core Principles for Effective Deposit Insurance Systems"[129] of 1 November 2014 were already incorporated into EU law. These core principles, adopted by the International Association of Deposit Insurers (IADI)[130], are also a by-product of the recent (2007–2009) international financial crisis and reflect the need for effective deposit insurance in preserving financial stability.

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[128] This delegated act, based on EBA's draft regulatory technical standards, provides for the adjustment of the amount of coverage level laid down in Article 6(1) DGSD (i.e. 100,000 euros per depositor per credit institution), in accordance with inflation in the EU on the basis of changes in the harmonised index of consumer prices published by the Commission since the previous adjustment (ibid., Article 6(6)–(7)).

[129] Available at: https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf. Noteworthy are the differences in terminology between the IADI report and the EU Directives, since the report makes use of the terms 'deposit insurance' instead of 'deposit guarantee', and 'deposit insurance systems' instead of 'deposit guarantee schemes'.

[130] On these principles, see Gortsos (2016a), pp. 8–15.

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PART II

# Institutional Architecture

CHAPTER 5

# The Systems and Mechanisms of the European Central Bank and National Central Banks

## 5.1 The European System of Central Banks and the Eurosystem

### 5.1.1 General Overview

*Composition and Legal Nature of the European System of Central Banks (ESCB) and of the Eurosystem*

The ESCB was established, as already mentioned, on 1 June 1998, immediately after the appointment of the initial members of the European Central Bank (ECB) Executive Board. The full exercise of its duties started on 1 January 1999 upon commencement of Stage Three of the Economic and Monetary Union (EMU).[1] It consists of 29 central banks: the first is the ECB, acting as a 'hub'; the others are the national central banks (NCBs) of all Member States, whether they are Member States whose currency is the euro or Member States with a derogation.[2] The ESCB does not have a legal personality and is a concept used in European Union (EU) monetary law as an "overall description" of, or "common name"

[1] TEC, Article 123(1), second sub-paragraph, points (a) and (b).

[2] TFEU, Article 282(1), first sentence; on the decentralised structure of the ESCB, see Smits (1997), pp. 92–94, Hadjiemmanuil (2006), pp. 551–554, Lastra (2006), pp. 208–214, Louis (2009), pp. 135–148 and Zilioli and Athanassiou (2018), pp. 625–626. The ECB is presented in more detail in Chap. 6; on the NCBs, see Sect. 5.1.2.

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for, its constitutive elements, that is the ECB and the NCBs of EU Member States.[3] The same applies to the Eurosystem, which (as already mentioned) consists of the ECB and the NCBs of the Member States whose currency is the euro.[4]

*Objectives and Tasks of the ESCB*

(1) The primary and secondary objectives of the ESCB (more accurately the Eurosystem) are laid down in Article 127(1) Treaty on the Functioning of the European Union (TFEU) [*verbatim* repeated in Article 2 (first sentence) ESCB/ECB Statute]: the primary objective of the ESCB is to maintain price stability.[5] The ECB and the NCBs of the Member States whose currency is the euro are, therefore, competent, within the Eurosystem, for defining and implementing monetary and exchange-rate policy for price stability purposes. Without prejudice to the primary objective, the Eurosystem must, first, support the general economic policies in the EU, in order to contribute to the achievement of its objectives as laid down in Article 3 Treaty on European Union (TEU); in addition, it must also act according to the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 TFEU.[6]

The rationale behind the prioritisation of the ESCB objectives lies within the prevailing view that the ESCB can only achieve its secondary objectives if it has assured the primary objective, that is maintaining price stability. In other words, it was deemed to contribute to the achievement of secondary objectives only indirectly and as a result of successfully helping towards achieving the primary objective. The ESCB is thus expected to perform its duties aimed at combating inflation and not at influencing the economic circumstances or keeping the balance in the balance of payments (as is the case, exceptionally, in other central banks, such as the Federal Reserve System in the United States).

[3] See indicatively Smits (1997), pp. 92–93, and Häde (1999), p. 1164, who refers to "Sammelbezeichnung".

[4] TFEU, Article 282(1), second sentence.

[5] Ibid., Article 127(1), first sentence; it is noted that reference to this primary objective is also made in other seven provisions of the EU Treaties: in Article 3(3) TEU, as well as in Articles 119(2)–(3), 219(1)–(2) and 282(2), second sentence TFEU.

[6] Ibid., Article 127(1), second sentence; on Article 127(1) TFEU (105(1) TEC), see, indicatively, Smits (1997), pp. 184–190, Papathanassiou (2001), pp. 13–15, Scheller (2006), pp. 51–54, Louis (2009), pp. 150–151 and Wutscher (2019), pp. 2045–2048. On Article 119 TFEU, see in Chap. 2, Sect. 2.2.3.

(2) The tasks of the ESCB (literally, of the Eurosystem) have already been discussed in Chap. 2 and will be further analysed in Chap. 7. In order to undertake these tasks, the ECB must collect the necessary statistical information, assisted by NCBs, according to Article 5 ESCB/ECB Statute.[7]

*Financial Provisions of the ESCB*

The financial provisions of the ESCB are found in Chap. VI of the ESCB/ECB Statute (Articles 26–33)[8] and refer to the following: the ECB's capital, which is a manifestation of its financial independence; the publication and control of financial accounts of the ECB and the NCBs of Member States whose currency is the euro, further discussed along with the presentation of the provisions on accountability; and the transfer to the ECB by the NCBs of the Member States whose currency is the euro of (part of) their foreign reserve assets.[9] They also refer to the allocation of monetary income of the NCBs of these Member States and the allocation of ECB net profits and losses. In this respect, the following is noted:

(1) The monetary income[10] accruing to the NCBs in the performance of the ESCB's monetary policy function must be allocated at the end of each financial year; its amount must be equal to each NCB's annual income derived from its assets held against notes in circulation and deposit liabilities to credit institutions, earmarked by NCBs in accordance with Governing Council (GC) Guidelines. This amount must be reduced by an amount equivalent to any interest paid by it on its deposit liabilities to credit institutions in accordance with Article 19. The GC may decide that NCBs must be indemnified against costs incurred in connection with the issue of banknotes or in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB, in a form deemed appropriate in the GC's judgment; these amounts may be offset against the NCB's monetary income.

[7] For more details on this task, see Smits (1997), pp. 202–221, Louis (2009), pp. 162–173 and Lastra and Louis (2013), pp. 81–95.

[8] Most of these provisions do not apply to the NCBs of Member States with a derogation (see Sect. 5.1.2).

[9] On these aspects, see Chap. 6, Sects. 6.4.1 and 6.4.2 and Chap. 7, Sect. 7.2.2, respectively.

[10] Monetary (or seigniorage) income means the difference between the value of money and the cost of its production, in other words the economic cost of producing a currency within a given state (or in a monetary union); see on this Bofinger (2001), pp. 369–383.

The sum of the monetary income must be allocated to the NCBs in proportion to their paid up shares in the ECB capital, subject to any decision taken by the GC pursuant to Article 33.2. The clearing and settlement of the balances arising from the allocation of monetary income must be carried out by the ECB in accordance with GC Guidelines.[11]

(2) The net profit of the ECB must be transferred as follows: an amount to be determined by the GC but not exceeding 20% of the net profit must be transferred to the general reserve fund subject; to a limit equal to 100% of the capital; the remaining net profit is distributed to the ECB shareholders in proportion to their paid-up shares. In the event of a loss incurred by the ECB, the shortfall may be offset against its general reserve fund and, if necessary, following a decision by the GC, against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the NCBs in accordance with Article 32.5.[12]

### *5.1.2 The NCBs Within the ESCB and the Eurosystem*

#### *NCBs of Member States Whose Currency Is the Euro*

**NCBs as an Integral Part of the ESCB**

The NCBs of the Member States whose currency is the euro are legal persons governed by their respective national laws.[13] Concurrently, they constitute an integral part of the ESCB, are bound by the provisions of the TFEU and the ESCB/ECB Statute and must act in accordance with ECB Guidelines and Instructions.[14] In particular, they are fully bound by all legal acts adopted by the ECB decision-making bodies[15] with respect to the duties conferred upon the ESCB. In relation to the monetary and exchange-rate policy, this actually means that they are not able to conduct independent policy, but their role is limited to the implementation of European policies within their territories. The same did not apply, until

[11] ESCB/ECB Statute, Articles 32.1 and 32.2 and 32.4–32.6.

[12] Ibid., Article 33.

[13] On the NCBs—members of the SSM, see Table 5.1.

[14] ESCB/ECB Statute, Article 14.3, first sub-paragraph. The GC must take the necessary steps to ensure compliance with the guidelines and instructions of the ECB and shall require that any necessary information be given to it (ibid., Article 14.3, first sub-paragraph).

[15] TFEU, Article 132 and ESCB/ECB Statute, Article 34.

**Table 5.1** The national central banks (NCBs)—members of the ESCB

| *Member state* | *Name* | *Year of establishment* |
|---|---|---|
| Austria | Österreichische Nationalbank | 1817 |
| Belgium | Banque Nationale de Belgique | 1850 |
| Bulgaria | Българска народна банка[a] | 1885 (1997, New Law) |
| France | Banque de France | 1800 |
| Germany | Deutsche Bundesbank | 1948 |
| Denmark | Danmarks Nationalbank[a] | 1818 |
| Greece | Bank of Greece | 1928 |
| Estonia | Eesti Pank | 1919 |
| United Kingdom | Bank of England (BoE)[a] | 1694 |
| Ireland | Central Bank and Financial Services Authority of Ireland | 1943 |
| Spain | Banco de España | 1921 |
| Italy | Banca d' Italia | 1894 |
| Croatia | Hrvatska narodna banka[a] | 1990 |
| Cyprus | Central Bank of Cyprus | 1963 |
| Latvia | Latvijas Banka | 1992 |
| Lithuania | Lietuvos Bankas | 1990 |
| Luxembourg | Banque Centrale du Luxembourg | 1998 |
| Malta | Central Bank of Malta | 1968 |
| Netherlands | De Nederlandsche Bank | 1815 |
| Hungary | Magyar Nemzeti Bank[a] | 1924 |
| Poland | Narodowy Bank Polski[a] | 1945 (1997, New Act) |
| Portugal | Banco de Portugal | 1846 |
| Romania | Banca Naţională a României[a] | 1880 |
| Slovakia | Narodna Banka Slovenska | 1993 |
| Slovenia | Banka Slovenije | 1991 |
| Sweden | Sveriges Riksbank[a] | 1656 |
| The Czech Republic | Ceska Narodni Banka[a] | 1993 |
| Finland | Suomen Pankki—Finlands Bank | 1811 |

[a]Central banks of Member States with a derogation

November 2014, with respect to the micro-prudential supervision of credit institutions, since competence in this field remained on national level, according to Article 127(5) TFEU, and was exercised by NCAs. As already mentioned, this regime changed radically since November 2014, when the ECB was assigned specific tasks with regard to the prudential supervision of credit institutions and groups established in the euro area, within the context of the Single Supervisory Mechanism (SSM) by activation of Article 127(6) TFEU.

They are also represented in the GC, participating through their governors in the decision-making process, and in the General Council, the members of their governing bodies (provided that they have the respective citizenship) are entitled to be appointed members of the Executive Board and are bound by the provisions governing professional secrecy. In addition, applicable to them are the Statutes provisions on the international cooperation of the ESCB, its external operations, its financial provisions and judicial control.[16] Finally, they enjoy institutional independence, the members of their Management enjoy personal independence, they are subject to the provisions of the Statute on judicial control and their financial statements are included in the consolidated financial statement of the ESCB published weekly by the ECB.[17]

**Relationship Between the ECB and NCBs: The Principle of Decentralisation—Power to Act Independently**

(1) The ECB must ensure that the tasks conferred upon the ESCB/Eurosystem are implemented either by its own activities or through the NCBs of the Member States whose currency is the euro.[18] The relation between the ECB and these NCBs is governed by the 'principle of decentralisation of operations', according to which, to the extent deemed possible and appropriate, the ECB has recourse to NCBs to carry out operations forming part of the tasks of the ESCB/Eurosystem.[19]

(2) The NCBs of the Member States whose currency is the euro may perform other functions on top of the ones provided for by the ESCB/ECB Statute, such as management of public debt ('fiscal agency'), management of reserves of pension funds, micro-prudential supervision of insurance companies and granting liquidity assistance to solvent credit institutions facing severe liquidity problems according to the terms of functioning of the so-called Emergency Liquidity Assistance (ELA) mechanism. Such functions must be performed on their own responsibility and not be regarded as forming part of the ESCB's functions. An NCB may, however, be required to cease the performance of such functions if the GC

[16] ESCB/ECB Statute, Articles 6, 10.1, 10.3, 26–23, 35, 37 and 44.2.

[17] TFEU, Article 130 and ESCB/ECB Statute, Articles 7, 14.2, 15.2 and 35.

[18] ESCB/ECB Statute, Article 9.2.

[19] Ibid., Article 12.1, third sub-paragraph; on this principle, see by way of mere indication Priego and Conlledo (2005), Hallerberg and Lastra (2017) and Zilioli and Athanassiou (2018), pp. 626–627.

decides that they interfere with the objectives and tasks of the ESCB.[20] These NCBs also have the competence to perform operations for administrative purposes or for their staff.[21]

**Independence of the Governors of NCBs—Liability of NCBs**

(1) As already mentioned in Chap. 1,[22] one of the most important aspects relating to the operation of central banks in today's economies is their independence. The concept of independence has four dimensions:[23] institutional, operational, personal and financial: institutional independence refers to the safeguarding of conditions enabling the exercise of monetary policy and of the other tasks assigned to a central bank without any intervention of the executive power; operational independence refers to the assurance of providing the central bank with all those means required for completion of its tasks; personal independence refers to assuring that the persons participating in the decision-making bodies of the central bank enjoy unhampered exercise of their competences; and financial independence refers to the financing autonomy of the central bank with respect to the public budget.

(2) The safeguarding of the institutional and personal independence of the Governors of the NCBs–members of the ESCB is granted by EU law. In particular, each Member State should ensure that its national legislation, including the statutes of its NCB, was compatible with the treaties and the ESCB/ECB Statute.[24] In addition, their statutes should provide that the term of office of their Governor shall be no less than five years, and he/she may be relieved from his/her duties only if he/she no longer fulfils the prerequisites for exercise of his/her duties or is found guilty of serious misconduct.[25] On the other hand, their financial independence is governed by national law.[26]

[20] Ibid., Article 14.4; on this Article and on the ELA, see Chap. 9, Sect. 9.3.

[21] Ibid., Article 24.

[22] See Sect. 1.1.2.

[23] The classification of the various aspects of independence follows closely the one initially proposed (and now widely accepted) by Louis (1989), pp. 25–28; see also Amtenbrink (1999), pp. 18–21.

[24] TFEU, Article 131 and ESCB/ECB Statute, Article 14.1.

[25] ESCB/ECB Statute, Article 14.2. Such a decision may be challenged before the ECJ by the Governor concerned or by the GC on the grounds of breach of the TFEU or of a legal rule relevant to its implementation. See also Chap. 6, Sect. 6.5.2.

[26] On further aspects of the institutional independence of these NCBs and the members of their decision-making bodies, as well as their operational independence under EU law, see Chap. 6, Sect. 6.4.1.

(3) NCBs are liable according to their respective national legislation.[27] The same applies in relation to their liability, as NCAs, to restore any damage caused by them or by their servants in the performance of their duties.[28]

*NCBs of Member States with a Derogation*

**Introductory Remarks and Individual Derogations**

The NCBs of Member States with a derogation have, as do those of Member States whose currency is the euro, a legal personality in accordance with national law. At the same time, they are, as already mentioned, members of the ESCB. However, due to the fact these Member States have not adopted the euro as a single currency and are not bound by the policies carried out by the Eurosystem, the position of their NCBs within the ESCB is significantly different to that of the NCBs of Member States whose currency is the euro. On that basis, the TFEU and the Statute have established a series of derogations applicable to these NCBs for the duration of the derogation regime:[29]

(1) The most essential manifestation of this differentiation is that the fundamental provision of Article 14.3 ESCB/ECB Statute, stipulating that "the national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB", does not apply to them.

(2) The basic tasks conferred upon the Eurosystem do not concern them; accordingly, the Statute's provision stipulating that the ECB must ensure that the tasks conferred upon the ESCB/Eurosystem are implemented through the NCBs does not apply, nor are these NCBs bound by the Guidelines and the Decisions adopted by the GC in order to carry out these basic tasks. Consequently, they are not bound by the single monetary policy nor do they participate in its definition, since their Governors are not members of the GC, retaining their powers in the field of monetary policy according to national law. In addition, the Statute's provisions on accounts with NCBs, on open market operations and minimum reserves that credit institutions must hold with the ECB and on other

[27] ESCB/ECB Statute, Article 35.3; this provision also applies to the NCBs of the Member States with a derogation (argument *a contrario* from Article 42).

[28] SSMR, recital (61).

[29] The provisions which do not apply to central banks of Member States with a derogation are listed in Articles 139(2) TFEU and 42 ESCB/ECB Statute.

instruments of monetary control do not apply thereto; they are not bound by the rules with respect to the facilities that NCBs and the ECB may provide to ensure efficient and sound clearing and payment systems within the EU and with other countries; and the Statute's provisions on the obligation of transfer of foreign reserve assets by the NCBs to the ECB and on the degree of freedom in the management by NCBs of such assets do not apply thereto either.

(3) Concerning the remaining tasks and competences conferred upon the ESCB and the ECB (as discussed above), the following derogations have been established for NCBs of Member States with a derogation: first, they have no right to issue euro banknotes, nor are they subject to the obligation for the exchange of banknotes in the currencies of the Member States with euro banknotes; in addition, they are not subject to the Statute's provisions on the international cooperation and the external operations of the ESCB; finally, the NCAs of credit institutions in Member States with a derogation (which may be the respective central banks) are not included in the list of authorities that the ESCB must assist for the smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system.

(4) They are excluded from participation in the permanent decision-making bodies of the ECB, namely the GC and the Executive Board and, in addition, members of the management of these NCBs cannot be appointed as members of the Executive Board of the ECB, even if they have the respective citizenship. Lastly, a series of Articles of the ESCB/ECB Statute relating to the financial provisions of the ESCB do not apply to the NCBs of Member States with a derogation. More specifically, non-applicable are those on the annual accounts of the ECB, on the auditing of NCBs' accounts, on the allocation of monetary income of NCBs and on the allocation of net profits and losses of the ECB.

**The Position Within the ESCB**

Taking into account the above-mentioned derogations, the position of the NCBs of the Member States with a derogation within the ESCB is shaped as follows: first, they are represented in the General Council;[30] furthermore, they are subscribers of the ECB's capital according to the key for capital subscription and must make a minimum payment of the subscribed

[30] ESCB/ECB Statute, Article 44.2.

capital;[31] in addition, they enjoy institutional and personal independence and may perform functions other than those specified in the Statute;[32] finally, the ECB may request their assistance for the collection of the statistical information deemed necessary for completion of its tasks, their financial statements are included in the consolidated financial statement of the ESCB published by the ECB, they may proceed to operations for administrative purposes or for their staff, they are subject to the provisions on judicial control and, lastly, members of their governing bodies and staff are bound by the provisions on professional secrecy.[33]

## 5.2 The Single Supervisory Mechanism[34]

### *5.2.1 Objective and Field of Application of the SSM Regulation*

(1) As mentioned in Chap. 4 (Sect. 4.2.1), Council Regulation (EU) No 1024/2013 "conferring specific tasks on the [ECB] concerning policies relating to the prudential supervision of credit institutions" (SSMR) is the main legal source governing the SSM. It was adopted by the ECOFIN Council in October 2013 within 14 months from the submission of the Commission's proposal. The ECB assumed its tasks under the SSMR on 4 November 2014.[35] This Regulation, which was a major leap towards the creation of the Banking Union (BU),[36] was adopted in full respect of the

[31] On these aspects, see details in Chap. 6, Sect. 6.4.1.

[32] TFEU, Article 131 and ESCB/ECB Statute, Articles 14.1 and 14.2 and 14.4.

[33] ESCB/ECB Statute, Articles 5, 15.2, 24, 35 and 37, respectively.

[34] Although the establishment of the SSM and the SRM, as the two main (and, for the time being, the only) pillars of the BU followed that of the ESFS (according to the above-mentioned in Chaps. 3 and 4), a discussion thereof was deemed appropriate in this chapter, due to the particularly significant importance of the SSM in the context of this book.

[35] SSMR, Article 33(2), first sub-paragraph; the ECB Press Release is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2014/html/sr141104.en.html. Since January 2014, it conducted, in collaboration with the NCAs and supported by the private company Oliver Wyman Consultants, a Comprehensive Assessment of the credit institutions and supervised groups to be directly supervised by it. The results of this exercise were published on 26 October 2014 and are contained in the ECB's "Aggregate Report on the Comprehensive Assessment" (https://www.bankingsupervision.europa.eu/banking/comprehensive/html/index.en.html).

[36] Several aspects of this Regulation (and its proposal) are analysed in Deutsche Bundesbank (2013), pp. 26–36, Ferran and Babis (2013), Ferrarini and Chiarella (2013), Huber and von Pföstl (2013), Tröger (2013), Verhelst (2013), Brescia Morra (2014), Gandrud and Hallenberg (2014), Moloney (2014b), Thiele (2014), pp. 519–525, Wymeersch (2014),

EU principles of subsidiarity and proportionality under Article 5(3)–(4) TEU[37] and respects the fundamental rights and observes the principles recognised in the Charter, in particular the right to the protection of personal data, the freedom to conduct a business and the right to an effective remedy and to a fair trial.[38]

(2) The SSMR confers on the ECB specific tasks "concerning policies relating to the prudential supervision of credit institutions" (a phrase taken over *verbatim* from Article 127(6) TFEU), with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State, which is the main objective of the ECB under the SSMR, and to preventing regulatory arbitrage, fully taking into account and caring for the unity and integrity of the internal market (a duty with which it was assigned) based on equal treatment of credit institutions.[39] Obviously, this ECB objective is different from the primary objective of the ESCB (literally of the Eurosystem) under the TFEU, that is maintaining price stability.

(3) The SSMR's scope covers, mainly and in principle, credit institutions and other supervised entities incorporated in euro area Member States. Nevertheless, specific provisions also apply to branches established in participating Member States by credit institutions incorporated (and authorised) in non-participating Member States, as well as to credit institutions and other supervised entities incorporated in Member States with a derogation, which have established a so-called close cooperation according to Article 7.[40] Exempted from its scope of application

Wiggins et al. (2014a), Wissink et al. (2014), Grundmann (2016), pp. 50–57 and 61–63, Alexander (2016) and D'Ambrosio (2016); see also Masciandaro and Nieto (2014) and Tönningsen (2018) on the governance of the SSM and Gortsos (2015) for an analysis of the entire Regulation. For a critical evaluation, see Smits (2012) and European Court of Auditors (2016) and (2018) and the Report submitted by the Commission on 11 October 2017 on the application of the SSMR (on the basis of its Article 32; available at: https://ec.europa.eu/info/sites/info/files/171011-ssm-review-report_en.pdf).

[37] SSMR, recital (87). On the principle of subsidiarity, see Chap. 2, Sect. 2.3.3; on the proportionality principle, see Lienbacher (2019a), pp. 125–129, Craig and de Búrca (2015), pp. 551–558 and Tridimas (2018).

[38] Ibid., recital (86); the relevant Charter's Articles (8, 16 and 47) are analysed, respectively, in Knecht (2019), Schwarze und Voet van Vormizeele (2019b) and Voet van Vormizeele (2019).

[39] Ibid., Article 1, first sub-paragraph.

[40] See Sect. 5.2.5.

are the credit institutions which are also exempted from the field of application of the Capital Requirements Directive No IV (CRD IV) (referred to in Article 2(5)). In addition, it does not confer on the ECB any supervisory tasks relating to the prudential supervision of central counterparties (the 'CCPs'),[41] which are, nevertheless, considered supervised entities for the purposes of the SSMR and the SSM Framework Regulation if they qualify as credit institutions within the meaning of the CRD IV and without prejudice to the fact that they are supervised by relevant NCAs under the EMIR.[42] Insurance and reinsurance undertakings are also exempted, since their prudential supervision could not have been conferred on the ECB without prior amendment of Article 127(6) TFEU.[43]

Prudential supervision still is an exclusive national competence in relation to the following four types of financial firms which are regulated under European financial law: financial institutions, investment firms, as well as undertakings for collective investment in transferable securities (UCITS) management companies and external alternative investment fund (AIF) managers (the 'AIFMs').[44] In accordance with Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 "on markets in financial instruments (…)"[45] (the 'MiFID II'), 'investment firm' means (in principle) any legal person whose regular occupation or business is the provision of one or more 'investment services' to third parties, and/or the performance of one or more 'investment

[41] SSMR, Article 1, second sub-paragraph, first and third sentences.

[42] Regulation (EU) No 648/201, Article 22(1); this exception is set out in Article 2, point (20) (second sentence) SSM Framework Regulation.

[43] See Sect. 5.2.2.

[44] The former are defined in Article 2(1), point (b) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 "on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)" (OJ L 302, 17.11.2009, pp. 32–96) (the 'UCITS IV Directive'; on this legislative act, see Moloney (2014a), pp. 200–269 and Zetzsche (2017)). The latter are defined in Article 5(1), point (a) of Directive 2011/61/EU of the same institutions of 8 June 2011 on "alternative investment fund managers (…)" (OJ L 174, 1.7.2011, pp. 1–73) (the 'AIFMD'; on this Directive, see Busch and van Setten (2014), Moloney (2014a), pp. 269–311, Zetzsche (2015, editor) and 2017), and Gortsos (2018)).

[45] OJ L 173, 12.6.2014, pp. 349–496.

activities' on a professional basis.[46] 'Financial institution' means[47] an undertaking, other than a credit institution or an investment firm, the principal activity of which is to acquire holdings or to pursue any of the activities listed in points (2)–(12) and (15) of Annex I to the CRD IV. On the other hand, included are financial holding companies, mixed financial holding companies, payment institutions (within the meaning of Directive (EU) 2015/2366 of the same institutions of 13 November 2007 "on payment services in the internal market (…)")[48] (the 'PSD II'), and asset management companies; excluded are insurance holding companies and mixed-activity insurance holding companies as defined in Directive 2009/138/EC of the same institutions of 25 November 2009 "on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)".[49]

(4) Even though the SSMR is binding in its entirety and directly applicable in all Member States, a distinction must be made between two categories: the first comprises the 'participating Member States', which are defined as meaning both the Member States whose currency is the euro (in the SSM Framework Regulation also called 'euro area participating Member States'), and the Member States with a derogation which have established a close cooperation in accordance with Article 7 (in the SSM Framework Regulation defined as 'participating Member States in close cooperation'), also referred to as 'non-euro area participating Member States'.[50] The term 'Member States with a derogation' also includes the Member States which opted out of the EMU, that is the UK and Denmark according to the provisions of and the (different) conditions laid down in Protocols (No 15) and (No 16) attached to the EU Treaties, respectively.[51] The second category comprises the 'non-participating Member States', which do not meet the above criteria ('non-euro area Member States' in the terminology of the SSM Framework Regulation).[52]

[46] MiFID II, Article 4(1), point (2); 'investment services and activities' means the services and activities listed in Section A relating to instruments listed in Section C of Annex I to that Directive (ibid., Article 4(1), point (1)).

[47] SRMR, Article 3(1), point (15), with reference to Article 4(1), point (26) CRR.

[48] OJ L 337, 23.12.2015, pp. 35–127.

[49] OJ L 335, 17.12.2009, pp. 1–155.

[50] SSM Framework Regulation, Article 2, points (15) and (1), respectively.

[51] On these protocols, see Chap. 2, Sect. 2.3.4.

[52] SSM Framework Regulation, Article 2, point (13); for a summary on the regulatory perimeter in respect of different types of financial firms and Member States, see Table 5.2.

**Table 5.2** The regulatory perimeter

| A. The perimeter in respect of different types of financial firms | |
|---|---|
| Included | Excluded |
| Credit institutions<br>'Financial holding companies', in the context of the conduct of consolidated supervision of banking groups<br>'Mixed financial holding companies', in the context of the conduct of supplementary supervision on financial conglomerates including credit institutions<br>Branches established in a participating Member State by a credit institution incorporated in a non-participating Member State | Credit institutions excluded from the field of application of the CRD IV<br>Financial institutions (e.g. leasing, factoring and credit companies), including payment institutions and asset management companies<br>Insurance and reinsurance undertakings<br>Investment firms<br>Central counterparties<br>UCITS management companies and alternative investment fund managers (including hedge funds) |
| B. The perimeter in respect of Member States | |
| Euro-area Member States | Member States with a derogation |
| Yes | Specific rules on:<br>Branches in participating Member States of credit institutions incorporated in non-participating Member States<br>Credit institutions incorporated in Member States with a derogation which have established a 'close cooperation' |

### 5.2.2 *Article 127(6) TFEU as the Legal Basis of the SSM Regulation*

Taking into account that the political decision was to make use of the existing EU Treaties, the legal basis of the SSMR is Article 127(6) TFEU (repeated in Article 25.2 ESCB/ECB Statute), which reads as follows: "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the [ECB], confer specific tasks upon the [ECB] concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."[53] On this TFEU provision, the use of which as the legal basis for the SSMR has not escaped criticism,[54] the following can be briefly noted:

[53] For a detailed analysis of these Articles, see Smits (1997), pp. 355–359, Hadjiemmanuil (2006), pp. 824–825, Louis (2009), pp. 166–168 and Lastra and Louis (2013), pp. 82–94.

[54] See Lastra (2013), p. 1197, with further references, and Alexander (2016), pp. 264–267.

(1) The Regulation must be adopted by the Council in accordance with the 'special legislative procedure',[55] in which the European Parliament's contribution (along with that of the ECB) is limited to an advisory role. Nevertheless, in the case of the SSMR the role of the European Parliament was enhanced, since it was adopted in parallel with Regulation (EU) No 1022/2013 amending the EBA Regulation,[56] which was a joint European Parliament and Council legislative act under the ordinary legislative procedure.[57] This coincidence allowed the European Parliament to intervene more intensively during the procedure for the elaboration of the SSMR, asking for several substantial amendments, which were indeed adopted in the context of the 'Trilogue' with the Council and the Commission, and was also the political lever for the adoption of the Interinstitutional Agreement between the European Parliament and the ECB of October 2013.[58]

In this context, in its Communication of 28 November 2012 "on a Blueprint for a deep and genuine economic and monetary union—Launching a European debate",[59] the Commission proposed the amendment of this Article in order to introduce the ordinary legislative procedure and eliminate some of the legal constraints currently placed on the design of the SSM, such as enshrine a direct and irrevocable opt-in to the SSM by Member States whose currency is not the euro, beyond the model of 'close cooperation', grant fully equal rights in the ECB's decision-making to Member States whose currency is not the euro but opt into the SSM, and further develop the internal separation of decision-making on monetary policy and prudential supervision.

(2) The Regulation may confer specific tasks upon the ECB concerning policies relating to the prudential supervision not only of credit institutions, but of other types of financial firms as well. Explicitly excluded are insurance undertakings. This phrasing does not rule out the possibility of conferring upon the ECB specific tasks with regard to the prudential supervision of investment firms and other financial firms operating in capi-

[55] On this procedure, see Appendix to this chapter.

[56] On this Regulation, see details under Sect. 5.4.3.

[57] TFEU, Article 289(1).

[58] The ECB submitted its Opinion on the proposals for the SSMR and the Regulation amending the EBA Regulation jointly on 27 November 2012 (OJ C 30, 1.2.2013, pp. 6.11).

[59] COM(2012) 777 final.

tal markets (an option which nevertheless is not contained, up to now at least, in any political agenda).[60]

(3) Since the Regulation may confer upon the ECB "specific tasks concerning policies relating to the prudential supervision" of these categories of financial firms, it must specify these tasks. According to this wording, the ECB may not become responsible for the entire range of prudential supervision of credit institutions and other categories of financial firms.

(4) Finally, the Regulation must be approved by the ECOFIN Council unanimously, since Article 127(6) TFEU is also applicable to Member States with a derogation, including the UK.[61] Accordingly, the SSMR was adopted by the Ministers of Finance of all EU Member States.

### *5.2.3 The Two Components of the SSM*

*Introductory Remarks*

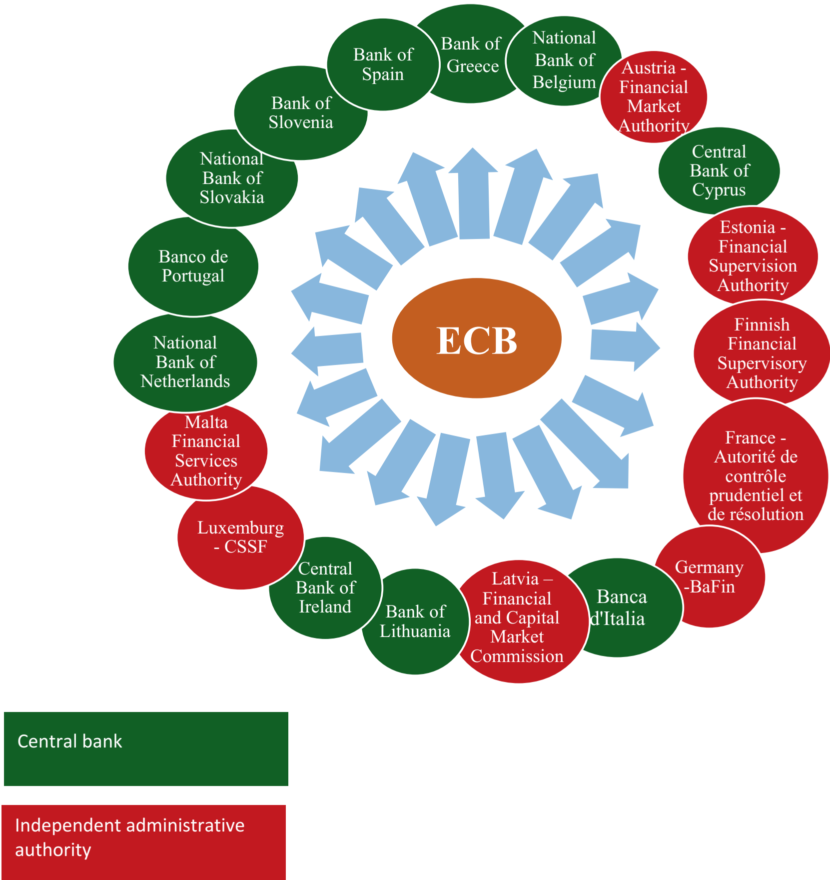
The specific supervisory tasks conferred on the ECB are carried out within the framework of the SSM. This mechanism is neither an authority nor an agency and has no legal personality. It is defined as the 'system of financial supervision' composed, as described in Article 6 SSMR, of the ECB, and participating Member States' NCAs, including those of Member States with a derogation, if the latter have established a 'close cooperation' according to Article 7.[62] Accordingly, the SSM has a different institutional architecture from the Eurosystem, to the extent that members of the latter are (as already mentioned) the ECB and (exclusively) the NCBs of the Member States whose currency is the euro. NCAs, other than NCBs, are not members of the Eurosystem. The same holds for NCBs of Member States with a derogation, which nevertheless are members of the ESCB (except in the case that they are also NCAs and a close cooperation has been established).[63]

[60] In any case, the wording "credit institutions and other financial institutions" is inconsistent with the provisions of existing EU banking law; the definition of credit institutions is different from that of financial institutions and the latter cannot be considered to be a subcategory of the former.

[61] TFEU, Article 139(2), point 3, ESCB/ECB Statute, Article 42.1 and Protocol (No 15), paragraphs 4 and 7.

[62] SSMR, Articles 2, point (9) and 6(1), first sentence. Carletti and Dell' Ariccia (2015) use the term "hub and spokes" supervisory regime; Article 6 SSMR is analysed in Chap. 8, Sect. 8.2 and Article 7 is discussed in this chapter (Sect. 5.2.5).

[63] On the composition of the SSM, see also Graph 5.1.




**Graph 5.1** Composition of the SSM

It is noteworthy that unlike the ESCB, the Eurosystem and the European System of Financial Supervision (ESFS), which are described as 'systems', in the case of the SSM [and the Single Resolution Mechanism (SRM)] use is made of the term 'mechanisms', a differentiation though of no legal significance.

*The ECB as the Main Actor*
(1) The SSMR introduced a 'vertical' transfer, from the Member States to the EU level, of specific tasks concerning policies relevant to the prudential

supervision of credit institutions with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State. Among various alternative options that could have been adopted, the Commission proposed and then the Council decided to confer the relevant specific tasks on the ECB.[64] According to recital (13): "As the euro area's central bank with extensive expertise in macroeconomic and financial stability issues, the ECB is well placed to carry out clearly defined supervisory tasks with a focus on protecting the stability of the financial system of the Union. Indeed, many Member States' central banks are already responsible for banking supervision. Specific tasks should therefore be conferred on the ECB concerning policies relating to the supervision of credit institutions within the participating Member States."

(2) The alternative options were either assigning the micro-prudential supervision of credit institutions to one or more of the European Supervisory Authorities members of the ESFS, and mainly to the EBA, or creating a new pan-European banking supervisory authority.[65] In practice, however, the Commission did not have any choice but to opt for this particular solution, since the Euro Area Summit of 29 June 2012 decided that "the Commission will present proposals on the basis of Article 127(6) for a single supervisory mechanism shortly",[66] a decision also confirmed by the European Council of the same day.[67] Accordingly, the ECB was clearly identified as the main actor.

(3) Applicable to the ECB, by virtue of Article 342 TFEU, is Council Regulation No 1[68] (as currently in force) determining the languages to be used by the EEC.[69] With regard to its processing of personal data for the purposes of the SSMR, fully applicable are two legal acts of the European

[64] SSMR, Article 1, first sub-paragraph.

[65] On the limitations to the implementation of these options, see Wymeersch (2012), pp. 237–240 (an article published before the launching of the BU), with reference to the "Meroni doctrine", which was established by the Court in its Judgment of 13 June 1958 in Case 9–56 "Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community" (ECLI:EU:C:1958:7, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61956CJ0009); see also Sect. 5.3.2.

[66] Euro Area Summit Statement, 29 June 2012, first paragraph, second sentence.

[67] European Council Conclusions, 28/29 June 2012, paragraph 4(b), in finem.

[68] OJ 17, 6.10.1958, p. 385. Article 342 TFEU and Council Regulation No 1 are discussed in more detail in Priebe (2019).

[69] SSMR, recital (62).

Parliament and of the Council:[70] Regulation (EU) 2016/679 of 27 April 2016 "on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (…) (General Data Protection Regulation)"[71] (the 'GDPR') and Regulation 2018/1725 of 23 October 2018 "on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data (…)".[72] Finally, for the purposes of combating fraud, corruption and other unlawful activities[73] applicable is Regulation (EU, Euratom) No 883/2013 of the same institutions of 11 September 2013 "concerning investigations conducted by the European Anti-Fraud Office (OLAF) (…)".[74]

*The NCAs Within the SSM*

The NCAs, defined as meaning the authorities designated as such by the participating Member States in accordance with the Capital Requirements Regulation (CRR) and the CRD IV,[75] are an integral part of the SSM. A participating Member State's NCA may be the NCB, that is the ex-monetary authority, if it is a euro-area Member State, and its monetary authority, if it is a Member State with a derogation having established a close cooperation with the ECB. Nevertheless, in order to separate monetary policy from banking supervisory tasks, several participating Member States have assigned by law micro-prudential banking supervision to independent national administrative authorities other than the NCB.[76]

[70] Ibid., recital (81).

[71] OJ L 119, 4.5.2016, pp. 1–88.

[72] OJ L 295, 21.11.2018, pp. 39–98.

[73] SSMR, recital (82). In relation to this aspect, the ECB had already adopted on 3 June 2004 Decision ECB/2004/11 "concerning the terms and conditions for European Anti-Fraud Office investigations of the [ECB] in relation to the prevention of fraud, corruption and any other illegal activities detrimental to the European Communities' financial interests and amending the Conditions of Employment for Staff of the [ECB]" (OJ L 230, 30.6.2004, pp. 56–60).

[74] OJ L 248, 18.9.2013, pp. 1–22. The OLAF was established by virtue of Commission Decision 1999/352/EC, ECSC, Euratom of 28 April 1999 (OJ L 136, 31.5.1999, pp. 20–22).

[75] This definition is without prejudice to arrangements under national law which assign certain supervisory tasks to an NCB not designated as an NCA (SSMR, Article 2, point (2) and SSM Framework Regulation, Article 2, point (9)).

[76] On the NCAs—members of the SSM, see Table 5.3.

**Table 5.3** National competent authorities (NCAs)—members of the SSM

| *Member state* | *National competent authority (NCB denotes national central bank)* |
|---|---|
| Austria | Finanzmarktaufsicht—FMA |
| Belgium | Nationale Bank van België/Banque Nationale de Belgique (NCB) |
| Cyprus | Central Bank of Cyprus (NCB) |
| Estonia | Finantsinspektsioon |
| Finland | Finanssivalvonta—Fiva |
| France | Autorité de contrôle prudentiel et de résolution—ACPR |
| Germany | Bundesanstalt für Finanzdienstleistungsaufsicht—BaFin |
| Greece | Τράπεζα της Ελλάδος (NCB) |
| Ireland | Central Bank of Ireland/Banc Ceannais na hÉireann (NCB) |
| Italy | Banca d'Italia (NCB) |
| Latvia | Finanšu un kapitāla tirgus komisija |
| Lithuania | Bank of Lithuania (NCB) |
| Luxembourg | Commission de Surveillance du Secteur Financier—CSSF |
| Malta | Malta Financial Services Authority—MFSA |
| Netherlands | De Nederlandsche Bank (NCB) |
| Portugal | Banco de Portugal (NCB) |
| Slovakia | Národná banka Slovenska (NCB) |
| Slovenia | Banka Slovenije (NCB) |
| Spain | Banco de España (NCB) |

In some participating Member States, however, national law has conferred on the NCB certain banking (or, in general, financial) supervisory tasks, even though the NCB is not designated as an NCA. In view of this situation, the following has been established:[77] first, NCBs of participating Member States must carry out these specific tasks within the framework set out in national law and the SSM Framework Regulation; second, any reference to an NCA in that Regulation applies, as appropriate, also to the NCB for the tasks assigned to it by national law.

### *5.2.4 Key Elements of the SSM Under the SSM Regulation*

(1) The Commission's 2012 proposals on the new EU architecture for financial prudential supervision within the context of the BU were based on four main elements: first, conferring 'specific tasks' on the ECB for the prudential supervision of certain types of financial firms, in transfer from NCAs, and establishing a 'Single Supervisory Mechanism' in relation to

[77] SSM Framework Regulation, Article 2, point (9), third and fourth sentences.

the exercise of the specific tasks conferred on the ECB; second, specifying the financial firms, mainly credit institutions, with regard to which these specific tasks should be conferred on the ECB; third, incorporating the SSM within the ESFS, without, in principle, touching upon the current tasks of the EBA and the other components of the ESFS; and finally, creating 'Chinese walls' within the ECB in order to ensure the effective separation of its monetary policy and other tasks from its supervisory ones. All these elements were taken over by the Council (under the participation and influence of the European Parliament), when adopting the SSMR.

(2) The SSM is hence governed by four key elements, which are consistent with Article 127(6) TFEU and (partly) reflect the compromise achieved between the EU institutions and Member States during its elaboration. In particular:

The first key element (and subject matter of the SSMR) is the conferral on the ECB of 'specific tasks' concerning policies relating to the prudential supervision of certain types of financial firms, transferred from NCAs, which are exercised within the SSM with a view to contributing to the safety and soundness of these entities and the stability of the financial system within the EU and each Member State;[78] these specific tasks are set out in Articles 4(1) and 5(2) SSMR.[79] The assignment to the ECB of these specific tasks covers credit institutions; 'financial holding companies', in the context of the conduct of consolidated supervision of banking groups; and 'mixed financial holding companies', in the context of the conduct of supplementary supervision on financial conglomerates.[80] All these types of financial firms are covered by the definition of the term 'supervised entities', which also includes branches established in a participating Member State by a credit institution incorporated in a non-participating Member State.[81] It is noted that this term is not defined in the SSMR, which mostly

[78] SSMR, Article 1, first sub-paragraph.

[79] See details in Chap. 8, Sect. 8.1.

[80] 'Financial holding company' means a financial institution the subsidiaries of which are exclusively or mainly credit institutions, investment firms or financial institutions, at least one of such subsidiaries being a credit institution or an investment firm, and which is not a mixed financial holding company; 'mixed financial holding company' means a parent undertaking, other than a regulated entity, which, together with its subsidiaries (at least one of which is a regulated entity with its registered office in the EU) and other entities, constitutes a financial conglomerate (SSMR, Article 3(1), point (16), with reference to Article 4(1), point (20) CRR and Article 3(1), point (17), with final reference to FICOD, Article 2, point (15)).

[81] SSM Framework Regulation, Article 2, point (20).

refers to credit institutions; even though credit institutions definitely constitute the most important type of supervised entities, this is a shortcoming in the drafting of the SSMR.[82]

The second key element is the designation of the entities with regard to which these specific tasks have been conferred on the ECB. In that respect, Article 6 SSMR established, in principle, a 'two-tier system' with regard to the distribution of powers within the SSM, distinguishing between two groups of supervised entities: the first comprises 'significant' ones, which are directly supervised by the ECB; and the second comprises 'less significant' ones (also named 'LSIs'), which are directly supervised by the NCA, both within the SSM. This distinction does not apply to the granting and withdrawal of authorisation of credit institutions, to the acquisition and disposal of qualifying holdings in credit institutions, which are ECB competences for all credit institutions, and the macro-prudential tasks conferred on the ECB by virtue of Article 5 SSMR. In addition, if necessary to ensure consistent application of 'high supervisory standards' within the SSM, the ECB, which is responsible for the effective and consistent functioning of the SSM, may decide to exercise directly the supervision of a less significant supervised entity or a less significant supervised group.[83]

The incorporation of the SSM within the ESFS without in principle touching upon the current tasks of the EBA and the other components of the ESFS constitutes the third key element of the SSMR.[84]

The last key element is the creation of 'Chinese walls' within the ECB in order to ensure the effective separation of its monetary policy and other tasks from its supervisory tasks.[85]

### *5.2.5 The 'Close Cooperation' Between the ECB and the NCAs of Member States with a Derogation*

(1) Credit institutions and other supervised entities and groups incorporated in a non-euro area participating Member State may become subject

[82] In the remainder of this book the author attempts to alleviate this shortcoming by using, when making references to the SSMR, the term 'supervised entity' instead of the term 'credit institution', as appropriate.

[83] These aspects are analysed in Chap. 8, Sect. 8.2.

[84] SSMR, Article 3 and Regulation (EU) No 1022/2013. This aspect is analysed in Sect. 5.4.3.

[85] SSMR, Article 25; relevant are also Articles 106–119 SSM Framework Regulation. This aspect is briefly discussed in Chap. 6, Sect. 6.2.2.

to the supervisory authority of the ECB under the provisions of the SSMR in the case of a 'close cooperation', as provided for in Article 7 SSMR.[86] This cooperation between the ECB and the NCA of a non-euro area participating Member State is established by an ECB Decision, provided that the requirements laid down in the SSMR (Article 7(2)) are met.[87] Upon its establishment, the ECB may carry out its specific supervisory tasks in relation to supervised entities and groups established in the relevant non-euro area participating Member State, in accordance with Article 6.[88]

(2) If the ECB deems that a non-euro area participating Member State no longer meets conditions set out in the SSMR (Article 7(2), points (a)–(c)) or the NCA does not act in accordance with the obligation referred to therein may, it decide to issue a warning that the close cooperation will be suspended or terminated. If no decisive corrective action has been taken by the Member State concerned within 15 days after the notification of such a warning, the ECB may decide to suspend or terminate the close cooperation.[89]

## 5.3 The Single Resolution Mechanism

### *5.3.1 Objective and Field of Application of the SRM Regulation*

(1) As mentioned in Chap. 4 (Sect. 4.3.1), Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 [Single Resolution Mechanism Regulation (806/2014) (SRMR)] is the main legal source governing the SRM. The objective of the SRMR[90] is laid

[86] By virtue of this Article the ECB adopted on 31 January 2014 Decision 2014/434/EU "on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro" (ECB/2014/5) (OJ L 198, 5.7.2014, pp. 7–13).

[87] The assessment by the ECB of the request to enter into a close cooperation is governed by Article 4 of Decision ECB/2014/5.

[88] SSMR, Article 7(1), first sub-paragraph and SSM Framework Regulation, Article 107(1).

[89] SSMR, Article 7(5).

[90] On the SRMR, see Eckhardt (2013), Gandrud and Hallenberg (2013), Gros (2013), Gordon and Ringe (2014) and (2015), European Central Bank (2014), Louis (2014), Ignatowski and Korte (2014), Wiggins et al. (2014b), Alexander (2015), pp. 175–186, Carmassi (2015), Hadjiemmanuil (2015), pp. 16–18, Zavvos and Kaltsouni (2015), pp. 2–35, Dermine (2016), Stephanou (2016), Busch (2017), Houben and Vandenbruwaene (2017), Gortsos (2019), pp. 73–98 and 107–261, as well as the individual contributions in Binder et al. (forthcoming).

down in its Article 1, which states that it establishes uniform rules and a uniform procedure for the (orderly) resolution of credit institutions (as well as parent institutions, investment firms and financial institutions), if they are subject to consolidated supervision carried out by the ECB,[91] established in the euro-area Member States and in the Member States which have entered into a 'close cooperation' with the ECB without recourse to taxpayers' money (including public financial assistance by EU facilities) for their recapitalisation. These uniform rules and uniform procedure must be applied by the Single Resolution Board (the 'SRB' or the 'Board'), which was established by the SRMR, together with the Council, the Commission and the national resolution authorities (the 'NRAs) within the framework of the SRM.[92]

(2) The SRMR applies to three types of entities, provided that they are established in participating Member States:[93] credit institutions, parent undertakings (including financial holding companies and mixed financial holding companies) if subject to consolidated supervision carried out by the ECB, as well as investment firms and financial institutions if covered by the consolidated supervision of the parent undertaking carried out by the ECB. For its purposes, 'participating Member States' are (in line with the definition in the SSMR) both the Member States whose currency is the euro and the Member States with a derogation which have established a close cooperation under Article 7 SSMR.[94]

[91] This supervision is carried out by the ECB in accordance with Article 4(1), point (g) SSMR; see details in Chap. 8, Sect. 8.1.2.

[92] SRMR, Article 42(1), first sentence and recital (120), first sentence. 'NRA' means a public administrative authority or an authority entrusted with public administrative powers, such as the NCB, a competent ministry or the NCA, designated by a participating Member State in accordance with Article 3(1)–(3) BRRD (ibid., Article 3(1), point (3)).

[93] Ibid., Article 2 and recital (22).

[94] Ibid., Article 4(1), with reference to Article 2, point (1) SSMR. If a close cooperation between a Member State and the ECB is suspended or terminated, entities established therein cease to be covered by the SRMR from the date of application of the suspending or terminating decision; the SRMR continues to apply only to resolution proceedings which were ongoing on the date of application of such a decision (ibid., Article 4(2)–(4)).

### *5.3.2 The Two Components of the SRM*

*The SRB and the Role of the ECB*

(1) The Board, established by the SRMR and operational since 1 January 2015, is responsible for the effective and consistent functioning of the SRM,[95] like the ECB for the SSM. Subject to the provisions on the cooperation within the SRM,[96] it is also responsible for drawing up the resolution plans and adopting all resolution decisions relating to the following entities and groups:[97] entities that are not part of a group (thus, institutions established in participating Member States), groups classified as significant or in relation to which the ECB has decided to exercise directly all of the relevant powers, and other 'cross-border groups'.[98]

(2) Unlike the ECB which is an EU institution, the Board is an EU agency with a specific structure corresponding to its specific tasks, which departs from the model of all other EU agencies in order to ensure a swift and effective decision-making process in resolution.[99] It belongs to the decentralised agencies set up in order to perform technical, scientific or managerial tasks that support the EU institutions in policy-making and implementation. According to the "Meroni doctrine", as revised by the ECJ Judgment of 22 January 2014 (in Case C-270/12),[100] any conferral of implementing powers needs to be clearly defined by the empowering

[95] Ibid., Articles 42(1), first sentence, 98(1) and 7(1), respectively.

[96] Ibid., Article 31(1).

[97] These entities and groups are referred to in Article 7(2) and, if the conditions for their application are met, in Articles 7(4), point (b) and 7(5)) (hereinafter the 'designated entities and groups').

[98] Ibid., Article 7(2) and recital (28), first sentence; on the classification of supervised entities as significant and on Article 6(5), point (b) SSMR, see Chap. 8, Sect. 8.1.1. 'Group' means a parent undertaking and its subsidiaries that are designated entities (SRMR, Article 3(1), point (23)); 'cross-border group' means a group that has designated entities established in more than one participating Member State (ibid., Article 3(1), point (24)).

[99] Ibid., Article 42(1), second sentence and recital (31), first sentence.

[100] Judgment of the Court (Grand Chamber) in Case C-270/12 "United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union (Regulation (EU) No 236/2012—short selling and certain aspects of credit default swaps—Article 28—validity—legal basis—powers of intervention conferred on the European Securities and Markets Authority in exceptional circumstances)", ECLI:U:C:2014:18, available at: https://curia.europa.eu/juris/liste.jsf?num=C-270/12. On this case (usually referred to as the "short selling case") and this judgment, see, by way of mere indication, Repasi (2014) and Chiti (2019), pp. 116–120.

act, and the exercise of the relevant powers must be effectively controlled by the delegating authority (political control) and be subject to legal review (control). As the purpose of this doctrine is the protection of EU institutional balance, it becomes evident that political responsibility cannot be conferred upon executive bodies.[101]

The Board has legal personality, enjoys in each Member State (including the non-participating ones) the most extensive legal capacity accorded to legal persons under national law (*inter alia*, the right to acquire or dispose of movable and immovable property and the right to be a party to legal proceedings) and is represented by its Chair. It must act in compliance with EU law and (since it is not an EU institution and does not have the power to take final binding decisions), in particular, with the Council and Commission decisions, in accordance with the SRMR.[102]

(3) The Board is composed of a Chair, four other full-time members and a member appointed by each participating Member State, representing their NRAs. Each member, including the Chair, has one vote.[103] The Commission and the ECB also designate a representative each, which are entitled to participate in the meetings of the Board's Plenary and Executive Sessions as permanent observers, entitled to participate in the debates and having access to all documents. The Board's Plenary Sessions are participated in by all its members (in line with the above). The Board may, if relevant, invite observers, in addition to the permanent ones appointed by the Commission and the ECB (which participate *ipso jure*), to participate in the Plenary Session's meetings on an *ad hoc* basis, including an EBA representative.[104] On the other hand, the Board in its Executive Session is composed of the Chair, the (four) other full-time members and the permanent observers appointed by the Commission and the ECB.[105]

[101] See also recital (26), third sentence SRMR; on the definition and powers of "Union agencies", see by way of mere indication Shapiro (2011) and Chiti (2018).

[102] Ibid., Articles 42(1), third sentence, 42(2)–(3) and 44.

[103] Ibid., Article 43(1), points (a)–(c), and 43(2). The appointment of the Chair and the other full-time members is made in accordance with Article 56.

[104] In this Session, the Board has a broad range of resolution and managerial tasks and must act in accordance with the general principles laid down in Article 6 and the resolution objectives laid down in Article 14.

[105] Ibid., Article 53(1), first sub-paragraph, first sentence and recital (32), second sentence. The Board's tasks in this Session consist in preparing the decisions to be adopted by its Plenary Session and taking the decisions to implement the SRMR to the fullest extent possible, unless otherwise provided therein (ibid., Article 54(1) and recital (33), first sentence).

(4) Applicable to the Board are, as also in the case of the ECB, Council Regulation No 1 determining the languages to be used by the EEC, in relation to data protection the GDPR and Regulation 2018/1725 (which, *inter alia*, applies to the processing of personal data carried out in the process of procurement), as well as Regulation (EU, Euratom) No 883/2013 concerning investigations conducted by the OLAF.[106]

*The Role of NRAs*

NRAs have been assigned significant tasks and powers within the SRM.[107] In particular, without prejudice to the responsibilities of the Board for the tasks conferred on it by the SRMR, they carry out, and are responsible for, the following tasks with regard to entities and groups other than those which are classified as significant and those which are cross-border:

**Table 5.4** National resolution authorities (NRAs)—members of the SRM

| *Member state* | *National resolution authority* |
|---|---|
| Austria | Austrian Financial Market Authority (FMA) |
| Belgium | National Bank of Belgium |
| Cyprus | Central Bank of Cyprus |
| Estonia | Financial Supervision Authority |
| Finland | Financial Stability Authority |
| France | Autorité de contrôle prudentiel et de résolution (ACPR) |
| Germany | Financial Markets Stabilization Authority (FMSA) |
| Greece | Bank of Greece—Hellenic Capital Market Commission (HCMC) |
| Ireland | Central Bank of Ireland |
| Italy | Banca d' Italia |
| Latvia | Financial and Capital Market Commission (FCMC) |
| Lithuania | Bank of Lithuania |
| Luxembourg | Commission de Surveillance du Secteur Financier |
| Malta | Malta Financial Services Authorities |
| Netherlands | De Nederlandsche Bank (DNB) |
| Portugal | Banco de Portugal |
| Slovakia | The Resolution Council |
| Slovenia | Bank of Slovenia |
| Spain | Banco de España |
| | Fondo de Resolución Ordenada Bancaria (FROB) |

[106] Ibid., Articles 81, 89 and 66(1), respectively.
[107] For a list of these authorities, see Table 5.4.

First, at the phase of preparation, they must adopt their resolution plans, carry out an assessment of their resolvability, apply simplified obligations or waive the obligation to draft a resolution plan, determine the minimum requirement for (own funds and) eligible liabilities (MREL) and adopt measures during early intervention.

In addition, they must adopt resolution decisions and apply resolution tools, in accordance with the relevant procedures and safeguards, provided that the resolution action does not require any use of the Single Resolution Fund (SRF) and is financed exclusively by writing down or conversion of capital instruments, by resolution tools and/or by the deposit guarantee scheme (DGS). If the resolution action requires the use of the SRF, the resolution scheme must be adopted by the Board. When adopting a resolution decision, they must take into account and follow the resolution plan, unless they assess, taking into account the circumstances of the case, that the resolution objectives can be achieved more effectively by taking actions not provided for therein.

Finally, they must write down or convert 'relevant capital instruments'.[108]

When performing these tasks, NRAs must apply the relevant SRMR provisions, exercise the powers conferred on them under the national law transposing the Bank Recovery and Resolution Directive (BRRD) and inform the Board of the measures to be taken and closely coordinate with it when taking them.[109] The framework on cooperation within the SRM between the Board and the NRAs is governed by a Board's Decision of 28 June 2016 (SRB/PS/2016/07)[110] (the "Cooperation Framework Agreement", 'COFRA').

*Transfer of Resolution Powers and Responsibilities to the Board*

(1) If deemed necessary to ensure the consistent application of 'high resolution standards' under the SRMR, the Board may issue a 'warning' to the relevant NRA (within the appropriate timeframe, having regard to the urgency of the circumstances), since those must notify to it any measure taken when it considers that a draft Decision with regard to an entity or a group does not comply with the SRMR or with its general instructions. In addition, it may also decide, at any time, to exercise directly all relevant powers under the SRMR with regard to an entity or a group referred to in

[108] On this aspect, see Santoro and Mecatti (2019).

[109] SRMR, Article 7(3) and recital (28), third sentence.

[110] Available at: https://srb.europa.eu/sites/srbsite/files/srb_ps_2016_07.pdf.

Article 7(3), in particular if the (above-mentioned) warning is not being appropriately addressed. It may take such a decision either on its own initiative, after consulting the NRA concerned, or upon a request from the latter.[111]

(2) In addition, participating Member States may as well decide that the Board should exercise all relevant powers and responsibilities conferred on it by the SRMR in relation to 'less significant' entities and groups established in their territory. In this case, the provisions on NRAs' tasks within the SRM, on resolution plans drawn up and the MREL determined by them and on cooperation within the SRM do not apply.[112]

### *5.3.3 Other Aspects of Relevance to the ECB*

*Cooperation Arrangements*

**Obligation to Cooperate and Information Exchange Within the SRM**

(1) The obligation to cooperate on the basis of Article 4(3) TEU laying down the 'principle of sincere cooperation' and the regime of information exchange within the SRM are regulated in Article 30 SRMR. In this respect, and *inter alia*, in the exercise of their respective responsibilities under the SRMR, the Board, the Council, the Commission, the ECB, the NRAs and the NCAs must at each stage (resolution planning, early intervention and resolution action) cooperate closely and provide each other with all information necessary for the performance of their tasks. In addition, the ECB or the NCAs must transmit to the Board and to the NRAs the group financial support agreements authorised and any changes thereto. Finally, for the purposes of the SRMR, the ECB may invite the Board's Chair to participate as an observer in its Supervisory Board; if deemed appropriate, the Board may appoint another representative to replace the Chair for that purpose. For the same purposes, it is entitled to appoint a representative to participate in the EBA Resolution Committee.[113]

(2) On the basis of a discretion set out in the SRMR, the Board and the ECB concluded on 22 December 2015 the Memorandum of Understanding

[111] SRMR, Article 7(4), points (a) and (b).

[112] Ibid., Article 7(5), with reference to Articles 7(3)–(4), 9, 12(2) and 31(1), respectively.

[113] Ibid., Article 30(2)–(5); this Committee was established by virtue of Article 127 BRRD.

(MoU) “in respect of cooperation and information exchange” (the ‘SRB-ECB MoU’), which must be reviewed regularly, and has been published, subject to the requirements of professional secrecy, on the Board’s and the ECB’s websites.[114] Its provisions on cooperation govern: institutional representation, external communication and communication between participants, as well as cooperation arrangements for resolution-related activities (in very detailed terms) and with regard to non-participating Member States and third country authorities.[115]

**Consultation of, and Cooperation with, Non-participating Member States and Third Countries**

For the purposes of consultation and cooperation with non-participating Member States or third countries,[116] if a group includes entities established both in participating Member States and in non-participating Member States or in third countries, the participating Member States’ NRAs are represented by the Board. Furthermore, the Board, the ECB, as well as the resolution and competent authorities of the non-participating Member States must conclude MoUs describing in general terms the way in which they cooperate in the performance of their tasks under the BRRD and clarifying, *inter alia*, the consultation relating to decisions of the Board that have effect on subsidiaries established or branches located in the non-participating Member States, where the parent undertaking is established in a participating Member State.[117]

*Investigatory Powers—Requests for Information—Professional Secrecy and Exchange of Information*

(1) The Board may, either through the NRAs or directly, after informing them, making full use of all of the information available to the ECB or to the NCAs, require the entities referred to in Article 2 SRMR, their employ-

[114] SRMR, Article 30(7) and SRB-ECB MoU, paras. 16-17 (available at: https://srb.europa.eu/sites/srbsite/files/en_mou_ecb_srb_cooperation_information_exchange_f_sign.pdf. Paragraph 4.1 provides that the MoU is a ‘statement of intent’ and does not create any directly or indirectly enforceable rights, meaning that its participants must endeavour to fulfil their responsibilities thereunder ‘on a best-effort basis’.

[115] SRB-ECB MoU, paragraphs 5, 6, 7.1, 8 and 10–11, respectively.

[116] This applies in accordance with Articles 7–8, 12–13, 16, 18, 55 and 88–92 BRRD.

[117] SRMR, Article 32(1)–(2), first sub-paragraph and recital (38).

ees and/or third parties to whom these entities have outsourced functions or activities to provide all information necessary to perform its tasks.[118]

(2) In order to ensure the smooth functioning of the SRM, the above-mentioned SRB–ECB MoU governs the following aspects: provision of information for resolution-related activities; the exchange of information related to the establishment, suspension and termination of a close cooperation between the ECB and the NCAs of Member States with a derogation; the permissible use of information and the confidentiality regime; and data protection. They also govern the exchange of general information relating to their respective fields of competence, *inter alia* in the context of training, conferences and workshops ('knowledge exchange').[119] NCAs, the ECB and NRAs must cooperate with the Board in order to verify whether the information requested is already available (wholly or partly) and, in a positive case, provide it to the Board.[120]

(3) The Board, the Council, the Commission, the ECB, the NRAs or the NCAs, including their employees and experts, may share information with each other and with competent ministries, central banks, DGSs and investor compensation schemes, authorities responsible for normal insolvency proceedings, resolution and competent authorities from non-participating Member States and the EBA (subject to strict confidentiality requirements).[121]

## 5.4 The Two Components of the European System of Financial Supervision[122]

### *5.4.1 The European Banking Authority*

*Legal Status, Objective, Organs and Scope of Action*

(1) As mentioned in Chap. 3 (Sect. 3.3.2), the EBA was established by virtue of Regulation 1093/2010 of the European Parliament and of the

[118] Ibid., Article 34(1)–(2) and recital (94).

[119] SRB-ECB MoU, paragraphs 7.2, 9, 12, 13 and 14, respectively.

[120] SRMR, Article 34(6).

[121] Ibid., Article 88(6).

[122] The ESMA and the EIOPA, which along with the EBA and the ESRB, constitute the ESFS are not further discussed, since the role of the ECB and NCBs therein is marginal, notwithstanding the fact that some NCBs are also competent for supervision in capital markets and in the insurance/reinsurance sector.

Council (the 'EBA Regulation') and forms part of the ESFS.[123] It entered into operation on 1 January 2011 as a successor to the CEBS and has its seat in Paris (since June 2019).[124] Like all European Supervisory Authorities (ESAs), it is a 'Union body' with legal personality and, thus, enjoys the most extensive legal capacity accorded to legal persons under each Member State' national law.[125]

(2) The EBA's objective consists in protecting the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the EU economy, its citizens and its businesses. In this respect, it must contribute to the following: better functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision; ensuring financial markets' integrity, transparency, efficiency and orderly functioning; strengthening international supervisory coordination; preventing regulatory arbitrage and promoting equal conditions of competition; ensuring that credit-taking and other risks are appropriately regulated and supervised; and enhancing customer protection. For these purposes, it must contribute to the consistent, efficient and effective application of the acts referred to in Article 1(2), foster supervisory convergence, provide opinions to the European Parliament, the Council and the Commission and undertake economic analyses of the markets to promote the achievement of its objective.[126]

(3) The EBA's 'strategic' management body is the Board of Supervisors, which is composed of its Chairperson, the heads of the NCAs (be they NCBs or other independent administrative authorities) and one representative of the Commission, the ECB's Supervisory Board, the European Systemic Risk Board (ESRB), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA); only the heads of NCAs have voting rights.[127] By contrast, NCBs which are not NCAs are not represented in the EBA Board of Supervisors;

[123] EBA Regulation, Articles 1(1) and 2(1), first sentence.

[124] Ibid., Articles 82, third sentence, 7; this was a by-product of the (expected) exit of the UK from the EU.

[125] Ibid., Article 5. On the EBA (and in some cases the ESAs, in general), see Louis (2010), Ferran and Alexander (2011), Gortsos (2011), Tridimas (2011), pp. 801–803, Di Noia and Furlò (2012), Ferran (2012), Papathanassiou and Zagouras (2012), Wymeersch (2012), Moloney (2014a), pp. 907–941, Thiele (2014), pp. 494–519, Haar (2015), Chiu (2016), and, in more detail, Schemmel (2018).

[126] Ibid., Article 1(5), first and second sub-paragraphs.

[127] Ibid., Article 40(1); on this aspect, see also Sect. 5.4.3. The rules governing this body are laid down in Articles 40–44.

cooperation between all NCBs of EU Member States takes place only within the Banking Supervision Committee ('BSC') of the ESCB. The 'operational' management body is the Management Board, which is composed of the EBA Chairperson, and six other members of the Board of Supervisors elected by and from its voting members.[128] The other bodies are as follows: the Chairperson, who is a full-time independent professional, appointed by the Board of Supervisors and representing the EBA;[129] the Executive Director, who is (also) a full-time independent professional in charge of managing the EBA, and is also appointed by the Board of Supervisors upon confirmation by the European Parliament;[130] and the Board of Appeals, which is a joint body of the three ESAs (just like the Joint Committee[131]), has six members and provides expert legal advice on the legality of the EBA's exercise of its powers.[132]

(4) The EBA must act within the powers conferred upon it pursuant to Articles 8–9 of its statutory Regulation, within the scope of specific, exhaustively listed, legislative acts (referred to in Article 1(2)), including all legal acts based thereon (i.e. delegated and implementing acts) (hereinafter the 'relevant legislative acts') and in accordance with the SSMR.[133] It must also act in the field of activities of credit institutions, financial conglomerates, investment firms, as well as payment and e-money institutions in relation to issues not directly covered in the above-mentioned acts (including, indicatively, matters of corporate governance, auditing and financial reporting) to the extent necessary to ensure the effective and consistent application of those acts.[134]

[128] Ibid., Article 45(1), first sub-paragraph; the rules governing this body are laid down in Articles 45–47.

[129] Ibid., Articles 48(1), first sub-paragraph, 48(2), first sub-paragraph and Article 5(3), respectively; the rules governing the Chairperson are laid down in Articles 48–50.

[130] Ibid., Article 51(1)–(2); the appointment of the Chairperson does not require any action on the part of the European Parliament which, however, may express its objection (ibid., Article 48(2), second sub-paragraph). The rules governing the Executive Director are laid down in Articles 51–53.

[131] On this Committee, see Chap. 3, Sect. 3.3.2.

[132] EBA Regulation, Article 58(2); the rules governing the Board of Appeals are laid down in Articles 58–59. The functioning of all these bodies is governed by (internal) decisions (see the EBA's website, at: https://www.eba.europa.eu/Aboutus/Legal-texts/EBA-legaldocuments.aspx).

[133] The list of this Article includes, *inter alia*, the SSMR, the CRR, the CRD IV, the BRRD, the DGSD, the PSD II and the FICOD.

[134] EBA Regulation, Article 1(3).

*Tasks and Powers*

**The Structure of Chapter II of the EBA Regulation**

In order to fulfil its objective, specific tasks and powers have been conferred upon the EBA; these are laid down in Chap. II (Articles 8–39), which is structured as follows: Article 8(1) of the EBA Regulation contains an exhaustive (without prejudice to Article 9) list of the tasks conferred upon the EBA; Articles 10–39 offer a qualified description of the tasks under Article 8. Article 8(2) features an exhaustive list of all regulatory and other powers conferred on the latter in order to fulfil these tasks; finally, Article 9 refers to the EBA's task in relation to consumer protection and financial services and its related powers. In the exercise of its tasks, the EBA must pay particular attention to any systemic risk posed by financial institutions[135] whose failure may impair the operation of the financial system or the real economy.[136] When carrying out its tasks and exercising its powers under Article 8(1), it must duly have regard to the principles of better regulation, including the results of cost–benefit analyses.[137]

**EBA's Tasks According to Article 8(1) EBA Regulation**

The tasks of the EBA under Article 8(1) (points (a)–(k)) can be grouped as follows:

The first (and in the author's opinion predominant task) is the contribution to the "establishment of high-quality common regulatory and supervisory standards and practices", in particular by providing Opinions to EU institutions and by developing Guidelines, Recommendations, draft regulatory and implementing technical standards, and other measures based on the relevant legislative acts.[138] Related is its task to develop and maintain up to date—taking into account, *inter alia*, changing business practices and business models of financial institutions—a European supervisory handbook on the supervision of financial institutions in the EU, setting out supervisory best practices for methodologies and processes.

[135] The term 'financial institutions' used in the EBA Regulation is defined in Article 2, point (a) ESRB Regulation; this definition is very broad and, in any case, not consistent with the definition of this term in Article 4(1), point (26) CRD IV (see Sect. 5.2.1).

[136] EBA Regulation, Article 1(5), third sub-paragraph; this provision was adopted particularly with a view to systemically important financial institutions (see recitals (15)–(16)).

[137] Ibid., Article 8(2a).

[138] Ibid., Article 1(5), third sub-paragraph.

In addition (and equally important), it contributes to the "consistent application of legally binding Union acts". The implementation of this task is pursued by the following means: ensuring consistent, efficient and effective application of the relevant legislative acts, without prejudice to the Commission's powers pursuant to Article 258 TFEU for ensuring compliance of Member States with EU law; taking action in emergency situations, namely in case of adverse developments, which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the financial system; assisting the settlement of disputes between NCAs; ensuring a coherent functioning of colleges of supervisors; contributing to the creation of a "common supervisory culture" among NCAs; preventing financial institutions from resorting to "supervisory arbitrage", choosing to be established in the Member State with the relatively most favourable prudential supervisory regime; and ensuring the most efficient and consistent prudential supervision of financial institutions by NCA.[139]

The third task consists in its contribution to the following: consistent and coherent functioning of colleges of supervisors; monitoring, assessment and measurement of systemic risk;[140] and development and coordination of recovery and resolution plans, providing a high level of protection to depositors and investors throughout the EU, developing methods for the resolution of failing financial institutions and assessing the need for appropriate financing instruments.[141]

Fourth, it stimulates and facilitates the delegation of tasks and responsibilities among NCAs and conducts peer reviews thereof; in performing this task and with a view to strengthening the cohesion of supervisory results, it can issue Guidelines and Recommendations and develop best practices.[142]

Finally, it monitors and assesses market developments in the area of its competence, including (if appropriate) trends in credit, in particular, to

[139] These aspects are regulated in Articles 1(4), 18, 19–20, 21 and 29, respectively; on Article 258 TFEU, see Borchardt (2010) and Schwarze und Wunderlich (2019).

[140] The term 'systemic risk' is defined in Article 2, point (c), of the ESRB Regulation to mean a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy; all types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree.

[141] These aspects are governed, respectively, by Articles 21, 22–24 and 25–27 EBA Regulation.

[142] These aspects are governed by Articles 28 and 30.

households and SMEs; it cooperates closely with the ESRB, in particular by providing it with the necessary information for the achievement of its tasks, and by ensuring a proper follow-up to its warnings and Recommendations, and is responsible for the fulfilment of any other tasks set out in the Regulation or in other legislative acts, including its general coordination role between NCAs and its international relations.[143]

**EBA's Powers Under Article 8(2) EBA Regulation**

Extensive powers have been assigned to the EBA in order to carry out its above-mentioned tasks. These powers can be grouped as follows:

The first group covers the EBA's regulatory powers, which include the elaboration of draft regulatory technical standards and draft implementing technical standards, as well as the issuance of Guidelines and Recommendations.[144]

In addition, in the cases laid down in Articles 17–19 (breach of EU law, action in emergency situations and settlement of disagreements between NCAs in cross-border situations) of its statutory Regulation, the EBA has the right to substitute NCAs if the latter fail to comply with the Commission's formal opinions or EBA's decisions. In the author's opinion, this is the sole genuine EBA's supervisory task (albeit indirect), exercised without prejudice to the relevant Commission's powers under (the just above-mentioned) Article 258 TFEU. In this respect, the EBA has the power to issue Recommendations addressed to NCAs in the event of a breach of EU law, as well as take individual Decisions addressed either to NCAs when action is needed in emergency situations and in order to settle disputes ('binding mediation') between NCAs in cross-border situations or, in specific cases concerning directly applicable EU law, to financial institutions.[145]

Furthermore, the EBA has been given the power to issue Opinions addressed to the European Parliament, the Council or the Commission on all issues related to its area of competence, either upon a request from these institutions or on its own initiative.[146] In this respect, recital (45)

[143] These aspects are governed by Articles 31–33 and 36. Article 32(2) constitutes the basis for the organisation and coordination of Europe-wide "stress tests".

[144] Ibid., Article 8(2), points (a)–(c); these powers are discussed in detail in Appendix to this chapter.

[145] Ibid., Article 8(2), points (d)—(f), with reference to Articles 17(3) and (6), 18(3)–(4) and 19(3)–(4). On binding mediation, see Wymeersch (2012), pp. 266–271.

[146] Ibid., Article 8(2), point (g), with reference to Article 34.

refers to the EBA as an "independent advisory body to the European Parliament, the Council, and the Commission".

Finally, the EBA's powers also include the following: collection of the necessary information concerning financial institutions, development of common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of institutions and on consumer protection and provision of a centrally accessible database of registered financial institutions in the area of its competence, if specified in the legislative acts which constitute its scope of action.[147]

**Contribution to the Protection of Consumers of Financial Services**

The EBA's tasks include "promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market". In order to fulfil this task it collects, analyses and reports on consumer trends; reviews and coordinates financial literacy and education initiatives by the NCAs; develops training standards for the financial system; and contributes to the development of common disclosure rules.[148] In this respect, its obligations and powers are as follows:[149]

First, it must monitor new and existing financial activities and may issue Guidelines and Recommendations with a view to promote the safety and soundness of markets and convergence of regulatory practice.

Furthermore, it may issue warnings in the event that a financial activity poses a serious threat to its objectives.

Third, it must establish a "Committee on financial innovation", bringing together all relevant NCAs. The Committee must achieve a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and products (e.g. consumer or mortgage credit products) and provide advice for the EBA to present to the European Parliament, the Council and the Commission.

Finally, it may temporarily prohibit or restrict (by means of 'injunction' procedures) certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the EU: in the cases specified and under the conditions laid down in the relevant legislative acts, or if so required, in the case of emergency situations.[150] It may also assess the need to prohibit

[147] Ibid., Article 8(2), points (h) (with reference to Article 35) and (i)–(j).
[148] Ibid., Article 9(1).
[149] Ibid., Articles 9(2) and 9(5), respectively.
[150] This aspect is governed by Article 18.

or restrict certain types of financial activity and, where there is such a need, inform the Commission in order to facilitate the adoption of any such prohibition or restriction.

Consequently, the EBA does not only address the issue-area of protecting consumers' financial interests but also that of promoting their right to training (namely two of the three pillars of EU policy in the area of protecting consumers), according to Article 169 TFEU.[151]

*Integration Within the EU Institutional Framework*

**Introductory Remarks**

In light of the above-mentioned, the EBA has been endowed with a significant range of tasks and has a significant role to play, along with ESMA and EIOPA, notably in terms of creating an important subset of EU financial law and implementing its provisions in Member State's national legislation. Taking this into account, it was deemed necessary to lay down provisions ensuring its integration in the EU institutional framework, providing for the independence of the EBA, its bodies and their members, the EBA's obligation to accountability *vis-à-vis* EU institutions and other bodies and the judicial review of the EBA's Decisions. With a view to ensuring transparency of its operation, applicable to the EBA is also EU legislation on combating fraud, corruption and other illegal activities, privileges and immunities, processing of personal data and access to documents.[152]

**Independence**

(1) The institutional independence of the EBA is principally premised on the general clause of Article 1(5) (last sub-paragraph), which reads as follows: "When carrying out its tasks, the [EBA] must act independently and objectively and in the interest of the Union as a whole." This is an important element of its overall independence, notably in the context of performing its task of organising and conducting 'peer reviews' of NCAs and of its general coordinating role.[153] Specific provisions govern the institutional

[151] On this TFEU Article, see, by way of mere indication, Strumpf (2019).

[152] EBA Regulation, Articles 66–67 and 71–72; see also above in this chapter (Sects. 5.2 and 5.3) on the application of several of these legal acts also to the ECB within the SSM and the Board within the SRM.

[153] Ibid., Articles 30–31; on this, see Louis (2010), p. 155.

independence of the Chairperson and the voting members of the Board of Supervisors (without prejudice to the tasks conferred on the ECB by the SSMR), the members of the Management Board and the Board of Appeal, as well as the Executive Director.[154]

(2) The EBA's financial independence is also ensured, since the revenues of its 'autonomous' budget consist of obligatory contributions from the NCAs, any fees paid to it in the cases specified in EU law, but also of a subsidy from the EU (entered in the General Budget—Commission Section).[155]

(3) In relation to personal independence, the Chairperson may be removed from office only by the European Parliament, following a decision of the Board of Supervisors (which has appointed him/her), and the Executive Director upon a decision of the Board of Supervisors. In both cases, no specific criteria are defined for the European Parliament and Board of Supervisors, respectively, to take the relevant decisions. On the other hand, the members of the Board of Appeal may be removed from office upon decision of the Management Board only if found guilty of serious misconduct.[156]

(4) Finally, one can reasonably argue that the EBA's operational independence is also granted on the basis of the above-mentioned in relation to the tasks and powers granted to it in order to fulfil its objective.

**Accountability**

The EBA is accountable to the European Parliament and the Council. The only provision further qualifying this accountability requirement as to its implementation is that the Board of Supervisors must transmit the EBA's Annual Report to these institutions, as well as to the Commission, the Court of Auditors and the European Economic and Social Committee by 15 June each year and publish it.[157]

[154] Ibid., Articles 42, 46, 49, 52, as well as 59(6) and 59(1), respectively.

[155] Ibid., Article 62(1) and recital (59); for this purpose, the EBA is considered as a "European body" in accordance with Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 "on the financial rules applicable to the general budget of the EU" (OJ L 298, 26.10.2012, pp. 1–96). Articles 62(2)–(4) and 63–64 contain further rules on the structure, establishment, implementation and control of the budget.

[156] Ibid., Articles 48(2), 48(5), 51(5) and 58(5).

[157] Ibid., Articles 3, first sentence and 43(5); on the Court of Auditors, see Lienbacher (2019b), Craig and de Búrca (2015), pp. 66–67 and Kennedy (2018).

**Appeals—Judicial Review of the Decisions of the EBA**
Any natural or legal person, including the NCAs, can appeal before the Board of Appeals any EBA Decision referred to in Articles 17–19 or any other Decision which either is addressed or is of direct and individual concern to it. In addition, proceedings may be brought before the ECJ, in accordance with Article 263 TFEU, contesting a Decision taken by the Board of Appeal or, if there is no right of appeal, by the EBA. Such proceedings may be instituted by Member States, EU institutions and any natural or legal person. If the EBA is under an obligation to act but fails to make a Decision, proceedings for failure to act may be brought before the ECJ in accordance with Article 265 TFEU. In both cases, the EBA is required to take the necessary measures to comply with the ECJ judgment.[158]

### *5.4.2 The European Systemic Risk Board*

*Legal Status, Objective and Organs*
(1) As mentioned in Chap. 3 (Sect. 3.3.3), the second pillar of the ESFS is the ESRB, which was established by virtue of Regulation (EU) No 1092/2010 (ESRB Regulation).[159] The ESRB entered into operation (along with the ESAs) on 1 January 2011, has its seat in Frankfurt and, unlike the ESAs, it is not a 'Union body' nor does it have legal personality.[160]

(2) The ESRB's objective consists in the macro-prudential oversight of the European financial system in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU arising from developments within the financial system and taking into account macroeconomic developments, in order to avoid periods of widespread financial distress. It must also contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.[161]

[158] Ibid., Articles 60–61; on Articles 263 and 265 TFEU, see indicatively Borchardt (2010) and Schwarze und Voet van Vormizeele (2019b). On the role of judicial review as a mechanism of accountability, see Bell (2019), pp. 8–12.

[159] On this Regulation, see more details in Ferran and Alexander (2011), Papathanassiou and Zagouras (2012) and Schoenmaker (2012).

[160] ESRB Regulation, Article 1(1)–(2) and recital (15), last sentence.

[161] Ibid., Article 3(1).

(3) The General Board is the ESRB's 'strategic' management body, taking the decisions necessary to ensure the performance of the tasks entrusted to the ESRB. It is composed of the President and the Vice-President of the ECB, the Governors of the NCBs members of ESCB, a member of the Commission, the Chairpersons of the ESAs, the Chair and the two Vice-Chairs of the Advisory Scientific Committee, as well as the Chair of the Advisory Technical Committee. Furthermore, a representative of the NCA of each EU Member State and the Economic and Financial Committee (EFC) President are members without voting rights.[162]

The Steering Committee is the 'operational' management body; it assists in the decision-making process of the ESRB by preparing the General Board's meetings, reviewing the documents to be discussed and monitoring the progress of the ESRB's ongoing work. It is composed of the Chair and the Vice-Chair of the ESRB; five other members of the General Board who are also members of the ECB General Council (in order to keep a balanced representation of all EU Member States), a member of the EU Commission, the President of the EFC, the Chairpersons of the ESAs, as well as the Chairs of the Advisory Scientific and Technical Committees.[163] Other ESRB's organs are the Secretariat, which is ensured by the ECB and is responsible for the ESRB's daily business, providing support under the direction of the Chair and the Steering Committee in accordance with Regulation 1096/2010;[164] the Advisory Scientific Committee, which provides advice and assistance on issues relevant to the ESRB's work and is composed of the Chair of the Advisory Technical Committee and fifteen experts representing a wide range of skills and experiences, approved by the General Board for a four-year, renewable mandate;[165] and the Advisory Technical Committee, which also provides advice and assistance on these issues and is composed of representatives of the institutions and bodies represented in the General Board and one representative per Member State of the NCAs.[166]

[162] Ibid., Articles 4(2) and 6(1)-(2); Articles 7–10 govern further aspects of the General Board.

[163] Ibid., Articles 4(3) and 11(1), first sub-paragraph; Article 11(2) governs its meetings.

[164] Ibid., Article 4(4); on the Secretariat and the specific task conferred upon the ECB to ensure it, see Chap. 9, Sect. 9.1.

[165] Ibid., Articles 4(5) and 12(1), first sentence; Article 12(2)–(6) governs further aspects.

[166] Ibid., Articles 4(5) and 13(1), first sub-paragraph; Article 13(2)–(5) governs further aspects.

(4) The ESRB is chaired by the President of the ECB, who presides at the General Board's and Steering Committee's meetings and represents the ESRB externally. The ESRB has also two Vice-Chairs, the first elected by and from the members of the ECB General Council (again in order to keep a balanced representation of all EU Member States) and the second being *ex officio* the Chair of the ESAs' Joint Committee.[167]

*Tasks and Powers*

(1) In order to fulfil its above-mentioned objective, the ESRB carries out, *inter alia*, the following tasks: first, determination and/or collection and analysis of all relevant and necessary information; second, identification and prioritisation of systemic risks; furthermore, issuance of warnings, where systemic risks are deemed to be significant, and of Recommendations for remedial action in response to the risks identified and monitoring the follow-up to those; in addition, close cooperation with the other parties to the ESFS and, in particular, in collaboration with the ESAs, development of a common set of quantitative and qualitative indicators for the identification and measurement of systemic risk; and finally, coordination of its actions with those of international financial organisations and fora, particularly the IMF and the FSB, as well as the relevant bodies in third countries on matters related to macro-prudential oversight.[168]

(2) In particular, the ESRB's task to issue warnings and Recommendations relates to remedial action in response to identified significant risks, which can be of either a general or a specific nature and are addressed to the EU as a whole, to one or more EU Member States, to one or more ESAs or to one or more NCAs. Recommendations may also be addressed to the Commission in respect of the relevant EU legislation. If a Recommendation is addressed to the Commission, to one or more Member States, to one or more ESAs or to one or more NCAs, the addressees must communicate to the ESRB and to the Council the actions undertaken in response to it and provide adequate justification for any inaction ('act or explain'). If the addressees do not follow the Recommendation or fail to provide adequate justification for their inaction, the ESRB must, subject to strict rules of

[167] Ibid., Article 5. In Article 5(1), it is provided that the ECB President would chair the Board for a term of five years and, for the subsequent terms, the Chair of the ESRB would be designated in accordance with the modalities determined on the basis of the review provided for in Article 20. Nevertheless, the ECB President still is the Chair.

[168] Ibid., Article 3(2).

confidentiality, inform them, along with the Council and, if relevant, the ESA concerned. The ESRB decides whether a warning or a Recommendation should be made public on a case-by-case basis and after having consulted the Council. The addressees must be informed in advance and have the right of making public their views and reasoning in response.[169]

### *5.4.3 In Particular: The SSM as Part of the ESFS*

On the basis of the SSMR and Regulation (EU) No 1022/2013, amending the EBA Regulation, the ECB has become part of the ESFS also with regard to the tasks conferred on it by the SSMR.[170] In this respect, the following cooperation principles have been established:[171]

First, the ECB is called upon to cooperate closely with the ESAs, the ESRB and the other authorities forming part of the ESFS, which ensure an adequate level of regulation and supervision in the EU, that is the NCAs, as specified in the EU legal acts referred to in Article 1(2) EBA Regulation.[172]

Second, if necessary, it must enter into MoUs with Member States' NCAs responsible for markets in financial instruments.[173] The Regulation does not specify any criteria on the basis of which to assess this necessity; nevertheless, from the phrasing of the relevant provision it can be concluded that it is up to the ECB to take the initiative. For the sake of accountability and transparency, such MoUs must be made available to the European Parliament, the Council and the NCAs of all Member States.

Furthermore, for the purposes of the SSMR and as already mentioned, the ECB participates in the EBA's Board of Supervisors by one representative nominated by the ECB Supervisory Board (not necessarily a member of this Board or a person employed by the ECB), which is a non-voting

[169] Ibid., Articles 16(1)–(2), 17(1)–(2) and 18(1)–(3).

[170] EBA Regulation, Article 2(2), point (f), as amended by Article 1, point (2), of Regulation (EU) No 1022/2013. On this legal act, see Schammo (2014), Wymeersch (2014), pp. 66–72 and Gortsos (2016b). Wymeersch (2014, p. 68) correctly remarks that in order to meet its enhanced tasks the EBA will have to be endowed with additional human and financial resources.

[171] SSMR, Article 3, on the basis of the considerations in recitals (31) and (33).

[172] EBA Regulation, Article 2(2), (new) point (f).

[173] These are designated in accordance with Article 67 MIFID II and are also part of the ESFS.

member.[174] In this respect, however, the ECB representative's position is subordinated to that of the NCAs—members of the EBA's Board of Supervisors. As Wymeersch (2014) correctly points out: "(…) So will the ECB [be] represented on the Board of Supervisors of the EBA, but without a vote, there where all national supervisors—including those of non-participating states—still have a vote".[175] This representative may exceptionally, like the EBA's Chairperson and Executive Director, attend discussions relating to individual financial institutions. In discussions not relating to such institutions, the ECB representative may be accompanied by a representative of the ECB (again not necessarily a person employed by the ECB) with expertise on central banking tasks.[176] The opposite, however, does not apply; the EBA is not represented in the ECB's Supervisory Board, not even under observer status.

Finally, the ECB must carry out its tasks under the SSMR without prejudice to the competence and the tasks of the ESAs and the ESRB. In particular, it is not permitted to take on the EBA's tasks (nor the tasks of the other ESFS components).

## Appendix: The Role of the EBA in the Making of European Banking (and, in General, Financial) Law

### *The TFEU Provisions: Legal and Soft Law Instruments*

(1) As also discussed in Chap. 1 (Section 1.2.1), according to the hierarchy of norms instituted by the Lisbon Treaty, the Treaties constitute the first tier, along with the 2000 Charter, which, according to the TEU, has the same legal value as the EU Treaties themselves.[177] The second tier encompasses the 'general principles of law', which can be used for the interpretation of Treaties' Articles. Regulations, Directives and Decisions may take the form of 'legislative acts', as defined in Article 289, 'delegated

[174] EBA Regulation, Article 40(1), (amended) point (d); see also Sect. 5.4.1.

[175] See Wymeersch (2014), p. 67.

[176] EBA Regulation, (amended) Article 44(4). Article 13o(1)–(2) of the Rules of Procedure of the ECB clarifies that the ECB representative is appointed (and revoked) by the ECB President on a proposal by the Supervisory Board and that the above-mentioned accompanying representative is nominated by the ECB President; on these Rules of Procedure, see Chap. 6, Sect. 6.1.1.

[177] TEU, Article 6(1), first sub-paragraph; see Craig and de Búrca (2015), pp. 110–111.

acts', as defined in Article 290, and 'implementing acts', as defined in Article 291. These acts are the third tier in the hierarchy of norms.

The legal acts which constitute the sources of EU banking (and, in general, EU financial) law are adopted pursuant to the TFEU, which provides for 'legal instruments' and 'soft law (non-legal) instruments'.[178] In particular, Article 288 (first sentence) TFEU stipulates that "to exercise the Union's competences the institutions shall adopt regulations, directives, decisions, recommendations and opinions". The legal nature of these legal instruments is as follows:[179] Regulations, Directives and Decisions are the main legal instruments: Regulations have general application, are binding in their entirety and directly applicable in all Member States; Directives are binding, as to the result to be achieved, upon each Member State to which they are addressed, but leave to the national authorities the choice of form and methods; and Decisions are binding in their entirety and if they specify those to whom they are addressed, they are binding only on them. Recommendations, as defined in Article 292[180] and Opinions, are soft law instruments and have no binding force.

(2) The legal acts, which constitute the sources of EU banking law (with the exception of those of the ECB), are adopted at three levels according to the terminology of the 'Lamfalussy process', which is still in use, and at the first two levels in accordance with the above TFEU Articles:[181]

'Level 1': at this level, legislative acts are adopted under Article 289 TFEU in the form of Regulations and Directives either (most commonly) by the European Parliament and the Council according to the 'ordinary legislative procedure', or by the Council under the 'special legislative procedure'.

[178] On the definition and content of European soft law, see MacCormick (1989) and Trubek, Cottrell and Nance (2005). On the definition of soft law in international law in general see, indicatively, Boyle and Chinkin (2007), pp. 211–229.

[179] TFEU, Article 288, second-fifth sentences; see Craig and de Búrca (2015), pp. 106–110.

[180] Recommendations are adopted by the Council either on a proposal of the Commission in all cases where the Treaties provide that it shall adopt acts on such a proposal, or unanimously when this is required for the adoption of an EU act. They may also be adopted by the Commission and the ECB in the specific cases stipulated in the Treaties (TFEU, Article 292).

[181] On the ECB's regulatory powers, see Chap. 6, Sect. 6.3.1. The following analysis also applies, *mutatis mutandis*, to EU capital markets and insurance law with the involvement of the ESMA and the EIOPA, respectively.

'Level 2': at this level, the Commission may be empowered by virtue of a 'Level 1' legislative act to adopt delegated acts and implementing acts, in accordance with Articles 290–291 TFEU, respectively, usually adopted on the basis of draft regulatory and implementing technical standards developed by the EBA.

'Level 3': finally, at this level, the EBA adopts Recommendations and Guidelines.

This legislative process enables the adoption of rules by EU institutions with the active involvement of supervisory authorities, through the EBA, which *de facto* has a definitely superior technical knowledge of the subject matters.[182]

### *Legislative Acts (Article 289 TFEU)*

Legislative acts, as defined in Article 289(3) TFEU, mean the legal acts adopted in accordance with either the 'ordinary legislative procedure', or the 'special legislative procedure'; as a rule, they are adopted upon a Commission's proposal, as stipulated in Article 17(2) TEU.[183] According to Article 289(1) TFEU, the ordinary legislative procedure consists in the adoption by the European Parliament and the Council of a Regulation, Directive or Decision on a proposal from the Commission, according to Article 294 TFEU. The practice of EU institutions to mainly issue Directives, rather than Regulations is founded on Protocol (No 2) "on the application of the principles of subsidiarity and proportionality", annexed to the Treaties.[184] This approach prevailed due to Member State pressures to preserve the principle of subsidiarity and use the form of legal acts (namely Directives) which would provide them with the greatest possible flexibility when transposing EU law provisions into national legislation. Article 289(2) TFEU provides that the special legislative procedure con-

[182] The table at the end of the Appendix summarises the law-making procedure with regard to the legal acts which constitute the sources of the three main branches of EU financial law (banking, capital markets and insurance law).

[183] By way of exception, Article 289(4) TFEU lays down a *lex specialis*, according to which, in the specific cases provided for by the Treaties, such acts may be adopted on the initiative of a group of Member States or of the European Parliament, on a recommendation from the ECB or at the request of the ECJ or the EIB.

[184] OJ C 202, 7.6.2016, pp. 206–209; on these two principles, see Craig and de Búrca (2015), pp. 96–102.

sists in the adoption of Regulations, Directives or Decisions either by the European Parliament with the participation of the Council, or by the latter with the participation of the former.[185]

### *Delegated Acts (Article 290 TFEU) and 'Regulatory Technical Standards'*

(1) The second category of legal acts under the TFEU comprises the delegated acts.[186] These are acts of general application,[187] adopted by the Commission, if the following conditions are met: the power to adopt such acts is delegated to the Commission by means of a legislative act, and they supplement or amend certain 'non-essential' elements of a given legislative act. Accordingly, a legislative act may delegate to the Commission the power to adopt such acts, including *ex ante* and *ex post* restrictions on this delegation without following the 'comitology procedure'.[188] In this context, the legislative acts, on the basis of which the power is delegated to the Commission to adopt delegated acts, must contain the objectives, content, scope and duration of the delegation of power; the essential elements of an area are reserved for the legislative act and accordingly are not the subject of a delegation of power. They must also explicitly lay down the conditions to which the delegation is subject; these conditions may be either the ability of the European Parliament or the Council to decide to revoke the delegation or the provision that the delegated act may enter into force only if no objection has been expressed by the European Parliament or the Council within a period set by the legislative act.[189]

(2) Particularly as regards the provisions of EU financial law, in Declaration 39 concerning provisions of the Treaties,[190] the Commission states its intention "to continue to consult experts appointed by the Member States in the preparation of draft delegated acts in the financial services area, in accordance with its established practice". According to

[185] On these procedures, see Craig (2010), pp. 252–253, Craig and de Búrca (2015), pp. 126–133 and Schoo (2019), pp. 3029–3034.

[186] TFEU, Article 290(3); Article 290 TFEU is analysed in Craig (2010), pp. 57–64 and 253–254, Craig and de Búrca (2015), pp. 114–116 and Schoo (2019), pp. 3034–3042.

[187] Ibid., Article 290(1), first sentence.

[188] On the comitology procedure (before the entry into force of the TFEU), see Blumann (1988), Bradley (1992) and Savino (2005).

[189] TFEU, Articles 290(1), second sentence and 290(2), first sentence.

[190] OJ C 326, 26.10.2012, p. 350.

Article 10 EBA Regulation, the European Parliament and the Council are entitled to delegate powers to the Commission to adopt regulatory technical standards (the 'RTSs') by means of delegated acts, as defined in Article 290 TFEU.[191] In such a case, the EBA must define the content of its draft RTSs on the basis of the restrictions set out in Article 290 TFEU, as further qualified in Article 10 EBA Regulation. These standards, technical in nature, do not imply strategic decisions or policy choices; their content is delimited by the legislative acts on which they are based.[192]

### *Implementing Acts (Article 291 TFEU) and 'Implementing Technical Standards'*

(1) According to Article 291(1) TFEU, Member States have to adopt "all measures of national law necessary to implement legally binding Union acts". If it is deemed that uniform conditions for the implementation of legally binding acts are needed, the Commission or, in "duly justified specific cases" and in the cases provided for in Articles 24 and 26 TEU,[193] the Council are entitled to issue implementing acts, based on 'implementing powers' conferred on them by means of the above legally binding acts.[194] For these purposes, the European Parliament and the Council, deciding by means of a Regulation in accordance with the ordinary legislative procedure, should lay down in advance the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers.[195] This is the legal basis for the 'comitology procedure', which applies only under

[191] In this respect, recital (22) EBA Regulation states: "There is a need to introduce an effective instrument to establish harmonised regulatory technical standards in financial services to ensure, also through a single rulebook, a level playing field and adequate protection of depositors, investors and consumers across the Union. As a body with highly specialised expertise, it is efficient and appropriate to entrust the Authority, in areas defined by Union law, with the elaboration of draft regulatory technical standards, which do not involve policy choices."

[192] See EBA Regulation, Article 10(1), second sub-paragraph; Articles 11–14 contain further detailed provisions; see, on this, Gortsos (2011), pp. 34-35 and Wymeersch (2012), pp. 249–254.

[193] Both these Articles refer to the common EU foreign and security policy.

[194] TFEU, Article 291(2) and (4).

[195] Ibid., Article 291(3). On Article 291 TFEU, see Craig (2010), pp. 64–66 and 254–255, Craig and de Búrca (2015), pp. 116–120 and Schoo (2019), pp. 3042–3046.

Article 291 TFEU for the adoption of implementing acts in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 "laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers".[196]

(2) At this level, the EBA develops draft implementing technical standards (the 'ITSs') according to Article 15 of its statutory Regulation, which are submitted to the Commission for adoption by means of implementing acts. These standards, similarly to regulatory technical standards, are technical in nature, do not imply strategic decisions or policy choices and their content is to determine the conditions of application of the legislative acts on which they are based.[197] They have been broadly used to provide for common templates and instructions, mainly for reporting purposes.[198]

### *Guidelines and Recommendations*

(1) The EBA has the power to issue Guidelines and Recommendations in areas not governed by regulatory or implementing technical standards. Their objectives are to establish consistent, efficient and effective supervisory practices within the ESFS, and to ensure the common, uniform and consistent application of EU law[199] and their addressees either competent authorities or financial institutions.[200] Forming part of European 'soft' law, they do not have a legally binding character,[201] but competent authorities and financial institutions must make every effort to comply with the

[196] OJ L 55, 28.2.2011, pp. 13–20; on this legal act and this procedure, see Gortsos (2016a).

[197] See indicatively EBA Regulation, Article 15(1), first sub-paragraph, second sentence.

[198] On Article 15 EBA Regulation, see Wymeersch (2012), pp. 254–255.

[199] Ibid., Article 16(1).

[200] In relation to the convergence of national supervisory practices, the EBA also publishes a Report (on the basis of its founding Regulation and Article 107(2) CRD IV); the most recent Report of 14 March 2019 is available at: https://eba.europa.eu/documents/10180/2551996/Report+on+Convergence+of+Supervisory+Practices.pdf.

[201] On this matter, see the Grimaldi case of the CJEC (C-322/88, ECR (1989), p. 4407 et seq.), especially the paragraph on the degree to which recommendations of European bodies are binding for national courts, which can apply *pro rata* to all acts of European soft law, and the 2007 Report of the European Parliament "on institutional and legal implications of the use of 'soft law' instruments" (A6-0259/2007, final, 28.6.2007).

**Table 5.5** Procedure for the adoption of legal acts which constitute the sources of European financial law after the entry into operation of the ESFS[a]

| | *Level 1[a]: legally binding acts* | *Level 2[a]: legally binding acts* | | *Level 3[a]: non-legally binding acts (soft law)* |
|---|---|---|---|---|
| *Type of legal act* | *Legislative acts falling within the Authorities' scope of action (Article 289 TFEU)* | *Regulatory technical standards by means of delegated acts (Article 290 TFEU)* | *Implementing technical standards by means of implementing acts (Article 291 TFEU)* | *Guidelines and recommendations (Regulations establishing the Authorities)* |
| Body issuing the legal act | European Parliament and Council (with the ordinary legislative procedure) | European Commission | European Commission | EBA/ESMA/ EIOPA(according to the scope of action) |
| Assistance with the issuance of a legal act | EBC/ESC/EIOPC[b] (as advisory committees) EBA/ESMA/EIOPA (as opinion-giving bodies) | EBA/ESMA/EIOPA (elaborating draft regulatory technical standards) | EBA/ESMA/EIOPA (elaborating draft implementing technical standards) EBC/ESC/EIOPC (as regulatory committees)[c] | |

Note: The ECB has to be consulted on any proposed EU legal act according to Article 127(4) TFEU

[a]Reference to these "three levels" depicts the wording that was used (without any explicit legal basis) in the Lamfalussy Report
[b]European Banking Committee, European Securities Committee, European Insurance and Occupational Pensions Committee
[c]According to the comitology procedure (Regulation (EU) No 182/2011)

provisions of these Guidelines and Recommendations on the basis of the 'comply or explain' principle.[202]

(2) In this respect, within two months of a Guideline's or Recommendation's issuance, each competent authority must confirm whether it intends to comply with that guideline or recommendation. If it does not or does not intend to comply, it must inform the EBA, stating its reasons; in that case, the EBA must publish the fact (giving the competent authority early notice of this) and may also decide, on a case-by-case basis, to publish the reasons provided by the competent authority for not complying with a particular guideline or recommendation.

Furthermore, the EBA must inform in its Annual Report the European Parliament, the Council and the Commission of the Guidelines and Recommendations issued, explicitly stating which competent authority has not complied with them and outlining how it intends to ensure its compliance in future. Finally, if required by a given Guideline or Recommendation, financial institutions must also report, in a clear and detailed way, whether they comply with (Table 5.5).[203]

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[202] EBA Regulation, Article 16(3), first sub-paragraph; on the 'comply or explain' principle, which is broadly used in the field of corporate governance codes stemming from self-regulation and in Commission's Recommendations, see Bianchi et al. (2010), Andersson (2011), pp. 91–105, and Keay (2012).

[203] Ibid., Articles 16(3), second sub-paragraph and 16(4); on EBA Guidelines and Recommendations, see Wymeersch (2012), pp. 276–277.

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CHAPTER 6

# Institutional Aspects of the European Central Bank

## 6.1 General Overview

### *6.1.1 Introductory Remarks*

(1) As mentioned in Chap. 2 (Sect. 2.3.2), the European Central Bank (ECB) was institutionalised only by means of the Treaty of Lisbon,[1] since under the previous regime, the ECB was not included among the Community institutions listed in Article 7(1) Treaty Establishing the European Community (TEC). The Treaty on the Functioning of the European Union (TFEU) as well as the European System of Central Banks (ESCB)/ECB Statute and secondary law [including since 2014 the Single Supervisory Mechanism Regulation (SSMR) and the Single Supervisory Mechanism (SSM) Framework Regulation] contain provisions with respect to the legal nature and various aspects of the ECB's operation, governing the following: the legal personality, the seat, as well as the privileges and immunities of the ECB (see Sect. 6.1.2); its decision-making and other internal bodies; its regulatory and sanctioning powers; its independence, accountability and transparency; as well as its "communication" with other European Union (EU) institutions, the judicial control of its acts and omissions, and its liability (see Sects. 6.2–6.5, respectively).

[1] TEU, Article 13(1), second sub-paragraph, sixth point.

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(2) Furthermore, the Rules of Procedure of the ECB[2] (hereinafter the 'ECB Rules of Procedure') govern, *inter alia*, the internal organisation of the ECB, which consists of the Eurosystem/ESCB Committees, *ad hoc* committees established by the Governing Council (GC), the Audit Committee, the internal structure and the ECB staff[3]; they also govern its internal structure with regard to its specific supervisory tasks and the employment conditions for its staff.[4] In relation to its specific tasks, these Rules of Procedure are complemented by the Rules of Procedure of the Supervisory Board.[5]

### *6.1.2 Legal Personality—Seat—Privileges and Immunities*

The ECB has legal personality, enjoying in each Member State the most extensive legal capacity accorded to legal persons under national law, including the capacity to acquire or dispose of movable or immovable property and legal standing.[6] The German city of Frankfurt am Main was determined as its seat on 29 October 1993, by a Joint Decision of the Member States' governments at the level of Heads of State or Government.[7] Within this context, on 18 September 1998, a 'Headquarters Agreement' was also signed between the ECB and the German government with respect to the ECB's seat.[8] The ECB enjoys in the territories of the Member States such privileges and immunities as required for the performance of its tasks.[9] Their terms are defined in Protocol (No 7) "on the privileges and immunities of the European Union",[10] which applies to the ECB, the members of its bodies and its staff.[11]

[2] These are included in ECB Decision of 19 February 2004 (ECB/2004/2) (OJ L 80, 18.3.2004, pp. 33–41), as in force, and were adopted on the basis of Article 12.3 ESCB/ECB Statute. The most recent unofficial consolidated version, of September 2016, is available at: https://www.ecb.europa.eu/ecb/legal/1001/1009/html/index.en.html.

[3] ECB Rules of Procedure, Articles 9, 9a, 9b, 10 and 11, respectively.

[4] Ibid., Articles 13m and 21, respectively.

[5] These are included in ECB Decision 2014/179/EU of 22 January 2014 (OJ L 95, 29.3.2014, pp. 56–63) and were adopted on the basis of Articles 25(2) and 26(12) SSMR. The most recent unofficial consolidated version, of December 2014, is available at: https://www.bankingsupervision.europa.eu/legalframework/ecblegal/framework/html/index.en.html.

[6] TFEU, Article 282(3), first sentence and ESCB/ECB Statute, Article 9.1.

[7] This decision was taken on the basis of Article 37 ESCB/ECB Statute, which, as already discussed in Chap. 2, was repealed by the Treaty of Lisbon.

[8] Available at: https://www.ecb.europa.eu/ecb/legal/pdf/en_headquarters_agreement_final.pdf.

[9] TFEU, Article 343, second sentence and ESCB/ECB Statute, Article 39.

[10] OJ C 202 (Consolidated version), 7.6.2016, pp. 266–272.

[11] Protocol (No 7), Article 22.

## 6.2 The Bodies of the ECB

### *6.2.1 The Decision-Making Bodies*

*Introductory Remarks*

For the fulfilment of the tasks conferred upon it by the TFEU, the ESCB is governed by two permanent ECB decision-making bodies: the GC and the Executive Board.[12] In addition, for as long as there are Member States with a derogation, the General Council has been constituted as the third ECB decision-making body.[13] Their composition and competences, the organisation of their meetings and the decision-making processes are governed by the TFEU and the ESCB/ECB Statute; applicable are also the (above-mentioned) ECB Rules of Procedure, as well as the Rules of Procedure of the Executive Board[14] and of the General Council.[15]

*The Governing Council*

(1) The GC is the supreme ECB body and comprises the six members of the Executive Board and the Governors of the national central banks (NCBs) of the Member States whose currency is the euro.[16] Taking into account the fact that the euro area is currently participated in by 19 Member States, NCB Governors participate as a majority in the GC (in personam and not as representatives of their NCBs).

(2) The GC is responsible for the adoption of the Guidelines and for taking the Decisions necessary in order to ensure the performance of the tasks entrusted to the ESCB under the Treaties and the ESCB/ECB Statute. In particular, it must formulate the single monetary policy including, as appropriate, Decisions relating to intermediate monetary objectives,

[12] TFEU, Articles 129(1) and 282(2), first sentence and ESCB/ECB Statute, Article 8.

[13] TFEU, Article 141(1) and ESCB/ECB Statute, Article 44.1.

[14] These are included in ECB Decision of 12 October 1999 (ECB/1999/7) (OJ L 314, 8.12.1999, pp. 34–35), were adopted on the basis of Articles 8 and 24 of the ECB Rules of Procedure and supplement its provisions.

[15] These are included in ECB Decision of 17 June 2004 (ECB/2004/12) (OJ L 230, 30.6.2004, pp. 61–63) and were adopted on the basis of Article 46(4) ESCB/ECB Statute. For an overview of these bodies, see also Smits (1997), pp. 95–102, Louis (2009), pp. 177–190 and Zilioli and Athanassiou (2018), pp. 619–621.

[16] TFEU, Article 283(1) and ESCB/ECB Statute, Article 10.1. The Governors of the NCBs of the Member States with a derogation do not participate in the meetings of the GC (ESCB/ECB Statute, Article 42.4–42.6, with reference to Articles 10.1 and 10.3).

key interest rates and the supply of reserves in the ESCB and establish the necessary Guidelines for their implementation. In addition, it exercises the advisory functions referred to Article 4 ESCB/ECB Statute[17] and takes the Decisions on the international cooperation in accordance with Article 6.[18]

*The Executive Board*

(1) The Executive Board comprises six members: the President (who is concurrently the GC's President), the Vice-President and four other members. All members must be persons of recognised standing and professional experience in monetary or banking matters. The decision on their appointment is taken by the European Council, acting by a qualified majority, on a recommendation from the Council, after having consulted the European Parliament and the GC. They must be nationals of Member States whose currency is the euro and exercise their duties on a full-time basis; their term of office is eight years and not renewable.[19]

(2) The Executive Board's main responsibility is the implementation of the single monetary policy on the basis of the GC's Guidelines and Decisions, giving the necessary instructions to NCBs. It is also responsible for exercising the powers delegated to it by the GC, preparing the latter's meetings and managing the current ECB business.[20]

[17] See, on this, Sect. 6.3.1, when discussing ECB Opinions.

[18] ESCB/ECB Statute, Articles 12.1, first sub-paragraph and 12.4–12.5. The ECB Rules of Procedure contain additional specific provisions on the body's meetings, including the rotation scheme of voting rights in the GC. Under this, as from the date on which the number of GC members exceeds 21, i.e. the number of NCB Governors with voting rights exceeds 15, the principle of equal voting rights will cease to apply, given that the six Executive Board members will retain their permanent right to one vote each, but the number of Governors with a voting right will be 15 (on the basis of a rotation scheme. However, the GC may decide with a majority of two-thirds of the members having a voting right to postpone the start of the rotation system until the number of NCB Governors exceeds 18. This system entered recently into force, on 1 January 2015, following the admission into the GC a 19th Governor-member, the Governor of the Central Bank of Lithuania. The implementation of this rotation scheme is further diversified if the number of Governors members exceeds 22. On Article 6 ESCB/ECB Statute, see details in Smits (1997), pp. 420–428.

[19] TFEU, Article 283(2) and ESCB/ECB Statute, Articles 11.1–11.2; the President and the Vice-President are appointed in positionem and are not elected in these positions by the GC or the Executive Board.

[20] ESCB/ECB Statute, Articles 12.1, second sub-paragraph, 12.2 and 11.6. Its meetings are governed by the ECB's Rules of Procedure (Articles 6–8) and its own, on a subsidiary basis.

*The General Council*

Since the NCBs of the Member States with a derogation are not represented in the (above-mentioned) permanent ECB bodies, the General Council was established as a transitional decision-making body, comprising the ECB President and Vice-President, as well as the Governors of the NCBs of all Member States; the other four members of the Executive Board may be present in the body's meetings, albeit with no voting rights.[21] Its (limited) responsibilities are listed in Article 46 ESCB/ECB Statute.

### 6.2.2 The Internal Bodies Established by the SSMR

*The Supervisory Board*

(1) The 'planning and execution of the tasks' conferred upon the ECB by the SSMR are undertaken by an internal body, the Supervisory Board, which is not an ECB decision-making body, like the GC and the Executive Board.[22]

It is composed of its Chair and Vice-Chair, appointed by the Council in accordance with a specific procedure, four representatives of the ECB, appointed by the GC, and one national competent authority (NCA) representative in each participating Member State. All members must act in the interest of the EU. The ECB representatives have voting rights and are not allowed to perform duties directly related to the ECB's monetary function of the ECB.[23]

For the sake of personal independence, the Chair may be removed from office, also by the Council, only if he/she no longer fulfils the conditions required for the performance of his/her duties, or has been guilty of serious misconduct. The Vice-Chair may be removed from office if he/she retires compulsorily as a member of the Executive Board (in accordance with Article 11.4 ESCB/ECB Statute), the material conditions being the same as those for the removal of the Chair.[24]

[21] Ibid., Article 44.2. The responsibilities of the General Council are laid down in Article 46 ESCB/ECB Statute and further specified in Articles 6–8 of its Rules of Procedure.

[22] Even if this were envisaged, it would have required an amendment to Article 282(2) TFEU, which, given the tight schedule for the adoption of the SSMR, was unrealistic.

[23] SSMR, Articles 26(1), first sub-paragraph and 26(5). The Chair and the Vice-Chair are appointed by the Council in accordance with the procedure laid down in Article 26(3) SSMR. The Supervisory Board establishes from among its members a Steering Committee in order to prepare its meetings, which, nevertheless, has no decision-making powers (ibid., 26(10)).

[24] Ibid., Article 26(4) first and second sub-paragraphs.

(1) Without prejudice to Article 6 SSMR,[25] the duties of the Supervisory Board consist in carrying out preparatory works regarding the supervisory tasks conferred upon the ECB, and proposing to the GC complete draft Decisions for adoption.[26] The GC has the power either to adopt a draft Decision or to object to it; such a Decision is deemed to be adopted, unless the GC objects within a period which may not exceed ten working days (the 'no-objection procedure'). If the GC objects to a draft Decision (e.g. by asking for amendments), its Decision must be in writing and reasoned, stating in particular monetary policy concerns.

If a non-euro area participating Member State disagrees with a draft Decision of the Supervisory Board, the procedure set out in Article 7(8) SSMR applies, which may lead in extremis to the Member State concerned requesting the ECB to terminate the close cooperation. On the other hand, if a Decision is amended following an objection by the GC, a non-euro area participating Member State (which is not represented in the GC) may notify the ECB of its reasoned disagreement with the objection. In such a case, it is the procedure set out in Article 7(7) that applies, also having the potential in extremis to lead to the suspension or termination of the close cooperation, upon an ECB initiative this time.[27]

*The Administrative Board of Review*

(1) The Administrative Board of Review (the 'ABoR') was established for the purposes of carrying out an internal administrative review of the Decisions taken by the ECB in the exercise of its powers under the SSMR after a request for review; its operating rules are laid down in the ECB Decision 2014/360/EU of 14 April 2014,[28] which supplements the ECB Rules of Procedure. The scope of this review pertains to the 'procedural and substantive conformity' of such ECB Decisions with the SSMR; in particular, any natural or legal person may request a review of such a Decision if it is either addressed or is of direct and individual concern to them. The ABoR must adopt an opinion on the review, which is not binding either on the Supervisory Board or on the GC, proposing whether the initial Decision should be abrogated, replaced with a Decision of identical content, or replaced with an amended one.[29]

[25] This Article is presented in detail in Chap. 8, Sect. 8.2.

[26] On ECB supervisory Decisions, see Sect. 6.3.1.

[27] SSMR, Article 26(8).

[28] OJ L 175, 14.6.2014, pp. 47–53; this was adopted on the basis of Article 24(10).

[29] SSMR, Articles 24(1), 24(5), first sentence and 24(7), first sentence and Decision 2014/360/EU, Articles 4(1)–(3), 7(1), 16(1)–(2) and 16(5).

(2) The ABoR is composed of five members (and two alternates to replace them) appointed by the GC. These persons must be of high repute, be nationals of Member States and have a proven record of relevant knowledge and professional experience, including supervisory experience, to a sufficiently high level in the fields of banking or other financial services. Their term of office is five years, which may be extended once, are not bound by any instructions and must act independently, in the public interest.[30]

*The Mediation Panel*

(1) As mentioned in Chap. 5 (Sect. 5.2.4), Article 25 SSMR established the principle of separation of monetary policy and specific supervisory tasks of the ECB. In this respect, when carrying out its specific tasks conferred under the SSMR, the ECB must pursue exclusively the objectives set therein and carry them out 'separately' from both its tasks relating to the definition and implementation of the single monetary policy and its other tasks. It must also ensure that the operation of the GC is completely differentiated as regards monetary and supervisory functions, including strictly separated meetings and agendas.[31]

(2) In order to comply with the above, the ECB adopted Decision ECB/2014/39 of 17 September 2014,[32] which governs the organisational separation, professional secrecy, access to information between policy functions and classification, and the exchange of confidential information. It also established a 'Mediation Panel', whose task is the resolution of differences of views on the part of interested participating Member States' NCAs, regarding an objection of the GC to a draft Decision by the Supervisory Board.[33] This is composed of one member per participating Member State, chosen by each of the members of the GC and the Supervisory Board. Regulation ECB/2014/26 of 2 June 2014[34] governs membership and internal organisation of this body, as well as the mediation procedure.[35]

[30] SSMR, Articles 24(2) and 24(4), first sentence; on the ABOR, see Gortsos (2015), pp. 255–262 and Brescia Morra et al. (2017).

[31] SSMR, Articles 25(1)–(2) and 25(4); see also ECB Rules of Procedure, Article 13k. The latter aspect is reinforced by the above-mentioned provision of Article 26(5).

[32] OJ L 300, 18.10.2014, pp. 57–62.

[33] SSMR, Article 25(5).

[34] OJ L 179, 19.6.2014, pp. 72–76; this was adopted on the basis of Article 25(3).

[35] For an analysis of Article 25 and the related ECB Decisions, see Gortsos (2016) and D'Ambrosio (2019), pp. 158–160.

## 6.3 Regulatory and Sanctioning Powers

### 6.3.1 Regulatory Powers

*Powers Under the TFEU and the ESCB/ECB Statute*

**Categories of ECB Legal Instruments**

For the accomplishment of the duties conferred upon the ESCB, but also in the context of participation of the ECB in the general law-making procedure, the latter has been granted autonomous regulatory (normative) powers. More specifically, the ECB bodies are competent to issue four categories of legal instruments: Regulations, Decisions, Recommendations and Opinions.[36] As a consequence, the ECB has, in principle, the competence to adopt all types of legal instruments, except Directives, which the (other) EU institutions issue by virtue of Article 288 TFEU. Furthermore, with the objective of assuring the efficient operation of the Eurosystem, the Statute confers on the ECB the power to issue Guidelines, Instructions and internal Decisions; these are internal Eurosystem legal instruments exclusively addressed to and legally binding for the NCBs of the Member States whose currency is the euro. The content of these legal instruments is further specified by Article 17 ECB of the Rules of Procedure.[37]

**Legal Instruments by Virtue of the TFEU**

Regulations: The ECB issues Regulations under the conditions set out in the TFEU and the ESCB/ECB Statute. They are required in order for the ESCB to carry out the following:[38] first, the definition and implementation of the single monetary policy in the euro area; second, the imposition of the requirement for credit institutions established in Member States whose currency is the euro to hold minimum reserves on accounts with the ECB and the NCBs; third, the assurance of efficient and sound clearing

[36] TFEU, Article 132(1) and ESCB/ECB Statute, Article 34.

[37] All these categories of ECB legal acts and instruments are, in principle, not binding for Member States with a derogation and for their NCBs, nor for the UK and the Bank of England [Protocol (No 15), paragraph 4]. Not being specifically required and for the sake of simplicity, the following analysis makes no further reference to the relevant paragraphs of Articles 132(1) TFEU, 34 ESCB/ECB Statute and 17 of the ECB Rules of Procedure. For an overview, see also Zilioli and Athanassiou (2018), pp. 621–624.

[38] These fields, exclusively enumerated in Article 132(1), first point TFEU, are governed by Articles 3.1, first point, 19.1, 22 and 25.2 ESCB/ECB Statute, respectively.

and payment systems within the EU and with other countries;[39] and fourth, the performance of specific supervisory tasks (currently, governed by the SSMR and Council Regulation 1096/2010). Regulations are also made by the ECB when there is an authorising provision in the Council's legal acts on complementary legislation.[40]

Exclusive competence for issuing Regulations lies with the GC, which, nevertheless, may delegate its powers to the Executive Board with respect to their implementation, provided that clear reference is made to the issues to be developed, as well as the limits and scope of the delegated powers. Regulations are binding for the totality of their provisions and are of general and direct application in Member States whose currency is the euro. They must be reasoned and, when they impose penalty payments against persons, constitute enforceable titles. In order for them to be binding for third parties, they must be published in the Official Journal (of the European Union) (OJ) in all official languages and, unless otherwise stipulated, they come into force twenty days after their publication.

Decisions: In terms of numbers, Decisions are the largest category of ECB legal acts. They are adopted, either by the GC or by the Executive Board, depending on their field of competence, with the aim of performing the tasks conferred upon the ESCB under the TFEU and the Statute, without prejudice to the competence for issuing Regulations.[41] Their recipients are Member States, the NCBs of Member States whose currency is the euro, as well as natural or legal persons and their provisions are binding in their totality for their individual addressees.

Recommendations: ECB Recommendations are the legal acts enabling it to initiate the procedure for the simplified amendment of Articles of the Statute[42] and the adoption of complementary legislation; furthermore, they are used by the ECB to promote a specific course of action by its addressees (such as Member States, EU institutions or NCBs of Member States whose currency is the euro). Competence for issuing Recommendations rests with the GC and the Executive Board, depending on the field of competence; nevertheless, those on the simplified procedure for amendment of Statute's Articles and on the complementary legislation must be issued by the GC.

[39] On these three issues, see details in Chap. 7.
[40] See Chap. 2, Sect. 2.4.2.
[41] By August 2019, all ECB Decisions bar none had been issued by the GC.
[42] See Chap. 2, Sect. 2.3.4.

Recommendations are not legally binding, but they, too, must be duly reasoned.[43]

Opinions: The ECB issues an Opinion alternatively to issuing a Recommendation, in the cases where the TFEU provides for consultation with the ECB prior to decision-making by (other) EU institutions on issues relating to the functioning of the monetary union. In addition,

Firstly, EU institutions should request an Opinion of the ECB and the latter should issue one, for any proposed EU act falling within its field of competence; furthermore, national authorities of Member States should also request an ECB Opinion on any draft legislative provision falling within its field of competence, within the limits and under the terms set by Council Decision 98/415/EC[44] adopted within the framework of the complementary legislation.[45] Under this legal act, an ECB Opinion is required on any draft legislative provision referring to the following subjects: currency and means of payments, NCBs, collection, compilation and distribution of statistical data, payment and settlement systems, and the rules applicable to financial institutions, insofar as they materially influence the stability of financial institutions and markets.

Secondly, the ECB may on its own initiative submit Opinions to the appropriate EU institutions, bodies, offices and agencies or to national authorities on issues falling within its fields of competence.[46]

Finally, the GC's Opinion should be requested before forthcoming amendments of the Treaties, of institutional nature, in the monetary field.[47]

[43] ESCB/ECB Statute, Article 40.3, and ECB Rules of Procedure, Article 17.4, second to fourth sub-paragraphs.

[44] OJ L 189, 3.7.1998, pp. 42–43.

[45] TFEU, Articles 127(4), first sub-paragraph and 282(5) and ESCB/ECB Statute, Article 4, point (a).

[46] TFEU, Article 127(4), second sub-paragraph and ESCB/ECB Statute, Article 4, point (b); Articles 127(4) TFEU and 4 ESCB/ECB Statute apply to all Member States, with the exception of the UK (Protocol (No 15), paragraphs 4 and 7).

[47] TEU, Article 48(6), second sub-paragraph. The relevant provision of the TEU previously applicable (Article 48, second sub-paragraph, point b) was activated in 2003, upon request for an ECB Opinion (issued on 19 September of the same year) with respect to the provisions of the Draft Treaty establishing a Constitution for Europe (CONV/2003/20). Following the last revision of the Treaties by the Treaty of Lisbon, the relevant provision (fully integrated within the new institutional framework governing amendment of the Treaties) was activated again in 2011, when an Opinion of the ECB was requested (and

ECB Opinions, just like Recommendations, are not legally binding and may be adopted by all three ECB decision-making bodies. The basic competence for their issuance also rests with the GC; the Executive Board can issue Opinions only under exceptional circumstances, provided that no wish has been expressed by any of the three Governors members of the GC that it maintains the competence to issue a specific Opinion and the Executive Board will take into account any GC's observations and the contribution of the General Council. The General Council is competent to issue Opinions only in two cases: for advising Member States with a derogation throughout the preparation of abrogation of derogation[48] and within the framework of monitoring compliance of NCBs with the prohibitions of monetary financing and of privileged access to financial institutions under Articles 123–124 TFEU.

**Legal Instruments by Virtue of the ESCB/ECB Statute**

ECB Guidelines are legally binding internal documents of the Eurosystem addressed to the NCBs of the Member States whose currency is the euro. They contain the general framework and the main rules to be followed by these NCBs at the implementation of the Eurosystem's policy. Guidelines are exclusively adopted by the GC, are notified to NCBs by any appropriate means and must be reasoned. As in the case of Regulations, the GC may transfer to the Executive Board its regulatory powers with respect to the implementation of Guidelines, provided that there is a clear reference of the issues to be achieved, as well as of the limits and the scope of the powers transferred. ECB Instructions are legally binding internal documents of the Eurosystem as well, by means of which the ECB pursues to assure the implementation of Decisions and Guidelines concerning the single monetary policy, by providing detailed instructions to the NCBs of the Member States whose currency is the euro. Instructions are adopted by the Executive Board and must be notified by any appropriate means to the NCBs. Finally, ECB internal Decisions govern internal organisation or administrative issues of the ESCB, have no specific addressees, but are legally binding for the Eurosystem.

issued on 17 March) with respect to the draft decision of the European Council on amending Article 136 TFEU for the establishment of the legal basis of the ESM (see Chap. 2, Sect. 2.4.4).

[48] ESCB/ECB Statute, Article 46.1, first point (with a reference to Article 43).

*Regulatory Powers Under the SSMR*

**The Substantive Framework**

(1) For the purpose of carrying out its tasks under the SSMR and with the objective of ensuring high standards of supervision, the ECB has to apply all relevant legal acts which constitute sources of EU banking law. In addition, to the extent that this law is composed of Directives or Regulations, it must apply the national legislation either transposing Directives or implementing Member States' options available under Regulations.[49] It is noted that, under this provision, the ECB is called upon to apply not only uniform EU law, but also national law, that is legal provisions which may vary in participating Member States.

(2) To that effect, the ECB has been granted the power to adopt Guidelines and Recommendations and take Decisions, subject to and in compliance with the relevant EU banking law in force. In particular, it is subject to binding regulatory and implementing technical standards developed by the EBA and adopted by the Commission in the form of delegated and implementing acts, to EBA Guidelines and Recommendations and to the provisions of the EBA Regulation on a "European supervisory handbook". This handbook is different from the ECB's "Guide to banking supervision", which is addressed to supervised entities in participating Member States in the context of the SSM.[50] In this respect and if deemed necessary, the ECB must contribute to the development by the EBA of draft regulatory or implementing technical standards or draw its attention to a potential need for draft standards amending existing ones.

The ECB may also adopt Regulations limited to the extent necessary in order to organise or specify the modalities for carrying out its tasks. Before adopting a Regulation, it must, for the sake of transparency, conduct open public consultations and conduct a related cost–benefit analysis, unless such consultations and such analysis are disproportionate in relation to the scope and impact of the Regulation concerned, or the particular urgency of the matter (to be justified).[51]

[49] SSMR, Article 4(3), first sub-paragraph.

[50] This ECB "Guide to Banking Supervision" of November 2014 (the 'ECB 2014 Guide to Banking Suprevision') is available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidebankingsupervision201411.en.pdf.

[51] SSMR, Article 4(3), second sub-paragraph. Article 17a of the ECB Rules of Procedure lays down specific rules with regard to the ECB legal instruments which are related to its supervisory tasks, which do not apply to non-participating Member States.

### Due Process for Adopting Supervisory Decisions—Supervisory Procedures

Any ECB supervisory procedure initiated in accordance with Articles 4 (but not Article 5) and 14–18 SSMR must be carried out in accordance with the relevant Articles of the SSM Framework Regulation.[52] An ECB supervisory procedure may be initiated *ex officio* or at the request of a party. In each ECB supervisory procedure initiated *ex officio*, the ECB must in principle determine the facts relevant for adopting its final Decision, and, in its assessment, take account of all relevant circumstances.

Parties to an ECB supervisory procedure are those making an application, and those to which the ECB intends to address or has already addressed a supervisory Decision; NCAs are exempted. Subject to EU law, a party must participate in an ECB supervisory procedure and provide assistance to clarify the facts. In procedures initiated at a party's request, the ECB may limit its determination of the facts to requesting it to provide the relevant factual information.[53] In order to ascertain the facts of a case, the ECB must make use of evidence as it deems appropriate. Subject to EU law, the parties must assist the ECB in ascertaining these facts, stating truthfully the facts known to them. If deemed necessary, it may also hear witnesses and experts (defining their task and setting a time limit for the submission of the relevant report), as well as require that the persons mentioned in Article 11(1), point (c) SSMR to attend as witnesses.[54]

### Right to Be Heard and Right of Access to the ECB's Files

Before taking supervisory Decisions, the ECB must give to any person-subject of the proceedings the right to be heard.[55] This rule does not apply, if urgent action is needed in order to prevent significant damage to the financial system, in which case the ECB may adopt a 'provisional Decision' and give the persons concerned the opportunity to be heard as soon as possible after its Decision is taken.[56]

The right of defence of the persons concerned must as well be fully respected in the proceedings. These persons are entitled to have access

[52] SSM Framework Regulation, Article 25(1), with reference to Articles 22 and 26–35 [the latter do not apply to procedures carried out by the ABoR (ibid., Article 25(2)].

[53] Ibid., Articles 26 and 28; a party may be represented by its legal or statutory representatives or by any other specifically designated representative (ibid., Article 27(1)).

[54] Ibid., Articles 29(1)–(2), 30(1)–(2) and 30(4), respectively.

[55] Article 31 SSM Framework Regulation is more detailed on this aspect.

[56] Ibid., Article 22(1); see, on this, also Article 41 of the Charter of Fundamental Rights of the European Union, analysed in Voet van Vormizeele (2019).

to the ECB's files, subject to the legitimate interest of other persons in the protection of their business secrets; the right of access to the file does not extend to confidential information. NCAs must forward to the ECB, without undue delay, any request received relating to the access to files relevant with ECB supervisory procedures (the files consisting of all documents obtained, produced or assembled by the ECB during the supervisory procedure). The ECB and the NCAs cannot be prevented from disclosing or using the information necessary to prove an infringement.[57]

**ECB Supervisory Decisions**

ECB supervisory Decisions must be reasoned, be accompanied by a statement of reasons, contain the material facts and the legal reasons on which they are based and be based only on facts and objections on which the parties concerned have been able to comment. The ECB may decide to grant suspensory effect to the application of a supervisory Decision either by stating it therein, or on request of its addressee, in cases other than a request for review by the ABoR.[58]

### *6.3.2 Sanctioning Powers*

*An Overview of the Legal Framework*

(1) According to primary EU law,[59] if an undertaking seated in a Member State whose currency is the euro fails to comply with the obligations arising from the provisions of ECB Regulations or Decisions, the ECB has the power to impose fines and/or periodic penalty payments. The limits of, and the conditions for their imposition, were initially laid down (as mentioned when analysing the Council's complementary legislation[60]), in Council Regulation (EC) No 2532/1998 of November 1998.[61] In order

[57] SSMR, Article 22(2), first sub-paragraph and SSM Framework Regulation, Article 32.

[58] SSMR, Article 22(2), second sub-paragraph and SSM Framework Regulation, Article 33–34; this applies without prejudice to Articles 278 TFEU (analysed in Schwarze und Voet van Vormizeele (2019)) and 24(8) SSMR. Article 35 lays down detailed provisions on the alternative ways in which the ECB must notify its supervisory Decisions to the parties concerned; for more details on this aspect, see D'Ambrosio (2013).

[59] TFEU, Article 132(3) and ESCB/ECB Statute, Article 34.3.

[60] See Chap. 2, Sect. 2.4.2.

[61] OJ L 318, 27.11.1998, pp. 4–7.

to apply the provisions of this legal act, the ECB adopted on 23 September 1999 Regulation (EC) No 2157/1999 (ECB/1999/4).[62] This legal act contained, *ab initio* and *inter alia*, provisions on the initiation and confidentiality of infringement procedures, the respective powers of the ECB and the NCBs, the notice of objections, the rights and obligations of the undertakings concerned and specific procedural issues.

(2) In relation to its supervisory tasks under the SSMR and notwithstanding its general powers to impose sanctions under these Regulations, the ECB has been granted by the SSMR specific powers to impose administrative penalties on supervised entities (i.e. credit institutions, financial holding companies and mixed financial holding companies) in two cases of breaches: breach of regulatory requirements under directly applicable EU legal acts and breach of ECB legal acts. In addition, procedures for cooperation between the ECB and the NCAs have been instituted with regard to other cases of breaches of EU banking law. The relevant (very complex, indeed) framework is governed by Articles 18 SSMR and 120–137 SSM Framework Regulation.

(3) Within this context, the above-mentioned Regulations were amended as follows:

First, Regulation ECB/1999/4 was amended on 16 April 2014 by Regulation (EU) No 469/2014 (ECB/2014/18)[63] in order to adapt the EU legal framework on ECB sanction-imposing powers to the functioning of the SSM;[64] the amendments aimed, *inter alia*, at clarifying that its provisions do not apply to the sanctions that may be imposed by the ECB in the exercise of its supervisory tasks, since those are covered exclusively by Article 18 SSMR.[65]

Then, on 27 January 2015, Council Regulation (EC) No 2532/98 was also amended by Council Regulation (EU) 2015/159[66] in order to obtain its alignment with Article 18 SSMR,[67] in particular with regard to the

[62] OJ L 264, 12.10.1999, pp. 21–26.

[63] OJ L 141, 14.5.2014, pp. 51–53.

[64] The most recent unofficial consolidated version of this legal act, of 16 November 2017, is available at: https://www.ecb.europa.eu/ecb/legal/1002/1328/html/index.en.html.

[65] Regulation ECB/2014/18, Article 1, point (1), introducing (a new) Article 1a in Regulation ECB/1999/4.

[66] OJ L 27, 3.2.2015, pp. 1–6.

[67] Council Regulation (EU) 2015/159, Article 1(2), introducing a new Article 1a in Council Regulation (EC) No 2532/98.

following: the upper limits of sanctions imposed by the ECB in the exercise of its supervisory tasks; the specific procedural rules for sanctions imposed by the ECB in the exercise of its supervisory tasks; and the specific time-limits for administrative penalties imposed by the ECB in the exercise of its supervisory tasks.[68]

*Breach of Regulatory Requirements Under EU Banking Law*

**Penalties Imposed by the ECB Under Article 18(1) SSMR**

Conditions for imposition of penalties: For the purpose of carrying out its tasks under the SSMR, the ECB has the power to impose administrative pecuniary penalties on significant supervised entities in the case of breach of directly applicable EU legal acts (other than ECB Regulations[69]) and the regulatory requirements arising therefrom. The necessary condition is that the significant supervised entity breaches, either intentionally or negligently, a requirement under relevant directly applicable legal acts which constitute sources of EU banking law [i.e. the Capital Requirements Regulation (CRR) and the technical standards adopted in the form of Regulations] and in relation to which such sanctions are available to NCAs under the provisions of relevant EU banking law, that is Article 67 Capital Requirements Directive No IV (CRD IV).[70] This implies that the ECB does not have the power (under Article 18(1)) to impose such sanctions, if a significant supervised entity breaches a requirement under the national law which transposed the CRD IV.

Penalties: The administrative pecuniary penalties that the ECB may impose in this case are the following: up to twice the amount of the profits gained or losses avoided because of the breach, if those can be determined; up to 10% of the total annual turnover, as defined in EU banking law, of a legal person in the preceding business year; or such other pecuniary sanctions as may be provided for in EU banking law.[71] The penalties applied

[68] Council Regulation (EC) No 2532/98, (new) Articles 4a, 4b and 4c, respectively, inserted by Article 1(5) of Council Regulation (EU) 2015/159.

[69] This case is regulated in Article 18(7) SSMR, which is presented later.

[70] SSMR, Article 18(1). The application of Article 18(1) only to significant supervised entities can be deduced from Article 134 SSM Framework Regulation.

[71] The total annual turnover of a subsidiary of a parent undertaking is that resulting from the consolidated account of the ultimate parent undertaking in the preceding business year (ibid., Article 18(1)–(2)); the term ‘total annual turnover’ is defined in Article 67 CRD IV.

must be effective, proportionate and dissuasive. In determining whether to impose a sanction and its appropriateness, the ECB must cooperate closely with NCAs according to Article 9(2).[72]

#### Cooperation Between the ECB and NCAs

If the above-mentioned conditions are not met in respect of significant supervised entities, the ECB may require NCAs to open proceedings with a view to taking action to ensure that appropriate sanctions are imposed in accordance with the acts of Article 4(3) and any relevant national legislation conferring specific powers, which are not required by EU banking law. An NCA may only open proceedings at the request of the ECB, if necessary for the purpose of carrying out the tasks conferred on the ECB under the SSMR, with a view to taking action to ensure that appropriate penalties are imposed in cases not covered by Article 18(1) SSMR. Such cases include the application of the following:

non-pecuniary penalties in the case of a breach of directly applicable EU banking law, that is the CRR, by legal or natural persons and pecuniary penalties in the case of a breach of such law by natural persons;

pecuniary or non-pecuniary penalties in the case of a breach of any national law transposing relevant EU Directives, that is the CRD IV, by legal or natural persons; and

pecuniary or non-pecuniary penalties to be imposed in accordance with relevant national legislation conferring specific powers on the NCA in participating Member States which are not required by EU banking law.[73]

[72] SSMR, Article 18(3); The ECB must apply these provisions (which apply *mutatis mutandis* also in respect of supervised entities and groups in participating Member States under the 'close cooperation' regime (SSM Framework Regulation, Article 113), in accordance with the legal acts of Article 4(3), including the procedures contained in Article 4b of Council Regulation (EC) No 2532/98, as appropriate. Specific procedural rules govern the establishment of an independent Investigating Unit composed of investigating officers designated by the ECB, the referral of alleged breaches to this Unit and its powers, the relevant procedural rights and the examination of the file by the Supervisory Board (SSMR, Article 18(4) and SSM Framework Regulation, Articles 123–127).

[73] The relevant NCA must notify the ECB of the completion of a penalty procedure initiated at the request of the latter and, in particular, of the penalties imposed, if any, and may also ask the ECB to request it to open proceedings in such cases. NCAs may also open proceedings on their own initiative regarding the application of national law for tasks not conferred on the ECB by the SSMR (ibid., Article 18(5) and SSM Framework Regulation, Articles 134–135).

*Breach of ECB Legal Acts*

In case of breaches of its Regulations or supervisory Decisions and again for the purposes of carrying out the tasks conferred on it by the SSMR, the ECB may also impose sanctions in the form of fines and periodic penalty payments, in accordance with Council Regulation (EC) No 2532/98. Such fines and periodic penalty payments can be imposed if there is a failure to comply with obligations under ECB Regulations or supervisory Decisions on behalf of significant supervised entities, or less significant supervised entities, if the relevant ECB legal acts impose obligations on such entities *vis-à-vis* the ECB.[74] The latter is the only case in which the ECB is allowed to impose administrative penalties to a less significant supervised entity.[75]

*Specific Provisions*

Specific provisions apply to administrative penalties imposed by the ECB on supervisory entities under (the above-mentioned) Articles 18(1) or 18(7). They refer to the following aspects: Imitation periods for the imposition and enforcement of administrative penalties and publication of relevant Decisions; the obligation imposed on the ECB to inform the EBA of all administrative penalties imposed on a supervised entity in a participating Member State (subject to the professional secrecy requirements under Article 27 SSMR); and the obligation imposed on it, if, as part of the discharge of its specific supervisory tasks, it has reason to suspect that a criminal offence may have been committed, to request the relevant NCA to refer the matter to the appropriate authorities for investigation and possible criminal prosecution under national law. The proceeds from administrative penalties imposed by the ECB are its property.[76]

[74] SSMR, Article 18(7) and SSM Framework Regulation, Articles 120, point (b) and 122.

[75] The procedural rules applicable to periodic penalty payments are laid down in Article 129 SSM Framework Regulation, complement those laid down in Article 4b(2)–(3) of Council Regulation (EC) No 2532/98 and must be applied in accordance with Article 25–26 SSMR on mediation and the Supervisory Board (SSM Framework Regulation, Article 121(2)).

[76] SSM Framework Regulation, Articles 130 (reflecting the content of Article 4c(1)–(3) of Council Regulation (EC) No 2532/98), 131 (reflecting the content of Article 4c(4) of that Council Regulation), 132 (on the basis of Article 18(6) SSMR), 133 and 136–137. For a summary of various administrative penalties and the division of competences between the ECB and the NCAs, see Table 6.1.

**Table 6.1** The powers of the ECB and national competent authorities (NCAs) to impose administrative penalties under the SSMR and the SSM Framework Regulation

| | |
|---|---|
| 1. Breach of directly applicable EU legal acts (EU Regulations) | |
| Significant supervised entities | The ECB may impose administrative pecuniary penalties (Article 18(1) SSMR)<br>The ECB may ask NCAs to impose non-pecuniary penalties (Article 134(1) SSM Framework Regulation) |
| Less significant supervised entities | Only NCAs may impose penalties (notification to the ECB) |
| Natural persons in significant supervised entities | The ECB may ask NCAs to impose non-pecuniary and/or pecuniary penalties (Article 134(1) SSM Framework Regulation)<br>An NCA may ask the ECB to request it to open proceedings (Article 134(2) SSM Framework Regulation) |
| Natural persons in less significant supervised entities | Only NCAs may impose penalties |
| 2. Breach of national legislation (including breach of national rules transposing EU Directives) | |
| Significant supervised entities | The ECB may ask NCAs to impose pecuniary penalties (Article 18(5) SSMR) and/or non-pecuniary penalties (Article 134(1) SSM Framework Regulation)<br>An NCA may ask the ECB to request it to open proceedings (Article 134(2) SSM Framework Regulation) |
| Less significant supervised entities | Only NCAs may impose penalties (notification to the ECB) |
| Natural persons in significant supervised entities | The ECB may ask NCAs to impose administrative penalties or measures (Article 18(5) SSMR), as well as non-pecuniary or pecuniary penalties (Article 134(1) SSM Framework Regulation)<br>An NCA may ask the ECB to request it to open proceedings (Article 134(2) SSM Framework Regulation) |
| Natural persons in less significant supervised entities | Only NCAs may impose penalties |
| 3. Breach of ECB legal acts (Regulations and Decisions) (Article 18(7) SSMR) | |
| Significant supervised entities | The ECB may impose fines and periodic penalty payments |
| Less significant supervised entities | The ECB may impose fines and periodic penalty payments, only if the relevant ECB legal acts impose obligations on such entities *vis-à-vis* the ECB |

## 6.4 Independence, Accountability and Transparency

### *6.4.1 Independence*

*The Provisions of the TFEU*

**Institutional Independence**

Introductory remarks: In order to ensure that the ESCB is in a position to efficiently pursue its primary objective, the ECB was granted institutional independence by virtue of Article 130 TFEU (*verbatim* repeated in Article 7 ESCB/ECB Statute). In its two sub-paragraphs, this Article, applicable to all Member States (except for the UK[77]), provides for the following:

firstly, the ECB, the NCBs and the members of their decision-making bodies are not allowed to seek or receive, when exercising powers and carrying out tasks and duties, instructions from EU institutions, bodies, offices and agencies, from any government of a Member State or from any other national body;

secondly, the obligation to respect the above-mentioned principle and to abstain from seeking to influence the members of the decision-making bodies of the ECB or the NCBs is imposed upon EU institutions, bodies, offices or agencies and governments of Member States when carrying out their tasks.

Prohibitions: With respect to its personal scope of application, in principle, the prohibition refers to all central banks members of the ESCB, with the exception of the Bank of England (BoE). It is also addressed to the members of decision-making bodies of these central banks. There is a wide range of entities whom the above-mentioned central banks and the above-mentioned persons are not allowed to address with the purpose of providing or receiving instructions covering EU institutions, bodies, offices or agencies, governments of Member States and any other body thereof.[78] With regard to the material scope of application of this provision, two remarks should be made: first, the prohibition refers to instructions that the above-mentioned central banks and the above-mentioned persons may seek or receive by the above-mentioned entities; furthermore,

[77] Protocol (No 15), paragraph 4.

[78] TFEU, Article 130, first sub-paragraph.

it covers exercise of the totality of duties and competences conferred upon the above-mentioned central banks and persons by the Treaties and the Statute.

Obligations imposed on EU institutions, other bodies, offices or agencies and on member state governments: With regard to its personal scope of application, the second sub-paragraph of Article 130 TFEU is to a certain extent different from its (similar in content) first sub-paragraph, since the obligation is only imposed on EU institutions, bodies, offices or agencies and on Member State governments, while national agencies are not covered. Respectively, the second obligation imposed on these entities is defined in relation to the members of the decision-making bodies of the ECB or of NCBs (excluding the BoE). By virtue of this provision, the above-mentioned EU and national entities are required to respect the principle established by the first sub-paragraph of Article 130 (as discussed earlier) and abstain from seeking to influence the above-mentioned persons when carrying out their tasks.[79]

**Operational Independence**

The operational independence of the ECB and of the NCBs has been established, especially with regard to the implementation of monetary policy, by virtue of Articles 17–20 ESCB/ECB Statute, which ensure that these have all the means required for definition and implementation of a single monetary policy.

**Personal Independence of the Members of the ECB Executive Board**

The safeguarding of the personal independence of members of the Executive Board is anchored in the TFEU and the ESCB/ECB Statute, which provide that these members are appointed from among persons of recognised standing and professional experience in monetary or banking matters. Their term of office is, as already mentioned, eight years (but not renewable), in order not to coincide with the political cycle of any Member State. Members of the Executive Board are compulsorily retired by the European Court of Justice (ECJ), on application by the GC or the

[79] Ibid., Articles 130, second sub-paragraph (and 282(3), fourth sentence). On this Article and the adequacy and sufficiency of the provisions of primary EU law on the ECB's this aspect of independence (also as in force according to Article 108 of the TEC which has not been amended), see de Haan and Gormley (1997), Smits (1997), pp. 176–178, Brentford (1998), Häde (1999), Smits (2000), Louis (2009), pp. 173–177, Zilioli and Riso (2018) and Wutscher (2019), pp. 2069–2073.

Executive Board, only on condition that they no longer fulfil the conditions required for the performance of their duties or they have been guilty of serious misconduct.[80]

**Financial Independence: ECB's Capital**

Subscription of capital: In order to ensure the ECB's financial independence, it was decided that it should have its own capital, with resources coming exclusively from the NCBs—members of the ESCB. The ECB's initial capital, the amount of which was set to five billion euros, was operational upon its establishment, on 1 June 1998. Subscription of the capital was achieved by the NCBs of all Member States, including the BoE, which are the sole subscribers and holders of the capital.[81]

Key for capital subscription: The subscription of the ECB's capital must obey to a specific key; the weightings assigned to NCBs in this key is equal to the sum of two factors: first, 50% of the share of the respective Member State in the population of the EU in the penultimate year preceding the establishment of the ESCB (i.e. 1996); and second, 50% of the share of the respective Member State in the gross domestic product of the EU at market prices, as recorded in the last five years preceding the penultimate year before the establishment of the ESCB. These weightings must be adjusted every five years, by analogy with the provisions of the initial weighting, the adjusted key applying with effect from the first day of the following year.

The statistical data used must be provided to the ECB by the Commission in accordance with the rules adopted by the Council under the procedure on the complementary legislation.[82] The initial weightings assigned to the NCBs in the key were determined by the GC[83] on 9 June 1998 and adjusted on 1 December 1998.[84] Since then the weightings have been periodically

[80] TFEU, Article 283(2), third sub-paragraph and ESCB/ECB Statute, Articles 11.2 and 11.4. In this respect, see also the recent Judgment of the Court (Grand Chamber) of 26 February 2019 in Cases C-202/18 and 238/18 "Ilmārs Rimšēvičs and European Central Bank v Republic of Latvia" (ECLI:EU:C:2019:139, available at: https://curia.europa.eu/juris/liste.jsf?num=C-202/18&language=en.

[81] ESCB/ECB Statute, Articles 28.1, first sentence and 28.2, first sentence. Article 282(3), third sentence, also provides that the ECB is independent in the management of its finances.

[82] Ibid., Article 29.1–29.3; in this respect, applicable is Council Regulation 98/382/EC (OJ L 171, 17.6.1998, pp. 33–34).

[83] Ibid., Article 29.4; all Decisions relating to the financial provisions of the ESCB are taken by the GC, with the sole exception of the Decision for payment of the capital by the NCBs of Member States with a derogation, which is taken by the General Council.

[84] Decisions ECB/1998/1 (OJ L 8, 14.1.1999, pp. 31–32) and ECB/1998/13 (OJ L 125, 19.5.1999, p. 33), respectively.

**Table 6.2** Weightings assigned to national central banks in the key for subscription in the ECB's capital

| *National central bank* | *Weighting (%)* | | |
|---|---|---|---|
| | *Since 1 May 2004* | *Since 1 January 2009* | *Since 1 January 2019* |
| Deutsche Bundesbank (Germany) | 21.1364 | 18.9373 | 18.3670 |
| Banque de France | 14.8712 | 14.2212 | 14.2061 |
| Banca d' Italia | 13.0516 | 12.4966 | 11.8023 |
| Bank of England (BoE) | 14.3822 | 14.5172 | 14.3374 |
| Banco de España (Spain) | 7.7758 | 8.3040 | 8.3391 |
| De Nederlandsche Bank | 3.9955 | 3.9882 | 4.0677 |
| Banque Nationale de Belgique | 2.5502 | 2.4256 | 2.5280 |
| Sveriges Riksbank (Sweden) | 2.4133 | 2.2582 | 2.2522 |
| Österreichische Nationalbank (Austria) | 2.0800 | 1.9417 | 2.0325 |
| Τράπεζα της Ελλάδος (Greece) | 1.8974 | 1.9649 | 1.7292 |
| Banco de Portugal | 1.7653 | 1.7504 | 1.6367 |
| Danmarks National Bank | 1.5663 | 1.4835 | 1.4986 |
| Suomen Pankki (Finland) | 1.2887 | 1.2539 | 1.2708 |
| Central Bank and Financial Services Authority of Ireland | 0.9219 | 1.1107 | 1.1754 |
| Banque Centrale du Luxembourg | 0.1568 | 0.1747 | 0.2270 |
| Central Bank of Cyprus | 0.1300 | 0.1369 | 0.1503 |
| Ceska narodni banka (The Czech Republic) | 1.4584 | 1.4472 | 1.6172 |
| Eesti Pank (Estonia) | 0.1784 | 0.1790 | 0.1969 |
| Magyar Nemzeti Bank (Hungary) | 1.3884 | 1.3856 | 1.3348 |
| Latvijas Banka (Latvia) | 0.2978 | 0.2837 | 0.2731 |
| Lietuvos Bankas (Lithuania) | 0.4425 | 0.4256 | 0.4059 |
| Central Bank of Malta | 0.0647 | 0.0632 | 0.0732 |
| Narodowy Bank Polski (Poland) | 5.1380 | 4.8954 | 5.2068 |
| Narodna Banka Slovenska (Slovakia) | 0.7147 | 0.6934 | 0.8004 |
| Banka Slovenije (Slovenia) | 0.3345 | 0.3288 | 0.3361 |
| Българска народна банка (Bulgaria) | – | 0.8686 | 0.8511 |
| Banca Națională a României (Romania) | – | 2.4645 | 2.447 |
| Hrvatska narodna banka (Croatia) | – | – | 0.5673 |

adjusted, the last adjustment brought about by Decision ECB/2018/27 of 29 November 2018.[85]

Payment of the subscribed capital by NCBs: By means of a Decision taken by qualified majority and on the basis of the principle of weighted

[85] OJ L 9, 11.1.2019, pp. 178–179; on the current weightings, see Table 6.2.

vote, the GC determines the extent and the form in which the capital must be paid by the NCBs of the Member States whose currency is the euro.[86] To this respect, in June 1998 the GC determined that NCBs should pay up in full their share in the subscribed capital of the ECB and the amounts due were determined on 1 July 1998.[87] Currently, this aspect is governed by Decision ECB/2018/28 of 29 November 2018.[88]

On the other hand, the NCBs of the Member States with a derogation have, in principle, no obligation to pay up their subscribed capital; the General Council may, nevertheless, impose on them the obligation to pay up a minimal percentage "as a contribution to the operational costs of the ECB".[89] In order to implement this authorising provision, the General Council adopted on 1 December 1998 a Decision stipulating that these NCBs should pay up 5% of their shares in the ECB's subscribed capital.[90] Currently, this aspect is governed by Decision ECB/2018/32 of 30 November 2018,[91] which provides that each non-euro area NCB should pay up 3.75% of its share in the ECB's subscribed capital taking into account the adjusted capital key. Upon abrogation of the derogation regime for any Member State, its NCB must pay up its subscribed share of the ECB's capital to the same extent as the NCBs of the Member States whose currency is the euro.

Properties of shares: NCBs' shares in the subscribed ECB's capital may not be transferred, pledged or attached; by way of derogation, when there is an adjustment of the weightings assigned to the NCBs in the key for capital subscription, the NCBs may transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares of the ECB corresponds to the adjusted key.[92] The details of such transfers are currently governed by Decision ECB/2018/29 of 29 November 2018.[93]

Capital increase: For the increase of the ECB's capital, a Decision of the GC is required, to be adopted by qualified majority, on the basis of the prin-

[86] ESCB/ECB Statute, Article 28.3.

[87] Decision ECB/1998/2 of 9 June 1998 (OJ L 8, 14.1.1999, pp. 33–35).

[88] OJ L 9, 11.1.2019, pp. 180–182.

[89] ESCB/ECB Statute, Article 47.

[90] Decision ECB/1998/14 of 1 December 1998 (OJ L 110, 28.4.1999, pp. 33–34).

[91] OJ L 9, 11.1.2019, pp. 196–197.

[92] ESCB/ECB Statute, Articles 28.4, 28.5 and 48.1, first sub-paragraph.

[93] OJ L 9, 11.1.2019, pp. 183–189; this was adopted on the basis of Article 28.5, last sentence ESCB/ECB Statute.

ciple of the weighted vote and within the limits and conditions set by the Council in accordance with the procedure for the adoption of complementary legislation.[94] On 8 May 2000, Council Regulation (EC) 1009/2000[95] was adopted, whereby the GC was entitled to increase the ECB's capital with a supplementary amount up to five billion euros.

The Regulation did not establish any further prerequisites for implementation of the capital increase, which might be decided by the GC, if necessary. In 2010, due to the emergency circumstances arisen from the need to support the European banking system following the recent international financial crisis, the ECB proceeded to the first increase (duplication) of its capital, by virtue of Decision ECB/2010/26 of 13 December 2010,[96] from 5.76 billion euros to 10.76 billion euros.[97]

*The Provisions of the SSMR*

**Introductory Remarks**

All aspects of ECB independence in relation to the basic tasks of the ESCB also pertain to the ECB's specific supervisory tasks. In particular, operational independence is guaranteed by Articles 9–18 SSMR (laying down the ECB's necessary powers in order to fulfil its objectives and the specific supervisory tasks conferred on it) and personal independence is

**Table 6.3** The independence of the ECB

| *Aspect of independence* | *TFEU* | *Statute* | *SSMR* |
|---|---|---|---|
| Institutional | Article 130 | Article 7 | Article 19 |
| Operational | | Articles 17–24 | Articles 9–18 |
| Personal | Article 283(2), second and third sub-paragraphs | Articles 11.2, 11.4 and 14.2 | Article 26(3)–(4) |
| Financial | Article 282(3), third sentence | Article 28 | Articles 28–30 |

[94] Ibid., Article 28.1, second sub-paragraph.

[95] OJ L 115, 16.5.2000, p. 1.

[96] OJ L 11, 15.1.2011, p. 53.

[97] Article 48 ESCB/ECB Statute governs the deferred payment of capital when a Member State's derogation has been abrogated.

governed by Article 26(3)–(4). Institutional independence is governed by Article 19 SSMR and financial independence by Articles 28 and 30 (presented later).[98]

### Institutional Independence

In relation to institutional independence, the SSMR provides (in a wording almost identical to that of Article 130 TFEU) that when carrying out its tasks under the SSMR, the ECB and the NCAs acting within the SSM must act independently. In particular, the members of the ECB Supervisory Board and Steering Committee must act independently and objectively in the interest of the EU as a whole and neither seek or take instructions from the EU's institutions or bodies, from any government of a Member State or from any other public or private body. On a reciprocal basis, this independence must be respected by EU institutions, bodies, offices and agencies, as well as the governments of the Member States and any other bodies.[99]

### Financial Independence

The ECB must devote the necessary financial resources to the exercise of its tasks under the SSMR. Within this context, the ECB can levy annual supervisory fees on supervised entities established in participating Member States, supervised by it both directly and indirectly, and on branches established in a participating Member State by a credit institution established in a non-participating Member State. The fees must cover expenditure incurred by the ECB in relation to its specific supervisory tasks and not exceed the expenditure relating to them.[100] ECB Regulation (EU) No 1163/2014 "on supervisory fees"[101] sets out the arrangements under which the ECB levies the annual supervisory fee for any expenditure incurred in relation to its supervisory tasks and establishes the methodology

[98] On the independence of the ECB within the SSM, see Gortsos (2015), pp. 262–269 and Teixeira (2019), pp. 144–146; for a summary, see Table 6.3.

[99] SSMR, Article 19(1)–(2). Article 19(3) stipulates for the establishment and publication by the GC of a Code of Conduct for the ECB staff and management involved in banking supervision concerning in particular conflicts of interest. Currently, in force is a single "Code of Conduct for high-level ECB officials", of 16 January 2019, which covers the members of the GC, the Executive Board, the Supervisory Board, the General Council, the Audit Committee, the Ethics Committee and the ABoR, which replaced three previous codes (available at: https://www.ecb.europa.eu/ecb/legal/pdf/en_single_code_conduct_for_high_level_ecb_officials_f_sign.pdf).

[100] Ibid., Articles 28 and 30.

[101] OJ L 311, 31.10.2014, pp. 23–31; this was adopted on the basis of Article 30(2) SSMR.

for determining the total amount of the annual supervisory fee, calculating the amount to be paid by each supervised credit institution or banking group and collecting the annual supervisory fee.

### 6.4.2 Accountability and Transparency

*The Provisions of the TFEU and the ESCB/ECB Statute*

**TFEU Provisions**

In order to compensate its independence, the ECB is accountable to EU institutions; this accountability requirement mainly consists in publishing an annual report on the ESCB's activities and the monetary policy of both the previous and the current year. This report has a twofold mission: first, the ECB must address it to the Council, the Commission, the European Parliament and the European Council;[102] furthermore, the ECB President must personally present it to the Council and the European Parliament, the latter having the power to hold a general debate on its basis. The accountability requirement is further strengthened by the stipulation that the ECB President and the other Executive Board members may, at the request of the European Parliament, be heard by its competent committees. This possibility may also arise on the initiative of the ECB President and the other members of the ECB Executive Board.[103]

**ESCB/ECB Statute Provisions**

Reporting commitments: The ECB must draw up and publish reports on the activities of the ESCB at least quarterly and publish a consolidated financial statement of the ESCB each week. These reports and statements, as well as the above-mentioned annual report on the activities of the ESCB and on the monetary policy, must be made available to interested parties free of charge.[104]

[102] Due to the significance of the matter, this is only the second case (next to the one provided in Article 121 TFEU on the broad guidelines of the economic policies) where the European Council is called upon to play an essential role within the framework of EMU under the TFEU.

[103] TFEU, Article 284(3) and ESCB/ECB Statute, Article 15.3. On the adequacy and sufficiency of the provisions of primary EU law on the ECB's accountability, see indicatively de Haan and Gormley (1997), Smits (1997), pp. 176–178 and (2000) and Zilioli and Athanassiou (2018), p. 619.

[104] ESCB/ECB Statute, Articles 15.1, 15.2 and 15.4.

Publication and auditing of financial accounts: The ECB is required to draw up annual accounts, which are elaborated by the Executive Board, in line with the principles set by the GC, are approved by the GC and thereafter published. For analytical and operational purposes, the Executive Board draws up, as well, a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the NCBs that fall within the ESCB.[105] The accounts of the ECB and of the NCBs are audited by independent external auditors and approved by the Council following a GC's Recommendation. Auditors are fully empowered to examine all books and accounts of the ECB and the NCBs and obtain full information about their transactions. Article 287 TFEU with respect to the Court of Auditors' audit only applies to an examination of the operational efficiency of the ECB management.[106]

Limitations on the publication of GC meetings' proceedings: The GC is not urged (as is the case for several other central banks) to publish the outcome of its deliberations. The proceedings of the meetings are confidential and GC may decide to make the outcome of its deliberations public.[107]

*The Provisions of the SSMR*

**Accountability *vis-à-vis* EU Institutions**

(1) The ECB is accountable to the European Parliament and to the Council for the implementation of the SSMR as well, and notably in an enhanced way, governed by Article 20 SSMR and complemented by the provisions of Sections I–II of the EP-ECB Interinstitutional Agreement, as well as those of Section I of the Council-ECB MoU of 2013.[108] In this respect:

Firstly, the ECB must submit to various EU institutions an Annual Report on the execution of its specific supervisory tasks; the Chair of the Supervisory Board must present that Report in public to the European Parliament and to the Eurogroup, at the request of the latter, be heard on the execution of the supervisory tasks by it (in both cases in the presence of representatives from any non-participating Member States), and

[105] Ibid., Article 26.2–26.3; the necessary rules for standardising the accounting and reporting of operations of the NCBs are established by the GC (ibid., Article 26.4).

[106] Ibid., Article 27.1–27.2.

[107] Ibid., Article 10.4.

[108] See Chap. 4, Sect. 4.2.1.

at the request of the European Parliament, participate in a hearing on the execution of the supervisory tasks by the competent committees of the European Parliament.

In addition, the ECB must reply orally or in writing to questions posed to it by the European Parliament or by the Eurogroup, in accordance with its own procedures, again in the presence of representatives from any non-participating Member States.

Finally, access to information and safeguarding of ECB classified information and documents, as well as 'sincere' cooperation in any investigations by the European Parliament are also provided for.[109]

(2) More specifically, in relation to its accountability as far as its regulatory powers are concerned, the ECB must duly inform the European Parliament's competent committee of the procedures it has instituted for adopting Regulations, Decisions, Guidelines and Recommendations, which are subject to public consultation under Article 4(3) SSMR. *Inter alia*, the information must cover the principles and kinds of indicators or information used in elaborating acts and policy recommendations aimed at enhancing transparency and policy consistency. In addition, the draft acts must be submitted before the beginning of the public consultation procedure, and, if the European Parliament submits comments, the ECB must informally exchange views with it on such comments in parallel with the open public consultations.[110]

(3) Any expenditure arising from the discharge of the ECB's specific tasks under the SSMR must be covered by its budget and be separately identifiable therein. As part of the annual report, the ECB must report in detail on the budget for its supervisory tasks and its annual accounts (Article 26.2 ESCB/ECB Statute) include the income and expenses related to the supervisory tasks (the annual accounts' supervisory section being subject to audits in line with Article 27.1).[111] Finally, when examining the operational efficiency of the ECB's management (Article 27.2), the Court of Auditors must also take into account the ECB's supervisory tasks under the SSMR.[112]

[109] SSMR, Articles 20(1)–(6) and 20(9) and EP-ECB Interinstitutional Agreement, Section I, paragraphs 4–5.

[110] EP-ECB Interinstitutional Agreement, Section V.

[111] SSMR, Article 29.

[112] Ibid., Article 20(7).

**Accountability *vis-à-vis* National Parliaments**

For the implementation of the SSMR, the ECB is also accountable to the national parliaments of participating Member States in relation to its tasks thereunder (an obligation not applying in relation to its basic tasks). In this respect, the ECB must forward its annual report on the execution of its specific supervisory tasks directly to the national parliaments of the participating Member States, which may address to the ECB their reasoned observations thereon. In addition, these national parliaments may, through their own procedures, request the ECB to reply in writing to any observations or questions submitted by them to the ECB in respect of its specific tasks under the SSMR and invite the Chair or a member of the Supervisory Board to participate in an exchange of views in relation to the supervision of credit institutions in their Member States together with a representative of the NCA.

NCAs are accountable to national parliaments in accordance with national law for the performance of tasks not conferred on the ECB by the SSMR and for the performance of activities carried out by them in accordance with Article 6.[113]

## 6.5 Other Institutional Aspects

### *6.5.1 Communication of the ECB with Other EU Institutions*

Council and Commission representatives may participate in the meetings of the GC, while also ECB representatives may take part in Council meetings; in particular[114]:

Firstly, in order to ensure an ongoing communication between the ECB and these EU institutions which are competent to coordinate the economic policies in the EU, it is stipulated that the Council's President and a Member of the Commission may participate, without having the right to vote (due to the institutional independence of the ECB), in the meetings of the GC; the Council's President may submit a motion for deliberation to the GC, having the possibility to potentially influence its agenda.

[113] Ibid., Article 21. On the accountability of the ECB within the SSM, see Gortsos (2015), pp. 269–278, Teixeira (2019), pp. 146–147 and Türk (2019), pp. 49–53.

[114] TFEU, Article 284(1)–(2); on this aspect, see details in Louis (2009), pp. 190–196.

Moreover, the ECB President must be invited to participate in Council meetings, when the latter is discussing matters relating to the ESCB's objectives and tasks.

### 6.5.2 *Judicial Control—Liability Issues*

(1) The acts and/or omissions of the ECB and the NCBs are subject to judicial control. ECB acts or omissions are open to review or interpretation by the ECJ in the cases and under the conditions laid down in the TFEU, while the ECB may also institute proceedings in such cases and under these conditions upon a Decision taken by the GC. Unless jurisdiction has been conferred upon the ECJ, disputes between the ECB and its creditors or debtors are decided by national competent courts.[115]

(2) The ECJ has jurisdiction to give judgment pursuant to any arbitration clause contained in a contract, governed by either public or private law, which was concluded by or on behalf of the ECB. It also has jurisdiction in disputes concerning the fulfilment by an NCB of obligations under the Treaties and the Statute. In this respect and given that the assurance of compliance of NCBs of Member States whose currency is the euro with ECB legal instruments is achieved by means of measures taken by the GC,[116] when the latter considers that an NCB has failed to fulfil such an obligation, it must deliver a reasoned Opinion after giving the NCB concerned the opportunity to submit its observations. If the latter does not comply with the opinion within the period laid down by the ECB, the latter may bring the matter before the ECJ.[117]

(3) The ECB is liable according to the regime provided for in Article 340 TFEU, whereas (as already mentioned)[118] the NCBs' liability falls under their respective national legislation.[119] Accordingly, its 'contractual liability' is governed by the law applicable to the contract in question. On

[115] ESCB/ECB Statute, Articles 35.1–2 and 35.5. See also, in this respect, Article 263 TFEU (also referred to in Chap. 5, Sect. 5.4.1), according to which the ECJ is competent to review, *inter alia*, the legality of acts of the Council, of the Commission and of the ECB, other than Recommendations and Opinions (which is already mentioned are soft law instruments).

[116] Ibid., Article 14.3, second sub-paragraph.

[117] Ibid., Articles 35.4 and 35.6.

[118] See Chap. 5, Sect. 5.1.2.

[119] ESCB/ECB Statute, Article 35.3. It is noted that (the entire) Article 35 also applies to the NCBs of the Member States with a derogation (argument *a contrario* from Article 42).

the other hand, in the case of 'non-contractual liability', the ECB must, in accordance with the general principles common to the laws of the Member States, make good any damage caused by it or by its servants in the performance of their duties. Finally, the 'personal liability' of its servants towards the EU is governed by the provisions laid down in their Staff Regulations or in the Conditions of Employment applicable to them.[120] In the latter case, the ECJ has jurisdiction over disputes relating to compensation for damage.[121]

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[120] TFEU, Article 340, first, third and fourth sub-paragraphs; on this TFEU Article, see indicatively Lageard (2010), Berg (2019) and in more detail D'Ambrosio (2016).

[121] Ibid., Article 268; on this TFEU Article, see indicatively Schwarze und Voet van Vormizeele (2019).

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PART III

# Tasks and Competences of the European Central Bank

CHAPTER 7

# The Basic Tasks of the European Central Bank Within the Eurosystem and Issuance of Banknotes and Coins

## 7.1 Definition and Implementation of the Single Monetary Policy

### *7.1.1 Definition of Monetary Policy*

*Introductory Remarks*

(1) As already mentioned in Chap. 2 (Sect. 2.3.2), since the start of Stage Three of Economic and Monetary Union (EMU) on 1 January 1999, the Eurosystem has been empowered "to define and implement the monetary policy of the Union", which is the first of its basic tasks in accordance with Article 127(2), first indent Treaty on the Functioning of the European Union (TFEU).[1] The European Central Bank (ECB)'s strategy for the definition of the single monetary policy was announced by its first Governing Council (GC) as early as October 1998 and is thereafter specified on an ongoing basis (first in 2003, in light also of the experience of

[1] On this TFEU Article and the related Articles of the ESCB/ECB Statute, which are presented below, see, by way of mere indication, Smits (1997), pp. 223–288, European Central Bank (2011), Lastra and Louis (2013), pp. 79–80 and Wutscher (2019), pp. 2049–2052. On the evolution of the single monetary policy and its framework (until the start of the recent crises), see also Weber (1995) (in the prospect of the creation of the ECB), Eijffinger and de Haan (2000), pp. 54–79, Issing et al. (2001), De Grauwe (2004), pp. 177–200, Louis (2005) and Issing (2008).


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the ECB's first four years of full operation), taking account of the latest economic developments. In more detail, the evaluation by the ECB of information collected on price developments in the European Union (EU) is premised on two types of analysis (called 'pillars'): an economic analysis, which seeks to assess the short-term determinants of price developments, focusing on both real economic activity and financial conditions in the economy, and a monetary analysis, which assesses with a medium to long-term perspective, the indications for monetary policy coming from the economic analysis.[2]

(2) As also mentioned in Chap. 2, in accordance with Article 127(1) TFEU (first sentence), the primary objective of the European System of Central Banks (ESCB) is to maintain price stability. Hence, the ECB and the national central banks (NCBs)—Members of the Eurosystem have been empowered to define and implement monetary (and exchange-rate) policy, mainly bearing in mind to safeguard price stability. Although both the TEC and the TFEU have strongly been emphasising the primacy of price stability, they provide no precise definition for this concept. For this purpose, in 1998 the GC adopted the following definition: "Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2%." According to this definition, stability "shall be maintained over the medium term". Publication of that quantitative definition of price stability aims at building credibility for the strategy required to safeguard the efficiency of monetary policy. Simultaneously, the public is provided with a clear indication on the assessment of success of this policy, granting thus transparency to the Eurosystem and the strategy of the monetary policy.

With respect to the above-mentioned definition, the following remarks should be made:

First, the definition provides a maximum limit for the increase rate of the inflation calculated on the basis of the Harmonised Index of Consumer prices (the 'HICP'), which is compiled by the Eurostat and the national statistical institutes of the Member States in accordance with harmonised statistical methods, and the 'inflation dashboard'. This index was developed for the assessment of price convergence in Stage Two of EMU and is in principle harmonised among the Member States of the

[2] The following analysis is based on European Central Bank (2011), pp. 55–82.

euro area; its use is consistent with the public's tendency to focus on consumer prices during assessment of changes in price level.[3]

Second, as all consumer price indexes, HICP for the euro area may be seen as biased in several ways with regard to its mode of calculation. This may be due to the change of consumer stereotypes or the improvement of the quality of goods and services included in the basket used for the definition of this specific index. This partiality cannot be fully corrected and usually leads to a slight overestimation of the real inflation rate. The partiality degree of HICP cannot be precisely calculated, being a relatively new concept as it is. However, the available empirical data indicate that HICP partiality is possibly lower than that of the respective national indexes, due to the noteworthy attempts of Eurostat.

Third, by choosing HICP, the GC made it clear that the single character of the monetary policy imposes that decisions must be adopted on the basis of developments in the entire euro area and not at the regional level, since the objective is to maintain price stability in the euro area as a whole. Nevertheless, there is a considerable risk that under specific economic circumstances, some Member States of the euro area are found in different stages of the economic cycle and, consequently, that the ECB be partial towards the benefit of bigger Member States during implementation of the monetary policy. This already happened during the period 2001–2003, when Germany and France were in financial recession, while many other Member States experienced financial growth and increased inflation. At the time, the ECB proceeded to decrease interest rates on open market operations, in order to strengthen financial growth in Germany and France.

Furthermore, the declaration that "price stability shall be maintained over the medium-term" reflects the admission that monetary policy should be focused on the future, with medium-term orientation. It recognises the existence of short-term price instability, which is mainly due to non-monetary shocks (such as, for instance, impacts from changes in indirect taxation or changes in international prices of products). Besides, medium-term orientation allows the ECB to respond gradually and in a calculated manner to unpredictable financial impediments threatening price stability.

[3] On the HICP, see at: https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html.

Finally, and most importantly at present, it is not deemed consistent with price stability either, when the HICP remains significantly (and persistently) below the 2% threshold.

*The First Pillar*

(1) Taking into account the experience of other central banks, the ECB chose to assign a prominent role to money as the first pillar of its strategy, a choice that reflects the fact that, as a rule and in the medium term, the origins of inflation are monetary. One of the most remarkable regularities in macroeconomics is the steady long-run relationship between the price level and the money stock, particularly with regard to its measurement through "broad monetary aggregates". Available data for the euro area confirm the existence of such a relationship, as opposed to countries where monetary developments lack normality. It is noted that, in fact, monetary and credit aggregates have sufficient quantities of a precursor for the medium-term development of prices and play a significant role in the "transmission mechanism" of monetary policy effects on the level of prices. Along with the benefits that money has in terms of the speed and accuracy of measurement, this explains the prominent role assigned thereto by the ECB.[4]

(2) The prominent role of money is signalled by the announcement of a reference value for the growth of "M3", the broadest of the Eurosystem's three monetary aggregates. M3 comprises all the items of 'Monetary Financial Institutions' (the 'MFIs') liabilities which as financial instruments have (a high degree of) 'moneyness': money, deposits and money market instruments which are considered to be close substitutes for deposits due to their (high degree of) liquidity and (price) certainty.[5]

*The Second Pillar*

(1) Despite the widespread consensus on the prominent role of money, monetary developments are not the only factor to be taken into account

[4] For a chart depicting the transmission mechanism of monetary policy effects, see European Central Bank (2011), p. 59.

[5] The reference value is reviewed on an annual basis and is derived from the standardised relationship between money, prices, real economic activity and velocity described in the quantity theory of money equation (on the basis of the 'Fischer equation'). This equation shows that the growth rate of money supply ($\Delta M$) is equal to the output growth rate ($\Delta Y$) and the inflation rate ($\Delta P$), minus the growth rate of money velocity ($\Delta V$). Therefore, the reference value is illustrated by the formula: $\Delta M = \Delta Y + \Delta P - \Delta V$.

for the evaluation of risks to price stability. In order for the GC to take appropriate decisions, it must form a complete picture of the financial situation and the size of financial disruptions threatening price stability. In order to evaluate risks, information is required on whether they are derived from the supply or the demand side, they may be of internal (i.e. intra-euro area) or external origin, and they may be temporary or permanent. Since such information cannot be derived from an analysis conducted in the context of the first pillar, the information gap is filled by an analysis based on a wide range of economic and financial indicators; this forms the second pillar of the ECB's monetary policy strategy.

(2) The latter analysis focuses on identifying the short-term impact that a series of factors has on price developments, as there is a risk for such developments to become entrenched and jeopardise price stability in the medium term. In line with standard models of the business cycle, this analysis is often centred on the effects of the interplay between supply and demand and/or the cost pressures on pricing behaviour in the goods, services and labour markets. In this respect, there is a close monitoring of developments in overall output, demand and labour market conditions, such as those shown in a broad range of price and cost indicators, as well as in the exchange rate and the balance of payments for the euro area. Of equal importance is close monitoring of developments in financial market indicators and asset prices. Movements in asset prices may affect price developments via income and wealth effects. Furthermore, asset prices and financial yields can be used to derive information on the expectations of financial markets, including information on expected future price developments.

(3) Under the second pillar, macroeconomic projections for future developments are produced by ECB services based on the assumption of unchanged interest rates and exchange rates. The projections are constructed by combining econometric model-based projections with non-model-based judgemental assessments. The final projections seek to organise a large amount of information and be coherent both with past experience and with economic theory. They offer a convenient analytical tool to help the GC define its policy and should not affect the expectations of economic stakeholders, given that the GC's commitment in maintaining price stability is not under question at all. Furthermore, projections are not always reliable because they are based on certain assumptions (e.g. level of oil prices and exchange rates), use specific techniques and do not include all relevant information. In the final analysis, the GC also uses similar data produced by economic experts outside the Eurosystem.

### *7.1.2 Implementation of Monetary Policy*

*General Remarks*

**Historical Overview**

In fulfilling the obligation set out in Article 117(3) TEC, the European Monetary Institute (EMI) published in January 1997 a report entitled: "The Single Monetary Policy in Stage Three: Specification of the operational framework", the content of which was further specified in September of the same year in its report: "The Single Monetary Policy in Stage Three: General Documentation on ESCB Monetary Policy Instruments and Procedures". These two reports set the framework in which the single monetary policy should be conducted in the euro area since 1 January 1999, laying down the following.

First, they identified the procedure for the definition and implementation by the ECB of the single monetary policy and, most importantly, the general principles guiding the selection of monetary policy instruments and the instruments themselves. With regard to the latter, the following was stipulated: in order to steer interest rates and manage liquidity in the market, the Eurosystem may use certain categories of open market operations; at its disposal are also two standing facilities to grant and absorb liquidity to and from credit institutions (and possibly other counterparties too) outside working hours; finally, it may impose on counterparties an obligation to hold a percentage of their deposits with ECB or NCB accounts in order to stabilise money market rates. In addition, specific criteria were determined for the selection of counterparties to Eurosystem monetary policy operations' categories of assets eligible as collateral in the conduct of its credit transactions.

Moreover, the second section of the report presented the accompanying framework that should be put in place in order to enable the conduct of the single monetary policy. This framework entered into full operation with the onset of Stage Three of EMU and comprises provisions on three subject areas:

firstly, creating an EU-wide real-time gross settlement (RTGS) system called (TARGET);[6]

[6] On this system, as adjusted to develop into the 'TARGET2' system, see Sect. 7.2.4.

secondly, imposing on counterparties to provide sufficient statistical data to the ECB for the completion of its mission in terms of monetary management;[7] and

thirdly, creating systems and establishing procedures appropriate for the settlement and clearing of security transactions, in order to ensure the efficient settlement of open market operations of the ECB in the conduct of the single monetary policy.[8]

**The Applicable Framework**

(1) In the context of their operational independence, the ECB and the NCBs—Members of the Eurosystem have at their disposal all the necessary instruments for the implementation of the single monetary policy. In accordance with the provisions of Chap. IV of the ESCB/ECB Statute on the achievement of the Eurosystem's objectives, the ECB and these NCBs have the following instruments for the implementation of the single monetary policy: conducting open market operations with and offering standing facilities to eligible counterparties and requiring (mainly) credit institutions to hold minimum reserves on accounts with the Eurosystem.[9] Furthermore, the GC may decide upon the use of other operational methods of monetary control, if it deems that they serve the objective of maintaining monetary stability in the euro area. If such methods impose obligations on third parties, their scope must be defined by the Council under the procedure set out in Article 41 ESCB/ECB Statute (on its complementary legislation).[10]

(2) In the current juncture, the general regulatory framework governing the monetary policy instruments includes a (wide) set of legal acts of the ECB, spearheaded by Guideline ECB/2014/60 of 19 December 2014 on the implementation of the Eurosystem monetary policy frame-

[7] In this context, the Council adopted (as part of its complementary legislation) Regulation (EC) No 2533/98 (OJ L 318, 27.11.1998, pp. 8–19), and the ECB issued Regulation ECB/1998/16 (OJ L 356, 30.12.1998, pp. 7–40).

[8] Such a system is the 'TARGET2-Securities system' for securities settlement in central bank money (see Sect. 7.2.4, as well).

[9] On the operational framework governing these instruments, see Smits (1997), pp. 223–288, Papathanassiou (2001), pp. 73–120 and European Central Bank (2011), pp. 93–116.

[10] ESCB/ECB Statute, Article 20. On Article 41, see Chap. 2, Sect. 2.4.2; by August 2019, this provision had not been activated.

work, as in force.[11] Several other legal acts govern specific aspects relating to the following: the application of minimum reserves (presented separately later), the valuation haircut applied in the implementation of the monetary policy framework, domestic asset and liability management operations undertaken by NCBs—Members of the Eurosystem and the remuneration of deposits, balances and holdings of excess reserves.[12] Of particular importance are also three ECB Decisions concerning measures which relate to three (consecutive) series of targeted longer term refinancing operations (the 'LTROs', see Sect. 7.1.3).[13]

*Instruments for the Implementation of Monetary Policy*

**Open Market Operations**

(1) The legal basis for the conduct of open market operations is Article 18.1 ESCB/ECB Statute, which reads as follows: "In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the [NCBs] may operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments whether in euro or other currencies, as well as precious metals, and conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral." The general principles governing the execution of open market operations by the ECB and the NCBs within the Eurosystem

[11] OJ L 91, 2.4.2015, pp. 3–135; by August 2019, this legal act had been amended eight times. An unofficial consolidated text is available at: https://www.ecb.europa.eu/ecb/legal/pdf/celex_02014o0060-20190805_en_txt.pdf.

[12] Guideline ECB/2015/35 of 18 November 2015 (OJ L 14, 21.1.2016, pp. 30–35), as in force, Guideline ECB/2014/9 of 20 February 2014 as in force and Decision ECB/2014/23 of 5 June 2014 (OJ L 168, 5.6.2014, p. 115–116), as in force, respectively. Relevant is also the Agreement of 19 November 2014 between the NCBs—Members of the Eurosystem "on net financial assets", by virtue of which these NCBs undertook the general obligation that, in each year, the average value of their net financial assets shall not exceed their net financial asset ceiling for that year (available at: https://www.ecb.europa.eu/ecb/legal/pdf/en_anfa_agreement_19nov2014_f_sign.pdf).

[13] For an overview of all ECB legal acts pertaining to the 'general framework' of monetary instruments (a term used to distinguish these instruments from those that formpart of the ECB's 'unconventional' monetary policy and are known under the term 'temporary framework'—see Sect. 7.1.3), see the ECB's website at: https://www.ecb.europa.eu/ecb/legal/1002/1014/html/index-tabs.en.html (constantly updated).

and the announcement of the terms of participation in such operations are defined by the ECB.[14]

(2) The operational framework governing the conduct of open market operations by the Eurosystem, laid down in Guideline ECB/2014/60, is quite detailed; their purpose is to steer interest rates, manage the liquidity situation in the financial market and signal the stance of monetary policy. There are four categories of open market operations, which differ depending on their specific purpose: main refinancing operations (the 'MROs'), longer-term refinancing operations (LTROs), fine-tuning operations and structural operations. The Eurosystem uses five types of instruments to conduct such operations either as alternatives or by way of exclusivity for each one: reverse transactions (which are used in all categories of open market operations), foreign exchange swaps for monetary policy purposes, the collection of fixed-term deposits, the issuance of ECB debt certificates and outright transactions.[15] On the four categories of open market operations, the following is (briefly) noted.[16]

MROs: The purpose of MROs, which are conducted (only) by means of reverse transactions, is the provision of liquidity. They are normally conducted each week and normally have a maturity of one week (in accordance with and as indicated in the indicative calendar for the Eurosystem's regular tender operations) and are executed by means of fixed-rate, standard tender procedures.[17] The decision on the interest rates for the MROs is made by the ECB on a regular basis.[18]

LTROs: The purpose of LTROs, which are conducted (only) by means of reverse transactions as well, is the provision of liquidity with a maturity longer than that of the MROs. They are conducted regularly each month and are executed by means of variable-rate standard tender procedures.

[14] ESCB/ECB Statute, Article 18.2.

[15] Guideline ECB/2014/60, Article 5(1)–(3). The five instruments are defined in Article (2), points (9), (40), (47), (72) and (80) and further analysed in Articles 10–14; and for a summary, see Table 7.1.

[16] Ibid., Articles 6–9, respectively.

[17] Tender procedure means a procedure whereby the Eurosystem provides liquidity to, or withdraws liquidity from, the market whereby the NCB enters into transactions by accepting bids submitted by counterparties after a public announcement (ibid., Article 2, point (92)). The indicative calendar for the Eurosystem's regular tender operations is endorsed by the GC and indicates the timing of the reserve maintenance period, as well as the announcement, allotment and maturity of main refinancing operations and regular longer term refinancing operations (ibid., Article 2, point (42)).

[18] This is the main ECB rate.

**Table 7.1** The five types of instruments used for the conduct of Eurosystem open market operations

| | |
|---|---|
| Reverse transaction | An instrument whereby an NCB buys or sells eligible assets under a repurchase agreement or conducts credit operations in the form of collateralised loans (this instrument is also used when providing access to the marginal lending facility) |
| Outright transaction | An instrument whereby the Eurosystem buys or sells eligible marketable assets outright in the market (spot or forward), resulting in a full transfer of ownership from the seller to the buyer with no connected reverse transfer of ownership |
| Foreign exchange swap for monetary policy purposes | An instrument whereby the Eurosystem buys or sells euro spot against a foreign currency and, at the same time, sells or buys it back in a forward transaction on a specified repurchase date |
| Collection of fixed-term deposits | An instrument whereby the Eurosystem invites counterparties to place fixed-term deposits on accounts with their home NCBs in order to absorb liquidity from the market |
| Issuance of ECB debt certificates | An instrument whereby the ECB issues debt certificates which represent a debt obligation of the ECB in relation to the certificate holder |

Normally, LTROs have a maturity of three months; nevertheless, the Eurosystem may conduct—on a non-regular basis—LTROs with another maturity (not specified in the indicative calendar for the Eurosystem's regular tender operations), which may have an early repayment clause representing either an option or a mandatory obligation for counterparties to repay, in full or in part, the amounts they were allotted in a given operation.[19]

Fine-tuning operations: These operations are conducted in order to smooth the effects on interest rates caused by unexpected liquidity fluctuations in the market by means of reverse transactions, foreign exchange swaps for monetary policy purposes or the collection of fixed-term deposits. They may be conducted either as a liquidity-providing or as a liquidity absorbing operation, normally have a non-standardised frequency and maturity and are normally executed by means of quick tender procedures. The ECB may conduct fine-tuning operations on any Eurosystem business day to counter liquidity imbalances in the reserve maintenance period.

Structural operations: These operations are conducted in order to adjust the structural position of the Eurosystem *vis-à-vis* the financial sys-

[19] On the extension of LTROs' maturity during the last years, see Sect. 7.1.3.

tem or to pursue other monetary policy implementation purposes; the instruments used are reverse transactions, the issuance of ECB debt certificates or outright transactions. Like the fine-tuning operations, they are liquidity-providing or liquidity-absorbing, have a frequency and maturity that is not standardised and are executed by means of tender or bilateral procedures,[20] depending on the specific type of instrument for their conduct.

Common features: All these categories of open market operations share in common that they are executed in a decentralised manner by the NCBs,[21] are subject to specific eligibility criteria for counterparties and are based on eligible assets as collateral (in the case of structural operations, this applies when conducted by means of reverse transactions and in the case of structural operations it applies when they are liquidity-providing, with the exception of outright purchases).[22]

**Standing Facilities**

(1) A second main instrument used by the Eurosystem in the context of the implementation of the single monetary policy is granting standing facilities to credit institutions in order to provide or absorb liquidity. These are aimed at signalling the general stance of monetary policy and provide a corridor for the overnight market interest rate under normal circumstances. The ECB is exclusively competent for establishing the general principles for the conduct of such operations as well.[23]

(2) Two standing facilities are available to credit institutions and other eligible counterparties of the Eurosystem: a marginal lending facility and a deposit facility. Both are administered overnight by the NCB of the

[20] Bilateral procedure means a procedure whereby the NCBs or, in exceptional circumstances the ECB, conduct fine-tuning operations or outright transactions, directly with one or more counterparties, or through stock exchanges or market agents, without making use of tender procedures; the Eurosystem provides liquidity to, or withdraws liquidity from, the market whereby the NCB enters into transactions by accepting bids submitted by counterparties after a public announcement (ibid., Article 2, point (4)).

[21] In the case of fine-tuning operations, this applies without prejudice to Article 45(3) of Guideline ECB/2014/60 on bilateral procedures executed by means of direct contact with counterparties (ibid., Article 8(2), point (d)).

[22] On the two latter aspects, see also later. The tender and bilateral procedures for Eurosystem open market operations are governed by Articles 24–54 of Guideline ECB/2014/60. On the main features of the Eurosystem's open market operations, see Table 7.2.

[23] ESCB/ECB Statute, Article 18(2).

**Table 7.2** Main features of the Eurosystem's open market operations

| | |
|---|---|
| Main refinancing operations (MROs) | |
| Purpose | Provision of liquidity |
| Instrument(s) used for execution | Reverse transactions |
| Maturity | One week |
| Other operational features | Conduct each week—execution by means of fixed-rate standard tender procedures |
| Longer term refinancing operations (LTROs) | |
| Purpose | Provision of liquidity in the longer term |
| Instrument(s) used for execution | Reverse transactions |
| Maturity | Usually three months |
| Other operational features | Conduct regularly each month—execution by means of variable-rate standard tender procedures |
| Fine-tuning operations | |
| Purpose | Dealing with liquidity fluctuations in the market—liquidity-providing or liquidity-absorbing operations |
| Instrument(s) used for execution | Reverse transactions, foreign exchange swaps for monetary policy purposes or the collection of fixed-term deposits |
| Maturity | Non-standardised |
| Other operational features | Non-standardised frequency of conduct—execution by means of tender or bilateral procedures |
| Structural operations | |
| Purpose | Adjustment of the structural position of the Eurosystem *vis-à-vis* the financial system or to the pursue of other monetary policy implementation purposes—liquidity-providing or liquidity-absorbing operations |
| Instrument(s) used for execution | Reverse transactions, the issuance of ECB debt certificates or outright transactions |
| Maturity | Non-standardised |
| Other operational features | Non-standardised frequency—execution by means of quick tender procedures |
| Common features | |
| Execution in a decentralised manner by the NCBs | |
| Subject to specific eligibility criteria for counterparties | |
| Based on eligible assets as collateral | |

Member State in which the requesting counterparty is established; the first, which is conducted by means of reverse transactions, is liquidity-providing and the second is liquidity absorbing. Applicable interest rates are uniform across the euro area; in particular, the interest rate on the marginal lending facility provides a ceiling for the overnight market interest rate, while the interest rate on the deposit facility provides a floor for

**Table 7.3** Evolution of the Eurosystem's balance sheet (2007–2017, in million euro)

| *Assets* | | | | *Liabilities* | | | |
|---|---|---|---|---|---|---|---|
| | *IV. 2017* | *V. 2010* | *V. 2007* | | *IV. 2017* | *V. 2010* | *V. 2007* |
| 1. Gold | 404,188 | 286,696 | 180,024 | 1. Banknotes in circulation | 1121,618 | 804,587 | 623,383 |
| 2. Claims on non-euro area residents denominated in foreign currency | 321,595 | 211,749 | 142,506 | 2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro | 1681,994 | 516,213 | 187,400 |
| 3. Claims on euro area residents denominated in foreign currency | 31,382 | 29,798 | 25,006 | 3. Other liabilities to euro area credit institutions denominated in euro | 10,722 | 390 | 201 |
| 4. Claims on non-euro area residents denominated in euro | 18,974 | 19,267 | 14,941 | 4. Debt certificates issued | 0 | 0 | 0 |
| 5. Lending to euro area credit institutions related to monetary policy operations denominated in euro | 784,153 | 811,688 | 445,739 | 5. Liabilities to other euro area residents denominated in euro (general government—other liabilities) | 344,246 | 126,471 | 68,777 |
| 6. Other claims on euro area credit institutions denominated in euro | 82,027 | 39,861 | 14,135 | 6. Liabilities to non-euro area residents denominated in euro | 169,136 | 59,248 | 20,135 |
| 7. Securities of euro area residents denominated in euro | 2236,213 | 387,114 | 94,505 | 7. Liabilities to euro area residents denominated in foreign currency | 3012 | 2383 | 155 |
| 8. General government debt denominated in euro | 26,372 | 35,582 | 37,657 | 8. Liabilities to non-euro area residents denominated in foreign currency | 10,494 | 12,619 | 15,474 |
| 9. Other assets | 234,494 | 248,214 | 232,539 | 9. Counterpart of SDR allocated by the IMF | 59,048 | 53,033 | 5578 |
| | | | | 10. Other liabilities | 225,723 | 169,162 | 72,098 |
| | | | | 11. Revaluation accounts | 412,030 | 249,205 | 125,521 |
| | | | | 12. Capital and reserves | 101,374 | 76,657 | 68,330 |
| Total | 4139,398 | 2069,968 | 1187,052 | Total | 4139,398 | 2069,968 | 1187,052 |

the overnight market interest rate. As a rule, there are no credit limits on standing facilities; nevertheless, a counterparty requiring recourse to the marginal lending facility must present sufficient underlying assets as collateral.[24]

**Minimum Reserves**

(1) In pursuit of monetary policy objectives, the ECB may "require credit institutions established in Member States to hold minimum reserve on accounts with the ECB and national central banks". This instrument pursues the aims of stabilising money market interest rates and creating (or enlarging) a structural liquidity shortage and help control monetary expansion. The GC is responsible for establishing the regulations concerning the calculation and determination of required minimum reserves. The definition of the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis must be based on a council regulation issued in accordance with the procedure of Article 41 ESCB/ECB Statute.[25]

(2) In accordance with the relevant Council Regulation (EC) No 2531/1998 of 23 November 1998 "concerning the application of minimum reserves by the [ECB]",[26] the ECB can impose, as of 1 January 1999, on credit institutions and other categories of financial firms operating in Member States whose currency is the euro a requirement to hold minimum reserves. This Regulation defined: the basis for minimum reserves, which may include liabilities resulting from both on-balance-sheet and off-balance-sheet items; the maximum permissible ratio between these reserves and their basis at 10% (the minimum set at 0%); the ECB's right to collect and verify the necessary information; and the sanctions to be imposed by the ECB in cases of non-compliance.

Regulation ECB/2003/9 (as in force[27]) further specifies the Council Regulation's provisions, stipulating, *inter alia*, that the subject to reserve requirements are both credit institutions in an EU Member State which

[24] Guideline ECB/2014/60, Articles 17–23. For an overview of the characteristics of both Eurosystem open market operations and Eurosystem standing facilities, see also Table I of the Guideline.

[25] ESCB/ECB Statute, Article 19(1)–(2).

[26] OJ L 318, 27.11.1998, pp. 1–3; this legal act is in force as (slightly) amended by Council Regulation (EC) No 134/2002 of 22 January 2002 (OJ L 24, 26.1.2002, p. 1).

[27] OJ L 250, 2.10.2003, pp. 10–16; by August 2019, this legal act had been amended four times.

has adopted the euro and to branches in such a Member State of credit institutions which have neither their registered nor their head office in the EU. The reserve ratio is set at 1% of all liabilities included in the reserve base, with the exception of deposits with agreed maturity over two years or deposits redeemable at notice over two years, repos and debt securities issued with an agreed maturity over two years for which applicable is a reserve ratio of 0%.[28]

*Eligible Counterparties*

Even though the purpose is provision of access to its monetary policy operations (i.e. open market operations and standing facilities[29]) to the broadest possible range of institutions, the Eurosystem only allows, in principle, participation by institutions fulfilling the following eligibility criteria[30]: first, they are subject to the Eurosystem's minimum reserve system and have not been granted an exemption from their obligations thereunder; second, they are subject to prudential supervision by National Competent Authorities in accordance with the Capital Requirements Directive No IV (CRD IV) and the Capital Requirements Regulation (CRR) are publicly owned credit institutions, within the meaning of Article 123(2) TFEU, subject to comparable prudential supervision, or are branches established in Member States whose currency is the euro of institutions incorporated outside the European Economic Area (EEA), provided that the home country has implemented the Basel III framework adopted by the Basel Committee;[31] third, they are financially sound;[32] and finally, they fulfil all operational requirements specified in the contractual or regulatory arrangements applied by the home NCB or the ECB with respect to the specific instrument or operation.[33]

[28] Regulation ECB/2003/9, Articles 2(1) and 4, respectively; the reserve base is determined in Article 3. Annex I of Guideline ECB/2014/60 also deals with minimum reserves (albeit for information purposes only).

[29] Guideline ECB/2014/60, Article 2, point (32).

[30] Ibid., Article 55.

[31] On this framework, see Chap. 4, Sect. 4.2.2.

[32] The criteria for the assessment of institutions' financial soundness are laid down in Article 55a of Guideline ECB/2014/60.

[33] Specific rules govern access to open market operations executed by means of standard tender procedures and to standing facilities and the selection of counterparties for access to open market operations executed by means of quick tender procedures or bilateral procedures (ibid., Articles 56 and 57).

*Assets Eligible as Collateral in the Eurosystem*

*General overview*: As already mentioned, pursuant to Article 18.1 ESCB/ECB Statute, the ECB and the NCBs may operate in the financial markets by buying and selling assets either outright or under repurchase agreements, provided that these operations are based on adequate collateral. As a result, since the start of Stage Three of EMU, all Eurosystem liquidity-providing operations were based on underlying assets provided by counterparties, either in the form of the transfer of ownership of assets or in the form of a pledge, an assignment or charge granted over relevant assets.[34]

*Eligible assets and accepted collateralisation techniques to be used for Eurosystem credit operations*: Under the Eurosystem monetary policy framework in force (i.e. Guideline ECB/2014/60), all 'Eurosystem credit operations'[35] are governed by a single framework for eligible assets. In order to participate in such operations, counterparties must provide the Eurosystem with assets that are eligible as collateral for such operations.[36] Without prejudice to this obligation, the Eurosystem may, upon request, provide counterparties with advice regarding the eligibility of either marketable assets already issued or of non-marketable assets which have already been requested for submission.

Eligible assets must be provided by counterparties either by ownership transfer in the form of a repurchase agreement or by the creation of a security interest in the form of a collateralised loan (in all cases pursuant to the national contractual or regulatory arrangements established and documented by the home NCB). In relation to the accepted collateralisation techniques, it is noted that, where counterparties provide eligible assets as collateral, the home NCB may require either their earmarking or their

[34] Initially, assets were divided into two tiers: while Tier 1 assets were specified by the ECB as marketable assets fulfilling certain uniform euro area-wide eligibility criteria, Tier 2 assets consisted of marketable or non-marketable assets, which were of particular importance for national financial markets and banking systems of euro-area Member States. Eligibility criteria for Tier 2 assets (which were normally not used by the Eurosystem in outright transactions) were established by the NCBs, subject to ECB approval.

[35] This term includes both liquidity-providing reverse transactions, that is liquidity-providing Eurosystem monetary policy operations excluding foreign exchange swaps for monetary policy purposes and outright purchases, and 'intraday credit'; the latter term is defined in Article 2, point (6) of Guideline ECB/2012/27 on the TARGET2 system (see Sect. 7.2.4) (Guideline ECB/2014/60, Article 2, points (31) and (46), respectively).

[36] Collateral provided by counterparties in respect of intraday credit must also comply with the eligibility criteria, as outlined in Guideline ECB/2012/27.

pooling, depending on the type of collateral management system it uses. It should also be noted that no distinction is made between marketable and non-marketable assets with regard to the quality of the assets and their eligibility for the various types of Eurosystem credit operations.[37]

*The 'Eurosystem credit assessment framework'*: In order to be eligible, assets must meet the high credit standards specified in the 'Eurosystem credit assessment framework' (the 'ECAF'), which lays down the procedures, rules and techniques to ensure, primarily, that the Eurosystem's requirement for high credit standards in relation to eligible assets is maintained and, secondarily, that these assets comply with the credit quality requirements defined by the Eurosystem. For this purpose, these requirements are defined by the Eurosystem in the form of credit quality steps by application of threshold values for the probability of default over a one-year horizon.[38] As part of its assessment of the credit standard of a specific asset, the Eurosystem may take into account institutional criteria and features ensuring similar protection for the asset holder (such as guarantees), having the right to determine whether an issue, issuer, debtor or guarantor fulfils its credit quality requirements on the basis of any information that it may consider relevant for ensuring adequate risk protection.[39]

### 7.1.3 In Particular: Implementation of ECB Monetary Policy Following the Recent (2007–2009) International Financial Crisis and the Ongoing Fiscal Crisis in the Euro Area

*Introductory Remarks*

Under the extraordinary circumstances arising from the need to bolster the European banking system following the recent (2007–2009) international financial crisis and the subsequent fiscal crisis in the euro area, the ECB (like almost all central banks in the Member States of the G-10[40])

[37] Guideline ECB/2014/60, Article 58.

[38] Ibid., Articles 59(1)–(3). Additional credit quality requirements for marketable and non-marketable assets are applied by the Eurosystem in accordance with Articles 60–88 and 89–112. When assessing credit quality requirements, the Eurosystem takes into account credit assessment information from credit assessment systems in accordance with Articles 119–136 (ibid., Article 59(5)). The ECAF follows the definition of 'default' laid down in the CRD IV and the CRR (ibid., Article 59(7)).

[39] Ibid., Article 59(6).

[40] See, on this, Chap. 1, Sect. 1.1.2.

adjusted its monetary policy in order to address the problem of low inflation (well below its target level of (close to) 2%). In particular:

(1) Immediately following the onset of the international financial crisis, and mainly after 2008, in order to bolster liquidity in the euro area economy, the ECB took the following measures: gradually cut the rate for its MROs from 4.5% to 1%; extended the maturity of LTROs from three months to one year; provided liquidity in foreign currency, particularly in US dollars and yen; carried out massive purchases of covered bonds denominated in euro; and markedly broadened the pool of assets eligible by the Eurosystem as collateral in the conduct of its credit transactions in the context of its single monetary policy.[41]

(2) Then, immediately following the onset of the ongoing fiscal crisis in the euro area in the spring of 2010,[42] several of the above-mentioned measures were further strengthened: the rate for the ECB's MROs was further cut to 0.5% (and then to 0%, a level held to this day); the maturity of LTROs was further extended;[43] the interest rate on the deposit facility entered negative territory (currently −0.40%); and the pool of assets eligible by the Eurosystem as collateral in the conduct of its credit transactions was further broadened.[44]

*The ECB Asset Purchase Programmes*

(1) The onset of the above-mentioned crises showed that the key problem of concern to the ECB has been an environment of very low inflation. Given that, as already mentioned,[45] a decision by the GC had defined price stability as a year-on-year increase in the HICP for the euro area of below, but close to, 2%, the fact that price levels remained persistently below this benchmark rendered necessary for the ECB, like other central banks around the world, to have recourse to quantitative easing, containing 'non-conventional' or 'unconventional' monetary policy instruments

[41] On this crisis, see Chap. 3, Sect. 3.1.2.

[42] On this crisis, see Chap. 2, Sect. 2.4.4.

[43] The (above-mentioned) three series of targeted LTROs are governed by Decisions ECB/2014/34 of 29 July 2014 (OJ L 258, 29.8.2014, pp. 11–29), as in force, ECB/2016/10 of 28 April 2016 (OJ L 132, 3.5.2016, pp. 107–128), as in force, and ECB/2019/21 of 22 July 2019 (OJ L 204, 2.8.2019, pp. 100–122), respectively.

[44] On the collateral framework of the Eurosystem throughout the two crises, also from a comparative point of view, see European Central Bank (2013a) and (2013b).

[45] See Sect. 7.1.1.

('temporary' monetary policy instruments in the jargon of the ECB) and mainly asset purchase programmes (APPs).[46]

(2) The ECB's first APP was the (first) covered bond purchase programme of 2 July 2009 (the 'CBPP'), replaced by the second covered bond purchase programme of 3 November 2011 (the 'CBPP2').[47] In the meantime, on 14 May 2010, the ECB had adopted the Securities Markets Programme (the 'SMP'), established by ECB Decision[48] of 14 May 2010, as a necessary measure for the achievement of its monetary policy objectives. In accordance with the latter programme, which was terminated in 2012, the ECB could, upon a decision of its GC, purchase bonds, including Member States' sovereign bonds, in the secondary market.[49]

(3) The ECB's Outright Monetary Transactions (the 'OMTs'), consisting in purchases of sovereign bonds of individual euro area Member States without access to the markets, were announced in September 2012, immediately following ECB President Draghi's statement that he would do "whatever it takes to save the euro". This programme has given rise to intense debate, culminating in an *ultra vires* review by the German Constitutional Court. The Court rejected constitutional complaints against the OMT programme, holding that a programme of unlimited bond purchases amidst a fiscal crisis in the euro area does not violate German law. This decision was based on the ECJ ruling in the case "Peter Gauweiler and others v Deutscher Bundestag",[50] which did not raise any objections as to the compatibility of OMTs with EU law, concluding that the ECB may, under exceptional circumstances, support euro area Member

[46] For an overview of all ECB legal acts pertaining to this temporary framework, see the ECB's website at: https://www.ecb.europa.eu/ecb/legal/1002/1014/html/index-tabs.en.html (constantly updated); for a general assessment, see European Central Bank (2010), Claeys and Leandro (2016), European Parliament (2014), Ross et al. (2015a) and (2015b), Claeys and Leandro (2016), Zilioli and Athanassiou (2018), pp. 633–644, Smits (2018), Draghi (2019) and Wutscher (2019), pp. 2052–2054. On the evolution of the Eurosystem's balance sheet during the period 2007–2017 as a result of the ECB's 'unconventional' monetary policy, see Table 7.3.

[47] Decisions ECB/2009/16 OJ L175, 4.7.2009, pp. 18–19) and ECB/2011/17 (OJ L 297, 16.11.2011, pp. 70–71), respectively. The legal bases in both cases were Article 127(2), first indent TFEU and Article 12.1, second sub-paragraph (in conjunction with the first indent of Article 3.1 and Article 18.1) ESCB/ECB Statute.

[48] Decision ECB/2010/5 (OJ L 124, 20.5.2010, pp. 8–9), adopted on the same legal bases as its above-mentioned decisions on the CBPP and the CBPP2.

[49] ECB purchases of Member States' sovereign bonds in the primary market (i.e. upon their issuance) are prohibited under Article 123(1) TFEU.

[50] Case C-62/14, 16 June 2015, (EU:C:2015:400), available at: https://curia.europa.eu/juris/celex.jsf?celex=62014CJ0062&lang1=el&type=TXT&ancre.

States facing acute financing problems, by purchasing their sovereign bonds, albeit (and mainly) under certain framework conditions, that is purchases should not be announced; their volume should be limited from the outset; and there should be a minimum period between the issue of the government bonds and their purchase by the ESCB, which should be defined from the outset in order to prevent the issuing conditions from being distorted.[51]

(4) Even though the OMT programme has not yet been activated, several other (corporate and sovereign) bond purchase programmes are currently under way (included in the so-called expanded asset purchase programme) to address the risks of a prolongation of the low-inflation period in the euro area.[52] These include the third covered bond purchase programme (the 'CBPP3');, the asset-backed securities purchase programme (the 'ABSPP');, the (secondary markets) public sector purchase programme (the 'PSPP'); and the corporate sector purchase programme (the 'CSPP').[53]

### *7.1.4 Introduction of the Euro Short-term Rate*

(1) As recently as 10 July 2019, the ECB adopted Guideline ECB/2019/19 on the euro short-term rate (the '€STR').[54] This legal act governs that rate, which is an interest rate benchmark, and establishes the ECB's responsibility for the administration and oversight of the euro short-term rate determination process, as well as the tasks and responsibilities of the ECB and the NCBs with respect to their contribution to the euro short-term rate determination process and other business procedures.[55] The reason underlying this initiative was the need to fully comply with the requirements introduced by Regulation (EU) 2016/1011 of the European

[51] On this case, see Smits (2015) (on the Advocate General's Opinion), Fabbrini (2015), Lastra (2015), pp. 261–264, Borger (2016), Zilioli and Athanassiou (2018), pp. 640–642, Chiti (2019), pp. 120–123, Baroncelli (2019), pp. 206–220 and Hadjiemmanuil (2019), pp. 90–94.

[52] On this programme, see European Central Bank (2015); see also at: https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html (continually updated).

[53] Decisions ECB/2014/40 (OJ L 335, 22.10.2014, pp. 22–24), ECB/2014/45 (OJ L 1, 6.1.2015, pp. 4–7), ECB/2015/10 (OJ L 121, 14.5.2015, pp. 20–24) and ECB/2016/16 (OJ L 157, 15.6.2016, pp. 28–32), respectively (and all as in force). The legal bases of all these decisions are, equally in this case, Article 127(2), first indent TFEU and Article 12.1, second sub-paragraph (in conjunction with the first indent of Article 3.1 and Article 18.1) Statute. On the PSPP, see Baroncelli (2019), pp. 220–230, also discussing the relevant ECJ judgment of 11 December 2018 in Case C-493/17 (EU:C:2018:1000) Heinrich Weiss and Others.

[54] OJ L 199, 26.7.2019, pp. 8–17.

[55] Guideline ECB/2019/19, Article 1.

Parliament and of the Council on financial benchmarks[56] and to avoid the risk that the use of the existing euro overnight index average (the 'EONIA') in new financial instruments or contracts may not be permitted in the future. As a result, it could complement existing benchmarks and serve as a backstop reference rate in the event of discontinuation of EONIA.[57]

(2) The €STR will reflect the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. It will be published for each TARGET2 business day based on transactions conducted and settled on the previous TARGET2 business day (reporting date 'T') with a maturity date of T + 1, which are deemed to be executed at arm's length and thereby reflect market rates in an unbiased way. The €STR methodology will include the rationale for its adoption, the definition of the underlying interest which it represents, the sources of the input statistical information, the calculation method, the arrangements for its publication and re-publication, a transparency policy concerning the periodic publication of errors, the conditions for triggering the contingency procedure and the calculation of the contingency rate.[58]

(3) Of particular importance is the provision stipulating that the ECB will adopt clear written policies and procedures (published on its website) on the possible cessation of the €STR owing to a situation, or any other condition, which would make it no longer representative of the underlying interest.[59] The ECB will have to review at least annually whether changes in the underlying market for the €STR require changes to the €STR and its methodology. The NCBs must comply with the Guideline by 1 October 2019, at the latest.[60]

[56] OJ L 171, 29.6.2016, pp. 1–65.

[57] Guideline ECB/2019/19, recital (1). The legal bases of the Guideline are Articles 127(2) and 127(5) TFEU, since the absence of robust and reliable benchmarks might trigger financial market disruptions with a possible significant adverse impact on the transmission of ECB monetary policy decisions and on the Eurosystem's ability to contribute to the smooth conduct of policies pursued by the competent authorities relating to stability of the financial system (ibid). The Guideline is also in line with the 2013 IOSCO Principles for Financial Benchmarks; although neither these IOSCO Principles nor Regulation (EU) 2016/1011 apply to central banks, in determining the euro short-term rate, the ECB as its administrator will endeavour to transpose the intention of these principles, where relevant and appropriate (ibid, recital (7)). The IOSCO Principles are available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[58] Ibid., Articles 3 and 6(1).

[59] Ibid., Article 10.

[60] Ibid., Articles 15(2) and 16(2).

## 7.2 The Other Basic Tasks of the ECB Within the Eurosystem

### 7.2.1 *Exchange-rate Policy*

*Introductory Remarks*

(1) According to Article 127(2), second indent TFEU, the Eurosystem's second basic task consists in the conduct of foreign exchange operations in consistency with Article 219 TFEU, which is structured as follows.

Article 219(1)–(2) (Article 111(1)–(2) TEC) refers to the single exchange-rate policy of the EU, which is regulated under two alternative regimes: first, the case in which (as is the case today) the euro freely floats in the markets as part of an international (non-)system of floating exchange rates; and second, the case in which the euro may in future take part in an international system of either fixed exchange rates (such as, for instance, the Bretton Woods system which was in operation from 1945 until 1971 within the framework of the IMF[61]) or managed floating exchange rates.

Article 219(3) (Article 111(3) TEC) determines then the procedure to be applied, by derogation from Article 218, when the EU negotiates bilateral or multilateral agreements concerning monetary or foreign exchange regime matters with one or more third states or international organisations.

Finally, Article 219(4) (Article 111(5) TEC) delineates the competence of Member States to negotiate independently in international bodies and conclude international agreements.

Article 219 TFEU is not applicable to the Member States with a derogation and the UK. Furthermore, these Member States do not have voting rights in the Council for the approval of the decisions referred to therein.[62]

(2) The reference made in Article 127(2) TFEU to Article 219 is due to the fact that the determination of the authority that should be responsible for defining the EU's single exchange-rate policy was one of the most disputed issues in the drafting of the Maastricht Treaty.[63] According to one point of view, which finally prevailed, conducting the single exchange-rate policy has a potentially political character and, as a result, must fall within the competence of the Council. This view was based also on the

[61] See Chap. 2, Sect. 2.1.1.

[62] TFEU, Article 139(4) and Protocol No 15, paragraphs 4 and 6, respectively. On Articles 127(2), second indent and 219 TFEU, see Smits (1997), pp. 369–409, Potacs (2019), pp. 2020–2022 and Wutscher (2019), pp. 2054–2055.

[63] On this, see Smits (1997), pp. 375–376.

practices of the Member States, 13 of which assigned (or still assign in the case of Member States with a derogation) the conduct of this policy to the government independently or concurrently with the central bank. It has been counter-argued that the exchange-rate policy should be defined by the same authority which is also entrusted with defining the single monetary policy, since conducting the former immediately impacts on the effectiveness of the latter, which is aimed at maintaining price stability. From this perspective, both defining and implementing exchange-rate policy should fully be assigned to the Eurosystem.

*Participation of the Euro in an International System of Fixed or Managed Floating Exchange Rates*

**Conclusion of Formal Agreements on the Participation of the Euro in an International System of Fixed or Managed Floating Exchange Rates**

(1) Article 219(1) TFEU lays down provisions with regard to the participation of the euro in an international system of either fixed or managed floating exchange rates in relation to the currencies of third states, stipulating that the competent body for the conclusion of the relevant formal agreements is the Council, executed in accordance with Article 219(3). The former "Declaration on Article 111" annexed to the Maastricht Treaty specified that the term "formal agreements" does not establish a new category of international agreements within EU law but is used as opposed to informal agreements between governments and/or central banks on interventions into currency markets as part of the operation of international systems of floating exchange rates (which are regulated by Article 219(2)).

(2) The conclusion of such formal agreements, by derogation from Article 218 TFEU, is initiated either by the ECB or by the Commission, upon consultation with the ECB, which must submit a recommendation in order to reach consensus consistent with the objective of price stability. Given the exceptional importance of the matter, the Council's decision must be made unanimously after consulting the European Parliament. In this respect, the Council must decide the arrangements for both the negotiation and for the conclusion of the arrangements, which must ensure that the EU expresses a single position, irrespective of the body assigned with the conduct of negotiations. The Commission must be fully associated with these negotiations.[64]

[64] TFEU, Articles 219(1), first sub-paragraph, and 219(3).

*Adoption, Adjustment or Abandonment of the Central Rates of the Euro Within the International Exchange Rate System*

The Council is also competent to make decisions (by qualified majority in this case), on the adoption, adjustment or abandonment of the euro's central rates within the international exchange-rate system, in which it would participate. This procedure is also initiated either by the ECB or by the Commission, upon consultation with the ECB, which must submit a recommendation in order (again) to reach consensus in line with the objective of price stability. The European Parliament is (simply) informed of this development by the Council's President.[65]

*The Single Exchange-rate Policy in the Context of an International System of Freely Floating Exchange Rates*

In the context of an international system of freely floating exchange rates, that is in absence of an international exchange-rate system, the Council is competent to formulate "general orientations for exchange-rate policy in relation to [third States'] currencies". These are formulated by the Council, on a recommendation from the ECB or by the Commission, upon consultation with the ECB, and must be without prejudice to the primary objective of the Eurosystem, that is maintaining price stability.[66] In this context, a resolution issued by the European Council of Luxembourg in December 1997 points out that it is only in exceptional circumstances (such as in the case of a clear misalignment) that the Council may formulate general orientations for exchange-rate policy, always respecting the independence of the ECB and the NCBs and in line with the objective of maintaining price stability.[67]

*Member States' Negotiating Power*

Member States maintain their power to independently negotiate in international bodies and to conclude international agreements; this is, however, delineated by the competence and agreements of the EU in relation

[65] Ibid., Article 219(1), second sub-paragraph.

[66] Ibid., Article 219(2).

[67] Resolution of the European Council on Economic Policy Coordination in Stage 3 of EMU and on Treaty Article 109 and 109b, Annex 1, Luxembourg European Council Presidency conclusions, 12–13 December 1997, paragraph 8, available at: https://www.consilium.europa.eu/media/21114/luxembourg-european-council.pdf.

to the EMU.[68] This provision covers by definition both international intergovernmental fora (such as the G7, G10 and G20), as well as international fora with the participation of central banks and/or supervisory authorities (e.g. the Basel Committee). This provision is especially important in the case of international organisations, such as the IMF, the Articles of Agreement of which only allow membership of sovereign states.[69] In accordance with the Resolution of the 1997 Luxembourg European Council, Member States should, in their capacities as members of the IMF, help to establish pragmatic arrangements, which would facilitate the conduct of surveillance functions by the IMF and the presentation of (then) Community positions, including the views of the ESCB, in IMF fora.[70]

### 7.2.2 *Holding and Management of Foreign Reserve Assets*

*Transfer of Foreign Reserve Assets to the ECB*

(1) According to Article 127(2), third indent TFEU, the third basic task of the Eurosystem consists in holding and managing the official foreign reserves of the Member States.[71] Under the ESCB/ECB Statute, NCBs should transfer to the ECB foreign reserve assets up to an amount equivalent to 50 billion euros and denominated in any freely traded currency, other than Member States' currencies, euro, IMF reserve positions and Special Drawing Rights ('SDRs'). Each NCB's contribution is fixed in proportion to its share in the ECB subscribed capital. The ECB has the full right to hold and manage these reserves and use them for the purposes set out in the Statute.[72]

[68] TFEU, Article 219(4). This aspect is governed by Article 138; see on this Potacs (2019), pp. 2095–2097.

[69] On the contrary, the ECB became itself a member of the BIS in 2000 (along with several other NCBs—Members of the Eurosystem), by virtue of an amendment to Article 15 of the BIS Statutes, according to which its members are central banks in general and not only national central banks (as initially provided for).

[70] Luxembourg European Council's Resolution, 12–13 December 1997, paragraph 10, in finem.

[71] On this Article, see Wutscher (2019), pp. 2055–2056.

[72] ESCB/ECB Statute, Articles 30.1, first and third sentences and 30.2. Each NCB is credited by the ECB with a claim equivalent to its contribution; the denomination and remuneration of such claims is determined by the GC (ibid., Article 30.3).

Part of the foreign reserve assets were provided upon the ECB's creation (39.5 billion euros from NCBs of Member States whose currency is the euro),[73] while the remaining amount was subsequently provided by a GC Decision made in accordance with the weighted voting procedure under Article 10.3 ESCB/ECB Statute.[74] Pursuant to Articles 9.2 and 12.1 of the Statute, the ECB may, in line with the principle of decentralisation, carry out its activities through the NCBs and have recourse to them for the implementation of certain operations included in the tasks conferred upon the ECB. The terms under which NCBs manage the ECB foreign reserve assets and the legal documentation for operations involving such assets (under a master netting agreement) are set out in a GC Guideline of 20 June 2008 (ECB/2008/5).[75]

(3) The ECB may request the provision of further foreign reserve assets within the limits and under the conditions laid down by the Council, in accordance with the procedure of Article 129(4) TFEU on its complementary legislation;[76] it may also hold and manage IMF reserve positions and SDRs and provide for their pooling.[77]

*Holding of Foreign Reserve Assets by NCBs*

Operations in foreign reserve assets remaining with NCBs (following the above-mentioned transfers to the ECB) are not subject to restrictions, provided that they are aimed at the fulfilment of obligations undertaken by NCBs towards international bodies pursuant to the Statutes' provisions

[73] See, in this respect, the Appendix to the ECB Guideline of 3 November 1998, as amended in 2000 (ECB/2000/15, OJ L 336, 3012.2000, pp. 114–117), which also sets out the composition and valuation of foreign reserve assets, modalities for their initial transfer, as well as the denomination and remuneration of equivalent claims.

[74] This decision was adopted on the basis of Article 30.1, third sentence ESCB/ECB Statute.

[75] OJ L 192, 19.7.2008, pp. 63–83; this Guideline, adopted on the basis of Article 30.6 ESCB/ECB Statute, is in force as amended by Guideline ECB/20013/45 (OJ L 57, 4.3.2014, pp. 23–24). Under, *inter alia*, the same legal basis, the ECB adopted on 26 September 2002 Guideline ECB/2002/6 on the minimum standards for the ECB and NCBs when conducting monetary policy operations, foreign exchange operations with ECB's foreign reserves and managing ECB's foreign reserve assets (OJ L 270, 8.10.2002, p. 14–16). It is noted, however, that—as indicated by its title—this Guideline is of horizontal applicability (hence, another legal basis are the first three indents of Article 127(2)).

[76] Relevant in this respect is Council Regulation (EC) No 1010/2000 (OJ L 115, 16.5.2000, pp. 2–3).

[77] ESCB/ECB Statute, Article 30.4–30.5. Article 48 governs the deferred payment of reserves when a Member State's derogation has been abrogated.

on the ECB's and NCBs' external relations.[78] By contrast, all other operations in foreign reserve assets remaining with the NCBs and Member States' transactions with their foreign exchange working balances, above a certain limit established by GC Guidelines, are subject to approval by the ECB in order to ensure consistency with the EU's exchange rate and monetary policies.[79]

### *7.2.3 Promotion of the Smooth Functioning of Payment Systems*

*General Overview*

Pursuant to Article 127(2), fourth indent TFEU and Article 3.1, last indent ESCB/ECB Statute, the Eurosystem's fourth basic task relates to the promotion of the smooth operation of payment systems in the euro area. This provision confirms the importance that central banks across all advanced economies attribute (at least over the last few years) to overseeing the operation of small-value payment systems and large-value payment systems.[80] Of particular importance is the regulatory competence assigned to the ECB under Article 22 ESCB/ECB Statute, based on which it is entitled to lay down regulations to ensure efficient and sound clearing and payment systems within the EU as well as with other countries, while, to this end, the ECB and NCBs may provide facilities.[81] It is, *inter alia*, in this context that the TARGET system, replaced in 2007 by the TARGET2 system and the TARGET2-Securities system were set up.[82]

*A Brief Overview of Regulation ECB/2014/28 of 3 July 2014 on Oversight Requirements for Systemically Important Payment Systems*

(1) The oversight requirements for systemically important payment systems (the 'SIPSs') are laid down in Regulation ECB/2014/28 of 3 July 2014, as in force.[83] This legal act, the content of which was influenced by

[78] Ibid., Article 31.1 with reference to Article 23.

[79] Ibid., Articles 31.2 and 31.3.

[80] On this Article, see Wutscher (2019), pp. 2056–2057.

[81] See Smits (1997), pp. 297–298 and Kokkola (2010), pp. 271–290.

[82] See details in Sect. 7.2.4.

[83] OJ L 217, 23.7.2014, pp. 16–30; an unofficial consolidated text is available at: https://www.ecb.europa.eu/ecb/legal/pdf/celex_02014r0795-20171206_en_txt.pdf. Further detailed rules are laid down in relation to the procedural aspects concerning the imposition of corrective measures for non-compliance with this Regulation, the methodology for calculating sanctions for infringements of the oversight requirements for SIPS, and the procedure

the "Principles for financial market infrastructures" of 16 April 2012 developed by the Committee on Payments and Markets Infrastructures and the International Organization of Securities Commission (IOSCO),[84] provides that a payment system must be identified as a SIPS if two conditions are met: first, it is eligible to be notified as a system pursuant to Directive 98/26/European Community (EC) of the European Parliament and of the Council of 19 May 1998 "on settlement finality in payment and securities settlement systems"[85] by a Member State whose currency is the euro or its operator is established in the euro area, including establishment by means of a branch, through which the system is operated; and second, at least two out of three specific quantitative factors set in the Regulation are met or it is used for the settlement of other financial market infrastructures (the 'FMIs') over a calendar year.[86] An identification exercise must be performed on an annual basis; the GC must adopt a relevant decision identifying SIPS, their respective operators and competent authorities.[87]

(2) The Regulation lays down rules which can be grouped as follows:

the first contains rules relating to legal soundness and governance issues, which are imposing several obligations of SIPS operators;[88]

the second group relates to the management of risks; this includes rules (and in certain cases prescribes procedures) which lay down a general

and conditions for exercise by a competent authority of certain powers in relation to oversight of SIPS (Decisions ECB/2017/33 of 3 November 2017 (OJ L 299, 16.11.2017, pp. 34–37) ECB/2017/35 of 3 November 2017 (OJ L 299, 16.11.2017, pp. 31–33) and ECB/2019/25 of 26 July 2019 (OJ L 214, 16.8.2019, pp. 16–24), respectively), adopted on the basis of this Regulation.

[84] Available at: https://www.bis.org/cpmi/publ/d101a.pdf.

[85] OJ L 166, 11.6.98, pp. 45–50. Despite the fact that TARGET2 has been developed as an SSP platform, NCBs maintain the rules they used to have during the operation of TARGET, which can mainly be attributed to monetary policy reasons (based on the obligation to mandatorily hold deposits with accounts of NCBs, but also mainly based on the principle of the decentralised implementation of the single monetary policy).

[86] 'FMI' means a multilateral system among participating institutions, including the system operator, used to clear, settle or record payments, securities, derivatives or other financial transactions (ibid., article 2, point (17)).

[87] Regulation ECB/2014/28, Article 1(2)–(3); the relevant list is maintained on the ECB's website and updated after each change (see at: https://www.ecb.europa.eu/paym/pol/activ/systems/html/index.en.html); *inter alia*, it includes the TARGET2 system (Decision ECB/2014/35, L 245, 20.8.2014, pp. 5–8).

[88] Ibid., Articles 3–4. 'SIPS operator' means the legal entity legally responsible for operating a SIPS (ibid., article 2, point (4)).

framework for risk management, and then govern, in a detailed manner, credit risk and the acceptance of collateral, liquidity risk, the final settlement to take place no later than the end of the intended settlement date, money settlements, payment *versus* payment (for the elimination of principal risk), participant-default rules and procedures, general business risk, custody and investment risks and operational risk;[89]

further rules refer to access and participation criteria, tiered participation arrangements, efficiency and effectiveness, communication procedures and standards, disclosure of rules, key procedures and market data, the powers of competent authorities, the organisation of oversight activities, confidentiality and corrective measures;[90]

finally, the power of the ECB to impose sanctions in the case of an infringement of the Regulation is laid down in accordance with Council Regulation (EC) No 2532/98 and Regulation ECB/1999/4.[91]

### *7.2.4 In Particular: The TARGET2 Payment System and the TARGET2-Securities System*

*The Migration from the Initial TARGET Payment System to the TARGET2 Payment System*

**The Initial TARGET Payment System**

(1) As part of its powers to provide facilities to payment systems operating in Member States, the EMI designed an interconnected system. This was then put into operation by the ECB and the NCBs members of the ESCB in January 1999 as a key infrastructure for the implementation of the single monetary policy, since this entails the need for a payment arrangement through which the monetary policy operations between NCBs and credit institutions can be effected in a timely and secure manner.[92] This system, the "Trans-European Automated Real-time Gross settlement Express Transfer System", known under the acronym 'TARGET', was a real-time gross settlement system (RTGS)[93] and its operation was based on Guideline

[89] Ibid., Articles 5–15.
[90] Ibid., Articles 16–21, 21a, 21b and 22.
[91] Ibid., Article 23; on these two regulations, see Chap. 6, Sect. 6.3.2.
[92] See Sect. 7.1.1.
[93] See Chap. 1, Sect. 1.1.1.

ECB/2001/3.[94] Its core was established in the ECB's headquarters, with which NCBs of Member States whose currency was (then) the euro, were mandatorily interlinked, whilst NCBs of Member States with a derogation could opt for such interlinkage.

(2) The TARGET system expanded the benefits offered by national RTGSs (which ensured final settlement of payments, under the rules governing their operation and guaranteed a high level of efficiency and security in terms of payment settlement and minimised credit risk and liquidity risk in payment systems) across borders, enabling, at the same time, participants to give or be given intraday settlement for their cross-border payments. Its role consisted in effecting large-value payments, on the one hand, and on the other hand, the final settlement (by debiting/crediting the participants' accounts in the NCB) of queued payments on a continuous basis in order to minimise the settlement risk arising from deferred execution of payments. By way of indication, TARGET was used to execute all payments in which the ESCB was a counterparty, such as those associated with the conduct of the single monetary policy by default, as well as all large-value transactions resulting from interventions of credit institutions in the foreign exchange market, as well as large-value clearing systems and settlement of sales of assets denominated in euro.[95]

The TARGET system's operation has been deemed successful. End-2005 TARGET had 1072 direct and 9322 indirect participants, while the overall number of banks that could be addressed through TARGET (including branches and subsidiaries) exceeded 52,700 worldwide.[96]

### The Need to Amend TARGET and Migration to TARGET2

(1) In October 2002, the GC elaborated a long-term strategy on TARGET[97] and in December of the same year a consultation text was published under the title "TARGET2: Principles and Structure". This systemic change had a twofold justification: first, the need for further integra-

[94] OJ L 140, 24.5.2001, pp. 72–86; this Guideline repealed the non-published Guideline ECB/2000/9. Its legal basis was Article 105(2), first and fourth indents, TEC, as well as Articles 3.1, 12.1, 14.3, 17, 18 and 22 ESCB/ECB Statute.

[95] RTGS systems of Member States with a derogation were allowed connection to TARGET and, conditionally, could process the euro as a foreign currency alongside their respective national currencies (Guideline ECB/2001/3, Article 2(2)).

[96] See, on this, European Central Bank (2006): TARGET Annual Report 2005, March.

[97] See European Central Bank (2002): The long-term evolution of TARGET, Press Release, 24 October.

tion of the European financial market (operational and technical homogeneity, harmonisation and single pricing of the services provided, EU enlargement); and second, the need to increase the system's efficiency/effectiveness in terms of cost and liquidity management efficiency, development economies of scale and increased availability/business continuity in contingency situations.[98]

(2) Following a consultation with interested parties, the GC adopted on 26 April 2007 Guideline ECB/2007/2 on the TARGET2[99] and on 24 July Decision ECB/2007/7 concerning the terms and conditions of TARGET2-ECB.[100] The former was repealed, with effect from 1 January 2013, by Guideline ECB/2012/27 of 5 December 2012,[101] which is currently in force (and is briefly analysed below). TARGET2 was geared to the operational needs of its users and is based on the principles of decentralisation and neutrality.[102] The essential difference with TARGET lies in the fact that all direct participant accounts are held with a single-shared platform (the 'SSP') through which payment orders are submitted and processed and payments are ultimately received in the same technical manner. As a result, debiting of the account of the sending participant and crediting of the account of the receiving participant are executed simultaneously, without the need for mediation of an interlinking component.[103]

[98] Initially, two different views had emerged: the 'advanced common features model' and the 'single platform model', which was finally accepted, in December 2004, by the GC.

[99] OJ L 237, 8.9.2007, pp. 1–70.

[100] OJ L 237, 8.9.2007, pp. 71–107; by August 2019, this decision had been amended eleven times. An unofficial consolidated text is available at: https://www.ecb.europa.eu/ecb/legal/pdf/celex_02007d0007-20181130_en_txt.pdf. Decision ECB/2010/9 on access to and use of certain TARGET2 data was also adopted on 29 July 2010 (OJ L 211, 12.8.2010, pp. 45–47); by August 2019, this decision had been amended six times. An unofficial consolidated text is available at: https://www.ecb.europa.eu/ecb/legal/pdf/celex_02007d0007-20181130_en_txt.pdf.

[101] OL L 30, 30.1.2013, pp. 1–93; by August 2019, this Guideline, adopted, *inter alia*, on the basis of (the above-mentioned) Article 22 ESCB/ECB Statute, had (already) been amended six times. An unofficial consolidated text is available at: https://www.ecb.europa.eu/ecb/legal/pdf/celex_02007d0007-20181130_en_txt.pdf.

[102] European Central Bank (2007): Single Shared Platform, General Functional Specifications, Document for users, Version 2.1, chap. 1.2. The latest update to this document is dated 22 March 2019 (Version 13.0).

[103] The interlinking component of TARGET was set out in Article 4 of Guideline ECB/2001/3. On this system, see Geva (2008), Kokkola (2010), pp. 245–259 and Whelan (2014); for a comparison of the main elements of the two systems, see Table 7.4.

**Table 7.4** TARGET *versus* TARGET2

| | *TARGET* | *TARGET2* |
|---|---|---|
| Average number of payments per day | 250,000 | 350,000 |
| Peak number of payments per day | 380,000 | 500,000 |
| Peak number of payments per hour | – | 105,000 |
| Estimated yearly growth | – | 5% |
| Number of credit institutions-participants | 1,500 | 1,000+ |
| Operational hours | 07.00–18.00 | 07.00–18.00 |
| Processing time | 30 minutes | less than 5 minutes for 99.94% of payments |
| Availability | 99.8% | 99.99% |
| Maximum number of short-term interruptions per year | 12 | 6 |
| Necessary recovery time | 2 hours | 1–2 hours |

**The TARGET2-Securities System for Securities Settlement in Central Bank Money**

(1) The GC decided at its meeting on 6 July 2006, in cooperation with central securities depositories (the 'CSDs'), to explore the possibility of setting up a new Eurosystem service, called TARGET2-Securities (the 'T2S'), in order to enable the settlement of securities in central bank money. The launching was decided on 17 July 2008 and then, on 19 March 2009, on the basis of an offer made by four NCBs (Deutsche Bundesbank, Banco de España, Banque de France and Banca d' Italia), the decision was made that the T2S would be developed and operated by these NCBs. Ultimately, on 21 April 2010, the GC adopted Guideline ECB/2010/2 on TARGET2-Securities,[104] followed by two decisions on the selection of TARGET2S network service providers and the establishment of detailed rules and procedures for implementing the eligibility criteria for CSDs to access TARGET2S services.[105]

(2) The T2S, which entered into operation in June 2015 (postponed from the initially planned date in September 2014), is based on a single

[104] OL L 125, 11.8.2012, pp. 19–29; by August 2019, this Guideline, adopted, *inter alia*, on the basis of Article 22 ESCB/ECB Statute as well, had been amended three times.

[105] Decisions ECB/2011/5 of 20 April 2011 (OJ L 134, 21.5.2011, pp. 22–26) and ECB/2011/20 of 16 November 2011 (OJ L 319, 2.12.2011, pp. 117–123). Decision ECB/2019/1666 (OJ L 102, 22.4.2009, pp. 12–17) governs the operation of the Market Infrastructure Board, the mandate of which is laid down in Annex I of the Decision.

technical platform incorporated in the RTGSs of NCBs and in TARGET2. It is a service provided by the Eurosystem to CSDs allowing core, neutral and borderless security settlement in central bank money to be carried out, with delivery *versus* simultaneous payment. It is not only available for settlement in euro, but is also open to non-euro area NCBs, as well as any other central banks that may wish to participate by making their currency available for central bank money is settlement therein.[106] Guideline ECB/2010/2 lays down the rules on the T2S programme governance, determines its main features and the main decisions to be taken by the GC and specifies the tasks and responsibilities of the T2S Programme Board and the four NCBs, as well as relations between them during the stage of T2S standard-setting and development.

In addition, it lays down the main principles for the following T2S-related matters: financial regime, rights and safeguards for participants and the Eurosystem, access conditions for CSDs and elaboration of contractual relations with them, eligibility conditions for currencies other than the euro for the purposes of T2S and development of the T2S programme.[107]

*The TARGET2 System*

**Scope and Transactions—Types of Payments**

(1) TARGET2, which is structured as a multiplicity of RTGS systems, provides RTGS for payments in euro, with settlement in central bank money across the following accounts: first, payments module (the 'PM') accounts; second, T2S-dedicated cash accounts (T2S DCAs) for the purpose of securities transactions in the context of the TARGET2-Securities; and third, TARGET instant payment settlement (TIPS) dedicated cash accounts (TIPS DCAs).[108] These accounts must always be used by NCBs for open market monetary policy operations, the settlement of transactions with ancillary systems and payments between credit institutions. Intra-ESCB transactions are also processed through TARGET2, unless

[106] For more details on the eligibility conditions of EEA currencies other than the euro for use in T2S, see Guideline ECB/2010/2 (OJ L 118, 12.5.2010, pp. 65–80), Article 18.

[107] Guideline ECB/2010/2, Article 1(2). On this system, see Kokkola (2010), pp. 265–270.

[108] Guideline ECB/2012/27, Articles 1(1), first sentence, and 1(2). Instant payments are governed by Articles 36 and 66–67 PSD II and Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 (OJ L 69, 13.3.2018, pp. 23–43).

there is a bilateral or multilateral agreement to process them through correspondent accounts.[109]

The following presentation is confined to the payments module and the related accounts. PM means an SSP module in which payments of its account holders are settled on PM accounts; in turn, 'PM account' means an account held by a PM account holder in the PM with a Eurosystem CB (i.e. the ECB and the euro area NCBs), which is necessary for such account holder to submit payment orders or receive payments via TARGET2 and settle such payments with a Eurosystem CB.[110]

(2) Each NCB—Member of the Eurosystem, which is a direct participant of the system, operates its own TARGET2 component,[111] which is a system designated as such by the relevant national legislation transposing Directive 98/26/EC. The NCBs of Member States with a derogation may only connect to TARGET2 if they conclude an agreement with the Eurosystem CBs specifying that the connected NCBs will comply with the TARGET Guideline, subject to any mutually agreed appropriate specifications and modifications.[112]

(3) The system's members may process transactions directly resulting from or made in connection with Eurosystem monetary policy operations. In addition, it may process the following types of payments: settlement of the euro leg of foreign exchange operations involving the Eurosystem, of the cash leg of securities transactions and of euro transfers resulting from transactions either in cross-border large-value netting systems or in euro retail payment systems of systemic importance; 'instant payment orders' and 'positive recall answers';[113] furthermore, various types of liquidity

[109] Ibid., Articles 2 and 5. Intra-Eurosystem settlement is governed by Article 6 of the Guideline.

[110] Ibid., Article 2, points (8) and (9), respectively. The opening and management of PM accounts is governed by Article 12 of Annex II of the Guideline.

[111] The names of TARGET2 national components comprise only the term 'TARGET2' and the name or abbreviation of the respective central bank or the Member State corresponding to the Eurosystem NCB (e.g. the Greek component is indicated as TARGET2-GR) (ibid., Article 3).

[112] Ibid., Article 4.

[113] 'Instant payment order' means, in line with the European Payments Council's SEPA Instant Credit Transfer (SCT Inst) scheme, a payment instruction which can be executed 24 hours a day any calendar day of the year, with immediate or close to immediate processing and notification to the payer (ibid., Article 2, point (81)); 'positive recall answer' is a payment order as defined in Article 2, point (83).

transfer orders;[114] and finally, any other transactions in euro addressed to TARGET2 participants.

### Types of Participants—Suspension or Termination of Participation

(1) There are two types of participants in TARGET2: direct and indirect. Direct participants (which can be credit institutions established in the EU or the EEA, credit institutions established outside the EEA, provided that they act through a branch established in the EU or the EEA, NCBs and the ECB) hold PM accounts with an NCB.[115] On the other hand, indirect participants (which can be credit institutions established in the EU or the EEA) do not hold PM accounts but enter into an agreement with a direct participant (except the ECB) to submit payment orders and/or receive payments, as well as to settle them via a PM account holder.[116] The latter may also designate 'addressable BIC holders' as indirect participants.[117]

Reference should also be made to the 'multi-addressee access'; this is defined as the facility by which branches or credit institutions established in the EU or the EEA can access the relevant TARGET2 component system by submitting payment orders and/or receiving payments directly to and from that system; this facility authorises these entities to submit their payment orders through the account holder's PM account without the latter's involvement.[118] A TARGET2 directory, updated on a weekly basis, is the database of bank identifier codes (BICs) used for the routing of payment orders addressed to various categories of TARGET2 participants.[119]

[114] These also include the following liquidity transfer orders: 'T2S DCA to T2S DCA', 'T2S DCA to PM', 'PM to T2S DCA', 'TIPS DCA to PM' and 'PM to TIPS DCA'; all these terms are defined in Article 2.

[115] Ibid., Article 2, point (6) and Annex II, Articles 4(1) and 5(2). Article 4(2)–(3) of Annex II lays down further access criteria for direct participation and Article the application procedure.

[116] Ibid., Article 2, point (13) and Annex II, Article 6(1). Article 7 of Annex II specifies the responsibilities of PM account holders.

[117] Ibid., Annex II, Article 5(2)–(3). 'Addressable BIC holder' means an entity which holds a Business Identifier Code (the 'BIC'), is not recognised as an indirect participant in the PM and is a correspondent or customer of a PM account holder or a branch of a direct or indirect participant, and is able to submit payment orders to and receive payments from a TARGET2 component system via the PM account holder (ibid., Annex II, Article 1, first indent). On the differences between direct and indirect participation in TARGET2, see Table 7.5.

[118] Ibid., Annex II, Article 1; Article 5(4) lays down specific rules.

[119] Ibid., Annex II, Article 9.

**Table 7.5** Direct *versus* indirect participants in the TARGET2 system

| | *Direct participant* | *Indirect participant* |
|---|---|---|
| Execution of payments | Directly | Through a direct participant |
| PA account | Yes | No |
| Liquidity provision and control | Through own PA account | Via direct participant |
| Access to the information and control module (ICM) | Yes | No |
| Access | Directly | Indirectly |
| Listed in the BIC TARGET2 directory | As a direct participant | As an indirect participant |

(2) Eurosystem CBs must immediately terminate, without prior notice, or suspend a participant's participation in the relevant TARGET2 component system if either insolvency proceedings are opened in relation to a participant or this no longer meets the access criteria for participation therein. If participation in TARGET2 is suspended or terminated for the above reasons or on the grounds of prudence,[120] the Eurosystem CB concerned must immediately notify accordingly all other Eurosystem; it also assumes liability in relation to those CBs if it either subsequently authorises the settlement of payment orders addressed to participants whose participation it has suspended or terminated or does not comply with the above obligations.[121]

### Key Aspects Relating to the Operation of the TARGET2

Processing of payment orders: The types of payment orders that may be used by TARGET2 members are credit transfer orders, direct debit instructions carried out under a direct debit authorisation and liquidity transfer orders.[122] Instructing participants must designate every payment order as one of the following three classes: normal (priority class 2), urgent (priority class 1) and highly urgent (priority class 0); by default, a payment order is treated as normal.[123]

[120] This aspect is governed by Article 19.

[121] Ibid., Article 17.

[122] Ibid., Annex II, Articles 3(2) and 13, respectively. The rules governing the acceptance and rejection of payment orders are laid down in Article 14 of Annex II.

[123] Ibid., Annex II, Article 15(2); Article 15(2)–(3) contains rules on the designation of specific payment orders as highly urgent or urgent.

Liquidity management: TARGET2 has set up a particularly flexible and efficient framework for liquidity management, which includes the following: bilateral and multilateral liquidity limits, liquidity reservation facilities, as well as standing instructions for liquidity reservation and dedication of liquidity.[124] In addition, in order to avoid the fragmentation of liquidity and simplify the liquidity management within a group of credit institutions, the system enables credit institutions that are interconnected or belong to the same group to manage and monitor their liquidity in a pooled manner ('liquidity pooling'). Liquidity may be pooled in two modes: a consolidated account information (CAI) mode, offering direct access to information consolidated at the level of the CAI group and an aggregated liquidity mode enabling the aggregation of liquidity for different credit institutions by means of a virtual account facility.[125]

Intraday credit: The euro area NCBs may grant intraday credit (meaning credit extended for a period of less than a day) in accordance with specific arrangements implementing the rules on its provision. Intraday credit may not be granted to a participant whose eligibility as counterparty for Eurosystem monetary policy operations has been suspended or terminated; in addition, intraday credit granted by the ECB is limited to the day in question and cannot be extended to overnight credit.[126]

The information and control module: This module enables PM account holders to obtain on-line information relating to their accounts and manage liquidity, gives them the possibility to submit liquidity transfer orders, manages and allows them to initiate backup liquidity redistribution and backup contingency payments in the event of a failure of its payment infrastructure (contingency situations).[127]

Ancillary systems: An 'ancillary system' is defined as a system managed by an entity established in the EU or the EEA that is subject to supervision and/or oversight by a competent authority and complies with the over-

[124] Ibid., Annex II, Articles 16, 17 and 17a, respectively.

[125] Ibid., Article 10 and Annex II, Articles 23–26. It is noted that the entities concerned must have established intraday credit arrangements with the respective participating NCB (ibid., Annex II, Article 24(4)–(7)).

[126] Ibid., Articles 2, points (26) and 12(1)–(2); the arrangements implementing the rules on the provision of such credit (eligibility of entities and collateral, credit extension procedure, as well as suspension, limitation or termination) are laid down in Annex III.

[127] Ibid., Article 2, point (44) and Annex II, Article 29(1); the technical details of this module are laid down in Annex II, Appendix I.

sight requirements for the location of infrastructures offering services in euro, in which payments and/or financial instruments are exchanged and/or cleared or recorded with the monetary obligations settled in TARGET2 and/or funds held in TARGET2; included are retail payment systems, large-value payment systems, foreign exchange systems, money market systems and securities settlement systems.[128] The Eurosystem CBs provide fund transfer services in central bank money to ancillary systems in the PM accessed through the TARGET2 network service provider; such services are governed by bilateral arrangements between the Eurosystem CBs and the respective ancillary systems.[129]

Via the ancillary systems interface (the 'ASI'),[130] ancillary systems are able to carry out credit transfers and direct debits for their own account and payments upon credit transfer orders, liquidity transfer orders or direct debit instructions in favour of participants in an ancillary system. The main advantage offered by this interface is standardisation at the level of messages, network and services and settlement processing (providing for six generic settlement procedures depending on the special needs of existing ancillary systems). The ASI may be used both by NCBs, for their own account or for the account of ancillary systems, and by the ancillary systems themselves. Participants in an ancillary system are able to settle their transactions via the SSP either directly if they are direct participants, or via a specially designated direct participant, referred to as a 'settlement bank'.[131] Ancillary system offsetting payments in TARGET2 are finally

[128] Ibid., Article 2, point (31). The TARGET2 system serves the needs of both settlement models for ancillary systems in central bank money in Member States, that is the 'interfaced model', whereby the settlement in central bank money of participant positions in the ancillary system takes place in the RTGS, and the 'integrated model' to settle securities transactions in central bank money, whereby the final settlement of the cash leg of transactions takes place within the ancillary system itself.

[129] Ibid., Article 13(1).

[130] An ancillary systems interface means the technical device allowing an ancillary system to use a range of special, predefined services for the submission and settlement of ancillary system payment instructions. It may also be used by an NCB participating in TARGET2 for the settlement of cash operations resulting from cash deposits and withdrawals (ibid., Article 2, point (32)).

[131] On the ancillary systems settling payments in central bank money through the TARGET2 system, see European Central Bank: Country and Ancillary Systems Profiles, available (and constantly updated), at: https://www.ecb.int/paym/t2/professional/participation/html/index.en.html#profiles.

settled, to the extent possible, under a harmonised time schedule at European level.[132]

Business continuity and contingency procedures—security requirements: The technical characteristics of the SSP minimise errors to the lowest level possible due to automated procedures. Nevertheless, in the event of an abnormal external event or any other event which affects the operation of the SSP, business continuity and contingency procedures apply. In particular,

firstly, if the above events affect the operation of the SSP modules other than the PM and the ICM, the Eurosystem CB concerned must monitor and manage them in order to prevent any spillover to the smooth functioning of the SSP;
secondly, if the event affects the normal operation of the PM and/or the ICM occurs, the Eurosystem CB concerned must immediately notify the TARGET2 coordinator, who together with the settlement manager of the Eurosystem CB concerned must decide on the further steps to be taken;
finally, the Eurosystem CBs must report the participant's failure to the TARGET2 coordinator if such failure might affect the settlement in ancillary systems or create systemic risk; the closure of TARGET2 must, normally, not be delayed due to a participant's failure.[133]

Furthermore, participants must implement adequate security controls to protect their systems from unauthorised access and use, as well as inform the respective NCB or the ECB of any security-related incident in their technical infrastructure and, where appropriate, security-related incidents

[132] The settlement procedures in ancillary systems are governed by Annex IV of Guideline ECB/2012/27. The ECB regularly publishes the times and procedures for settlement in central bank money through the TARGET2 system that are selected by ancillary systems; see on this European Central Bank: Ancillary Systems Settlement Times, available (and constantly updated) at: https://www.ecb.int/paym/t2/professional/participation/html/index.en.html#times.

[133] Guideline ECB/2012/27, Article 21 and Annex II, Article 27. 'TARGET2 coordinator' means a person appointed by the ECB to ensure the daily operational management of TARGET2, to manage and coordinate activity in the event of an abnormal situation occurring and to coordinate the dissemination of information to PM account holders (ibid., Article 2, point (45)). Business continuity and contingency procedures are further described in Appendix IV of Annex II.

occurring in the technical infrastructure of third-party providers. The respective NCB or the ECB may impose additional security requirements on all participants and/or on participants they considered as critical.[134]

## 7.3 Powers of the ECB in Relation to the Issuance of Banknotes and Coins

### *7.3.1 An Overview of the Legal Framework*

The issuance and circulation of cash, that is banknotes and coins, in the EU are governed by Article 282(3), second sentence TFEU, which stipulates that the ECB alone may authorise the issue of the euro, and also (in more detail) by Articles 128 TFEU and 16 ESCB/ECB Statute (the latter on banknotes only); these provisions only apply to Member States whose currency is the euro and their NCBs.[135] On the basis of these Articles, the Council and the ECB have also adopted legal acts of secondary law.[136]

### *7.3.2 Banknotes*

*Primary Law Provisions: Authorisation of Banknote Issue, Issue of Banknotes and Banknote Features*

(1) The authorisation of banknote issue is an exclusive right of the ECB, performed by its GC.[137] The concept of "issue" encompasses not only the circulation of banknotes but also all other actions related to banknote circulation, including their withdrawal. Hence, all the said activities are subject to authorisation by the GC. Since this competence is exercised from the start of Stage Three of EMU, it concerned both banknotes denominated in the national currency units of Member States whose currency is the euro, for as long as their issuance was permitted, as well as euro banknotes, which circulated on 1 January 2002. Thus, Member States granted the ECB the competence to authorise the issue of euro banknotes, which up until then was a competence under national legislation.

(2) The TFEU created a system of plurality of banknote issuers in the EU, given that the ECB and the NCBs of the Member States whose cur-

[134] Ibid., Annex II, Article 28.

[135] TFEU, Article 139(2), point (d) and ESCB/ECB Statute, Article 42.4.

[136] On these Articles, see Wutscher (2019), pp. 2061–2065.

[137] TFEU, Article 128(1), first sentence, and ESCB/ECB Statute, Article 16, first sentence.

rency is the euro may issue such notes,[138] without prejudice to the ECB's exclusive right to authorise such issue.[139] The banknotes issued by the ECB and the NCBs are the only such notes to have the status of legal tender within the EU.[140] Pursuant to this provision, euro banknotes have the status of legal tender in all Member States whose currency is the euro, irrespective of their issuer.[141]

*Secondary Law Provisions*

**Global Overview**

(1) The main source of secondary law governing banknotes was Council Regulation (EC) No 974/98. This legal act (adopted on the basis of Article 123 TEC) regulated the following matters: first, during the transitional period (1999–2001), banknotes (and coins) denominated in national currency units of the euro area Member States would retain their status as legal tender only within the territorial limits of the respective Member States; in addition, euro banknotes were put into circulation by the ECB and the NCBs of the Member States whose currency is the euro as from 1 January 2002; furthermore, for a period of up to two months in each Member State whose currency was the euro (known as 'the dual circulation period'), euro banknotes and banknotes denominated in a national currency unit (to be withdrawn) both had the status of legal tender; finally, issuers of banknotes under withdrawal had to continue to accept, against euro at the conversion rate, the banknotes previously issued by them in accordance with the relevant provisions of Member State national legislation or applicable practices in their territorial limits.[142]

[138] TFEU, Article 128(1), second sentence, and ESCB/ECB Statute, Article 16, second sentence.

[139] For banknotes of national currency units of euro area Member States, this provision was necessary in order to allow their NCBs to continue to issue such banknotes for as long as their circulation was allowed following the start of Stage Three (by contrast, no provision granted the right to issue such banknotes to the ECB).

[140] TFEU, Article 128(1), third sentence, and ESCB/ECB Statute, Article 16, third sentence.

[141] The wording of this provision provoked controversy with regard to whether the banknotes denominated in national currency units of euro area Member States—for as long as they would circulate after the start of Stage Three—would have the status of legal tender across the (then) European Community or merely in the jurisdiction of the issuing NCB. This matter was settled with Council Regulation (EC) No 974/98.

[142] Council Regulation (EC) No 974/98, Articles 9, 10, first sentence, 15(1) and 16, respectively.

(2) The key ECB Decisions on this field (briefly presented just below) are Decision ECB/2013/10 of 19 April 2013,[143] which lays down the denominations, specifications, reproduction, exchange and withdrawal of euro banknotes, and ECB/2010/29 on the issue of euro banknotes.[144] Furthermore, the ECB has issued several other legal acts relating to specific aspects of these banknotes, such as the authorisation to issue national banknotes during the transitional period and the 2002 cash changeover, the frontloading of euro banknotes outside the euro area, the adoption of certain measures to enhance the legal protection of euro banknotes (and coins), the authenticity and fitness checking and recirculation of euro banknotes the enforcement of measures to counter non-compliant reproductions of euro banknotes and on the exchange and withdrawal of euro banknotes, the establishment of the Eurosystem Production and Procurement, data collection regarding the euro and the operation of the Currency Information System, and the Data Exchange for Cash Services.[145]

**Denomination and Technical Specifications**

The first series of euro banknotes, selected by the EMI in 1997, included seven different denominations of euro banknotes: €5, €10, €20, €50, €100, €200 and €500, which were defined, taking account of the denominations of euro coins.[146] On the front of euro banknotes, windows and doorways are shown, while the back features bridges. The picture elements of all the banknotes represent the characteristic architectural styles of each period and do not refer to specific constructions. The banknotes also show: the symbol of the EU, the name of the currency—euro—in both the Latin (EURO) and the Greek alphabets (ΕΥΡΩ), the initials of the ECB in several linguistic variations, the euro symbol (€), the symbol ©

[143] OJ L 118, 30.4.2013, pp. 37–42; this is in force as amended by Decision ECB/2019/9 of 4 April 2019 (OJ L 113, 29.4.2019, pp. 6–8).

[144] OJ L 35, 9.2.2011, pp. 26–30; by August 2019, this legal act had been amended four times.

[145] Even the mere further reference to these legal acts is beyond the scope of this book. For those interested in reading further information, see the ECB's website at: https://www.ecb.europa.eu/ecb/legal/1004/1329/html/index.en.html (on euro banknotes production), https://www.ecb.europa.eu/ecb/legal/1004/107641/html/index.en.html (on euro banknotes issuance), https://www.ecb.europa.eu/ecb/legal/1004/1019/html/index.en.html (on the protection of the euro) and https://www.ecb.europa.eu/ecb/legal/1004/1020/html/index.en.html (on the 2002 cash changeover).

[146] These banknotes were designed by Robert Kalina, an Austrian banknote designer, who drew inspiration from the theme 'Ages and Styles of Europe'.

indicating copyright protection for the ECB, and the signature of the ECB President.

The second series of euro banknotes was introduced gradually over several years, with its issuance starting in 2013 and completed in May 2019. It is known as the "Europa" series because two of the new enhanced security features contain an image of Europa. The series includes six denominations of euro banknotes, given that the ECB has decided to stop producing the €500 banknote (although the €500 banknote of the first series remains legal tender). The banknotes of the "Ages and Styles" series will continue to be issued alongside the second series until all remaining stocks are used up.[147]

### Reproduction, Exchange of Damaged Genuine and Withdrawal of Euro Banknotes

The reproduction of all or part of a euro banknote which the general public might mistake for a genuine euro banknote is deemed unlawful, unless specific criteria (laid down in CB law) are met, since such a risk for the general public does not exist.[148] Reproduction rules for euro banknotes also apply to euro banknotes that have been withdrawn or have lost their legal tender status.[149]

The exchange of damaged genuine euro banknotes is carried out by the NCBs when the applicant presents more than 50% of the banknote or 50% or less of the banknote and proves that the missing parts have been destroyed, and, in addition, several other specific conditions are met.[150] Finally, the withdrawal of a euro banknote type or series is regulated by a GC decision, covering the euro banknote type or series to be withdrawn from circulation, the duration of the exchange period, the date on which banknote type or series will lose its legal tender status and the treatment of the euro banknotes presented once the withdrawal period is over and/or they have lost their legal tender status.[151]

[147] Decision ECB/2013/10, Article 1(1), as amended by Article 1 of Decision ECB/2019/9. The copyright on euro banknotes belongs to the ECB and has been passed on to it from the initial holder, the EMI, in 1998 (ibid., recital (4)).

[148] Ibid., Article 3(2)–3(3). Reproduction means any tangible or intangible image that uses all or part of a euro banknote or parts of its individual design elements (such as, *inter alia*, colour, dimensions and use of letters or symbols), which (image) may resemble or give the general impression of a genuine euro banknote (ibid., Article 3(1)).

[149] Ibid., Article 3(6).

[150] Ibid., Article 3(1)–(2).

[151] Ibid., Article 6.

**Allocation of Banknotes**

The total value of euro banknotes in circulation is allocated to the Eurosystem members, that is the ECB and the NCBs of Member States whose currency is the euro by application of the 'banknote allocation key' [meaning the percentages resulting from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key (rounded to the nearest multiple of 0.0005 percentage point) to the NCB's share in such total]. The difference between the value of euro banknotes allocated to each NCB in accordance with that key and the value of the euro banknotes that such NCB puts into circulation gives rise to 'intra-Eurosystem balances'. The ECB must hold intra-Eurosystem claims on NCBs in proportion to their shares in the subscribed capital key, for a value equivalent to the value of euro banknotes it issues.[152]

**Obligations of Banknote Issuers**

NCBs issuing euro banknotes have the following obligations: first, to put them into and withdraw them from circulation and perform any physical handling in relation to them (the second leg applying also to euro banknotes issued by the ECB); second, to accept all euro banknotes on the request of the holder for exchange against euro banknotes of the same value or, in the case of account holders, to be credited to accounts held at the recipient NCB; furthermore, to treat all euro banknotes accepted by them as liabilities and process them in an identical manner; and finally, not to transfer euro banknotes accepted by them to other NCBs and keep such euro banknotes available for the re-issue; exceptionally, and in accordance with any rules laid down by the ECB GC, the recipient NCB may destroy mutilated, damaged, worn or withdrawn euro banknotes, while euro banknotes held by NCBs may, for logistical reasons, be redistributed in bulk within the Eurosystem.[153]

[152] Decision ECB/2010/29, Articles 1, point (d) and 4. On the banknote allocation key applying since 1 January 2019 (as determined by Decision ECB/2018/31 of 29 November 2018, which amended Decision ECB/2010/29, OJ L 9, 11.1.2019, pp. 194–195), see Table 7.6.

[153] Ibid., Article 3.

**Table 7.6** Banknote allocation key

| | *Since 1 January 2002 (%)* | *Since 1 January 2009 (%)* | *Since 1 January 2019 (%)* |
|---|---|---|---|
| European Central Bank (ECB) | 8 | 8 | 8 |
| Banque Nationale de Belgique | 3.2550 | 3.1975 | 3.3410 |
| Deutsche Bundesbank | 27.8215 | 24.9630 | 24.2720 |
| Eesti Pank | – | – | 0.2600 |
| Central Bank of Ireland | 0.9650 | 1.4640 | 1.5535 |
| Bank of Greece | 2.3360 | 2.5900 | 2.2850 |
| Banco de España | 10.1020 | 10.9465 | 11.0200 |
| Banque de France | 19.1210 | 18.7465 | 18.7735 |
| Banca d' Italia | 16.9190 | 16.4730 | 15.5970 |
| Central Bank of Cyprus | – | 0.1805 | 0.1985 |
| Banque centrale du Luxembourg | 0.1695 | 0.2305 | 0.3000 |
| Central Bank of Malta | – | 0.0835 | 0.0965 |
| De Nederlandsche Bank | 4.8595 | 5.2575 | 5.3755 |
| Oesterreichische Nationalbank | 2.6800 | 2.5595 | 2.6860 |
| Banco de Portugal | 2.1845 | 2.3075 | 2.1630 |
| Banka Slovenije | – | 0.4335 | 0.440 |
| Narodna Banka Slovenska | – | 0.9140 | 1.0575 |
| Suomen Pankki | 1.5870 | 1.6530 | 1.6795 |

### *7.3.3 Coins*

*Primary Law Provisions*

As opposed to the issue of banknotes, the ECB was not competent to issue coins in national currency units of Member States whose currency was (then) the euro nor is it competent to issue coins denominated in euro. This is still the exclusive competence of these Member States,[154] which define in accordance with their domestic legislation the body which has the relevant power. Nevertheless, the competence of Member States to issue coins in the euro area is, thus, subject, in accordance with the TFEU, to significant restrictions.[155]

[154] TFEU, Article 128(2), first sentence.

[155] Ibid., Article 128(2), first and second sentences, respectively.

First, the volume of the issue of euro coins in circulation in the euro area is subject to approval by the ECB, which could not remain uninvolved, given that the volume of the issue of euro coins is, just like that of euro banknotes, part of the monetary base and affects money supply and, as a result, the single monetary policy of the EU. Furthermore, the Council has been granted the competence to adopt, based on a proposal from the Commission and after consulting the European Parliament and the ECB, measures to harmonise the denominations and technical specifications of euro coins intended for circulation to the extent necessary to permit their appropriate circulation within the EU.

*Secondary Law Provisions*

On the basis of the competence granted to the Council under Article 128 TFEU earlier (Article 106 TEC), provisions relating to coins can be found in the following legal acts: first, the provisions of (the above-mentioned) Council Regulation (EC) No 974/98, concerning banknotes also apply to coins; in addition, the Council adopted on 3 May 1998 a Regulation 1998 on the denominations and technical specifications of euro coins intended for circulation.[156] On the other hand, on the basis of Article 128 TFEU as well, the procedural framework for the approval of the volume of euro coin issuance is governed by Decision ECB/2015/43 of 4 December 2015, as in force;[157] the volume of euro coin issuance is also approved annually by ECB Decisions.[158]

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[156] Regulation (EC) No 975/98 (OJ 139, 11.5.1998, pp. 6–8); this was repaled by Council Regulation (EU) No 729/2014 of 24 June 2014 (OJ L 194, 2.7.2014, pp. 1–7), which is currently in force.

[157] OJ L 328, 12.12.2015, pp. 123–125; this legal act was amended by Decision ECB/2017/41 of 8 December 2017 (OJ L 344, 23.12.2017, pp. 63–64).

[158] For the year 2019, Decision ECB/2018/35 is applicable (OJ L 327, 21.12.2018, pp. 87–88).

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CHAPTER 8

# The Specific Supervisory Tasks of the European Central Bank and Its Cooperation with National Competent Authorities

## 8.1 The Specific (Supervisory) Tasks Conferred on the European Central Bank

### *8.1.1 Introductory Remarks*

*Specific Supervisory Tasks in Relation to Credit Institutions and Other Supervised Entities Incorporated in Participating Member States*

(1) As mentioned in Chap. 5 (Sect. 5.2.4), the Single Supervisory Mechanism Regulation (SSMR) conferred on the European Central Bank (ECB) an extensive range of 'specific tasks' in relation to the supervision of credit institutions and other categories of supervised entities incorporated (hence established and authorised) in participating Member States,[1] covering key areas of micro- and macro-prudential regulation.[2] The ECB has been assigned these supervisory tasks in relation to such supervised entities and must exercise them in accordance with the SSMR, the Capital Requirements Regulation (CRR), the CRD IV and also the Bank Recovery

[1] According to Article 13(2), point (a) CRD IV, credit institutions must have both their registered office and their head office in the same Member State.

[2] The scope of the tasks finally adopted is narrower than under the Commission's initial proposal of September 2012.

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and Resolution Directive (BRRD) (in particular its provisions on recovery planning and early intervention).

(2) With regard to this conferral of specific tasks upon the ECB, the SSMR sets out the following general principles:[3]

First, when carrying out its tasks under the SSMR, and without prejudice to the objective of ensuring the safety and soundness of credit institutions, the ECB must have full regard to credit institutions' different types, business models and sizes, as well as the systemic benefits of diversity in the banking industry of the EU in accordance with the proportionality principle.[4]

Second, no ECB action, proposal or policy should, directly or indirectly, discriminate against any Member State or group of Member States as a venue for the provision of banking or financial services in any currency.

Third, the provisions of the SSMR are without prejudice to the responsibilities and related powers of participating Member States' NCAs to carry out supervisory tasks not conferred on the ECB, and the responsibilities and related powers of the NCAs or the national designated authorities (the 'NDAs') of participating Member States to apply macro-prudential tools not provided for in relevant acts of EU banking law.[5] In particular, tasks not conferred on the ECB remain with the NCAs.[6]

Those tasks include indicatively the following: reception of notifications from credit institutions in relation to the right of establishment and the freedom to provide services; supervision of bodies not covered by the definition of credit institutions under EU law but supervised as credit institutions under national law; supervision of credit institutions from third countries having established branches or providing cross-border services in the EU; supervision of payments services (governed, mainly, by the provisions of the Payment Systems Directive No II); carrying out of day-to-day credit institutions' verifications; and carrying out (if applicable depending on each Member State's national law) the function of a competent authority over credit institutions in relation to markets in financial

[3] SSMR, Article 1, third, fourth and fifth–sixth sub-paragraphs, respectively (and recital (17)).

[4] On this principle, see Castro Carvalho et al. (2017), Lehmann (2017), Joosen et al. (2018) and Joosen and Lehmann (2019).

[5] 'NDAs' are defined in the SSMR those within the meaning of EU banking law (Article 2, point (7)); according to Article 458 CRR on macro-prudential or systemic risk identified at the level of a Member State, this must designate the authority in charge of its application.

[6] SSMR, Article 1, fifth sub-paragraph; see also recital (28).

instruments,[7] the prevention of the use of the financial system for the purpose of money laundering and terrorist financing,[8] as well as consumer protection.[9]

In relation to the last two aspects, recital (29) also provides that the ECB must fully cooperate, as appropriate, with the national authorities which are competent to ensure a high level of consumer protection and combat money laundering (and may be different from the NCAs). In this respect, it is also noted that, even though the ECB is not responsible for establishing breaches in relation to anti-money laundering (from a crime avoidance perspective), it may, on the basis of the facts identified, apply measures from a prudential perspective within the scope of its own tasks [e.g. when assessing, in qualifying holding proceedings, a proposed acquirer of shareholdings in a credit institution (see Sect. 8.1.2)], in the course of the Supervisory Review and Evaluation Process (SREP) or when assessing the suitability of a (proposed) board member in fit-and-proper proceedings (for significant credit institutions) (see Sect. 8.2.3).[10]

(3) The specific tasks conferred on the ECB with regard to supervised entities incorporated in participating Member States are laid down in Articles 4(1) and 5 SSMR (discussed Sects. 8.1.2 and 8.1.3, respectively[11]). Article 13g of the ECB Rules of Procedure lays down specific rules on the procedure for the adoption of Decisions for the purpose of carrying out the tasks referred to in Article 4.

[7] The substantive EU rules governing this aspect are mainly laid down in MiFID II.

[8] The substantive EU rules governing this aspect are mainly laid down in Directive (EU) 2015/849 of 20 May 2015 "on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (…)" (OJ L 141, 5.6.2015, pp. 73-117) (the so-called fourth AML Directive).

[9] It is noted that in most Member States, the policy objective of consumer protection in financial services is a responsibility of one or more administrative authorities other than (or in cooperation with) the NCA. On the national authorities competent in this field, see at: https://www.eba.europa.eu/consumer-corner/national-competent-authorities-for-consumer-protection.

[10] On this aspect, see the note of the ECB, available at: https://www.bankingsupervision.europa.eu/press/publications/newsletter/2018/html/ssm.nl180516_2.en.html.

[11] For a summary, see also Table 8.1; the allocation of tasks between the ECB and NCAs is summarised in Table 8.2.

**Table 8.1** The specific tasks conferred upon the ECB (SSMR, Articles 4 and 5)

| Specific task | Legislative acts to which Articles 4 and 5 SSMR make reference | | |
|---|---|---|---|
| SSMR, Article 4 | SSMR | CRD IV and CRR | Other |
| Granting and withdrawal of authorisation of credit institutions | Article 14 | CRD IV, Articles 8–18 and 21 | |
| In cross-border cases, the discharge of tasks which fall upon the home Member State's NCA | | CRD IV, Articles 35 and 39 | |
| Assessment of applications for the acquisition and disposal of 'qualifying holdings' in credit institutions, except in the event of a bank resolution | Article 15 | CRD IV, Articles 22–27 | |
| Own funds requirements, limits on large exposures, liquidity requirements and leverage ratio | | CRR, Articles 25–386 and 404–410, Articles 387–403, Articles 411–426, and Articles 429–430, respectively | |
| Public disclosure of information on these matters (Pillar 3) | | CRR, Articles 431–455 | |
| Ensuring compliance by supervised entities with the provisions of EU law on corporate governance arrangements and internal capital adequacy assessment processes | | CRD IV, Articles 74 and 75, and 88–96<br>CRD IV, Articles 76–87 | |
| Conduct of supervisory reviews of supervised entities | | CRD IV, Articles 97–101 | |
| *Ad hoc* imposition of additional requirements ('Pillar 2' of the regulatory framework) | | CRD IV, Articles 102–107 | |
| Specific tasks on the micro-prudential of banking groups on a consolidated basis | | CRD IV, Articles 111–118 | |
| Specific tasks in the area of supplementary supervision of financial conglomerates | | | Directive 2002/87/EC |
| Supervisory tasks in relation to recovery plans and early intervention | | | BRRD, Articles 5–9 and 27–30 |
| SSMR, Article 5 | SSMR | CRD IV and CRR | Other |
| Tasks with regard to macro-prudential regulation | | CRD IV, Articles 130–142, and CRR, Articles 124(2), 164(5) and 458 | |

**Table 8.2** Allocation of tasks between the ECB and the national competent authorities (NCAs)

| | *Significant supervised entities* | *Less significant supervised entities* |
|---|---|---|
| Granting and withdrawal of authorisation | ECB | ECB |
| Assessment of applications for the acquisition and disposal of 'qualifying holdings' | ECB | ECB |
| Conduct of micro-prudential supervision | ECB | NCA |
| Conduct of macro-prudential regulation | ECB/NCA or NDA | NCA or NDA |
| Carrying out supervisory tasks in relation to recovery plans and early intervention | ECB | NCA |
| Conduct of stress tests | ECB | NCA |
| Participation in colleges of supervisors | ECB | NCA |
| Protection of the economic interests of consumers transacting with financial service providers | NCA | NCA |
| Supervision of (retail) payment services | NCA | NCA |
| Prevention of the use of the financial system for the purposes of money laundering and terrorist financing | NCA | NCA |

*Specific Supervisory Tasks in Relation to Branches in Participating Member States by Credit Institutions Incorporated in Non-participating Member States*

As regards credit institutions incorporated in non-participating Member States, which have established branches or provide cross-border services (without establishment) in a participating Member State, the ECB must carry out the specific tasks conferred on it, if the NCAs are competent as host Member State supervisors in accordance.[12] In this respect, the Single Supervisory Mechanism (SSM) Framework Regulation lays down the following clarifying rules: with regard to branches, the ECB exercises the powers of the competent authority of the host Member State only if a branch is significant; otherwise, they are exercised by the NCA of the participating Member State where the branch is established;[13] on the other hand, the ECB carries out the tasks of the competent authority of the host

[12] SSMR, Article 4(2); these aspects are governed, respectively, by Articles 35–39 and 40–46 CRD IV.

[13] SSM Framework Regulation, Article 14.

Member State in respect of all credit institutions incorporated in non-participating Member States, which exercise the freedom to provide services in participating ones. If there are certain conditions under the national law of the latter in order for the freedom to provide services to be justified by the general good, NCAs must inform accordingly the ECB.[14]

### *8.1.2 The Specific Tasks Under Article 4(1) SSMR*[15]

*Granting and Withdrawal of Authorisation*[16]

**Introductory Remarks**

The first specific task is the granting and withdrawal of authorisation of credit institutions in relation to both significant and less significant ones and does not apply to other types of supervised entities.[17] Under the CRD IV, such an authorisation (the so-called single licence) is granted by NCAs, to the extent that the requirements laid down therein are fulfilled. In the context of the SSM, it is also regulated (in addition to Article 14 SSMR) in Articles 73–79 and 88 SSM Framework Regulation. On the other hand, the withdrawal of EU credit institutions' authorisation is regulated in 18 CRD IV and, in the context of the SSM (in addition to Article 14 SSMR), in Articles 80–84 and 88 SSM Framework Regulation.

**Granting of Authorisation**

(1) Any application for an authorisation to take up the business of a credit institution to be established in a participating Member State has to be submitted to the NCA of the Member State where the credit institution is to be established in accordance with the requirements set out in relevant national law. The NCA receiving the application must inform the ECB about its receipt (within 15 working days) and about the time limit within

[14] Ibid., Article 16. Detailed procedural provisions govern the notification of the exercise of the right of establishment within the SSM by credit institutions established in non-participating Member States, and the notification of the exercise of the freedom to provide services within the SSM by such credit institutions (ibid., Articles 13 and 15, respectively).

[15] Article 4 SSMR is analysed in detail in Lackhoff (forthcoming), who, *inter alia*, addresses the (contestable) issue on whether the list of specific tasks laid down in the SSMR is restrictive or not. For a critical view, see also D'Ambrosio (2019), pp. 160–165.

[16] SSMR, Article 4(1), point (a).

[17] This aspect is regulated in Articles 8–18 and 21 CRD IV and, in the context of the SSM, by Article 14 SSMR.

which a Decision must be taken and notified to the applicant in accordance with the relevant national law of the Member State of establishment. It must then assess whether the applicant complies with all conditions for authorisation laid down in the relevant national law: if the assessment is positive, it must take, within the period provided for by relevant national law, a draft Decision to propose to the ECB to grant the authorisation and notify it to the ECB and the applicant; if, on the other hand, it assesses that the applicant does not comply with all authorisation conditions, it must reject the application sending a copy of its Decision to the ECB.[18]

(2) If the applicant complies with all the conditions for the authorisation in accordance with the relevant EU law and national law, the ECB must adopt a Decision granting authorisation. The NCA's draft authorisation Decision is deemed to be adopted by the ECB, unless it objects within a maximum period of ten working days, extendable once for the same period in duly justified cases. The ECB may object to the draft Decision, only if the conditions for authorisation set out in EU law are not met stating the reasons for rejection in writing. All Decisions must be notified by the NCA to the applicant for authorisation. The Decision granting authorisation must cover the applicant's activities as a credit institution as provided for in the relevant national law, without prejudice to any additional requirements for authorisation under the relevant national law.[19]

**Withdrawal of Authorisation**

General provisions: If the ECB becomes aware of circumstances that may warrant the withdrawal of an authorisation, it must assess, on its own initiative, whether the authorisation should be withdrawn in accordance with the relevant EU banking law. If it intends to withdraw an authorisation, it must consult with the NCA of the Member State where the credit institution is established at least 25 (and in duly justified urgent cases five) working days before the date on which it plans to make its Decision. It must also inform the relevant NCA of any comments provided by the credit institution, with due respect of the credit institution's right to be heard,[20] and coordinate with the NRA, informing accordingly the NCA.

[18] SSMR, Article 14(1)–(2).

[19] SSMR, Article 14(3)–(4) and SSM Framework Regulation, Article 78(4)–(5). ECB Decisions must be based on its assessment of the application, the draft Decision and comments provided by the applicant (ibid., Article 78(2) with reference to Article 77).

[20] On this right, see Chap. 6, Sect. 6.3.1.

If the relevant NCA considers that a credit institution's authorisation should be withdrawn in whole or in part according to relevant European or national banking law, including at the credit institution's request, it must submit to the ECB a draft decision proposing the withdrawal, together with any relevant supporting documents. The ECB must take a decision on the proposed withdrawal fully taking account of the justification for withdrawal put forward by the NCA, without undue delay, accepting or rejecting the relevant draft withdrawal decision.[21]

Procedure in case of potential resolution measures to be taken by NRAs: To the extent that NRAs remain competent for the resolution of credit institutions, if they consider that the withdrawal of an authorisation would prejudice the adequate implementation of (or actions necessary for) resolution or financial stability, they must duly notify their objection to the ECB, explaining in detail the prejudice that a withdrawal would cause. In such a case, the ECB must reach an agreement with the NRA on a time period during which it will abstain from proceeding with the withdrawal of the authorisation and immediately inform accordingly the NCA. After the expiry of the agreed time period and taking into account any progress made, the ECB must assess whether it intends to proceed to the authorisation's withdrawal or to extend the agreed time period, consulting with both the relevant NCA and NRA (if different). In turn, NCA must inform the ECB of the measures taken by the NRA and its assessment of the consequences of a withdrawal. Nevertheless, if the ECB's reasoned decision ascertains that proper actions necessary to maintain financial stability have not been implemented by the NCAs, the withdrawal of the authorisation applies immediately.[22]

*Cross-Border Issues*[23]

The second task is the performance of tasks which fall upon the NCA of the home Member State for credit institutions and other supervised entities incorporated in a participating Member State, if they intend either to establish a branch or to exercise the freedom to provide services in a non-participating Member State.[24] With regard to this task, the following distinction applies.

[21] SSMR, Article 14(5) and SSM Framework Regulation, Article 83(1).
[22] SSMR, Article 14(6) and SSM Framework Regulation, Articles 83(3) and 84.
[23] SSMR, Article 4(1), point (b).
[24] CRD IV, Articles 33–46.

If a significant supervised entity intends to establish a branch or to exercise the freedom to provide services within the territory of a non-participating Member State, it must notify the relevant NCA of its intention, in accordance with the CRD IV. On receipt of this notification, the NCA must immediately inform the ECB, which then becomes responsible for the exercise of the powers of the competent authority of the home Member State.

A less significant supervised entity intending to establish a branch or to exercise the freedom to provide services within the territory of a non-participating Member State must also notify of its intention the relevant NCA in accordance with the CRD IV. In this case, the relevant NCA continues to exercise the powers of the competent authority of the home Member State, with no involvement of the ECB.[25]

*Acquisition and Disposal of 'Qualifying Holdings'*[26]

(1) The third task is the assessment of applications for the acquisition and disposal of 'qualifying holdings' in a credit institution,[27] except in the case of a bank resolution, applies both to significant and less significant credit institutions and does not apply to other types of supervised entities. The assessment of acquisitions of qualified holdings in credit institutions is regulated in Articles 22–27 CRD IV[28] and, in the context of the SSM (in addition to Article 15 SSMR), in Articles 85–88 SSM Framework Regulation.

(2) Any person intending to acquire a qualifying holding in a credit institution established in a participating Member State must submit a notification to its NCA in accordance with the requirements set out in relevant national law based on the legal acts referred to in Article 4(3) SSMR, notifying also any related information.[29] The NCA receiving the notifica-

[25] SSM Framework Regulation, Article 17. Detailed procedural provisions govern the right of establishment of and the exercise of the freedom to provide services within the SSM by credit institutions established in participating Member States (ibid., Articles 11 and 12).

[26] SSMR, Article 4(1), point (c). 'Qualifying holding' means a direct or indirect holding in an undertaking which accounts for 10% or more of the capital or voting rights or makes it possible to exert significant influence on the management of that undertaking (ibid., Article 2, point (8), with reference to point (36) of Article 4(1) CRR).

[27] CRD IV, Articles 22–27.

[28] For an analysis of these provisions, as they were introduced by Directive 2007/44/EC and have been carried over *verbatim* in the CRD IV, see Kerjean (2008), pp. 47–79.

[29] Ibid., Article 15(1).

tion must forward the notification to the ECB,[30] assess whether the potential acquisition complies with all the conditions laid down in the relevant European and national banking law and submit to the ECB a proposal for a decision to oppose or not the acquisition, based on the assessment criteria set out in the above-mentioned legal acts at least ten working days before the expiry of the relevant assessment period.[31] It is up to the ECB to decide whether to oppose or not the acquisition on the basis of the assessment criteria set out in EU banking law, and in accordance with the procedure and within the assessment periods set out therein. The right to be heard is applicable.[32]

Accordingly, mergers and acquisitions in the banking sector will be subject to approval by the ECB rather than NCAs. With this in mind, the European banking landscape will be shaped at supranational level in the next few decades, and, most definitely, this decade. In the author's view, this may lead to a greater degree of concentration in the European banking system and, as a result, may significantly reduce the number of credit institutions operating across euro area Member States.

*Ensuring Compliance with Micro-prudential Regulations*

(1) The fourth task[33] consists in ensuring compliance on the part of significant supervised entities with EU banking law provisions on the following aspects of micro-prudential regulation: own funds (capital) requirements, including securitisation, limits on large exposures, liquidity, leverage and public disclosure of information on those matters ('Pillar 3' of the current regulatory framework).[34]

(2) The (related) fifth task[35] consists in ensuring compliance by significant credit institutions and other supervised entities with the provisions of EU banking law, as to the existence of robust corporate

[30] Article 85 SSM Framework Regulation stipulates in this respect that the NCA must notify the ECB of such notification no later than five working days following the acknowledgement of receipt under Article 22(2) (first sub-paragraph) CRD IV, also notify it if the assessment period must be suspended due to a request for additional information and inform it of the date by which the decision to oppose or not to oppose the acquisition of a qualifying holding has to be notified to the applicant pursuant to the relevant national law.

[31] Article 86 SSM Framework Regulation provides for a period of at least 15 working days.

[32] SSMR, Article 15(2)-(3) and SSM Framework Regulation, Article 87.

[33] SSMR, Article 4(1), point (d).

[34] CRR, Articles 25–386 and 404–410, 387–403, 411–426, 429–430 and 431–455, respectively.

[35] SSMR, Article 4(1), point (e).

governance arrangements, including fit-and-proper requirements as regards persons responsible for their management, risk management processes, internal control mechanisms, as well as remuneration policies and practices,[36] and, finally, effective internal capital adequacy and liquidity assessment processes.[37] The aim of internal capital adequacy assessment process (the 'ICAAP') and the internal liquidity adequacy assessment process (the 'ILAAP') is to encourage credit institutions to identify, effectively manage and cover their capital and liquidity risks at all times, taking into account their business models, size, complexity and risk exposure. The ECB Guides to the ICAAP and ILAAP were published in November 2018.[38]

### Conduct of Supervisory Reviews and Imposition of *Ad Hoc* Additional Requirements[39]

The sixth task contains two related sub-tasks: the first is the conduct of 'supervisory reviews' of significant credit institutions and other supervised entities, including, where appropriate, in coordination with EBA, stress tests and their possible publication,[40] in order to determine whether the arrangements, strategies, processes and mechanisms put in place and the own funds held by these entities ensure a sound management and coverage of their risks. The second sub-task is the imposition (on the basis of such reviews) of specific additional own funds requirements, disclosure obligations and liquidity requirements, as well as other supervisory measures, in the cases specifically made available to NCAs by Articles 102-107 CRD IV.

[36] CRD IV, Articles 74 and 75 and 88–96. On this aspect, see indicatively Hopt (2012), and in particular on banks' remuneration policies and practices also Célérier (2014), Nobel (2014), Seiler (2014) and Avgouleas and Cullen (2015).

[37] Ibid., Articles 76–87.

[38] Available, respectively, at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.icaap_guide_201811.en.pdf and https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ilaap_guide_201811.en.pdf.

[39] SSMR, Article 4(1), point (f).

[40] CRD IV, Articles 97–101. According to Article 101, NCAs have the power to require an institution to take the necessary measures (including the supervisory powers referred to in Article 104(1)) at an early stage to address relevant problems in two cases: if the institution does not meet the requirements laid down in the CRD IV or in the CRR, and if the authorities have evidence that it is likely to breach these requirements within the following 12 months.

*Micro-prudential Supervision of Banking Groups on a Consolidated Basis*[41]

(1) As regards the micro-prudential supervision of banking groups on a consolidated basis, the (seventh) task consists in the exercise of first, supervision on a consolidated basis over credit institutions' parent companies incorporated in a participating Member State (including over financial holding companies and mixed financial holding companies), and second, participation in the supervision on a consolidated basis, including in colleges of supervisors without prejudice to the participation of NCAs of participating Member States in these colleges as observers, in relation to parent companies not established in one of the participating Member States.[42] The following rules apply in this respect:[43]

**Table 8.3** Supervision on a consolidated basis and participation of the ECB and NCAs in colleges of supervisors

| *SSM consolidating supervisors* | | | |
|---|---|---|---|
| *Supervised entity* | *Consolidating supervisor* | *College of supervisors members* | *College of supervisors observers* |
| Significant supervised entity on a consolidated basis | ECB | | NCA |
| Less significant supervised entity on a consolidated basis | NCA | | |
| Non-SSM consolidating supervisors | | | |
| Supervised entities in participating members are | Consolidating supervisor | College of supervisors members | College of supervisors' observes |
| All significant entities | Non-SSM NCA | ECB | NCAs |
| All less significant supervised entities | Non-SSM NCA | NCAs | |
| Both significant and less significant supervised entities | Non-SSM NCA | ECB NCAs | NCAs of the participating Member States where the significant supervised entities are established |

[41] SSMR, Article 4(1), point (g).
[42] CRD IV, Articles 111–118.
[43] SSM Framework Regulation, Articles 8–10; for a summary, see also Table 8.3.

First, the ECB must conduct supervision on a consolidated basis, as provided for by Article 111 CRD IV, in respect of supervised entities which are significant on a consolidated basis, if the parent undertaking is either a parent institution in a participating Member State, or an EU parent institution established in a participating Member State. In respect of supervised entities that are less significant on a consolidated basis, the task of the supervisor on a consolidated basis must be performed by the relevant NCA.

Second, its role as chair of a college of supervisors is specified as follows: if the ECB is the consolidating supervisor, it chairs the college established under Article 116 CRD IV. The NCAs of the participating Member States where the parent, subsidiaries and 'significant branches' within the meaning of Article 51 CRD IV, if any, are established have the right to participate in the college as observers.[44] If, on the other hand, no college is established under Article 116 CRD IV and a significant supervised entity has significant branches in non-participating Member States according to Article 51(1) CRD IV, the ECB must establish a college of supervisors with the NCAs of the host Member States.

Finally, if the consolidating supervisor is not in a participating Member State, the ECB and NCAs participate in the college of supervisors in accordance with the following rules and the relevant EU banking law: if the supervised entities in participating Member States are all significant supervised entities, the ECB participates as a member and the NCAs as observers; if they are all less significant supervised entities, it is the NCAs which participate as members; if they are both less significant and significant, the ECB and the NCAs participate as members, in which case the NCAs of the participating Member States where the significant supervised entities are established may participate as observers.

*Supplementary Supervision of Financial Conglomerates*[45]

In the area of supplementary supervision of financial conglomerates according to the FICOD (Directive 2002/87/EC), the (eighth) task comprises participation in the supplementary supervision over credit insti-

[44] According to the Article 51(1) (second sub-paragraph) CRD IV, a branch is considered to be significant on the basis of the following three aspects: whether its market share of in terms of deposits exceeds 2% in the host Member State, the likely impact of a suspension or closure of the operations of the institution on systemic liquidity and the payment and settlement systems therein and its size and importance in terms of number of clients in the host Member State.

[45] SSMR, Article 4(1), point (h).

tutions included in such financial conglomerates, and assumption of the tasks of coordinator, if the ECB is appointed as the coordinator for a financial conglomerate in accordance with the criteria set out in relevant European financial law. In relation to a significant supervised entity, the ECB assumes the task of coordinator of a financial conglomerate in accordance with the criteria set out in relevant European financial law, while in relation to a less significant supervised entity, the task of coordinator is assumed by the NCA.[46]

*Specific Supervisory Tasks in Relation to Recovery Plans and Early Intervention*[47]

The ECB is called upon to carry out supervisory tasks in relation to the following aspects pertaining to the early stages of a resolution procedure: recovery planning and 'early intervention', if a credit institution or group, in relation to which the ECB is the consolidating supervisor, does not meet or is likely to breach the applicable micro-prudential supervision requirements.[48] Recovery planning along with resolution planning constitutes a key element in the preparation phase for resolution; under the BRRD, resolution plans are drawn up and adopted by NRAs, while recovery plans are drawn up by institutions and adopted by the ECB or the NCAs.[49]

Resolution powers are explicitly excluded,[50] since those are exercised by the Board, the Council and the Commission and, if relevant, the NRAs as to their respective responsibilities. Nevertheless, the ECB must cooperate closely with the authorities empowered to resolve credit institutions, *inter alia*, in the preparation of resolution plans.[51]

[46] SSM Framework Regulation, Article 18.

[47] SSMR, Article 4(1), point (i).

[48] BRRD, Articles 5–9 and 27–30, respectively.

[49] 'Recovery plan' means a plan drawn up and maintained by an institution in accordance with Article 5 BRRD (Article 2(1), point (32); it is governed by Articles 5–9; on this, see Van Heukelem (2017). On both recovery and resolution planning under the BRRD, see Binder (2015), Section II, Haentjens (2017), pp. 197–206, as well as Merc (2017a) and (2017b).

[50] 'Resolution powers' are those referred to in Articles 63–72 BRRD.

[51] SSMR, Article 3(4); see also Chap. 9, Sects. 9.2.1 and 9.2.2.

### *8.1.3 The Specific Tasks Under Article 5 SSMR*

*Introductory Remarks*

Article 5 SSMR (for the purpose of the application of which the distinction between 'significant' and 'less significant' supervised entities does not apply) governs macro-prudential tasks and macro-prudential tools used by national authorities (NCAs and NDAs) and the ECB.[52] The ECB is required to apply the macro-prudential tools in accordance with Articles 5 and 9(2) SSMR and the SSM Framework Regulation and, where those are provided for in a Directive, subject to implementation of that legislative act into national law.[53]

*Use of Macro-prudential Tools by National Authorities*

(1) Participating Member States' NCAs and NDAs must apply requirements for capital buffers to be held by credit institutions, at the relevant level, according to the provisions of EU banking law (in particular the CRR and the CRD IV), in addition to the own funds requirements referred to in Article 4(1), point (d). This applies whenever appropriate or deemed required and without prejudice to the power of the ECB to use macro-prudential tools (see later) and includes countercyclical buffer rates, and any other measures aimed at addressing systemic or macro-prudential risks provided for, and subject to the procedures laid down in the CRR and in the CRD IV in the cases specified therein.[54]

In this respect, the SSM Framework Regulation provides that the term 'macro-prudential tools' covers the following instruments:[55] capital buffers within the meaning of Articles 130–142 CRD IV, measures for domestically authorised credit institutions or a subset thereof, according to

[52] On Article 5, see Gortsos (2015), pp. 152–161 and Alexander (forthcoming). The macro-prudential procedures laid down in Article 5(1)–(2) do not constitute ECB or NCAs' 'supervisory procedures' within the meaning of the SSM Framework Regulation; accordingly, Articles 25–32 SSMR do not apply to them, without prejudice to Article 22 on the due process for adopting supervisory Decisions addressed to individual supervised entities (SSM Framework Regulation, Article 101(2)). The ECB Rules of Procedure (Article 13h(1)–(3)) lay down specific rules on Decisions to adopt procedures for the purpose of carrying out the tasks referred to in Article 5 SSMR.

[53] SSM Framework Regulation, Article 102(1).

[54] SSMR, Article 5(1), first sentence; Articles 5(1), second to fourth sentences SSMR and 104 SSM Framework Regulation lay down the related procedural conditions.

[55] SSM Framework Regulation, Article 101(1).

Article 458 CRR[56] and any other measures adopted by NCAs or NDAs aimed at addressing systemic or macro-prudential risks provided for, and subject to the procedures set out, in the CRR and the CRD IV in the cases specifically set out therein, such as higher real estate risk weights and stricter lending criteria, as well as higher minimum exposure-weighted average loss given defaults.[57]

Capital buffers within the above-mentioned meaning include the following:

1. the 'institution-specific countercyclical capital buffer', meaning the own funds that an institution is required to maintain in accordance with Article 130;
2. the 'G-SII buffer', meaning the own funds that are required to be maintained in accordance with Article 131(4); the identification methodology for G-SIIs is based on the factors listed in Article 131(2);[58]
3. the 'O-SII buffer', meaning the own funds that may be required to be maintained in accordance with Article 131(5); the systemic importance of other systemically important institutions (the 'O-SIIs') is assessed on the basis of at least any of the factors listed in Article 131(3);

[56] 'Domestically authorised institution' means an institution that has been authorised in the Member State for which a particular NDA is responsible for setting the countercyclical buffer rate (ibid., Article 128, point (8)). Under Article 458 CRR, if an NCA or an NDA identifies changes in the intensity of macro-prudential or systemic risk in the financial system with the potential to have serious negative effects on the financial system and the real economy, which it considers would be better addressed by means of stricter national measures, it must notify accordingly the European Parliament, the Council, the Commission, the ESRB and the EBA, and submit, *inter alia*, draft national measures for domestically authorised institutions intended to mitigate changes in the intensity of risk.

[57] CRR, Articles 124 and 164, respectively.

[58] The CRD IV provides (Article 131(1), fourth and fifth sentences, and 131(2), first and second sub-paragraph, respectively) that a G-SII must be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company, or an institution, and in no event an institution that is its subsidiary. The methodology for identifying G-SIIs must be based on the following five categories: size of the group, its interconnectedness with the financial system, substitutability of its services or of the financial infrastructure provided by it, its complexity and its cross-border activity. Each category must receive an equal weighting and consist of quantifiable indicators. The most recent (9 August 2019) list of these institutions is available at: https://eba.europa.eu/-/the-eba-updates-data-used-for-the-identification-of-global-systemically-important-institutions-g-sii-2.

4. the 'systemic risk buffer', meaning the own funds that an institution is or may be required to maintain in accordance with Article 133; and
5. the 'combined buffer requirement', meaning the CET1 capital required to meet the requirement for the capital conservation buffer extended, as applicable, by any of the above buffers.

'Capital conservation buffers', that is own funds that an institution is required to maintain in accordance with Article 129, are excluded, since they do not constitute macro-prudential, but rather micro-prudential regulatory measures.[59]

(2) NCAs and NDAs retain also their power to apply macro-prudential tools not provided for in relevant acts of EU banking law, such as loan-to-value ratios, loan-to-income ratios, debt-service-to-income ratios and loan-to-deposits limits. The ECB is not allowed to apply such measures but must collect from NCAs and NDAs of participating Member States information regarding the identity of the authorities designated for the respective macro-prudential tools and the macro-prudential tools they can use.[60]

*Use of Macro-prudential Tools by the ECB*

Instead of the NCA or the NDA of the participating Member State, the ECB may, if deemed necessary, undertake the following:

first, apply higher requirements for capital buffers than those applied by national authorities to be held by supervised entities at the relevant level in accordance with EU banking law, in addition to own funds requirements and including countercyclical buffer rates;

second, apply more stringent measures aimed at addressing systemic or macro-prudential risks at the level of supervised entities, subject to the procedures set out in the CRR and the CRD IV in the cases specifically set out therein; and

third, set a buffer requirement if an NDA has not set a buffer rate; an NCA or NDA may also propose to the ECB to use macro-prudential tools in order to address the specific situation of the financial system and the economy in its Member State.

[59] SSM Framework Regulation, Article 128, points (2)–(6) and (1), respectively.

[60] SSMR, Article 1, sixth sub-paragraph, and SSM Framework Regulation, Article 103, respectively.

When carrying out these tasks, the ECB must cooperate closely with the NDAs concerned and, in particular, notify its intention to the NCAs and NDAs concerned ten working days prior to taking such a decision; any objection by a national authority concerned must be reasoned and stated in writing within five working days. In addition, it must take into account the specific situation of the financial system, the economic situation and the economic cycle in individual Member States.[61]

## 8.2 Cooperation Between the ECB and National Competent Authorities Within the SSM

### 8.2.1 *General Principles and Obligations on the Operation of the SSM*

(1) As mentioned in Chap. 5 (Sect. 5.2.4) as well, the specific tasks conferred on the ECB by the SSMR must be exercised within the framework of the SSM, which consists of the ECB and the NCAs of the participating Member States. In this respect, the ECB has been assigned the responsibility for the "effective and consistent functioning of the SSM".[62] Both the ECB and the NCAs are subject to two elementary obligations: a 'duty of cooperation in good faith' and an obligation to exchange information.[63]

(2) The NCAs must provide the ECB, in a timely and accurate manner, with all information necessary for the purposes of carrying out its (above-mentioned) specific tasks under Articles 4–5 SSMR, including information arising from the NCAs' verification and on-site activities. This is without prejudice to the ECB's power to receive directly or to have direct access to information reported, on an ongoing basis, by supervised entities.[64] When the ECB obtains information directly from the legal or natural persons referred to in Article 10(1) SSMR, it must provide the NCAs concerned with such information in a timely and accurate manner, including, in particular, information necessary for the NCAs to carry out their role in assisting the ECB. Without prejudice to this, the ECB must ensure that

[61] SSMR, Article 5(1)–(5) and SSM Framework Regulation, Article 102; further procedural conditions, which, *mutatis mutandis*, are similar to those applying when NCAs make use of macro-prudential tools, are laid down in Article 105 SSM Framework Regulation.

[62] SSMR, Article 6(1), first and second sentences, respectively.

[63] SSMR, Article 6(2), first sub-paragraph, and SSM Framework Regulation, Article 20.

[64] This aspect is governed by Decision ECB/2014/29 (OJ L 214, 19.7.2014, pp. 34–37).

NCAs have regular access to updated information to carry out their tasks related to prudential supervision.[65]

(3) If appropriate, NCAs are responsible for assisting the ECB, under the conditions laid down in the SSM Framework Regulation, with the preparation and implementation of any acts relating to its specific tasks under Article 4 SSMR with regard to all supervised entities, including assistance in verification activities.[66] In addition, NCAs must follow the instructions given by the ECB when performing these tasks. To the extent that the ECB is assisted by NCAs and NDAs for exercising its tasks under the SSMR, the ECB and the NCAs must comply with the provisions set out in EU banking law with regard to the allocation of responsibilities and cooperation between competent authorities from different Member States.[67]

(4) In order to carry out its specific supervisory tasks, the ECB may require, by way of instructions, NCAs and/or NDAs to make use of their powers, under and in accordance with the conditions set out in national law and as provided for in Article 9 SSMR, if such powers are not conferred upon it. In respect of Article 5, NCAs and/or NDAs must inform the ECB about the exercise of these powers without undue delay.[68]

### *8.2.2 The Dichotomy Between Significant and Less Significant Supervised Entities*

*General Provisions on the Classification of a Supervised Entity as Significant or Less Significant*

**Classification on an Individual and on a Group Basis: General Overview**

Article 6 SSMR established, in principle, a 'two-tier system' with regard to the distribution of powers within the SSM in relation to the specific tasks defined in Article 4(1) (with the exception of points (a) and (c), but not to those in Article 5)[69] distinguishing between two groups of supervised entities (including credit institutions): 'significant' and 'less significant'.

[65] SSMR, Article 6(2), second sub-paragraph, and SSM Framework Regulation, Article 21.

[66] This is without prejudice to the ECB's responsibility and accountability with regard to its specific tasks under Articles 4 and 5; on ECB accountability, see Chap. 6, Sect. 6.4.2.

[67] SSMR, Articles 6(3) and 6(8).

[68] SSM Framework Regulation, Article 22.

[69] See Sect. 8.1.2.

Significant supervised entities are, in principle, directly supervised by the ECB, within the SSM. A less significant supervised entity or group may also be classified as significant upon an ECB Decision adopted pursuant to Article 6(5), point (b) SSMR. Supervised entities not meeting these criteria are classified as 'less significant' and continue to be directly supervised by NCAs, within the SSM as well.[70]

(2) The criteria for determining significance in relation to one or more supervised entities, which are part of a supervised group, are set at the highest level of consolidation within participating Member States. Each supervised entity forming part of such a group is deemed to be a significant supervised entity if either the supervised group at its highest

**Table 8.4** The criteria for classifying supervised entities as significant

1. Size criterion: in principle (unless particular circumstances justify otherwise), supervised entities and groups if the total value of their assets exceeds 30 billion euros
2. Economic importance criterion: in principle (unless particular circumstances justify otherwise), supervised entities and groups meeting any one of the following criteria:
   the ratio of their total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of their assets is below 5 billion euros, or
   following a notification by their NCA that it considers such institutions of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such significance
3. Cross-border activities criterion: those considered by the ECB, on its own initiative, to be of significant relevance if:
   they have established banking subsidiaries in more than one participating Member States, and
   their cross-border assets or liabilities represent a significant part of their total assets or liabilities
4. Direct financial assistance criterion: those for which public financial assistance has been requested or received directly from the EFSF or the ESM
5. In any case, the three most significant credit institutions or supervised groups in each Member State, unless otherwise justified by particular circumstances
6. When necessary to ensure consistent application of high supervisory standards, the ECB may at any time, on its own initiative after consulting with national authorities or upon request by an NCA, decide to exercise directly the supervision of a less significant supervised entity or group, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM

[70] SSMR, Article 6(4), first sub-paragraph; this applies subject to Articles 6(5)–(6) SSMR and 96–100 SSM Framework Regulation. The criteria and conditions for classifying supervised entities as significant are presented in detail later; for a summary, see also Table 8.4.

level of consolidation within participating Member States fulfils the size criterion, the economic importance criterion or the cross-border activities criterion, or one of the supervised entities forming part of the supervised group either fulfils the direct public financial assistance criterion, or is one of the three most significant credit institutions in the participating Member State. If a supervised group is classified as significant or, in the opposite case, is deemed as no longer significant, the ECB must adopt a decision to this effect and notify the start and end dates of its direct supervision to each supervised entity forming part of that supervised group, according to the above-mentioned criteria and procedures.[71]

**Specific Provisions**

All branches opened in the same participating Member State by a credit institution incorporated in a non-participating Member State are deemed to be a single supervised entity. However, without prejudice to this provision, when determining whether any of the criteria set out in Article 6(4) SSMR is fulfilled, branches of a credit institution incorporated in a non-participating Member State must be assessed individually as separate supervised entities, and separately from subsidiaries of the same credit institution. Branches opened in different participating Member States by a credit institution incorporated in a non-participating Member State must in any case be treated individually as separate supervised entities.

On the other hand, when determining whether any of the above-mentioned criteria is fulfilled, subsidiaries established in one or more participating Member States by a credit institution that has its head office either in a non-participating Member State or in a third country must be assessed separately from its branches. In addition, for the same purpose, the following subsidiaries must be assessed separately: those incorporated in a participating Member State, those belonging to a group whose parent undertaking has its head office in a non-participating Member State or a third country and those not belonging to a supervised group in participating Member States.[72]

[71] SSM Framework Regulation, Article 40 (Article 40(3) with reference to Article 39).
[72] Ibid., Articles 41 and 42.

*The Criteria for Classifying Supervised Entities as Significant*

**General Overview**

(1) A supervised entity is classified as significant upon notification of a reasoned ECB Decision to this effect. In turn, it ceases to be classified as significant, if the ECB determines also in a reasoned decision notified to the entity that it is either a less significant supervised entity or that it is no longer a supervised entity. A supervised entity's classification as significant is made on the basis of any of the following five criteria: its size (the 'size criterion'), its importance for the EU economy or the economy of a participating Member State (the 'economic importance criterion'), its significance with regard to cross-border activities (the 'cross-border activities criterion'), a request for or the receipt of direct public financial assistance (the 'direct public financial assistance criterion') or the fact that it is one of the three most significant credit institutions (groups) in each participating Member State.[73]

(2) As already mentioned, significant supervised entities are directly supervised by the ECB, within the SSM, unless particular circumstances justify their supervision by NCAs.[74] The ECB may also, on its own initiative or upon a request by an NCA, directly supervise a less significant supervised entity or group. This requires a decision adopted pursuant to Article 6(5), point (b) SSMR[75] to the effect that it will exercise directly itself all relevant powers referred to in Article 6(4). Such an entity or group is classified as significant. The ECB must consult with the relevant NCAs prior to taking decisions and notify its decisions to the latter.[76]

**The Size Criterion**

According to the size criterion, supervised entities and groups are deemed to be significant if the total value of their assets exceeds 30 billion euros (the 'size threshold'), unless otherwise justified by 'particular circumstances'. The 'total value of assets' must be derived from the line 'total assets' on a balance sheet prepared for prudential purposes, in accordance with EU law.[77] 'Particular circumstances' exist if there are

[73] Ibid., Article 39(1)–(3).

[74] Ibid., Article 39(4).

[75] On this Article, see Sect. 8.2.4.

[76] SSM Framework Regulation, Article 39(5)–(6).

[77] SSMR, Article 6(4), second sub-paragraph, point (i), and SSM Framework Regulation, Articles 50–55.

'specific and factual circumstances' leading to the classification of a significant supervised entity as less significant, taking into account the objectives and principles of the SSMR and, in particular, the need to ensure the consistent application of high supervisory standards. Under the strict interpretation required, whether such circumstances exist must be determined on a case-by-case basis, and specifically for the supervised entity or supervised group concerned, but not for categories of supervised entities.[78]

**The Economic Importance Criterion**

A supervised entity is considered significant, if any of the following conditions applies (again unless otherwise justified by 'particular circumstances'): the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below five billion euros, or following a notification by its NCA that it considers the entity of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such a significance (on the basis of a comprehensive assessment, including a balance sheet assessment).[79]

**The Cross-border Activities Criterion**

The ECB may also, on its own initiative, consider a supervised entity or group to be of significant relevance, if it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities. In this respect, a supervised group may be considered significant by the ECB on the basis of its cross-border activities: first, if its parent undertaking has established subsidiaries, which are also credit institutions, in more than one other participating Member State, or second, if the total value of its assets exceeds five billion euros and the ratio of its cross-border assets to its total assets or the ratio of its cross-border liabilities to its total liabilities is above 20%.[80]

[78] SSM Framework Regulation, Articles 70–71(1); the ECB decision must state the reasons leading to the conclusion that such circumstances exist (ibid., Article 71(3), second sentence).

[79] SSMR, Article 6(4), second sub-paragraph, points (ii) and (iii); this criterion is further specified in Articles 56–58 SSM Framework Regulation.

[80] SSMR, Article 6(4), third sub-paragraph, and SSM Framework Regulation, Article 59; the terms 'cross-border assets' and 'cross-border liabilities' are defined in Article 60 of the latter.

### The Direct Public Financial Assistance Criterion

(1) Significant are also considered to be supervised entities for which public financial assistance has been requested or received directly from the European Financial Stability Facility (EFSF) or (anymore) the European Stability Mechanism (ESM) under the Direct Recapitalisation Instrument (DRI).[81] In that respect, the following distinction applies:[82] first, direct public financial assistance to a supervised entity is considered to have been requested, if a request is made by an ESM member for financial assistance to be granted by the ESM to that entity in accordance with a decision taken by the Board of Governors of the ESM under Article 19 ESM Treaty regarding a credit institution's direct recapitalisation and the instruments adopted under that decision; second, direct public financial assistance is considered to have been received by a supervised entity, if received according to the above decision and instruments.

(2) The relevant NCA must inform the ECB as soon as it becomes aware of the possible need for public financial assistance for such an entity to be granted at national level indirectly from the ESM. Its assessment of the less significant supervised entity's financial situation must be submitted to the ECB, for consideration, before submitting it to the ESM, except in duly justified cases of urgency. A supervised entity in respect of which direct public financial assistance is requested or which has received such assistance is classified as significant from the date on which the assistance was requested on its behalf. The date on which the ECB assumes the direct supervision is specified in its decision. If direct public financial assistance is requested in respect of a supervised entity which forms part of a supervised group, all supervised entities which are part of that supervised group are classified as significant.[83]

### The Supervised Entity Is One of the Three Most Significant Credit Institutions in a Participating Member State

The three most significant credit institutions or supervised groups in each participating Member State are covered in any case, irrespective of whether

[81] SSMR, Article 6(4), fourth sub-paragraph; it is worth noting that the EFSF had not provided any direct public financial assistance during its existence; on the DRI, see Chap. 4, Sect. 4.3.3.

[82] SSM Framework Regulation, Article 61.

[83] Ibid., Articles 62–64; the provisions of Article 62 apply without prejudice to the obligation (set out in Article 96) to inform the ECB of the deterioration of a less significant supervised entity's financial situation.

they meet other criteria, unless otherwise justified by 'particular circumstances'; the size criterion is used in order to identify such institutions or groups.[84]

*The 2017 Judgment of the European Court of Justice*

In this respect, it is of importance to discuss the ECJ judgment (in particular, of the General Court) of 16 May 2017 in Case T-122/15 "Landeskreditbank Baden-Württemberg – Förderbank v European Central Bank (ECB)".[85] The case was brought by that German credit institution, which was classified by the ECB in 2014 as significant but was claiming that, given its low-risk profile, the objective of financial stability protection would be sufficiently achieved by being supervised by the German NCA (BaFin). In this judgment, the Court held that the prudential supervision of less significant credit institutions by NCAs within the SSM is not the exercise of an autonomous competence, but rather a decentralised implementation of an exclusive competence of the ECB. It further points out that a credit institution's classification as significant may be avoided only if there are specific, factual circumstances (the 'particular circumstances') entailing that the direct prudential supervision by NCA is better able to attain the objective of financial stability protection and to ensure the consistent application of high supervisory standards.[86]

*The Procedure for Classifying Supervised Entities as Significant*

**Classifying a Supervised Entity as Significant**

(1) The ECB must review, at least on an annual basis, whether a significant supervised entity or group continues to fulfil any of the criteria of Article 6(4) SSMR in the order set out therein. In addition, it may review, at any time following receipt of relevant information, whether a supervised entity fulfils any of these criteria and whether it no longer fulfils any of them. On

[84] SSMR, Article 6(4), fifth sub-paragraph, and SSM Framework Regulation, Articles 65 and 66.

[85] ECLI:EU:T:2017:337, available at: https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-05/cp170054en.pdf. The appeal on this judgment in Case C-450/17 was dismissed by the Judgment of the Court (First Chamber) of 8 May 2019 (ECLI:EU:C:2019:372, available at: https://curia.europa.eu/juris/liste.jsf?num=C-450/17&language=en).

[86] On this judgment, see Tröger (2017), Annunziata (2018) and Chiti (2019), pp. 129–130.

the other hand, each NCA must also review, at least on an annual basis as well, whether a less significant supervised entity or group fulfils any of these criteria. In the case of a less significant supervised group, this review must be carried out by the relevant NCA of the participating Member State in which the parent undertaking, determined at the highest level of consolidation within participating Member States, is incorporated. If it assesses that a less significant supervised entity or group fulfils any of these criteria, it must, without undue delay, inform the ECB. At the request of the ECB or an NCA, the ECB and the relevant NCA must cooperate in determining whether any of these criteria are fulfilled in respect of a supervised entity or group.[87]

If the ECB decides either to assume the direct supervision of a supervised entity or group or that its direct supervision over a supervised entity or group must end, it must cooperate with the relevant NCA in order to ensure the smooth transition of supervisory competences. In particular, a report setting out the supervisory history and risk profile of the supervised entity must be prepared by the relevant NCA when the ECB assumes the direct supervision of a supervised entity and by the ECB when the relevant NCA becomes competent to supervise the entity concerned.[88]

(2) The ECB must notify in writing a decision on the classification as significant of a supervised entity or group to each entity concerned and communicate it to the relevant NCA. For supervised entities being part of a significant supervised group, its decision must be notified to the supervised entity at the highest level of consolidation within the participating Member States; all supervised entities within the group must be duly informed. It must also give each relevant supervised entity the opportunity to make submissions in writing prior to the adoption of such a decision and the relevant NCAs the opportunity to submit observations and comments in writing and duly consider them. A supervised entity or group is classified as significant from the date of notification of the ECB decision to this effect.[89]

[87] SSM Framework Regulation, Articles 43(1)–(2) (applying unless the Regulation provides otherwise), 43(3)–(5) and 43(7).

[88] Ibid., Article 43(6).

[89] Ibid., Articles 44(1) and 44(4)–(5); the notification must be made within the timeframe laid down in Article 45. When taking decisions on the classification of a supervised entity or a supervised group as significant, and unless otherwise specified, the ECB must apply the procedural rules set out in Articles 25–35 (ibid., Article 44(1)).

**Beginning and End of Direct Supervision by the ECB**

(1) The ECB must specify in its decision the date on which it is to assume direct supervision of a supervised entity or group that has been classified as significant. In principle, the ECB must notify the decision to each supervised entity concerned, at least one month prior to the date on which it will assume direct supervision. It must also provide copies of its decision to the relevant NCAs. Exceptionally, when the ECB assumes direct supervision of a supervised entity or group either on the basis of a request for or receipt of direct public financial assistance from the ESM, it must notify its decision to each supervised entity concerned in due time, at least one week prior to the date on which it will assume direct supervision. The ECB assumes direct supervision of a supervised entity or group, at the latest, 12 months after the date its decision is notified to the supervised entity or group. In the case of supervised groups, it must notify its decision to the supervised entity at the highest level of consolidation within the participating Member States and ensure that all supervised entities within that group are duly informed by the relevant deadline.[90]

(2) When the ECB determines that direct supervision by the ECB of a supervised entity or group will end, it must issue a decision to each supervised entity concerned specifying the date and reasons why the direct supervision will end, adopt it at least one month prior to the date on which direct supervision will end and provide a copy thereof to the relevant NCAs. In addition, it must give each relevant supervised entity the opportunity to make submissions in writing prior to the adoption of such a decision. Any ECB Decision specifying the date on which direct supervision of a supervised entity by the ECB is to end may be issued together with the decision classifying that supervised entity as less significant.[91]

(3) According to the SSM Framework Regulation, there are three reasons justifying an ECB Decision ending the classification as significant of a supervisory entity and direct ECB supervision:[92]

first, in the case of a significant supervised entity that is classified as such on the basis of its size, its importance for the economy of the EU or any participating Member State or the significance of its cross-border activi-

[90] Ibid., Article 45.
[91] Ibid., Article 46.
[92] Ibid., Article 47(1)–(3), respectively.

ties, or because it forms part of a supervised group fulfilling at least one of these criteria, if, for three consecutive calendar years, none of the above criteria has been met either on an individual basis or by the supervised group to which the supervised entity belongs;

second, in the case of a supervised entity classified as significant on the basis that direct public financial assistance from the ESM has been requested in respect of itself, the supervised group to which the supervised entity belongs, or any supervised entity belonging to that group and which is not significant on other grounds, if the direct public financial assistance has been denied, fully returned or is terminated; in the event of return or termination of direct public financial assistance, such a decision may only be taken three calendar years after the complete return or termination of direct public financial assistance;

finally, in the case of a supervised entity classified as significant on the basis that it is one of the three most significant credit institutions in a participating Member State, or belongs to the supervised group of such a credit institution, and which is not significant on other grounds, if, for three consecutive calendar years, that entity has not been one of the three most significant credit institutions in a participating Member State.

In addition, in the case of a supervised entity directly supervised by the ECB under a decision adopted pursuant to Article 6(5), point (b) SSMR and which is not significant on other grounds, the ECB must adopt a decision ending its direct supervision, if, in its reasonable discretion, direct supervision is no longer necessary to ensure consistent application of high supervisory standards.[93]

**Pending Procedures**

If a change in competence between the ECB and an NCA is to take place, the authority whose competence ends must inform, by means of a decision, the authority which assuming supervision of any supervisory procedure formally initiated.[94] In case of supervisory competence

[93] Ibid., Article 47(4).

[94] The information must be provided immediately after the authority whose competence ends becomes aware of the imminent change in competence and be updated on a continuous basis, when there is new information on a supervisory procedure to report, unless duly justified conditions require reporting on a less frequent basis (ibid., Article 48(1)).

changes, the former must try to complete any pending supervisory procedure prior to the date on which the change in the supervisory competence is to occur. Nevertheless, if a formally initiated supervisory procedure cannot be completed prior to that date, the authority whose competence ends must maintain competence to complete such pending supervisory procedure, retain all relevant powers until the supervisory procedure has been completed, complete the pending supervisory procedure in question in accordance with the applicable law under its retained powers, inform the authority assuming supervision prior to taking any decision in a supervisory procedure pending prior to the change in competence and provide to the authority assuming supervision a copy of the decision taken and any relevant documents relating to that decision.[95]

### *8.2.3 Micro-prudential Supervision of Significant Supervised Entities and Groups*

*General Provisions*

**Joint Supervisory Teams: Composition and Tasks**

(1) As already mentioned, in principle the ECB is responsible for the direct micro-prudential supervision of significant supervised entities and groups in participating Member States. For the supervision of each of them a joint supervisory team (the 'JST') must be established,[96] composed of staff members from the ECB and from the NCAs appointed in accordance with Article 4 SSM Framework Regulation and working under the coordination of a designated ECB staff member (the 'JST coordinator') and one or more NCA sub-coordinators.[97]

[95] Ibid., Article 48(2)–(4). The ECB and the relevant NCA must cooperate with regard to the completion of any pending procedure and may exchange any relevant information to this end (ibid., Article 48(5); that Article does not apply to the common procedures laid down in Articles 73–88 (ibid., Article 48(6)).

[96] 'Joint supervisory team' means a team of supervisors in charge of the supervision of a significant supervised entity or a significant supervised group (ibid., Article 2, point (6)).

[97] Ibid., Article 3(1) in conjunction with Article 6.

Its first task consists in performing the 'Supervisory Review and Evaluation Process' (SREP) for significant supervised entities or groups. This process is governed by Articles 97–101 CRD IV; on this basis, NCAs must first review the arrangements, strategies, processes and mechanisms implemented by credit institutions to comply with the CRD IV and the CRR; second, they must evaluate several risk aspects, taking into account the identification and measurement of systemic risk under Article 23 EBA Regulation, European Systemic Risk Board Recommendations, as well as the nature, scale and complexity of an institution's activities.[98] In this context, of particular importance are the two above-mentioned processes (ICAAP and ILAAP),[99] since their insights feed into SREP assessments and supervisors' decisions about capital and liquidity requirements. Since 1 January 2019, the SPEP, which applies to the ECB within the SSM as well, is performed, in accordance with the EBA Guidelines of 19 July 2018 (EBA/GL/2018/03), which were adopted on the basis of Article 107(3) CRD IV.[100]

In addition, taking into account the SREP, it also participates in the preparation of a supervisory examination programme to be proposed to the Supervisory Board, including an 'on-site inspection plan', as laid down in Article 99 CRD IV, for such a significant supervised entity or group;[101] implements the supervisory examination programme approved by the ECB and any ECB supervisory decisions with respect to the significant supervised entity or group that it supervises and coordinates with the on-site inspection team on the implementation of the on-site inspection plan and, if relevant, liaise with NCAs.[102]

(2) The ECB is responsible for the establishment and the composition of JSTs. Staff members from NCAs to JSTs are appointed by them. If a participating Member State's national law confers specific supervisory

[98] CRD IV, Article 97(1); when making the above reviews and evaluations, NCAs must take into account the technical criteria set out in Article 98.

[99] See Sect. 8.1.2.

[100] These Guidelines, which also cover supervisory stress testing, are available at: https://eba.europa.eu/documents/10180/2282666/Revised+Guidelines+on+SREP+%28EBA-GL-2018-03%29.pdf.

[101] According to Article 99(1) CRD IV, the NCAs must, at least annually, adopt a supervisory examination programme for the institutions they supervise, containing, *inter alia* (point (c)), a plan for inspections at the premises used by an institution, including its branches and subsidiaries established in other Member States according to Articles 52, 119 and 122.

[102] SSM Framework Regulation, Article 3(2); on-site inspections, conducted under Article 12 SSMR, and on-site inspection teams are governed by Articles 143–146.

tasks on the NCB which is not the NCA, this may also appoint staff members, the relevant authorities required to coordinate participation within the JSTs. The ECB and the NCAs must consult with one another and agree on the use of the latter's resources with regard to JSTs.[103]

**JST Coordinator and Sub-coordinators**

The JST coordinator must ensure the coordination of the work within the JST. For this purpose, JST members must follow the JST coordinator's instructions as regards their tasks in the JST, without prejudice to their tasks and duties with their respective NCA. Each NCA appointing more than one staff member to the JST must designate an NCA sub-coordinator who must assist the JST coordinator as regards the organisation and coordination of the tasks in the JST and may give instructions to the members of the JST appointed by the same NCA, provided that these do not conflict with the instructions given by the JST coordinator.[104]

*Procedures for Micro-prudential Supervision*

**Micro-prudential Supervision and Assistance by NCAs**

(1) The direct supervision of significant supervised entities must be performed by the ECB according to the procedures set out in the SSM Framework Regulation, in particular in respect of the tasks and the composition of JSTs.[105] NCAs must assist the ECB, following its instructions, in the performance of its tasks under the conditions set out in the SSMR and the SSM Framework Regulation and, in particular, submit draft decisions to the ECB;[106] they must also assist it in preparing and implementing any acts relating to the exercise of the tasks conferred on the ECB by the SSMR, including assistance in verification activities and the day-to-day assessment of the supervised entities' situation, and in enforcing its decisions.[107]

[103] Ibid., Articles 4(1), 4(4)–(5) and 5(1); Article 4(2)–(3) lays down the appointment conditions.

[104] Ibid., Article 6.

[105] Ibid., Article 89.

[106] Article 91 provides in this respect that, in accordance with Article 6(3) and (7), point (b) SSMR, the ECB may request an NCA to prepare a draft decision regarding the exercise of its specific tasks under Article 4 SSMR for consideration, specifying the time limit for sending. An NCA may also, on its own initiative, submit a draft decision in respect of a significant supervised entity to the ECB for its consideration through the JST.

[107] Ibid., Article 90.

(2) A significant supervised entity must address to the ECB any request, notification or application relating to the exercise of its tasks conferred; the latter must make any such request, notification or application available to the relevant NCA and may request the latter to prepare a draft decision.[108]

**Exchange of Information**

The ECB and the NCAs must, without undue delay, exchange information relating to significant supervised entities in the following two cases: if there is a serious indication that such entities can no longer be relied on to fulfil their obligations towards their creditors and, in particular, provide security for the assets entrusted to them by their depositors, or if there is a serious indication of circumstances that could lead to a determination that the credit institution's deposits are 'unavailable' according to Article 1(3), point (i) DGSD.[109] The ECB and the NCAs must do so prior to a decision relating to such a determination.[110]

**Compliance with Fit-and-Proper Requirements for Managers**

In order to ensure the existence of robust governance arrangements, and, in particular, that the members of the management body are of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties, a significant supervised entity must notify, without undue delay, the relevant NCA of any change in the membership of its management bodies as far as managerial and supervisory functions are concerned (the 'managers'). The ECB must be notified by the relevant NCA without undue delay of the timeframe within which a decision has to be taken, in accordance with relevant national law.[111] In order to assess the suitability of managers of significant supervised entities, the ECB has the supervisory powers that NCAs have under the relevant EU and national

[108] Ibid., Article 95, with reference to Article 91; this applies without prejudice to the specific procedures provided for in Articles 73–88 SSM Framework Regulation and to its ordinary interaction with its NCA.

[109] For details, see Gortsos (2014), pp. 125–126.

[110] SSM Framework Regulation, Article 92.

[111] Ibid., Article 93(1); see also Sect. 8.1.2. This is without prejudice to relevant EU and national law and Articles 73–88 SSM Framework Regulation, specifying the provisions of Articles 14 and 15 SSMR on the granting and withdrawal of credit institutions' authorisations, and the assessment of notifications of the acquisition and disposal of qualifying holdings in them. The term 'management body' is defined in Article 3(1), point (7) CRD IV.

law.[112] This 'fit-and-proper assessment' of the members of the management body of significant and less significant institutions is a key part of supervisory activities concerning both a credit institution's initial authorisation, as well as any membership change.[113]

A significant supervised entity must inform the relevant NCA of any new facts that may affect an initial assessment of suitability or any other issue which could impact on a manager's suitability, without undue delay once these facts or issues are known to the supervised entity or the relevant manager. The latter must then notify of such new facts or issues, without undue delay, the ECB which may initiate a new assessment and then decide on the appropriate action in accordance with the relevant EU and national law and inform accordingly the relevant NCA without undue delay.[114]

### *8.2.4 Micro-prudential Supervision of Less Significant Supervised Entities and Groups*

*Powers of the ECB*

**General Provisions**

With regard to less significant supervised entities and taking into account the provisions of the SSM Framework Regulation, the ECB has also been granted a wide range of powers, even though, in principle, these are under the direct supervision of NCAs. In particular, it can issue regulations, guidelines or general instructions addressed to NCAs and adopt supervisory decisions. In order to ensure consistency of supervisory outcomes within the SSM, such instructions may refer to the ECB's specific supervi-

[112] Ibid., Article 93(2).

[113] See ECB 2014 Guide to Banking Suprevision ECB Guide of November 2014, paragraph 67. As regards the process and criteria used for this assessment, applicable are the Joint ESMA and EBA Guidelines of 21 March 2018 "on the assessment of the suitability of members of the management body and key function holders" (ESMA 71-99-598, EBA/GL/2017/12, available at: https://www.esma.europa.eu/document/joint-esma-and-eba-guidelines-assessment-suitability-members-management-body-and-key-0), the ECB "Guide to fit and proper assessments" of May 2019 (at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.fap_guide_201705_rev_201805.en.pdf), and paragraph 89 of the (above-mentioned) EBA Guidelines on the SREP (EBA/GL/2018/03). On this aspect, see Busch and Teubner (2019).

[114] SSM Framework Regulation, Article 94.

sory powers for groups or categories of supervised entities.[115] In addition, it exercises oversight over the SSM's functioning based on the responsibilities and procedures set out in Article 6 and in the SSM Framework Regulation and it may, at any time, make use of its investigatory powers and may request, on an *ad hoc* or on a continuous basis, information from the NCAs on the performance of their tasks.[116] If deemed appropriate, it may also require from an NCA to involve in its supervisory team in relation to the supervision of less significant supervised entities staff members from other NCAs, without prejudice to Article 31(1) SSMR on staff exchange.[117]

**In Particular: The Provisions of Article 6(5), Point (b) SSMR**

If necessary in order to ensure consistent application of 'high supervisory standards', the ECB may, at any time, decide to exercise directly itself the supervision of a less significant supervised entity or a less significant supervised group. This decision may be taken either on its own initiative after consulting with NCAs or upon request by an NCA.[118] Before taking the decision, the ECB must take into account, in particular, any of the following six factors: whether the less significant supervised entity or group is close to meeting one of the criteria referred to in Article 6(4); its interconnectedness with other credit institutions; whether it is a subsidiary of a supervised entity with its head office in a non-participating Member State or a third country and has established one or more subsidiaries, which are also credit institutions, or one or more branches in participating Member States, of which at least one is significant; the fact that the ECB's instructions have not been followed by the NCA; the fact that the NCA has not complied with the acts referred to in Article 4(3), first sub-paragraph; and the fact that the less significant supervised entity has requested or received indirectly financial assistance from the EFSF or the ESM.[119]

[115] These supervisory powers are laid down in Article 16(2) SSMR. As already mentioned, in the cases of points (a) and (c) of Article 4(1), the relevant supervisory tasks are performed by the ECB itself for all supervised entities according to Articles 14–15.

[116] Ibid., Article 6(5), points (a) and (c)–(e).

[117] SSM Framework Regulation, Article 7.

[118] SSMR, Article 6(5), point (b), and SSM Framework Regulation, Article 67(1).

[119] In the latter case, the NCA must inform the ECB as soon as it becomes aware of the possible need for public financial assistance and submit its assessment of the financial situation of the less significant supervised entity to the ECB, for its consideration, before submit-

*Responsibilities of NCAs*

With regard to less significant supervised entities, taking into account the provisions of the SSM Framework Regulation and subject to the procedures provided therein, NCAs must carry out and are responsible for the specific tasks referred to in Article 4(1)[120] on the supplementary supervision of financial conglomerates and adopt all relevant supervisory decisions. On the other hand, with regard to all supervised entities, the NCAs and the NDAs maintain their powers, in accordance with national law, to obtain information from such entities and undertakings included in their consolidated financial situation, and perform on-site inspections thereof. This is without prejudice to the responsibilities of the ECB and Articles 10–13 on its investigatory powers. The NCAs must inform the ECB, in accordance with the SSM Framework Regulation, of the measures taken and closely coordinate those measures with the ECB and report to the ECB on a regular basis on the performance of their activities in accordance with Article 6.[121]

*Procedures for Micro-prudential Supervision*

(1) If the situation of any less significant supervised entity deteriorates 'rapidly and significantly', the relevant NCA must inform the ECB, especially if such deterioration could lead to a request for direct or indirect financial assistance from the ESM.[122]

(2) NCAs must provide the ECB with information relating to their 'material supervisory procedures' concerning less significant supervised entities in order to enable it to exercise oversight over the functioning of the SSM under Article 6(5), point (c) SSMR. Such procedures consist of the removal of members of the Management Board of a less significant supervised entity and the appointment of special managers to take over, and the procedures having a significant impact on such an entity. In this respect, the ECB must define 'general criteria', taking into account, in particular, the risk situation and the potential impact on the domestic financial system of the less significant supervised entity concerned, in order

ting it to the ESM, except in duly justified cases of urgency (SSM Framework Regulation, Articles 67(2) and 62). It is noted that, in the author's knowledge, the ECB has not yet made any use of these powers.

[120] Points (a), (c) and (h) of Article 4(1) SSMR are exempted.

[121] Ibid., Article 6(6), first to third sub-paragraphs.

[122] Ibid., Article 96; this applies without prejudice to Article 62.

to determine the information to be notified with respect to each less significant supervised entity.

In addition to the above information requirements, the ECB may at any time request NCAs to provide information on the performance of their tasks in respect of less significant supervised entities. The latter must, on their own initiative, notify the ECB of any other supervisory procedure which they consider material or which may negatively affect the reputation of the SSM.[123]

(3) For that same purpose, NCAs must send to the ECB draft supervisory decisions concerning less significant supervised entities for which the ECB considers that, based on the general criteria defined by it and regarding their risk situation and potential impact on the domestic financial system, the information must be notified to it. Such draft supervisory decisions must be sent to the ECB prior to being addressed to less significant supervised entities if they relate to the removal of members of the Management Boards of the less significant supervised entities and the appointment of special managers or have a significant impact on the less significant supervised entity. In addition, NCAs must transmit to the ECB any other draft supervisory decisions on which the ECB's views are sought or which may negatively affect the SSM's reputation; these draft supervisory decisions are called 'material draft ECB supervisory Decisions'.[124]

(4) The ECB may also require NCAs (for that same purpose as well) to report to it on a regular basis on the measures they have taken and on the performance of the tasks they carry out in accordance with Article 6(6) SSMR and must inform them annually of the categories of less significant supervised entities and the nature of the information required. These requirements are also without prejudice to the ECB's right to make use of the investigatory powers referred to in Articles 10–13 in respect of less significant supervised entities. NCAs must also submit to the ECB an annual report on less significant supervised entities, supervised groups or categories of such entities in accordance with the ECB's requirements.[125]

[123] Ibid., Article 97.

[124] Such decisions must be sent by NCAs to the ECB at least ten days in advance of the planned date of adoption of the decision and the latter must express its views within a reasonable time before the planned adoption of the decision. In cases of urgency, a reasonable time period for sending a material draft decision to the ECB is be defined by the relevant NCA (ibid., Article 98).

[125] Ibid., Articles 99–100.

**Box 8.1 Essential Definitions with Regard to 'Significant' and 'Less Significant' Supervised Entities (SSM Framework Regulation, Article 2)**

1. 'Significant supervised entity': a significant supervised entity in a euro area Member State and a significant supervised entity in a non-euro area participating Member State
2. 'Significant supervised entity in a euro area Member State': a supervised entity established in a euro area Member State which has this status pursuant to an ECB Decision based either on Article 6(4) or on Article 6(5), point (b) SSMR
3. 'Significant supervised entity in a non-euro area participating Member State': a supervised entity established in a non-euro area participating Member State which has the status of a significant supervised entity pursuant to an ECB Decision based on the above articles of the SSMR (under (2))
4. 'Supervised group': any of the following:
   a. A group whose parent undertaking is a credit institution or financial holding company with its head office in a participating Member State
   b. A group whose parent undertaking is a mixed financial holding company with its head office in a participating Member State, provided that the coordinator of the financial conglomerate, within the meaning of the FICOD (Directive 2002/87/EC) is an authority competent for the supervision of credit institutions, and is also the coordinator in its function as supervisor of credit institutions
   c. Supervised entities each having their head office in the same participating Member State, provided that they are permanently affiliated to a central body which supervises them under the conditions laid down in Article 10 of the CRR and is established in the same participating Member State
5. 'Significant supervised group': a supervised group which has this status following an ECB Decision based either on Article 6(4) or on Article 6(5), point (b) SSMR
6. 'Less significant supervised group': a supervised group which does not have the status of a significant supervised group within the meaning of Article 6(4) SSMR

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CHAPTER 9

# Other Specific Tasks and Competences of the European Central Bank Relating to Financial Stability

## 9.1 The Specific Tasks of the European Central Bank in the Context of the European Systemic Risk Board

### *9.1.1 Introductory Remarks*

In Chap. 3 (Sect. 3.3.1), it was discussed that, even though the *De Larosière Report* advised against the European Central Bank's (ECB's) exercising micro-prudential supervision over the European financial system, it pointed out that specific tasks concerning the macro-prudential oversight of the financial system should be conferred on it. To this end, in connection to the operation of the European Systemic Risk Board (ESRB), specific tasks have been conferred on the ECB under Council Regulation (EU) No 1096/2010. In this respect, and as already discussed,[1] the ECB is represented both in the ESRB's General Board and in its Steering Committee: its President and Vice-President are members of the General Board and, respectively, Chair and first Vice-Chair, while five other members of the General Board who are also members of the ECB General Council are members of the Steering Committee. In addition, the ECB has been assigned the specific task to provide to the ESRB analytical, statistical, logistical and administrative support by ensuring its Secretariat. In

[1] See details in Chap. 5, Sect. 5.4.2.

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fulfilling this task, it must provide sufficient human and financial resources and appoint the Secretariat's head, in consultation with the ESRB's General Board.[2]

### 9.1.2 *In Particular: Mission and Management of the ESRB's Secretariat—Collection and Confidentiality of Information*

(1) The Secretariat's mission consists in preparing the ESRB meetings, collecting and processing information, including statistical information, on behalf and for the benefit of the fulfilment of the ESRB tasks (in accordance with Article 5 ESCB/ECB Statute) and preparing analyses necessary to carry out the tasks of the ESRB, drawing on technical advice from national central banks (NCBs) and supervisors. In addition, it must support the ESRB in its international cooperation at administrative level with other relevant bodies on macro-prudential issues, as well as the work of its General Board, Steering Committee and Advisory Technical and Scientific Committees.[3] The Secretariat's head, who attends the meetings of the ESRB's above-mentioned bodies, takes directions, on behalf of the ESRB, by its Chair and its Steering Committee.[4]

(2) In fulfilling its mission in relation to the collection of information on behalf of the ESRB, the Secretariat must, on a regular and *ad hoc* basis, collect all the necessary information, which has been determined by the ESRB as necessary for the purposes of the performance of its tasks, and make available to the ESAs the information on risks necessary for the performance of their tasks.[5]

In relation to the confidentiality of information and documents, the following rules apply[6]: first, without prejudice to the application of criminal law, any confidential information received by the Secretariat while performing its duties may not be divulged to any person or authority outside the ESRB, except in summary or aggregate form, such that individual financial firms cannot be identified; furthermore, the Secretariat must ensure the submission of documents to the ESRB in a manner ensuring their confidentiality; third, the ECB must ensure the confidentiality of the

[2] Regulation (EU) No 1096/2010, Articles 2, first sentence, and 3.
[3] Ibid., Article 2, second sentence.
[4] Ibid., Article 4.
[5] Ibid., Article 5, with reference to Article 15 ESRB Regulation.
[6] Ibid., Articles 6(1)–(4), respectively.

information received by the Secretariat for the performance of its tasks, establishing internal mechanisms and adopting internal rules to ensure the protection of information collected by the Secretariat on behalf of the ESRB; in addition, ECB staff must comply with the applicable rules relating to professional secrecy; lastly, information acquired by the ECB may only be used for the purposes of the Secretariat's mission.[7]

## 9.2 Competences of the ECB Within the Single Resolution Mechanism

### *9.2.1 Resolution Planning*

As mentioned in Chap. 8 (Sect. 8.1.3), the ECB is called upon to carry out supervisory tasks, *inter alia*, in relation to recovery plans if a credit institution or group, in relation to which the ECB is the consolidating supervisor, does not meet or is likely to breach the applicable micro-prudential supervision requirements. On the other hand, resolution powers are explicitly excluded, since those are being exercised by the Board, the Council, the Commission, and, if relevant, the NRAs as to their respective responsibilities. Nevertheless, the ECB must cooperate closely with the Board or the NRAs in resolution planning[8] in accordance with the following:

First, institutions subject to direct supervision by the ECB under Article 6(4) Single Supervisory Mechanism Regulation (SSMR) or constituting a significant share in the financial system of a participating Member State are subject to 'individual resolution plans'.[9] These are drawn up by the Board, after consulting the ECB or the relevant NCAs, the NRAs, including the 'group-level resolution authority' (the 'GLRA')[10] of the participating

[7] The confidentiality procedures established at the Secretariat in order to safeguard information regarding financial institutions and their identification are governed by the Agreement of 25 November 2011 between the ESAs and the ESRB (available at: https://www.esrb.europa.eu/pub/pdf/111125_agreement_EBA_EIOPA_ESMA_ESRB.pdf).

[8] For an analysis of resolution planning under the SRMR, see Gortsos (2019), pp. 149–167.

[9] An institution's operations are deemed to constitute a 'significant share' of a participating Member State's financial system if the total value of its assets exceeds 30 billion euros, or the ratio of its total assets over the GDP of the Member State of establishment exceeds 20%, unless the total value of its assets is below five billion euros (SRMR, Article 11(8)).

[10] 'GLRA' means the resolution authority in the participating Member State where the institution or parent undertaking subject to consolidated supervision (at the highest level of

Member States in which the entities are established, and (if relevant) the resolution authorities of non-participating Member States in which 'significant branches' are located. Towards that end, the Board may require the NRAs to submit draft resolution plans and the GLRA to submit a draft group resolution plan. Resolution and group resolution plans must be reviewed (and, if appropriate, updated) at least annually and after any 'material changes' to the legal or organisational structure or to the business or the financial position of the entity or of the group in the case of group resolution plans, including any group entity that could have a 'material effect' on the effectiveness of the plan or that otherwise necessitates its revision; for the purpose of this revision or update, the institutions, the ECB or the NCAs must promptly communicate to the Board any change necessitating it.[11]

Second, the assessment of resolvability is the first step in the resolution planning process. In this respect, when drafting and updating resolution plans, the Board must assess the extent to which designated entities and groups are resolvable without the assumption of any extraordinary public financial support besides the use of the Single Resolution Fund, central bank emergency liquidity assistance (ELA) or central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms. In doing so, it must consult the NCAs and the ECB, as well as the resolution authorities of non-participating Member States in which significant branches are located (if relevant). On the basis of the recovery plans or group recovery plans submitted by the ECB or the relevant NCA, the Board must identify any actions therein which may adversely impact the resolvability of an entity or a group, and make relevant recommendations to the ECB or the NCA.[12] If, on the basis of these assessments, the Board determines, after consulting the NCAs and the ECB, that there are 'substantive impediments' to the resolvability for an entity or a group, it must prepare a report (in cooperation with the NCAs and the ECB) addressed to the institution or the parent undertaking analysing them.

Finally, the Board must determine, after consulting the NCAs and the ECB, the Minimum Requirement for (Own Funds and) Eligible Liabilities (MREL), subject to write-down and conversion powers, which must be

consolidation within participating Member States in accordance with Article 111 CRD IV) is established (ibid., Article 3(1), points (4) and (27), respectively).

[11] Ibid., Articles 8(2) and 8(12).

[12] Ibid., Articles 10(1)–(2).

met all times by the designated entities and groups. Among the other requirements imposed on it, the Board must inform the ECB and the EBA of the MREL it has determined for each institution and parent undertaking.[13] Under both the BRRD and the Single Resolution Mechanism Regulation (806/2014) (SRMR), the MREL is calculated as the following ratio: the amount of 'own funds' and 'eligible liabilities' of the institution, as a percentage of its own funds and total liabilities.[14]

### *9.2.2 Early Intervention*

(1) As mentioned in Chap. 8 (Sect. 8.1.3) as well, the ECB is called upon to carry out supervisory tasks, *inter alia*, in relation to early intervention, if a credit institution or group, in relation to which it is the consolidating supervisor, does not meet or is likely to breach the applicable micro-prudential supervision requirements.[15] Under the SRMR, the Board must be informed by the ECB or the NCAs of any measure that these require an institution or a group to take or that they themselves take in relation to their supervisory powers under the SSMR or the CRD IV or on early intervention and notify the Commission of any information received.[16]

Upon receipt of this information, and without prejudice to the powers of the ECB and the NCAs under other EU legal acts, the Board must prepare for the resolution of the institution or group concerned. For this purpose, the ECB or the relevant NCA must closely monitor, in cooperation with the Board, the conditions of the institution or the parent undertaking and their compliance with any early intervention measure required of them. It must also provide the Board with all information necessary in order to update the resolution plan and prepare for the potential resolution and for the valuation. In this respect, the Board may require the institution or the parent undertaking to contact potential purchasers in order to prepare for the institution's resolution, subject to the criteria specified in the BRRD on the marketing requirements in case of application

[13] Ibid., Articles 12(13)–(15).

[14] BRRD, Article 45(1) and SRMR, Article 12(4). For a comprehensive overview of the MREL, see Maragopoulos (2016); see also Lamandini (2017), Merc (2017), Tröger (2017) and Gortsos (2019), pp. 169–175.

[15] BRRD, Articles 27–29; on these articles, see Haentjens (2017), pp. 214–218.

[16] SRMR, Article 13(1), with reference to Articles 16 SSMR and 104 CRD IV and Articles 27(1), 28 or 29 BRRD, respectively.

of the sale of business tool[17] and the requirements of professional secrecy; it may also require the relevant NRA to draft a preliminary resolution scheme for the institution or the group concerned. In both cases, it must inform accordingly the ECB and the relevant NCAs and NRAs.[18]

(2) If the ECB or the NCA intend to impose on an institution or a group any additional measure under the (just) above-mentioned provisions of EU banking law before that has fully complied with the first measure notified to the Board, they must inform the Board before its imposition. The ECB or the NCA, the Board and the relevant NRAs must ensure the consistency of any additional measure and any Board action aimed at preparing for resolution.[19]

### *9.2.3 The Conditions for Resolution within the Resolution Procedure*

*Introductory Remarks*

The adoption of a resolution scheme in relation to designated entities and groups is a competence of the Board as well, exercised (only) when it assesses that the 'conditions for resolution' are met cumulatively. This assessment is made in its Executive Session either on receiving a communication or on its own initiative.[20] The resolution conditions are three: the 'failing or likely to fail' criterion, the criterion of the reasonable prospect for effective alternative private sector measures or supervisory action, and the 'public interest' criterion. They are laid down in Article 18(1) SRMR and in substance (even though not in procedural terms) are identical to

[17] This resolution tool is governed by Article 24 SRMR.

[18] Ibid., Articles 13(2), with reference to Article 20, and 13(3); on Article 20 governing the valuation for the purposes of resolution, see Gortsos (2019), pp. 227–232, with extensive further references. See also the Board's Report of 19 February 2019 "Framework for Valuation", which (*inter alia*) provides an indication of its expectations regarding the principles and methodologies for valuation reports as laid down in the SRMR (and the BRRD) (available at: https://srb.europa.eu/sites/srbsite/files/framework_for_valuation_feb_2019_web_0.pdf).

[19] Ibid., Articles 13(4)–(5); on Article 13 SRMR, see Gortsos (2019), pp. 181–183.

[20] Ibid., Articles 18(1), first sub-paragraph and 18(6); the fact that assessments in this respect must be made in the Executive Session implies that NRAs are, in principle, not involved. The previous adoption of a measure according to Article 16 SSMR, Articles 27(1) and 28–29 BRRD, or Article 104 CRD IV is not a condition for taking a resolution action (ibid., Article 18(3)).

**Table 9.1** The conditions for the resolution of credit institutions under Article 18 of the SRM Regulation

| *Criteria* | *Case 1* | *Case 2* | *Case 3* |
|---|---|---|---|
| The credit institution is failing or likely to fail | ✓ | ✓ | ✓ |
| No reasonable prospect for effective alternative private sector measures or supervisory action | ✗ | ✓ | ✓ |
| A resolution action is necessary in the public interest | ✓ | ✓ | ✗ |
| Outcome | | | |
| | Recapitalisation with the use of private sector funds | 1. Resolution<br>3. Potential use of the SRF's available financial means | 1. Winding up under normal insolvency proceedings<br>4. Activation of national DGS to repay covered depositors |
| Recent cases | | Banco Popular Español | Banca Popolare di Vicenza<br>Veneto Banca<br>ABLV Bank and ABLV Luxembourg |

those laid down in Article 32 BRRD.[21] Relevant are also the EBA Guidelines of 6 August 2015 (EBA/GL/2015/07) "on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail".[22]

*The 'Failing or Likely-to-Fail' Criterion*

**The Rule**

(1) The first condition for resolution consists in the determination that the entity (typically but not exclusively a credit institution) is 'failing or likely

[21] On the resolution conditions, see more details Conlon and Cotter (2014), Joosen (2014), Binder (2016a), Section 2.3.2, Freudenthaler and Lintner (2017), Haentjens (2017), pp. 221–226 and Gortsos (2019), pp. 205–211. For a summary, see also Table 9.1.

[22] Available at: https://www.eba.europa.eu/documents/10180/1156219/EBA-GL-2015-07_EN_GL+on+failing+or+likely+to+fail.pdf.

to fail'. A credit institution is deemed to be in such a situation in one or several of the following four circumstances[23]: first, it infringes, or there are objective elements to support a determination that it will, in the near future, infringe the requirements of its authorisation, in a way that would justify its withdrawal by the competent authority; this includes, but is not limited to, the fact that the institution has incurred or is likely to incur losses that might deplete the entirety or a significant amount of its own funds; second, its assets are, or there are objective elements to support a determination that they will, in the near future, be less than its liabilities; third, it is, or there are objective elements to support a determination that it will, in the near future, be unable to pay its debts or other liabilities as they fall due; finally, extraordinary public financial support is required, unless that support takes any of the three forms mentioned below. The (just above-mentioned) 2015 EBA Guidelines (EBA/GL/2015/07) further specify the first three of these circumstances, which are referred to as 'objective elements'. The assessment of these elements is carried out in the course of the SREP, which constitutes the clearest indication of the link between the supervisory and the resolution functions.

(2) In principle, an assessment of this condition must be made by the ECB after consulting the Board. The Board may also make such an assessment, in its Executive Session as well, provided that it has informed the ECB of its intention and that the latter, within three calendar days of receipt of that information, does not make such an assessment. The ECB must, without delay, provide the Board with any relevant information that the Board may request in order to inform its assessment. When the ECB makes an assessment that this condition is met in relation to an entity or group, it must communicate it without delay to the Commission and to the Board. Without prejudice to cases where the ECB has decided to directly exercise supervisory tasks relating to entities in accordance with Article 6(5), point (b) SSMR,[24] when receiving a communication or intending to make an assessment on its own initiative in relation to an entity or a group with respect to which NRAs are competent, the Board must communicate its assessment, without undue delay, to the ECB.[25]

[23] SRMR, Article 18(4), first sub-paragraph, points (a)–(d), respectively; for a summary, see Table 9.2.

[24] On this article, see Chap. 8, Sect. 8.2.4.

[25] SRMR, Articles 18(1), second and third sub-paragraphs, and 18(2).

**Table 9.2** The 'failing or likely-to-fail' criterion under the 2015 EBA Guidelines

| | |
|---|---|
| The first condition for resolution consists in that the competent authority (i.e. as the case may be the ECB for significant credit institutions or the NCA for less significant ones) determines, after consulting the resolution authority, that the credit institution is 'failing or likely to fail' | |
| (1) A credit institution is deemed to be in such a situation upon assessment of one or several of the objective elements relating to the following areas: | |
| Capital position | (a) It infringes, or there are objective elements to support a determination that it will, in the near future, infringe own fund requirements relating to the continuing of its authorisation, in a way that would justify its withdrawal by the competent authority. This includes, but is not limited to, the fact that the institution has incurred or is likely to incur losses that might deplete the entirety or a significant amount of its own funds<br>(b) Its assets are, or there are objective elements to support a determination that they will, in the near future, be less than its liabilities |
| Liquidity position | It infringes, or there are objective elements to support a determination that it will, in the near future, infringe regulatory liquidity requirements for continuing authorisation in a way that would justify its withdrawal by the competent authority |
| Other requirements for continuing authorisation | It infringes, or there are objective elements to support a determination that it will, in the near future, infringe other requirements of its authorisation, in a way that would justify its withdrawal by the competent authority. For that purpose, the competent and/or resolution authority should consider<br>(a) governance arrangements, and<br>(b) the reliability and operational capacity to provide regulated activities |
| The assessment of the objective elements is usually carried out by the competent authority in the course of the 'Supervisory Review and Evaluation Process' ('SREP'), which is performed in accordance with the 'EBA SREP Guidelines (2015)' | |
| (2) 'Extraordinary public financial support' is required, unless that support takes any of the three permissible forms | |

## The Three Forms of Provision of Extraordinary Public Financial Support Which Do Not Activate the Resolution Regime

(1) If the extraordinary public financial support required takes any of the following three forms, in order to remedy a "serious disruption" in the national economy and preserve financial stability, the resolution

regime is not activated.[26] The first form is support granted by means of a state guarantee to back liquidity facilities provided by the central bank on conditions set by it; the second form is support granted by means of a state guarantee of newly issued liabilities; even though in principle Member States' guarantees for equity claims should be prohibited, the third form is support granted by means of an injection of own funds or purchase of capital instruments "at prices and on terms that do not confer an advantage upon the credit institution" (so-called precautionary recapitalisation).[27] The guarantee or equivalent measures must, in each of these cases, meet five criteria[28]; if these conditions are met, the measures do not trigger the resolution of the credit institution concerned but result in a state aid case.[29] Applicable are the provisions of the so-called 2013 Banking Communication[30] (which was adopted to support measures in favour of credit institutions in the context of the financial crisis), including those on the conversion of subordinated debt into equity ('burden sharing').[31]

(2) Support measures in the form of a precautionary recapitalisation may be exempted, only if the following two additional conditions are met:

First, the exemption can only take place under the condition that neither the above-mentioned circumstances leading to an assessment that a

[26] Ibid., Article 18(4), first sub-paragraph, points d(i)–(iii).

[27] Even though legally permitted, this is a form of "hidden" bail-out by "taxpayers' money".

[28] SRMR, Article 18(4), second sub-paragraph.

[29] On the financing of credit institution resolution and EU state aid rules, see Grünewald (2014), pp. 126–134, Hadjiemmanuil (2017b) and Smoleńska (2017).

[30] Communication from the Commission "on the application, from August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis" ('Banking Communication') (OJ C 216, 30.7.2013, pp. 1–15).

[31] On the relation between the principle of proportionality and the application of the bail-in to subordinated debtholders in application of the Banking Communication, see the recent so-called Kotnik case (Case C-526/14) of the ECJ (available at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62014CJ0526&qid=1470488103569&from=IT).

A notable case of provision of precautionary recapitalisation is that of the Italian credit institution Monte dei Paschi di Siena S.p.A., whose capital ratios were deemed sufficiently high under the so-called baseline scenario under the 2016 stress test carried out by the EBA and the ECB but had a capital shortfall in the "adverse case scenario" (meeting thus the "failing or likely-to-fail" resolution condition). On this case, see Hadjiemmanuil (2017a) (an opinion submitted a month before the Agreement was reached) and Haentjens (2017), Section 6. See also De Groen (2016), reviewing that credit institution's financial condition during the very last years before 2017.

credit institution is failing or likely to fail, nor the circumstances with regard to the exercise of the power to write down or convert capital instruments are present at the time this public support is granted to the credit institution.

Second, they are limited to injections necessary to address a capital shortfall established in stress tests, asset quality reviews or equivalent exercises conducted by the ECB, the EBA or NCAs.[32] In principle, an assessment of this condition must be made by the ECB after consulting the Board; the latter may also make such an assessment, in its Executive Session, provided that it has informed the ECB of its intention and that the ECB, within three calendar days of receipt of that information, does not make such an assessment. Upon making an assessment that this condition is met in relation to an entity or group, the ECB must communicate it without delay to the Commission and to the Board.

Without prejudice to cases where the ECB has decided to directly exercise supervisory tasks relating to entities in accordance with Article 6(5), point (b) SSMR, in the event of receipt of a communication or if it intends to make an assessment on its own initiative in relation to an entity or a group with respect to which NRAs are competent, the Board must communicate its assessment, without undue delay, to the ECB.[33]

*The Second Criterion*

The second condition for resolution consists in that, having regard to timing and other relevant circumstances, there is no reasonable prospect that the credit institution's failure could be prevented within a reasonable timeframe by taking, in respect thereof, any 'alternative private sector measures', including measures by an IPS or any 'supervisory action' (e.g. early intervention measures or the write-down or conversion of 'relevant capital instruments'). An assessment of this condition must be made by the Board, in its Executive Session as well, or, if applicable, by the NRAs, in close cooperation with the ECB. The latter may also inform the Board or the NRAs concerned that it considers this condition fulfilled.[34]

[32] Such supervisory powers of the ECB are based on Article 4(1), point (f) SSMR (see Chap. 8, Sect. 8.1.2); the corresponding powers of EBA are based on Article 32(2) EBA Regulation (see Chap. 5, Sect. 5.4.1).

[33] SRMR, Articles 18(1), second and third sub-paragraphs, 18(2) and 18(4), third sub-paragraph.

[34] Ibid., Article 18(1), first sub-paragraph, point (b) and fourth sub-paragraph.

*The 'Public Interest' Criterion*

A resolution action is deemed to be in the public interest if two conditions are met cumulatively[35]: first, it is necessary for the achievement of, and is proportionate to, at least one of the resolution objectives laid down in Article 14 SRMR; and second, winding up of the credit institution under normal insolvency proceedings would not meet these resolution objectives to the same extent. Hence, a decision to resolve a credit institution can be taken only if, in addition to above-mentioned two other conditions, the public interest criterion (also referred to as the 'public interest test'[36]) is met. If this is not case, the failing or likely-to-fail credit institution may not be resolved but must be wound up under normal insolvency proceedings, winding up being, thus, the primary option.[37] The ECB is not involved in this case at all.

*Recent Decisions of the Board on the Basis of Determinations Made by the ECB*

(1) In June 2017, the conditions for resolution under the SRMR have been tested in three cases and led to differentiated assessments and decisions by the Board:

First, on 7 June, the Board has taken resolution action in respect of Banco Popular Español ("Banco Popular"), after having assessed that the conditions for resolution in accordance with Article 18(1) SRMR were met. In particular, on 6 June 2017, the ECB concluded that this entity was failing or likely to fail, since taking into account its rapidly deteriorating liquidity situation, the ECB considered that there were sufficient grounds supporting the determination that the institution would, in the near future, be unable to pay its debts as they fall due.[38]

[35] Ibid., Articles 18(1), first sub-paragraph, point (c) and 18(5).

[36] See indicatively Binder (2019) and Grünewald (2017); on the interpretation of 'public interest' and the criteria to define it, see Lastra, Russo and Bodellini (2019), pp. 13–15. On the Board's approach to the public interest assessment (the 'PIA'), see its related 2019 paper (available at: https://srb.europa.eu/sites/srbsite/files/2019-06-28_draft_pia_paper_v12.pdf).

[37] Lastra, Russo and Bodellini (2019) (at p. 11) correctly refer to the 'dichotomy' between resolution and liquidation. Under EU law, 'normal insolvency proceedings' means collective insolvency proceedings entailing the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those or generally applicable to any natural or legal person (BRRD, Article 2(1), point (47)).

[38] The ECB press release deeming Banco Popular as failing or likely to fail is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170607.en.html. On this (first for the Board) resolution case, see Binder (2017) and Haentjens (2017).

Second, on 23 June, the Board decided not to take resolution action in respect of two Italian credit institutions, namely Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. For both these credit institutions, the ECB had as well concluded that they were failing or likely to fail on the basis of Article 18(4), first sub-paragraph, point (c) SRMR.[39] Nevertheless, the Board assessed that, while the conditions for resolution action of Article 18(1), first sub-paragraph, points (a)–(b) SRMR were met, the condition of point (c) of that sub-paragraph, concerning the public interest criterion, was not satisfied. In particular, it concluded that, given the particular characteristics of these credit institutions and their specific financial and economic situation, resolution action with respect thereto was not necessary in the public interest.[40]

(2) In February 2018, the conditions for resolution under the SRMR were tested once again. In particular, following the decision by the ECB of 23 February 2018 to declare ABLV Bank, AS, Latvia's third largest credit institution, and its subsidiary ABLV Bank Luxembourg S.A. as failing or likely to fail,[41] the Board decided, on the same date, after having assessed the conditions for resolution that resolution action was not necessary. This decision was based (once again) on the fact that it was not in the public interest for these credit institutions to be resolved, since they did not provide critical functions and their failure was not expected to have a significant adverse impact on financial stability.[42]

### *9.2.4 Write-Down and Conversion of Relevant Capital Instruments*

The Board can exercise the power to write down or convert 'relevant capital instruments' in relation to designated entities and groups on the basis of an assessment, in its Executive Session, that any of the following

[39] The relevant ECB press release is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html.

[40] On these resolution cases, see Grünewald (2017), pp. 299–302.

[41] The relevant ECB press release is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2018/html/ssm.pr180224.en.html.

[42] For a regularly updated inventory of actions against Board's Decisions, see the website of the European Banking Institute (EBI) at: https://ebi-europa.eu/publications/eu-cases-or-jurisprudence, under Section 3.

conditions is met[43]: first, before any resolution action is taken, the determination has been made that the conditions for resolution are met; second, the entity will no longer be viable, unless the relevant capital instruments are written down or converted into equity; third, in relation to relevant capital instruments issued by a subsidiary (provided that these are recognised for the purposes of meeting 'own funds requirements' both on an individual and a consolidated basis), the group will no longer be viable unless the write-down or conversion power in relation to these instruments is exercised[44]; fourth, in relation to relevant capital instruments issued at the level of the parent undertaking (provided that these are recognised for the purposes of meeting own funds requirements on an individual basis at the level of the parent undertaking or on a consolidated basis), the group will no longer be viable unless the write-down or conversion power is exercised; and finally, extraordinary public financial support is required by the entity or group, except an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the entity.

The assessment of the first, the third and the fourth above-mentioned conditions can also be made by the ECB, after consulting the Board. In addition, the assessment of whether the entity or group is viable can be made by the Board only after informing the ECB of its intention and the ECB, within three calendar days of receipt of such information, does not make such an assessment; the latter must, without delay, provide the Board with any relevant information that this requests in order to inform its assessment.[45] The role of the ECB in this respect is, thus, important.

[43] SRMR, Article 21(1), first sub-paragraph. 'Relevant capital instruments' means Additional Tier 1 instruments and Tier 2 instruments; deposits, regardless of the amount, do not fall within the definition of this term (ibid., Article 3(1), point (51)).

[44] Such capital instruments may not be written down to a greater extent or converted on worse terms than equally ranked capital instruments at the level of the parent undertaking which have been written down or converted (ibid., Article 21(6)).

[45] Ibid., Articles 21(1), second sub-paragraph, and 21(2).

## 9.3 Last-Resort Lending—The (Still) Limited Role of the ECB in the ELA Mechanism

### *9.3.1 Introductory Remarks*

*Last-Resort Lending by Central Banks as a Liquidity Crisis Management Measure*

**Definition, Functions and Delimitation**

(1) In accordance with the (predominant) traditional approach,[46] last-resort lending means the provision of liquidity by a monetary authority, that is a central bank, to individual solvent banks in exceptional circumstances and on a temporary basis.[47] This power is typically associated with central banks given the synergies existing between the provision of liquidity to the banking system, safeguarding the stability of payments systems, and ensuring financial system stability, which highlights the close relationship between the monetary and financial systems.[48] Two remarks deserve a specific attention in this respect: first, the term 'lending of last resort' is also used for the provision of financial support to independent states faced with financing of public expenditure and public debt refinancing problems (on an international level, this role is assumed by the IMF and on EU level by the ESM); second, at times of liquidity crisis, alternatively to the 'cen-

[46] This approach is based on the seminal work by Bagehot of 1873 (which Tucker calls the "classic" Bagehot view, see (2014), p. 16). On the other three alternative approaches (the "free banking school", the "Richmond Fed view" and the "New York view"), see ibid., pp. 16–19.

[47] Consequently, such liquidity is not provided to the banking system as a whole, as in the case of monetary policy operations. As to whether last-resort lending should also be provided to financial firms other than banks, see Tucker (2014), pp. 27–28. This question was particularly relevant in the case of the US investment bank Lehman Brothers in September 2008, when the Federal Reserve declined to act as a lender of last resort given that it lacked the statutory authority to do so; see indicatively Posner (2010), pp. 63–67. With regard to the Fed's general interventions during the recent international financial crisis, see Baxter and Gross (2010), Oganesyan (2013), Gorton and Metrick (2013), pp. 58–60, and Nelson (2014).

[48] See European Central Bank (2007), pp. 80–81. For an overview of the functions of the lender of last resort, see Guttentag and Herring (1983), (1986, 1987), the various contributions in Goodhart (2000) and in Bank for International Settlements (2014) and Tucker (2014, 2018). For a historical overview of the role of central banks as lenders of last resort, see Gorton and Metrick (2013) and Bordo (2014).

tral bank money solution', there are three other options: financing of a troubled bank through coordinated actions of the private banking sector ('private money solution'); intervention of administrative authorities as market-makers of last resort, and emergency, non-standard monetary policy measures taken by a central bank for the banking system as a whole.[49]

(2) A central bank intervention in the capacity of lender of last resort is driven by the need to meet one or more (solvent) banks' emergency liquidity needs, should they arise. Last-resort lending thus performs two functions: the first consists in enabling individual solvent banks to address their exposure to exceptional liquidity risk—thereby prevent illiquidity-caused solvency problems; the second function is activated when circumstances emerge, which would lead banks with exceptional liquidity problems to become insolvent immediately; in this case, last-resort lending is provided in order to prevent a generalised banking crisis as a result of the simultaneous or successive exposure of several banks to insolvency and avoid spillover effects.[50]

(3) Last-resort lending as an instrument of liquidity crisis management should be distinguished, at least conceptually, from measures undertaken at the level of solvency crisis management.[51] Of course, central banks play an active role in the resolution and withdrawal of the authorisation of insolvent banks: in the former case, mainly when they are the competent resolution authorities, and in the latter case, if they are the competent supervisory authorities. Nevertheless, such powers should not be confused with their power to act as lenders of last resort. In addition, deposits are by no means guaranteed by central banks; deposit guarantee schemes are, in principle, funded by their member banks.[52]

Last-resort lending as a liquidity crisis management instrument should also be distinguished from monetary policy measures implemented by

[49] On these aspects, see Padoa-Schioppa (2000), pp. 24–26 (on the first), Tucker (2014), pp. 28–32 (on the second), as well as Borio and Disyatat (2009) and Lenza et al. (2010) (on the third). See also Domanski, Moessner and Nelson (2014), who use the term 'emergency liquidity assistance' as equivalent to the term 'last-resort lending', actually to describe all forms of central bank intervention at times of liquidity crisis. This is also the standard term used for last-resort lending in the euro area (see later).

[50] See Guttentag and Herring (1983), (1986, 1987), as well as the contributions in Goodhart (2000), Tucker (2014) and Bank for International Settlements (2014). It is noted that there is no last-resort lending for firms operating in the shadow banking sector.

[51] For the linkage between these two types of measures, see Freixas and Parigi (2008).

[52] On the relationship between prudential banking supervision, last-resort lending, and deposit guarantee, see Kahn and Santos (2001).

central banks. In both cases, central banks provide liquidity to the banking system; nevertheless, in the case of monetary policy actions, the objective is not to ensure the stability of the financial system, but to maintain price stability,[53] the liquidity granted is not of an emergency nature, but rather permanent, and the liquidity is provided to the banking system as a whole (without exception), rather than to individual banks.

**Principles Governing the Implementation of Last-Resort Lending**
(1) According to theory, a bank's solvency is a prerequisite for its ability to have access to lending of last resort.[54] Relevant information must be provided to the central bank by the competent supervisory authority (which may be the central bank itself). It is noted, however, that there are past examples of last-resort lending to insolvent banks as well, depending on a central bank's evaluation of the probability of risk for a generalised crisis producing a domino effect across the entire banking system.[55]

(2) Always according to theory, last-resort lending should be provided against adequate collateral, and at a rate higher than that of monetary policy operations.[56] In this respect, the following two remarks are useful: first, as a rule, the collateral that can be provided by a counterparty bank includes assets (securities) which are not eligible, given their low credit rating, in the context of open market operations (as part of a central bank's monetary policy). This is particularly the case if a bank has lost the ability to raise liquidity on money and capital markets, does not have assets on its balance sheet that are eligible in the context of central bank monetary policy operations and is finally forced to have recourse to last-resort lending in order to raise liquidity. Second, the reasoning behind charging significantly higher rates than those applied to monetary policy operations (thus causing an additional burden on banks' financial accounts) is based on the premise that this rate should be of a punitive nature and, thus, act in a way to discourage banks; in reality, though, it is also related to the preceding remark about the (lower) quality of the collateral provided, not eligible for any other use.

[53] For a look into the differences between these two key objectives of central banks, see Central Bank Governance Group (2009), pp. 21–28.

[54] See, on this, Guttentag and Herring (1987), pp. 163–165, and Tucker (2014), pp. 19–23.

[55] Guttentag and Herring (1987, p. 164) cite many relevant examples.

[56] See, on this, Tucker (2014), pp. 23–27 (directly citing Bagehot (1873)).

(3) As already mentioned, the terms for exercising the power of central banks to act as lenders of last resort are not usually set out explicitly in legislative or regulatory provisions. This is attributed to the fact that, according to the principle of 'constructive ambiguity' relating to the conditions that must be met in order for the central bank to intervene in the capacity of lender of last resort, the central bank must have the highest discretion possible to this end in order to be in a position to appropriately weigh the risks and act accordingly in each given case. More specifically, it is argued that the existence of an explicit legislative or regulatory provision would put the stability of the financial system at a higher risk as a result of a greater exposure of banks to moral hazard and hence ultimately to insolvency,[57] and, as a result, would render necessary the imposition of stricter micro-prudential regulations than generally required, in view of preventing banks' exposure to risks undertaken in their conduct of business.[58]

*The Euro Area Framework—Documentation on the ELA Mechanism*
(1) In line with the above-mentioned, the provision of central bank credit in the form of emergency liquidity assistance to solvent credit institutions established in the euro area, which are facing temporary liquidity is different from (but related to) the monetary policy operations. Given that neither the Treaty Establishing the European Community nor the Statute contained any explicit provisions on last-resort lending [and there are also no relevant provisions in the Treaty on the Functioning of the European Union (TFEU)] two alternative, diametrically opposed views had been put forward: according to the 'decentralised approach', this power should belong to the NCBs of the Member States without a derogation (whose currency is the euro), while according to the 'centralised approach', the ECB should be the competent authority, assisted by the NCBs.[59] With regard to this issue the following should be pointed out:

[57] Last-resort lending at a rate higher than monetary policy operations rates, as argued above, is deemed to partly resolve the issue of moral hazard (see Tucker (2014), p. 23).

[58] For an overview of this topic, and notably whether this ambiguity is necessary or not, see Guttentag and Herring (1987, pp. 167–172 and Herring and Litan (1995), pp. 126–131.

[59] For an overview of these approaches, see Smits (1997), pp. 269–271, Schoenmaker (1997), Bini-Smaghi (2000), Lastra (2000), Padoa-Schioppa (2000), Prati and Schinasi (2000), Schoenmaker (2000), and Lastra and Louis (2013), pp. 88–91.

First, in accordance with the (predominant) traditional approach, last-resort lending means the provision (usually exclusively) by the central bank of liquidity to individual solvent credit institutions in exceptional circumstances and on a temporary basis. This power is associated with the functions of central banks given the synergies existing between the provision of liquidity to the banking system, safeguarding the stability of payment systems and ensuring the stability of the financial system. In the event of a generalised crisis in the euro area which would affect the liquidity position of every credit institution operating in the euro area, there is a general consensus that an ECB intervention should be performed by means of monetary policy operations, including in extremis also non-standard ones.[60] This occurred during both the recent international financial crisis and the ongoing fiscal crisis in the euro area.[61]

In addition, apart from the fact that last-resort lending should, in principle, only be provided to solvent credit institutions, lending to insolvent credit institutions also stumbles on the provisions regarding the prohibition of State aid under Articles 107–108 TFEU.[62] Furthermore, lending to credit institutions should not contravene Article 123 TFEU prohibiting monetary government financing.[63] In this case, monetary government financing may be effected indirectly, if the credit institution uses the liquidity provided to buy government securities. Indirect monetary financing may also be affected if a credit institution is insolvent, since in such a case the central bank enters into government activities (which it is in any case not allowed to undertake), releasing the government from any expenditure incurred as a result of capital injections to it.

(2) On the occasion of the onset in 2010 of the ongoing fiscal crisis in the euro area and its negative impact on the banking system of several Member States, last-resort lending to credit institutions established in euro area member states was repeatedly activated: in the 2010–2013 period, in turn by Ireland, Greece and Cyprus, in 2014, by Portugal, and lately (2015–2018) again by Greece; this is the 'Emergency Liquidity Assistance' (the 'ELA') mechanism activated by NCB members of the

[60] See Padoa-Schioppa (2000), p. 28, Lastra (2000), p. 205 and Schoenmaker (2000), pp. 218–219.

[61] See European Central Bank (2010) and Claeys (2014).

[62] On the compliance of last-resort lending with EU state aid rules, see Smits (1997), pp. 270–271, and Lastra (2015), pp. 380–382.

[63] European Central Bank (2007), p. 80.

Eurosystem rather than the ECB. The procedural arrangements governing the provision of such liquidity had already been laid down on 1 January 1999, although they were not made public.[64]

On 17 October 2013, however, the GC decided to make them public by issuing a relevant Communication,[65] and on 19 February 2014, it approved certain, technical, specifications on these procedures, the content of which was included in its new communication (the 'ECB Communication (2014)').[66] Then, since May 2017, these procedural arrangements are laid down in its "Agreement on emergency liquidity assistance"[67] (the 'ECB Agreement (2017)'), which is analysed later.[68] The procedures referred to in this Agreement relate to the actions necessitated by the GC and the data to be provided to the ECB in order to be in a position to assess, pursuant to Article 14.4 ESCB/ECB Statute, whether the provision of emergency liquidity by NCBs to individual credit institutions interferes with the objectives and tasks of the Eurosystem. This Article provides the following: "National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB."[69] It is noted that, due to the importance of the matter, a simple majority vote (which is the rule) is not enough for such a decision of the GC, but rather a majority of two-thirds of the votes cast is required.

[64] The sole reference of the ECB to the ELA mechanism until the issuance of this Communication in 2013 can be found in European Central Bank (2007).

[65] Available at: https://www.ecb.europa.eu/pub/pdf/other/elaprocedures.el.pdf.

[66] European Central Bank (2014); on this Communication, see Gortsos (2015b), pp. 58–63. For a brief presentation and critical evaluation of the ELA, see also Papadia (2014).

[67] Available at https://www.ecb.europa.eu/mopo/ela/html/index.en.html.

[68] It is noted that both the Communications and the Agreement do not constitute legal acts of the ECB and are not legally binding. They merely register the ECB's procedural practices; nevertheless, it is strongly expected that the NCBs comply with them.

[69] This Article is analysed in Smits (1997), pp. 99–101 and 338–339.

### *9.3.2 The Content of the ECB Agreement (2017): A Detailed Presentation*

*General Aspects*

**Scope of Application—Definition of the Term 'Emergency Liquidity Assistance'**

(1) The ECB Agreement (2017) presents a definition of ELA and describes the allocation of responsibilities, costs and risks for ELA operations, as well as a framework for the provision and exchange of information, as well as the control of liquidity effects to prevent any provision of ELA from interfering with the objectives and tasks of the ESCB. In addition, the Agreement, which will have to be reviewed by end-2019 at the latest, acknowledges that ELA must be in compliance with the prohibition of monetary financing.[70]

(2) Credit institutions established in euro area Member States may draw liquidity from central banks in two alternative manners: either, as a rule, in the context of monetary policy operations or, in exceptional circumstances, via the emergency liquidity assistance. For the purposes of the Agreement, ELA occurs when "(a) a Eurosystem NCB provides central bank money and/or (b) any other assistance that may lead to an increase in central bank money to a financial institution or a group of financial institutions facing liquidity problems, where, in either case, such operation is not part of the single monetary policy".[71]

The provision of ELA is not considered to be part of the single monetary policy in the euro area. In both cases, the central bank provides liquidity to the banking system, but in the case of monetary policy actions the objective is not to ensure the stability of the financial system, but to maintain price stability; the liquidity granted is not of an emergency nature, but rather permanent; and liquidity is provided to the banking system as a whole, rather than to individual credit institutions. Although the provision of such assistance undoubtedly has an impact on total liquidity in an economy, the ECB has the ability to sterilise this through appropriate monetary policy operations. In its words: "The impact of an ELA intervention on

[70] ECB Agreement (2017), Sections 1.1 and 9. This prohibition, laid down in Article 123 TFEU, forms part of the economic union.

[71] Ibid., Section 1.2. This definition is very close to the one that is provided for in a 2014 ECB Communication (ECB Communication (2014), second paragraph, first sentence).

aggregate liquidity conditions in the euro area can be managed in a manner consistent with the maintenance of the appropriate single monetary policy stance."[72]

**Allocation of Responsibilities, Costs and Risks**

(1) The provision of ELA falls under the main responsibility of the NCB concerned.[73] As a result, the provision of such assistance is at the sole discretion of NCBs, on condition of course that the ECB has not prohibited it. Indicatively, the following is provided: "A credit institution cannot (…) assume automatic access to central bank liquidity. As a central banking function, the provision of ELA is within the discretion of the national central bank, which will consider the relevant factors that may justify the access to this lending of last resort. Specifically, the provision of ELA may be justified to prevent or mitigate potential systemic effects on financial institutions, including repercussions for market infrastructure such as the disruption of payment and settlement systems."[74] Hence, it is not the ECB that provides ELA and the dilemma about a lender of last resort for the euro area has been resolved in that way.

(2) The NCB concerned (or a third party acting as a guarantor) incurs any costs and risks that may arise from the provision of ELA.[75] In practice, this means that relevant funds appear on its balance sheet and any relevant losses are debited to its financial results. In any event, pursuant to Article 26.3 ESCB/ECB Statute, the ECB's Executive Board draws up, for analytical and operational purposes, a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the NCBs that fall within the ESCB.[76] In addition, on the legal basis (mainly) of Article 26.4 ESCB/ECB Statute, the ECB adopted Guideline ECB/2010/20 "on the legal framework for accounting and financial reporting in the [ESCB]",[77] requiring the elaboration of a consolidated ESCB balance sheet. It is also noted that, as of 2015, the Eurosystem's consolidated balance sheet is

[72] European Central Bank (2007), p. 81. By means of a 'sterilised intervention', central banks conduct appropriate open market operations in order to ensure that the provision of emergency liquidity assistance does not have an impact on the monetary basis and money supply and does not affect its monetary policy strategy.

[73] ECB Agreement (2017), Section 2.1.

[74] European Central Bank (2007), p. 80.

[75] ECB Agreement (2017), Section 2.2.

[76] This Article also applies to Member States with a derogation (in accordance with Articles 42.1 and 42.4 ESCB/ECB Statute), including Denmark and the UK.

[77] OJ L 35, 9.2.2011, pp. 31–68.

published together with the ECB's Annual Accounts; in this consolidated balance sheet, ELA features on the 'assets' side, under item 6 entitled "Other claims on euro area credit institutions".

**Situations Where ELA May Be Limited or Prohibited**

NCBs may provide ELA unless the GC, pursuant to Article 14.4 ESCB/ECB Statute, finds that its provision interferes with the ESCB objectives and tasks. In relation to that aspect, the ECB Agreement (2017) provides also that the violation of the prohibition of monetary financing under Article 123 TFEU may constitute such an interference with the objectives and tasks of the ESCB. The provision of ELA as notified under Sections 3.2(b) and 3.3 is, therefore, assessed *ex ante* as regards compliance with the prohibition of monetary financing. ELA transactions akin to an overdraft facility or any other type of credit facility for the state, in particular, any financing of the public sector's obligations *vis-à-vis* third parties, or the central bank *de facto* taking over a task of the state, violate the prohibition of monetary financing. Nevertheless, the provision of ELA to insolvent institutions and institutions for which insolvency proceedings have been initiated under national law violates the prohibition of monetary financing.[78]

**The ELA Solvency Criterion for Credit Institutions**

In principle, the solvency of credit institutions is being assessed by the authorities competent for their micro-prudential supervision (i.e. in the euro area the ECB for 'significant' credit institutions and the NCAs, for 'less significant' ones). Nevertheless, the Agreement provides explicitly that a credit institution is considered solvent for ELA purposes in either of the following two cases:

1. first, its CET1, Tier 1 and total capital ratios, as reported under the CRR on an individual and consolidated basis, comply with the minimum regulatory capital levels (namely 4.5%, 6% or 8%, respectively);
2. second, if the above condition is not met, there is a credible prospect of recapitalisation by which the above minimum regulatory capital levels would be restored within 24 weeks after the end of the reference quarter of the data that showed that the bank does not comply with these standards; in duly justified, exceptional cases the GC may decide to prolong this 'grace period'.[79]

[78] ECB Agreement (2017), Section 5.

[79] ECB Agreement (2017), Section 4.

### Duration and Pricing of ELA

(1) The ECB Communication (2014) did not make any specific reference to the duration of ELA provision. Nevertheless, it was expected that provision of ELA should, in principle, be made on a temporary basis, in order, on the one hand, to justify its 'emergency' nature and, on the other hand, to minimise any potential moral hazard concerns involved. The ECB Agreement (2017) touches upon this issue stipulating that the provision of ELA may only exceed 12 months at the latest, following a non-objection by the GC requested by the Governor of the NCB concerned once the provision of ELA exceeds ten months. If any provision of ELA exceeds 12 months, the Governor of the NCB concerned must justify the further provision of ELA in a letter to the President of the ECB on a monthly basis, and the GC may impose additional requirements and conditions.[80]

(2) Under the Agreement, the ECBs must charge a penalty interest rate to the institution receiving ELA. In the case of ELA euro-denominated reverse transactions, NCBs should in principle apply a minimum rate equal to the Eurosystem's marginal lending facility rate plus 100 basis points, irrespective of the net cost of relevant guarantees and other costs of collateral. In the case of euro-denominated intraday ELA reverse transactions, NCBs should in principle apply a minimum rate equal to 1% p.a.[81]

*Flow of Information, Control of Liquidity Effects and Monetary Policy*

### The Main Framework

In order to ensure that ELA operations do not interfere with the single monetary policy of the Eurosystem, the ECB must have been informed or consulted. This information should allow a smooth sterilisation of any undesired liquidity effects and an assessment of any systemic implications. The information obligations provided for in the Agreement are additional and without prejudice to any other such obligations applying under the current legal framework.[82] The information must be provided by the NCB concerned. If it is provided by the institution receiving ELA, such NCB must ensure that the information is provided by the institution to the NCB and passed on by the NCB to the ECB without undue delay.

[80] Ibid., Sections 6.1 and 6.2, respectively.

[81] Ibid., Sections 7.1–7.3.

[82] Ibid., Section 3.1.

Regardless of the size or nature of ELA operations, the information to be provided consists at least of the following elements:

First, NCBs should always inform the ECB of the details of any ELA operation, at the latest, within two business days after the operation has been carried out. The information needs to include, at least, nine specific elements. These elements include the following:

1. The name(s) of the financial institution(s) to which the ELA is (intended to be) provided.
2. The value date and maturity date of the ELA that is (intended to be) provided.
3. The volume of the ELA that is (intended to be) provided.
4. The currency in which the ELA is (intended to be) provided.
5. The collateral/guarantees against which the ELA is (intended to be) provided, including the valuation of, and any haircuts applied to, the collateral provided and, where applicable, details on the guarantee provided and terms of any contractual safeguards.[83]
6. The interest rate to be paid by the institution receiving ELA on this assistance.[84]
7. The specific reason(s) for the ELA (intended to be) provided (such as margin calls and deposit outflows[85]).

[83] As a rule, collateral provided in such cases by counterparty credit institutions includes assets (securities), which are not eligible, given their low credit rating, in the context of open market operations (as part of a central bank's conduct of monetary policy). Although the ELA is granted at particularly high rates or against elevated levels of collateral, it is worth pointing out that, at the first stages of the fiscal crisis in the euro area, demand for emergency liquidity assistance was so strong that credit institutions exposed to (not only) liquidity risk were often not in a position to provide collateral of sufficient quality. A case in point is the Central Bank of Ireland which granted short-term emergency loans to such institutions guaranteed by itself; on this, see Sinn and Wollmershäuser (2011).

[84] The wording is literally not precise, since interest rates are set and it is the interest that is paid.

[85] Deposit outflows, even if they do not reach excessive levels (bank run or panic), are by definition the main basis. Liquidity problems may also ensue from a crisis in the interbank market rendering it impossible to raise capital on this market (a case in point is the interbank market crisis in 2008 as a result of the recent international financial crisis), or the inability to service debt instruments issued by a credit institution as they fall due, mainly if this form of funding (on capital markets) is rather substantial (such as in the case of Ireland and Spain, also during that crisis). It is noted that banks' exposure to liquidity risk arises from the maturity transformation function (see Chap. 1, Sect. 1.1.1) and has two aspects: the first is the 'funding (or liability) liquidity risk', which refers to the probability of loss as a result of a

8. The prudential supervisor's assessment of the liquidity position and solvency of the institution receiving ELA. In this respect, it is noted that in a press release dated 21 March 2013,[86] the ECB made public a GC decision on ELA to credit institutions in Cyprus,[87] which provided that after 25 March 2013, ELA could only be considered if an EU/IMF programme was in place to ensure the solvency of the concerned credit institutions.[88]
9. Finally, if relevant, an assessment of the cross-border dimensions and/or the potential systemic implications of the situation having made (making) the extension necessary.

After the initial notification, further relevant information should be provided on an ongoing basis until ELA is repaid and information on all above-mentioned elements that has not been provided *ex ante* must be provided *ex post*. This information must be updated on a daily basis; exceptionally, collateral valuation changes must only be updated when other information changes are reported or upon an ECB request.

Second, the institution receiving ELA must provide a funding plan within two months following the first provision of ELA and update it on a quarterly basis until the ELA is repaid.[89] It must also provide monthly updated information on the precise level of its (above-mentioned) regulatory capital ratios as well as the leverage ratio as reported under the CRR, both on an individual and on a consolidated basis, within two months

bank's inability to borrow funds at an acceptable cost in order to refinance its debt; the second aspect is 'asset (or market) liquidity risk', that is the risk of loss resulting from the inability to liquidate assets at prices that do not deviate significantly from their nominal value, in order to meet obligations when due. On liquidity crises, see by way of mere indication Baxter and Sommer (2001). On the funding (or liability) liquidity risk and various measurement, management and micro-prudential regulation measures to address it, see Basel Committee on Banking Supervision (2008).

[86] Available at: https://www.ecb.europa.eu/press/pr/date/2013/html/pr130321.en.html.

[87] For a more detailed analysis of the 2014 banking crisis in Cyprus and the activation of the ELA mechanism, see Orphanides (2014) and Zenios (2014), pp. 8–11.

[88] This was confirmed in the last paragraph of the ECB's Press Release published on 25 March 2013 (available at: https://www.ecb.europa.eu/press/pr/date/2013/html/pr130325.en.html). This does not constitute, in the author's view, a precedent for future decisions of the ECB, given that the specificities of each individual case are always taken into account.

[89] The funding plan must be provided in line with the funding plan procedure approved by the GC on 25 September 2015.

after the end of each reference month. An institution receiving ELA and being in breach of such own funds requirements must submit a recapitalisation plan to the ECB for assessment within a timeframe determined by the GC.

Finally, if ELA is provided for a period exceeding six months, the Governor of the NCB concerned must address a letter to the ECB President outlining the intended exit strategy from the ELA provision and for as long as the institution is receiving ELA, it must update the exit strategy in case of relevant changes to the exit plan.[90]

**Size of ELA Operations Exceeding Specific Thresholds**

(1) If the size of ELA operations envisaged by one or more NCBs for a given financial institution or a given group thereof exceeds a threshold of 500 million euros, the NCB(s) involved must inform the Executive Board at the earliest possible time prior to the extension of assistance. In particular, they must provide background information about the nature of the problem, the instruments to be used and the liquidity implications of the assistance. This information will then be provided by the Executive Board to the GC. The size of ELA operations for a given financial institution or group should be determined as the best possible estimate of the total cumulative amount of assistance needed to resolve the liquidity crisis, considering the financial institution or group on a consolidated basis and including its foreign branches.[91]

(2) In addition, if the size of ELA operations envisaged by one or more NCBs for a given financial institution or group exceeds a threshold of two billion euros, on the basis of all the information available, the Executive Board must decide in a timely manner whether the issue needs to be addressed by the GC. If the Executive Board concludes that there is a risk that the respective ELA interferes with the single monetary policy of the Eurosystem, it must request the GC to take a position at short notice. NCBs are allowed to undertake the planned ELA operations, unless the GC decides to prohibit their execution, on the grounds that they interfere with the single monetary policy of the Eurosystem, within 24 hours of the notification by the NCBs.

At the request of the NCB concerned, and in order to expedite ELA operations in the case of particular urgency or to avoid potential systemic

[90] ECB Agreement (2017), Section 3.2(a).

[91] Ibid., Section 3.2(b).

implications, the GC may decide not to prohibit potential future ELA operations to deal with the same problem up to a certain ceiling and within a short pre-specified period of time, which may be extended by a subsequent decision.[92] The GC Decision must be taken on the basis of a majority vote of two-thirds. If immediate action is necessary to avoid systemic implications, the NCB can undertake an overnight operation while the GC's decision is pending. The Executive Board has to be informed immediately about any such operation.[93]

**Specific Cases**

(1) For ELA operations concerning a banking group with branches and subsidiaries in several euro area Member States, the NCBs concerned must establish networks to facilitate cooperation. The coordination of such 'central bank networks' must be entrusted to the NCB of the Member State where the parent of the banking group is established, while the ECB in its monetary policy function and the Eurosystem will be involved pursuant to their responsibilities. In matters of common interest, these networks must cooperate closely with the colleges of supervisors or the SSM.[94]

(2) An NCB intending to enter into a 'liquidity arrangement' with a non-Eurosystem NCB (or monetary authority) in order to facilitate the provision of emergency euro or foreign currency liquidity to a financial institution or a group operating within or outside the euro area must notify in advance the GC, through the Executive Board, of such an arrangement.[95]

[92] Such a ceiling may also refer to several financial institutions and/or several groups at the same time. The NCB should submit its request to the ECB at least three business days before the GC meeting at which the request is to be considered, together with all available *ex ante* information on the elements listed under points 1–9 of Section 3.2(a), under the conditions set out therein; where the threshold refers to several financial institutions or several groups of financial institutions at the same time, the information should be provided on a bank-by-bank basis, and a projection—covering, in principle, the period up to the next regular GC meeting—of the funding gap for each individual bank that is to receive ELA on the basis of two scenarios, namely the expected scenario and a stress scenario.

[93] This does not apply to operations defined in Section 1.2(b) that have contractual safeguards in place ensuring that the financial institution or the group cannot use the assistance received as collateral for Eurosystem credit operations, subject to adequate monitoring by the lending NCB and any GC decision under Article 14.4 ESCB/ECB Statute (ibid., Section 3.3).

[94] Ibid., Section 3.4.

[95] The information to be provided should be, to the extent available, the same as laid down in Sections 3.1 and 3.2, point (a), including the name of the non-Eurosystem NCB or monetary authority. As regards principles and procedures for the assessment of these arrangements, applicable are *mutatis mutandis* Sections 3.2, point (b) and 3.3 (ibid., Section 3.5).

*Communication on ELA*
It is at the discretion of NCBs to communicate publicly about the aggregate provision of ELA in their country, if they deem it necessary. In such a case, the NCB must notify in advance the GC with regard to the intended communication plan and content, including a communication proposal. The communication, nevertheless, should not refer to any assessment made or decision taken by the GC, but may contain information on the ELA ceiling (including the duration of its applicability) to which the GC did not object, the actual amount of ELA provided by the NCB on average over a recent period of time, and relevant context information, if deemed helpful to facilitate a proper perception by the public. The GC may object to the proposed communication plan and content in view of the potential broader confidence and financial stability implications for the euro area.[96]

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[96] Ibid., Sections 8.1–8.4.

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# PART IV

# Conclusion

CHAPTER 10

# Concluding Remarks

## 10.1 On the Evolution of European Central Banking Law

The evolution of European central banking law, which has gradually developed since the beginning of Stage Three of EMU, has been impressive and has led, in particular, to the European Central Bank (ECB)'s enhanced role, which, apart from its initial tasks, was given new tasks and powers. Currently, the ECB and the national central banks (NCBs) participate in and have been assigned tasks and powers within two systems, that is the European System of Central Banks (ESCB) (and, mainly, the Eurosystem) and the European System of Financial Supervision (ESFS), and in two mechanisms, that is the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), which were established over a period of 20 years. In particular:

(1) The ESCB/Eurosystem was established by virtue of the Treaty on European Union (TEU) (1992) and the Treaty Establishing the European Community and started operating on 1 January 1999. The treaties assigned to the ECB four basic tasks, which the latter is exercising within the Eurosystem, assisted by NCBs on the basis of the principle of decentralisation. The ECB also has powers in relation to the issuance of euro-denominated banknotes and coins since the outset. However, the micro-prudential supervision of credit institutions did not form part of the ECB's initial tasks, since the relevant Article 105(6) was only subsequently

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activated. This had been one of the main two asymmetries of the EMU. The remaining (previously second) asymmetry is that whereas the EU has exclusive competence on monetary policy for the euro area Member States within the framework of the 'monetary union', the same does not hold for fiscal policy within the framework of the 'economic union', since EU Member States must (simply) coordinate their economic policies. Europeanisation in this field has thus progressed significantly, albeit asymmetrically.

The primary objective of the Eurosystem is to maintain price stability. The ECB and the NCBs of the Member States whose currency is the euro are, therefore, competent, within the Eurosystem, for defining and implementing monetary and exchange-rate policy for price stability purposes. Without prejudice to the primary objective, the Eurosystem must: *first*, support the general economic policies in the EU, in order to contribute to the achievement of its objectives as laid down in Article 3 TEU; *in addition*, it must act according to the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 TFEU.

(2) The ESFS is a 'child' of the recent (2007–2009) international financial crisis and a by-product of the 2009 *De Larosière Report*, which laid down the foundations for reshaping (and further deepening the institutionalisation of) arrangements at European level with regard to the financial system's micro-prudential supervision, and establishing for the first time a European framework for the financial system's macro-prudential oversight. It was established by virtue of four Regulations of the European Parliament and of the Council of 2010, operates since January 2011 and consists of two pillars: the *first pillar* of the ESFS comprises the three European Supervisory Authorities (ESAs) [European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA)], which are *mainly* regulatory authorities composed of national supervisory authorities, one of their main tasks being to contribute to the establishment of high-quality common regulatory and supervisory standards and practices.

The *second pillar* is the European Systemic Risk Board (ESRB), which is responsible for the macro-prudential oversight of the European finan-

cial system, while NCBs have been designated by Member States entrusted with the conduct of macro-prudential policy in national legislation. Even though a key conclusion of the *De Larosière Report* was that the setting up of supranational supervisory authorities at the European level was neither necessary nor feasible and, in any case, the micro-prudential supervision of credit institutions should not be assigned to the ECB, it pointed out that specific tasks concerning the macro-prudential oversight of the financial system should be conferred upon it. Subsequently, in connection to the operation of the ESRB, specific tasks have been conferred on the ECB, which became part of the ESFS upon its establishment. The legal basis of the relevant Council Regulation was the enabling clause of Article 127(6) TFEU, which was activated for the first time in this case.

(3) Finally, the SSM and the SRM are 'children' of the fiscal crisis in the euro area and constitute the two of the three main pillars of the Banking Union (BU). The SSM was established by a 2013 Council Regulation (SSMR), by virtue as well of the enabling clause of Article 127(6) TFEU, and the SRM by a Regulation of the European Parliament and of the Council of 2014 [Single Resolution Mechanism Regulation (SRMR)]. The SSMR conferred upon the ECB-specific tasks concerning, for the first time, policies relating to the prudential supervision of (mainly) euro area credit institutions (in accordance with Article 127(6) TFEU) with a view to contributing to the safety and soundness of credit institutions and the stability of the EU financial system and to preventing regulatory arbitrage.

On the other hand, the objective of the SRMR was the establishment of *uniform rules and a uniform procedure* for the (orderly) resolution of (mainly) euro area credit institutions without recourse to taxpayers' money (including public financial assistance by EU facilities) for their recapitalisation. These uniform rules and uniform procedure must be applied by the Single Resolution Board (Board), which was established by the SRMR, together with the Council, the Commission and the national resolution authorities (NRAs) within the framework of the SRM. The SSM constitutes the first main pillar of the BU and the SRM, supported by the SRF, its second main pillar.

## 10.2 On the Institutional Aspects of the Systems and Mechanisms of the European Central Bank and NCB

### *10.2.1 The ESCB and the Eurosystem*

*General Remarks*
The ESCB consists of 29 central banks, that is the ECB (acting as a ‘hub’) and the NCBs of all Member States, whether they are Member States whose currency is the euro or Member States with a derogation. The ESCB does not have a legal personality; the same applies to the Eurosystem, which consists of the ECB and the NCBs of the Member States whose currency is the euro. The primary objective of the ESCB (more accurately the Eurosystem) is to maintain price stability; without prejudice to this primary objective, the Eurosystem must support the general economic policies in the EU, in order to contribute to the achievement of its objectives and act according to the principle of an open market economy with free competition, favouring an efficient allocation of resources.

*The Role of the NCBs*
(1) The NCBs of the Member States whose currency is the euro are legal persons governed by their respective national laws and, concurrently, constitute an integral part of the ESCB, fully bound by all legal acts adopted by the ECB decision-making bodies with respect to the duties conferred upon the ESCB/Eurosystem. The relation between the ECB and these NCBs is governed by the ‘principle of decentralisation’, according to which, to the extent deemed possible and appropriate, the ECB has recourse to NCBs to carry out operations forming part of the tasks of the ESCB/Eurosystem. These NCBs may perform other functions on top of the ones provided for by the ESCB/ECB Statute, including granting liquidity assistance to solvent credit institutions faced with severe liquidity problems according to the terms of the Emergency Liquidity Assistance (ELA) mechanism. An NCB may, however, be required to cease the performance of such functions if the Governing Council (GC) decides that they interfere with the objectives and tasks of the ESCB. The safeguarding of the institutional and personal independence of their Governors is granted by EU law.

(2) The NCBs of Member States with a derogation have, like the Member States whose currency is the euro, a legal personality in accordance with national law and are members of the ESCB. However, given that these Member States have not adopted the euro, the position of their NCBs within the ESCB is significantly different to that of the NCBs of Member States whose currency is the euro. On that basis, the TFEU and the Statute have established a series of derogations applicable to these NCBs for the duration of the derogation regime.

### *10.2.2 The Two Main Pillars of the BU*

*The Single Supervisory Mechanism (SSM)*

The specific supervisory tasks conferred on the ECB are carried out within the framework of the SSM, which has no legal personality and is defined as the 'system of financial supervision' composed, as described in Article 6 SSMR, of the ECB, and participating Member States' NCAs (which in some cases are the NCBs), including those of Member States with a derogation, if the latter have established a 'close cooperation' (under Article 7). The SSM has a different institutional architecture from the Eurosystem, to the extent that members of the latter are the ECB and (exclusively) the NCBs of the Member States whose currency is the euro.

The SSM is governed by four key elements: *first*, the conferral on the ECB of the 'specific tasks' set out in Articles 4(1) and 5(2) SSMR concerning policies relating to the prudential supervision of certain types of financial firms, which are exercised within the SSM; *second*, the establishment, *in principle*, of a 'two-tier system' with regard to the distribution of powers within the SSM, distinguishing between two groups of supervised entities: the first comprises the significant ones, which are directly supervised by the ECB and the second the less significant ones, which are directly supervised by the NCA, both within the SSM; *third*, the incorporation of the SSM within the ESFS, without in principle touching upon the tasks of the EBA and the other components of the ESFS; and, *finally*, the creation of 'Chinese walls' within the ECB in order to ensure the effective separation of its monetary policy and other tasks from its supervisory tasks.

*The Single Resolution Mechanism (SRM)*
(1) The Board, established by the SRMR and operational since 1 January 2015, is responsible for the effective and consistent functioning of the SRM, like the ECB for the SSM. Unlike the ECB which is an EU institution, the Board is an EU agency with a specific structure corresponding to its specific tasks. It has legal personality and must act in compliance with EU law (since it is not an EU institution and does not have the power to take final binding decisions), that is with the Council and Commission decisions, in accordance with the SRMR.

(2) The Board is composed of a Chair, four other full-time members and a member appointed by each participating Member State, representing their NRAs. The Commission and the ECB also designate a representative each, which are entitled to participate in the meetings of the Board's Plenary and Executive Sessions as permanent observers, entitled to participate in the debates and having access to all documents. The NRAs, which in several participating Member States are the NCBs, have also been assigned significant tasks and powers within the SRM. Even though the ECB is not the competent resolution authority, its powers as a supervisory authority in recovery planning, (to a certain extent) resolution planning, early intervention and resolution action, especially for the determination of whether a credit institution is failing or likely to fail, are significant.

(3) For this reason, of relevance to the ECB are several other provisions of the SRMR as well. In particular, in relation to the obligation to cooperate on the basis of the 'principle of sincere cooperation' in the exercise of their respective responsibilities under the SRMR, the Board, the Council, the Commission, the ECB, the NRAs and the NCAs must at each stage (resolution planning, early intervention and resolution action) cooperate closely and provide each other with all information necessary for the performance of their tasks. *In addition*, for the purposes of the SRMR, the ECB may invite the Board's Chair to participate as an observer in its Supervisory Board. The SRB-ECB MoU of 22 December 2015 governs several aspects of cooperation and information exchange. In addition, for the purposes of consultation and cooperation with non-participating Member States or third countries, the Board, the ECB, as well as the resolution and competent authorities of the non-participating Member States must conclude MoUs describing in general terms the way in which they cooperate in the performance of their tasks under the Bank Recovery and Resolution Directive (BRRD).

### *10.2.3 The ESFS*

*The EBA*

(1) The EBA is a union body with legal personality. Its objective consists in protecting the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the EU economy, its citizens and its businesses. Its strategic management body is the Board of Supervisors, composed of its Chairperson, the heads of the NCAs (be they NCBs or other independent administrative authorities) and one representative of the Commission, the ECB's Supervisory Board, the ESRB, the ESMA and the EIOPA; only the heads of NCAs have voting rights. The operational management body is the Management Board.

(2) The EBA must act within the powers conferred upon it pursuant to its statutory Regulation, within the scope of specific, exhaustively listed, legislative acts. Its tasks include the contribution to the establishment of high-quality common regulatory and supervisory standards and practices, to the consistent application of legally binding EU acts, to the consistent and coherent functioning of colleges of supervisors and to the monitoring, assessment and measurement of systemic risk. In this respect, the EBA has extensive regulatory powers (development of Guidelines, Recommendations, draft regulatory and implementing technical standards, and other measures based on the relevant legislative acts). *In addition*, in the cases laid down in Articles 17–19 (breach of EU law, action in emergency situations and settlement of disagreements between NCAs in cross-border situations) of its statutory Regulation, the EBA has the right to substitute NCAs if the latter fail to comply with the Commission's formal opinions or EBA's decisions. *Furthermore*, the EBA has been given the power to issue Opinions addressed to the European Parliament, the Council or the Commission on all issues related to its area of competence, either upon a request of these institutions or on its own initiative. The EBA's tasks also include the promotion of transparency, simplicity and fairness in the market for consumer financial products or services across the internal market.

(3) In light of the wide scope of tasks assigned to the EBA, it was deemed necessary to lay down provisions ensuring its integration in the EU institutional framework, providing for the independence of the EBA, its bodies and their members, the EBA's obligation to accountability *vis-à-vis* EU institutions and other bodies and the judicial review of the EBA's Decisions.

*The European Systemic Risk Board*

(1) The ESRB's objective is the macro-prudential oversight of the European financial system in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU arising from developments within the financial system and taking into account macroeconomic developments, in order to avoid periods of widespread financial distress. It must also contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth. The General Board is the ESRB's strategic management body, composed of the President and the Vice-President of the ECB, the Governors of the NCBs—Members of the ESCB, a member of the Commission, the Chairpersons of the ESAs, the Chair and the two Vice-Chairs of the Advisory Scientific Committee, as well as the Chair of the Advisory Technical Committee. This composition ensures a clear majority for members from NCBs. The Steering Committee is the operational management body. The ESRB is chaired by the President of the ECB, who presides at the General Board and Steering Committee meetings and represents the ESRB externally. The ESRB also has two Vice-Chairs, the first elected by and among the members of the ECB General Council and the second being *ex officio* the Chair of the ESAs' Joint Committee.

(2) In order to fulfil its above-mentioned objective, the ESRB carries out several tasks, which include, *inter alia*, the collection and analysis of all relevant and necessary information; the identification and prioritisation of systemic risks and the issuance of warnings, where systemic risks are deemed to be significant, and of Recommendations for remedial action in response to the risks identified and, finally, monitoring of the follow-up.

*In Particular: The SSM as Part of the ESFS*

Apart from its involvement in the ESRB, the ECB has become part of the ESFS also with regard to the tasks conferred upon it by virtue of the SSMR. In this respect, it is called upon to cooperate closely with the ESAs, the ESRB and the NCAs. In addition, for the purposes of the SSMR, it participates in the EBA's Board of Supervisors by one representative nominated by the ECB Supervisory Board, which is a *non-voting* member and in this respect its position is subordinated to that of the NCAs—members of Board of Supervisors. The ECB must carry out its tasks under the SSMR without prejudice to the competence and the tasks of the ESAs and the ESRB and, in particular, it is not permitted to take on the EBA's tasks (nor the tasks of the other ESFS components).

## 10.3 On the Institutional Aspects of the ECB

The ECB became an EU institution by virtue of the Treaty of Lisbon. The TFEU, the ESCB/ECB Statute, the ECB Rules of Procedure, the Rules of Procedure of the Supervisory Board and secondary law (including since 2014 the SSMR and the SSM Framework Regulation) contain provisions with respect to several institutional aspects.

### *10.3.1 The Bodies*

(1) The TFEU and the ESCB/ECB Statute established three decision-making bodies. The supreme body is the GC, which comprises the six members of the Executive Board and the Governors of the NCBs of the Member States whose currency is the euro, which are appointed from among persons of recognised standing and professional experience in monetary or banking matters and participate as a majority in the GC (*in personam* and not as representatives of their NCBs). The Executive Board comprises six members, that is the President (who is concurrently the GC's President), the Vice-President and four other members. Its main responsibility is the implementation of the single monetary policy on the basis of the GC's Guidelines and Decisions, giving the necessary instructions to NCBs. Finally, as long as there are Member States with a derogation [which are not represented in the (above-mentioned) permanent ECB bodies], the General Council was established as a transitional decision-making body, comprising the ECB President and Vice-President, as well as the Governors of the NCBs of all Member States. Its (limited) responsibilities are listed in Article 46 ESCB/ECB Statute.

(2) The SSMR also established three internal, not decision-making ECB bodies for the purpose of the specific tasks conferred upon the ECB. The first is the Supervisory Board, which is responsible for the planning and execution of these tasks and is composed of its Chair and Vice-Chair (appointed by the Council) four representatives of the ECB (appointed by its GC), and one NCA representative in each participating Member State. Its duties consist in carrying out preparatory works regarding the supervisory tasks conferred upon the ECB, and proposing to the GC, the ultimate decision-making body, complete draft Decisions for adoption. The GC has the power either to adopt a draft Decision or to object to it in accordance with a 'no-objection procedure'. The Administrative Board of Review was established for the purposes of

carrying out an internal administrative review of the Decisions taken by the ECB in the exercise of its powers under the SSMR, after a request for review pertaining to the procedural and substantive conformity of such ECB Decisions with the SSMR. It is composed of five members, which are appointed by the GC, must be of high repute, be nationals of Member States, have a proven record of relevant knowledge and professional experience and act independently, in the public interest. Finally, the ECB established a Mediation Panel in order to comply with the principle of separation of its monetary policy and specific supervisory tasks. The task of this internal body, composed of one member per participating Member State, chosen by each of the members of the GC and the Supervisory Board, is the resolution of differences of views on the part of interested participating Member States' NCAs, regarding an objection of the GC to a draft Decision by the Supervisory Board.

### *10.3.2 Regulatory Powers*

(1) In order to accomplish its duties within the ESCB, the ECB was granted autonomous regulatory powers, its bodies being competent to issue Regulations, Decisions, Recommendations and Opinions. Furthermore, the Statute confers on the ECB the power to issue Guidelines, Instructions and internal Decisions, which are internal Eurosystem legal instruments exclusively addressed to and legally binding for the NCBs of the Member States whose currency is the euro.

(2) For the purpose of carrying out its tasks under the SSMR, the ECB must apply all relevant legal acts which constitute sources of EU banking law and to the extent that this law is composed of Directives or Regulations, it must apply the *national legislation* either transposing Directives or implementing Member States' options available under Regulations. To that effect, the ECB has been granted the power to adopt Guidelines and Recommendations and take Decisions (subject to and in compliance with the relevant EU banking law) and adopt Regulations limited to the extent necessary in order to organise or specify the modalities for carrying out its tasks. Before taking supervisory Decisions, the ECB must give to any person-subject of the proceedings the right to be heard, unless urgent action is needed in order to prevent significant damage to the financial system, in which case the ECB may adopt a 'provisional Decision' and give the persons concerned the opportunity to be heard as soon as possible after its Decision is taken. The persons involved in proceedings are entitled

to have access to the ECB's files, with the exception of confidential information. ECB supervisory Decisions must be reasoned, be accompanied by a statement of reasons, contain the material facts and the legal reasons on which it is based and be based only on facts and objections on which the parties concerned have been able to comment.

### *10.3.3 Sanctioning Powers*

(1) According to primary EU law, if an undertaking seated in a Member State whose currency is the euro fails to comply with the obligations arising from the provisions of ECB Regulations or Decisions, adopted in relation to the Eurosystem's basic tasks, the ECB has the power to impose fines and/or periodic penalty payments. The limits of, and the conditions for, their imposition are laid down in a Council Regulation.

(2) In relation to its supervisory tasks under the SSMR and notwithstanding its general powers to impose sanctions, the ECB has been granted by the SSMR specific powers to impose administrative penalties on supervised entities in two cases of breaches: breach of regulatory requirements under directly applicable EU legal acts and breach of ECB legal acts. In addition, procedures for cooperation between the ECB and the NCAs have been instituted with regard to other cases of breaches of EU banking law.

### *10.3.4 Independence*

(1) In order to ensure that the ESCB is in a position to efficiently pursue its primary objective, the ECB was granted institutional independence, meaning that the ECB and the members of its decision-making bodies are not allowed to seek or receive, when exercising powers and carrying out tasks and duties, instructions from EU institutions, bodies, offices and agencies, from any government of a Member State or from any other national body; the obligation to respect the above-mentioned principle and to abstain from seeking to influence the members of the decision-making bodies of the ECB is also imposed upon the above-mentioned entities when carrying out their tasks. The ECB is also operationally independent to the extent that it has all the means required for definition and implementation of the single monetary policy, while the personal independence of members of the Executive Board is granted as well, since their term of office is eight years (but not renewable), in order not to

coincide with the political cycle of any Member State and are retired by the ECJ, on application by the GC or the Executive Board, only if they no longer fulfil the conditions required for the performance of their duties or they have been guilty of serious misconduct.

Finally, the ECB's financial independence is guaranteed by the fact that it has its own capital, with resources coming exclusively from the NCBs—members of the ESCB. The subscription of the ECB's capital follows a specific key; the weightings assigned to NCBs in this key are equal to the sum of two factors (50% of the share of the respective Member State in the population of the EU and 50% of the share of the respective Member State in the gross domestic product of the EU at market prices); these weightings are adjusted every five years. The GC determines the extent and the form in which the capital must be paid by the NCBs of the Member States whose currency is the euro. *On the other hand*, the NCBs of the Member States with a derogation have, in principle, no obligation to pay up their subscribed capital; the General Council may, nevertheless, impose on them the obligation to pay up a minimal percentage "*as a contribution to the operational costs of the ECB*".

(2) All aspects of ECB independence in relation to the basic tasks of the ESCB also pertain to its specific supervisory tasks. The SSMR reaffirms the independence of the ECB, as laid down in the TFEU and the Statute, and enhances its accountability *vis-à-vis* not only the EU institutions (and in particular the European Parliament on the basis of the provisions of the relevant EP-ECB Interinstitutional Agreement) but also the national parliaments.

### *10.3.5 Accountability and Transparency*

(1) In order to compensate its independence, the ECB is accountable to EU institutions; this accountability requirement mainly consists in publishing an annual report on the ESCB's activities and the monetary policy of both the previous and the current year. The accountability requirement is further strengthened by the stipulation that the ECB President and the other Executive Board members may, at the request of the European Parliament, be heard by its competent committees. This possibility may also arise on the initiative of the ECB President and the other members of the ECB Executive Board. Specific rules are also laid down in the ESCB/ECB Statute.

(2) The ECB is accountable to the European Parliament and to the Council for the implementation of the SSMR as well, and notably in an enhanced way. In this respect, it must, *inter alia*, submit to various EU institutions an annual report on the execution of its specific supervisory tasks and reply orally or in writing to questions posed to it by the European Parliament or by the Eurogroup. In relation to its accountability as far as its regulatory powers are concerned in particular, it must duly inform the European Parliament's competent committee of the procedures it has instituted for adopting legal acts which are subject to public consultation. Unlike in relation to its basic tasks, the ECB is also accountable to the national parliaments of participating Member States in relation to its specific tasks under the SSMR. In this respect, and *inter alia*, it must forward its annual report on the execution of these tasks directly to the national parliaments of the participating Member States, which may address to the ECB their reasoned observations thereon.

### *10.3.6 Communication of the ECB with Other EU Institutions: Judicial Control—Liability Issues*

Council and Commission representatives may participate in the meetings of the GC, while also ECB representatives may take part in Council meetings. The acts and/or omissions of the ECB (and the NCBs) are subject to judicial control and ECB acts or omissions are open to review or interpretation by the ECJ in the cases and under the conditions laid down in the TFEU, while the ECB may also institute proceedings in such cases and under these conditions upon a Decision taken by the GC.

The ECJ has jurisdiction to give judgment pursuant to any arbitration clause contained in a contract, governed by either public or private law, which was concluded by or on behalf of the ECB. It also has jurisdiction in disputes concerning the fulfilment by an NCB of obligations under the Treaties and the Statute. Finally, the ECB is liable according to the regime provided for in Article 340 TFEU, whereas the NCBs' liability falls under their respective national legislation. This covers contractual liability, governed by the law applicable to the contract in question, non-contractual liability, whereby the ECB must make good any damage caused by it or by its servants in the performance of their duties, and the personal liability of its servants towards the EU, governed by the provisions laid down in their Staff Regulations or in the Conditions of Employment applicable to them. Nevertheless, an issue relevant for supervisory liability is that the judicial

review of acts adopted by the ECB and by NCAs is likely to be governed by different procedural rules. Review of NCAs is governed by national law, while EU law applies to the ECB. This discrepancy could give rise to undesirable differences in outcomes across jurisdictions.

## 10.4 On the Tasks and Powers of the ECB and the NCBs

### *10.4.1 A Classification of the ECB's Tasks: Division of Objectives and Allocation of Tasks of the ECB, the EBA and the ESRB*

(1) Since 4 November 2014, the ECB's tasks consist of the following[1]:

The *first group* comprises the ECB's 'basic tasks' within the Eurosystem as set out in Article 127(2) TFEU (under the primary objective of pursuing the maintenance of price stability), that is the definition and implementation of the euro area monetary policy, the conduct of foreign exchange operations consistent with Article 219 TFEU, the holding and management of Member States' official foreign reserves and the promotion of the smooth operation of payment systems.

The *second group* contains the other ECB tasks set out in the TFEU, such as *first*, the exclusive right to authorise the issue of banknotes denominated in euro and the approval of the volume of euro coins issued by Member States (Article 128 TFEU); *second*, the contribution to the smooth conduct of policies pursued by the NCAs relating to the prudential supervision of credit institutions and the stability of the financial system (Article 127(5) TFEU); and *third*, the collection of statistical information, assisted by NCBs (Article 6 ESCB/ECB Statute).

The *third group* consists of the specific tasks conferred on the ECB under Article 2 of Council Regulation (EU) No 1096/2010 (based on Article 127(6) TFEU) concerning the macro-prudential oversight of the EU financial system in the context of the functioning of the ESRB (established by Council Regulation (EU) No 1092/2010), which is one of the components of the ESFS.

Finally, the *fourth group* comprises the specific tasks conferred on the ECB in 2014 under the SSMR concerning the micro-prudential supervision, within the SSM, of certain types of financial firms and predominantly credit institutions, based on Article 127(6) TFEU as well.

[1] For a summary, *see* Table 10.1.

**Table 10.1** The tasks conferred upon the ECB

| *Category of ECB tasks* | *Legal basis* | *Application to euro area Member States* | *Application to Member States with a derogation* |
|---|---|---|---|
| 1. ***Basic*** **tasks** within the Eurosystem<br>• Definition and implementation of monetary policy<br>• Conduct of foreign exchange operations consistent with Article 219 TFEU<br>• Holding and management of Member States' official foreign reserves<br>• Promotion of the smooth operation of payment systems | Article 127(2) TFEU | Yes | No |
| 2. ***Other*** **tasks**, for example: | | | |
| • Issue of euro banknotes | Article 128(1) TFEU | Yes | No |
| • Contribution to the smooth conduct of policies *pursued by the (national) competent authorities* relating to the prudential supervision of credit institutions and the stability of the financial system | Article 127(5) TFEU | Yes | No |
| • Collection of statistical information | Statute, Article 5 | Yes | Yes |
| 3. ***Specific*** **tasks** on the macro-prudential oversight of the EU financial system | Council Regulation (EU) No 1096/2010 (based on Article 127(6) TFEU) | Yes | Yes |
| 4. ***Specific*** **tasks** on the micro-prudential supervision over credit institutions, financial holding companies and mixed financial holding companies ***(new)*** | Council Regulation (EU) No 1024/2013 (SSMR, based on Article 127(6) TFEU) | Yes | Under the conditions of the 'close cooperation' procedure |

(2) In light of the above-mentioned, the division of objectives and the allocation of tasks of the ECB, the ESRB and the EBA is the following:

The ECB is responsible, within the SSM and with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU as a whole and in each Member State, for the micro-prudential supervision of credit institutions and some other

types of supervised entities (financial holding companies and mixed financial holding companies) with regard to the specific tasks conferred on it.

The ESRB, supported by the ECB (to which specific tasks have been assigned), is responsible (according to Article 3(1) of its statutory Regulation) for the macro-prudential oversight of the European financial system with the objective of contributing to the prevention or mitigation of systemic risks to financial stability in the EU arising from developments within the financial system.

Finally, the EBA, whose objective (according to Article 1(5) of its statutory Regulation) is the protection of the public interest by contributing to the stability of the financial system, for the EU economy, its citizens and businesses and is definitely not a supervisory authority, continues to have the tasks and powers conferred on it by Articles 8–9, which have nevertheless been enhanced with the entry into force of Regulation (EU) No 1022/2013.

This Regulation, along with the SSMR, also lays down the relationship, the new *modus operandi*, between the ECB and the EBA after the establishment of the SSM, in order in particular to take account of the fact that the ECB is also a competent authority. Finally, it amends the EBA's governance, especially taking into account the different position of the two groups of NCAs—members of the EBA's Board of Supervisors after the establishment of the SSM: those of participating and those of non-participating Member States.[2]

**Table 10.2** A comparison: ECB (as a supervisory authority), EBA and ESRB

| | *ECB* | *EBA* | *ESRB* |
|---|---|---|---|
| Objective | Contribution to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State (SSMR, Article 1) | Protection of the public interest by contributing to the stability of the financial system, for the EU economy, its citizens and businesses (EBA Regulation, Article 1(5)) | Contribution to the prevention/mitigation of systemic risks to financial stability in the EU arising from developments within the financial system (ESRB Regulation, Article 3(1)) |
| Tasks | Micro-prudential supervision of credit institutions (**SSMR**, Articles 4 and 5) | Various (EBA Regulation, Articles 8–9), but *not a supervisory authority* | Macro-prudential oversight of the financial system (ESRB Regulation, Article 3(1)1) |
| Seat | Frankfurt | Paris | Frankfurt |

[2] For a summary, *see* Table 10.2.

### 10.4.2 *Definition and Implementation of the Single Monetary Policy*

(1) The first basic task of the ECB within the Eurosystem is the definition and implementation of the single monetary policy. Its strategy for the definition of the single monetary policy is premised on two pillars, namely an *economic analysis*, which seeks to assess the short-term determinants of price developments, focusing on both real economic activity and financial conditions in the economy, and a *monetary analysis*, which assesses with a medium to long-term perspective, the indications for monetary policy drawn from the economic analysis.

(2) Implementation of the single monetary policy is based on the following instruments: conduct of open market operations, offering of standing facilities to eligible counterparties and requiring the latter to hold minimum reserves on accounts with the Eurosystem. Eligible counterparties are those which are subject to the Eurosystem's minimum reserve system, are subject to prudential supervision by NCAs, are financially sound and fulfil all operational requirements specified in the contractual or regulatory arrangements applied by the home NCB or ECB with respect to the specific instrument or operation. The instruments for the implementation of monetary policy are open market operations, a marginal lending facility and a deposit facility and, finally, minimum reserve requirements. The purpose of open market operations, the prominent instrument, is to steer interest rates, manage the liquidity situation in the financial market and signal the stance of monetary policy. Depending on their specific purpose, they include main refinancing operations (MROs), longer term refinancing operations (LTROs), fine-tuning operations and structural operations. Their conduct is based on reverse transactions (which are used in all categories of open market operations), foreign exchange swaps for monetary policy purposes, the collection of fixed-term deposits, the issuance of ECB debt certificates and outright transactions.

Under the Eurosystem monetary policy framework in force, all Eurosystem credit operations are governed by a single framework for eligible assets. In order to participate in such operations, counterparties must provide the Eurosystem with assets that are eligible as collateral for such operations. Eligible assets must be provided by counterparties either by ownership transfer in the form of a repurchase agreement or by the creation of a security interest in the form of a collateralised loan. Specific rules govern the Eurosystem credit assessment framework.

(3) Under the extraordinary circumstances arising from the need to bolster the European banking system following the recent (2007–2009) international financial crisis and the subsequent fiscal crisis in the euro area, the ECB adjusted its monetary policy in order to address the problem of low inflation. In this respect, it gradually cut the rate for its MROs from 4.5% to 0%, extended the maturity of LTROs, set the interest rate on the deposit facility in negative territory, provided liquidity in foreign currencies, carried out massive purchases of covered bonds denominated in euro and markedly broadened the pool of assets eligible by the Eurosystem as collateral in the conduct of its credit transactions in the context of its single monetary policy.

Recourse to quantitative easing, containing unconventional monetary policy instruments ('temporary' monetary policy instruments in the jargon of the ECB) and mainly asset purchase programmes, is still being made. Of particular importance in this respect are the ECB's outright monetary transactions, consisting in purchases of sovereign bonds of individual euro area Member States without access to the markets. Even though this programme, which has given rise to intense debate as to its compatibility with EU law (which the ECJ rules to the affirmative in the case "Peter Gauweiler and others v Deutscher Bundestag" (albeit under certain framework conditions), has not yet been activated, several other (corporate and sovereign) bond purchase programmes are currently under way (included in the so-called expanded asset purchase programme) to address the risks of a prolongation of the low-inflation period in the euro area.

(4) It is also worth noting that, in July 2019, the ECB adopted a Guideline governing the euro short-term rate (€STR), which is an interest rate benchmark to be established in order to prevent the risk of the existing euro overnight index average not being permitted for use in new financial instruments or contracts given the applicable (strict) regulatory framework on financial benchmarks.

### *10.4.3 The Other Basic Tasks*

(1) According to Article 127(2) TFEU, the Eurosystem's second basic task consists in the conduct of foreign exchange operations in consistency with Article 219 TFEU. The legal framework governing this aspect distinguishes between two alternative regimes: *first*, the case in which (as is the case today) the euro freely floats in the markets as part of an interna-

tional (non-)system of floating exchange rates; and *second*, the case in which the euro may in future take part in an international system of either fixed exchange rates (such as, for instance, the Bretton Woods system which was in operation from 1945 until 1971 within the framework of the IMF) or managed floating exchange rates. Member States maintain their power to independently negotiate in international bodies and to conclude international agreements, subject to the competence and the agreements of the EU in relation to the EMU.

(2) The third basic task of the Eurosystem under Article 127(2) indent TFEU (closely related to the second) consists in holding and managing the official foreign reserves of the Member States. The NCBs of the Member States whose currency is the euro have transferred to the ECB foreign reserve assets up to an amount equivalent to 50 billion euros and denominated in any freely traded currency, other than Member States' currencies, euro, IMF reserve positions and Special Drawing Rights. The ECB has the full right to hold and manage these foreign reserves and use them for the purposes set out in the ESCB/ECB Statute and may request the provision of further foreign reserve assets within the limits and under the conditions laid down by a Council Regulation. Operations in foreign reserve assets remaining with NCBs (following the above-mentioned transfers to the ECB) are not subject to restrictions, provided that they are aimed at the fulfilment of obligations undertaken by NCBs towards international bodies pursuant to the Statutes' provisions on the ECB's and NCBs' external relations.

(3) Pursuant to Article 127(2) TFEU, the Eurosystem's fourth basic task relates to the promotion of the smooth operation of payment systems in the euro area. This provision confirms the importance that central banks across all advanced economies attribute (at least over the last few years) to overseeing the operation of small-value payment systems and large-value payment systems. Of particular importance is the regulatory competence assigned to the ECB under Article 22 ESCB/ECB Statute, based on which it is entitled to lay down Regulations to ensure efficient and sound clearing and payment systems within the EU as well as with other countries, while, to this end, the ECB and NCBs may provide facilities. The oversight requirements for systemically important payment systems are laid down in an ECB Regulation of July 2014, which, *inter alia*, lays down rules relating to legal soundness and governance issues, the management of risks access and participation criteria, and the power of the ECB to impose sanctions in the case of infringements.

(4) In this context, the TARGET2 system and the TARGET2-Securities system were also set up. TARGET2 is structured as a multiplicity of RTGS systems and provides RTGS for payments in euro, with settlement in central bank money across several accounts, including the so-called payments module accounts, which must always be used by NCBs for open market monetary policy operations, the settlement of transactions with ancillary systems and payments between credit institutions. Each NCB—member of the Eurosystem, which is a direct participant of the system, operates its own TARGET2 component, which is a system designated as such by the relevant national legislation. The system's members may process, *inter alia*, transactions directly resulting from or made in connection with Eurosystem monetary policy operations and various types of liquidity transfer orders.

On the other hand, the T2S is a service provided by the Eurosystem to CSDs allowing core, neutral and borderless security settlement in central bank money to be carried out, with delivery *versus* simultaneous payment. It is mainly available for settlement in euro but may also be used by non-euro area NCBs and any other central bank wishing to participate by making their currency available for central bank money settlement therein.

### *10.4.4 Powers of the ECB in Relation to the Issuance of Banknotes and Coins*

(1) The authorisation of banknotes issue is an exclusive right of the ECB, performed by its GC. Without prejudice to this, such notes may be issued the ECB and the NCBs of the Member States whose currency is the euro. The banknotes issued by the ECB and the NCBs are the only such notes to have the status of legal tender within the EU. The total value of euro banknotes in circulation is allocated to the Eurosystem members, that is the ECB and the NCBs of Member States whose currency is the euro, by application of the 'banknote allocation key'.

(2) As opposed to the issue of banknotes, the ECB is not competent to issue coins denominated in euro, which still is the exclusive competence of the Member States whose currency is the euro under their domestic legislation. Nevertheless, the volume of the issue of euro coins in circulation in the euro area is subject to approval by the ECB, which could not remain uninvolved, given that the volume of the issue of euro coins is, just like that of euro banknotes, part of the monetary base and affects money supply and, as a result, the single monetary policy of the EU.

### *10.4.5 The Specific (Supervisory) Tasks of the ECB and Its Cooperation with NCAs in the Context of the SSM*

(1) On the basis of the SSMR, an extensive range of specific tasks in relation to the supervision of credit institutions and other categories of supervised entities incorporated in participating Member States has been conferred upon the ECB. When carrying out these tasks, the ECB must have full regard to credit institutions' different types, business models and sizes, as well as the systemic benefits of diversity in the banking industry of the EU in accordance with the proportionality principle. This applies without prejudice to the responsibilities and related powers of participating Member States' NCAs to carry out supervisory tasks not conferred on the ECB, and the responsibilities and related powers of NCAs or NDAs to apply macro-prudential tools not provided for in EU banking law. Tasks not specifically conferred on the ECB remain with NCAs.

(2) The specific tasks conferred on the ECB with regard to supervised entities incorporated in participating Member States are laid down in Articles 4(1) and 5 SSMR. The specific tasks under the first article include the granting and withdrawal of authorisation to credit institutions, the performance of tasks which fall upon the NCA of the home Member State for credit institutions and other supervised entities incorporated in a participating Member State, if they intend either to establish a branch or to exercise the freedom to provide services in a non-participating Member State, the acquisition and disposal of qualifying holdings, the ensuring of compliance with micro-prudential regulations, the conduct of supervisory reviews and imposition of *ad hoc* additional requirements, the micro-prudential supervision of banking groups on a consolidated basis and the supplementary supervision of financial conglomerates, as well as specific supervisory tasks in relation to recovery plans and early intervention.

On the other hand, Article 5 SSMR governs macro-prudential tasks and macro-prudential tools used by national authorities (NCAs and NDAs) and the ECB. The ECB is required to apply the macro-prudential tools in accordance with that Article and, where those are provided for in a Directive, subject to implementation of that legislative act into national law. In particular, the ECB may substitute to the NCA or the NDA of the participating Member State and, if deemed necessary, apply higher requirements for capital buffers than those applied by national authorities to be held by supervised entities at the relevant level in accordance with EU banking law, apply more stringent measures aimed at addressing systemic or macro-prudential

risks at the level of supervised entities and set a buffer requirement if an NDA has not set a buffer rate. An NCA or NDA may also propose to the ECB to use macro-prudential tools in order to address the specific situation of the financial system and the economy in its Member State.

(3) The specific tasks conferred on the ECB must be exercised within the framework of the SSM. Article 6 SSMR established, *in principle*, a 'two-tier system' with regard to the distribution of powers within the SSM in relation to these tasks, distinguishing between two groups of supervised entities: significant supervised entities, which are, in principle, directly supervised by the ECB, within the SSM and less significant entities, which are directly supervised by NCAs, within the SSM as well.[3] The criteria for determining significance in relation to one or more supervised entities, which are part of a supervised group, are set at the highest level of consolidation within participating Member States; these are the size criterion, the economic importance criterion, the cross-border activities criterion, the direct public financial assistance criterion and the fact that it is one of the three most significant credit institutions (groups) in each participating Member State. In this respect, in its judgment of 16 May 2017 in Case T-122/15 "Landeskreditbank Baden-Württemberg—Förderbank v ECB", the ECJ held that the prudential supervision of less significant credit institutions by NCAs within the SSM is not the exercise of an autonomous competence, but rather a decentralised implementation of an ECB's exclusive competence. It further pointed out that a credit institution's classification as significant may be avoided only if there are specific, factual circumstances entailing that the direct prudential supervision by NCA is better able to attain the objective of financial stability protection and to ensure the consistent application of high supervisory standards.

(4) In relation to the micro-prudential supervision of significant supervised entities and groups, significant is the role of joint supervisory teams, which are established by the ECB, are composed of staff members from the ECB and from the NCAs and, *inter alia*, perform the Supervisory Review and Evaluation Process for those entities or groups. The procedures for the micro-prudential supervision of significant supervised entities and groups are based on a close cooperation between the ECB and

[3] This distinction does not apply to the granting and withdrawal of authorisation of credit institutions, to the acquisition and disposal of qualifying holdings in credit institutions, which are ECB competences for all credit institutions, and the macro-prudential tasks conferred on the ECB by virtue of Article 5 SSMR.

NCAs, especially in terms of assistance provided by the latter to the former and information exchange, while compliance with fit-and-proper requirements for managers is governed by specific rules.

(5) The ECB has also been granted a wide range of powers in relation to the micro-prudential supervision of less significant supervised entities and groups, which are under the direct supervision of NCAs. It can issue Regulations, Guidelines or general instructions addressed to NCAs and adopt supervisory Decisions, it exercises oversight over the SSM's functioning and it may, at any time, make use of its investigatory powers and may request, on an *ad hoc* or on a continuous basis, information from the NCAs on the performance of their tasks. In addition, if necessary in order to ensure consistent application of 'high supervisory standards', the ECB may, at any time, decide to exercise directly itself the supervision of a less significant supervised entity or a less significant supervised group. This Decision may be taken either on its own initiative after consulting with NCAs or upon request by an NCA.

(6) The ECB has been granted extensive powers in order to pursue its objectives and fulfil its tasks under the SSM Regulation. These include investigatory powers, specific supervisory powers with regard to the authorisation of credit institutions and the assessment of acquisitions of qualifying holdings in them, supplementary supervisory powers and the power to impose administrative sanctions.

### *10.4.6 Other Specific Tasks and Competences Relating to Financial Stability*

*The Specific Tasks of the ECB in the Context of the ESRB*

In connection to the operation of the ESRB, specific tasks have been conferred on the ECB under Council Regulation (EU) No 1096/2010. In this respect, the ECB is represented both in the ESRB's General Board and in its Steering Committee: its President and Vice-President are members of the General Board and, respectively, Chair and first Vice-Chair, while five other members of the General Board who are also members of the ECB General Council are members of the Steering Committee. *In addition*, the ECB has been assigned the specific task to provide to the ESRB analytical, statistical, logistical and administrative support by ensuring its Secretariat. In fulfilling this task, the ECB must provide sufficient human and financial resources and appoint the Secretariat's head, in consultation with the ESRB's General Board.

*ECB Competences within the SRM*

(1) Even though the ECB is called upon to carry out supervisory tasks, *inter alia*, in relation to recovery plans if a credit institution or group, in relation to which the ECB is the consolidating supervisor, does not meet or is likely to breach the applicable micro-prudential supervision requirements, resolution powers are explicitly excluded, since those are being exercised by the Board, the Council, the Commission, and, if relevant, the NRAs as to their respective responsibilities. Nevertheless, the ECB must cooperate closely with the Board or the NRAs in resolution planning in accordance with specific rules. The ECB is also called upon to carry out supervisory tasks, *inter alia*, in relation to early intervention, if a credit institution or group, in relation to which it is the consolidating supervisor, does not meet or is likely to breach the applicable micro-prudential supervision requirements. Under the SRMR, the Board must be informed by the ECB or the NCAs of any measure that these require an institution or a group to take or that they themselves take in relation to their supervisory powers under the SSMR or the CRD IV or on early intervention and notify the Commission of any information received. If the ECB or the NCA intend to impose on an institution or a group any additional measure under the (just) above-mentioned provisions of EU banking law before that has fully complied with the first measure notified to the Board, they must inform the Board before its imposition.

(2) The adoption of a resolution scheme in relation to designated entities and groups is also a competence of the Board, exercised (only) when it assesses that the conditions for resolution (the failing or likely-to-fail criterion, the criterion of the reasonable prospect for effective alternative private sector measures or supervisory action, and the 'public interest' criterion) are met cumulatively. Nevertheless, the role of the ECB in relation to the two first resolution conditions is very important. In particular, in relation to the determination that the entity (typically but not exclusively a credit institution) is failing or likely to fail, the assessment must, in principle, be made by the ECB after consulting the Board (which may also make such an assessment, provided that it has informed the ECB of its intention and that the ECB does not make such an assessment). The ECB must, without delay, provide the Board with any relevant information that the Board may request in order to inform its assessment. In addition, the ECB is also actively involved in the process for the determination of provision to a credit institution of extraordinary public financial support, which does not activate the resolution regime.

Furthermore, even though the assessment of the second resolution condition must be made by the Board, or, if applicable, by the NRAs, in close cooperation with the ECB, the latter may also inform the Board or the NRAs concerned that it considers this condition fulfilled. On the other hand, the ECB is not involved in the determination of the public interest criterion, upon which a resolution action is deemed to be in the public interest if it is necessary for the achievement of, and is proportionate to, at least one resolution objective and the winding up of the credit institution under normal insolvency proceedings would not meet these resolution objectives to the same extent.

(3) The role of the ECB is also important in relation to the exercise by the Board of the power to write down or convert 'relevant capital instruments' in relation to designated entities and groups on the basis of an assessment that any of the five conditions laid down in the SRMR is met. The assessment of three of these conditions can also be made by the ECB, after consulting the Board, while the assessment of whether the entity or group is viable (one of these conditions) can be made by the Board only after informing the ECB of its intention and the ECB does not make such an assessment.

*The Role of the ECB in the ELA Mechanism*

(1) The ECB is not a lender of last resort in the euro area. The ECB Agreement (2017) presents a definition of ELA and describes the allocation of responsibilities, costs and risks for ELA operations, as well as a framework for the provision and exchange of information, and the control of liquidity effects to prevent any provision of ELA from interfering with the objectives and tasks of the ESCB. The provision of ELA is not considered to be part of the single monetary policy in the euro area. In both cases, the central bank provides liquidity to the banking system, but in the case of monetary policy actions the objective is not to ensure the stability of the financial system, but to maintain price stability; the liquidity granted is not of an emergency nature, but rather permanent; and liquidity is provided to the banking system as a whole, rather than to individual credit institutions.

(2) The provision of ELA falls under the *main* responsibility of the NCB concerned. As a result, the provision of such assistance is at the sole discretion of NCBs, on condition of course that the ECB has not prohibited it. The NCB concerned incurs any costs and risks that may arise from the provision of ELA. Nevertheless, NCBs may provide ELA unless the GC, pursuant to Article 14.4 ESCB/ ECB Statute, finds that its provi-

sion interferes with the ESCB objectives and tasks. In relation to that aspect, the ECB Agreement (2017) provides also that the violation of the prohibition of monetary financing under Article 123 TFEU may constitute such an interference with the objectives and tasks of the ESCB. In principle, the solvency of credit institutions is being assessed by the authorities competent for their micro-prudential supervision (i.e. in the euro area the ECB for significant credit institutions and the NCAs, for less significant ones).[4]

**Table 10.3** The allocation of tasks and competences between the ECB and the NCBs in the euro area in the context of European central banking law

| *Task or competence* | *ECB* | *NCBs* | |
|---|---|---|---|
| | | *As monetary authorities* | *As NCAs* |
| Authorisation of banknote issue | ˅ | | |
| Issue of banknotes | ˅ | ˅ | |
| Definition and implementation of monetary policy | ˅ | | |
| Oversight of payment systems—operation of the TARGET2 system | ˅ | | |
| Granting and withdrawal of authorisation to credit institutions | ˅ | | |
| Acquisition and disposal of qualified holdings in credit institutions | ˅ | | |
| Micro-prudential supervision in relation to the specific tasks laid down in Article 4 SSMR | ˅ (for significant supervised entities) | | ˅ (for less significant supervised entities) |
| Micro-prudential supervision in relation to other aspects | | | ˅ |
| Use of macro-prudential tools | ˅ (exceptionally) | | ˅ (in principle) |
| Resolution planning | ˅ (for significant credit institutions) | | ˅ (for less significant credit institutions) |
| Early intervention | ˅ (for significant credit institutions) | | ˅ (for less significant credit institutions) |
| Lending of last resort (ELA mechanism) | Powers under Article 14.4 ESCB/ECB Statute | ˅ | |

[4] On the allocation of competences between the ECB and the NCBs, *see* Table 10.3.

CHAPTER 11

# Assessments and Proposals

## 11.1 Assessments Relating to the EMU and the Role of the European Central Bank as Monetary and Banking Supervisory Authority

### *11.1.1 The Basic Tasks of the ECB Within the Eurosystem and Institutional Aspects Governing Its Operation*

(1) In light of the above, it becomes evident that the European Central Bank (ECB) has exclusive powers in relation to the definition and implementation of monetary policy, the conduct of the other basic tasks of the Eurosystem (without prejudice to the provisions of Article 219 on exchange-rate policy) and the issuance of euro-denominated banknotes, which are executed under the principle of decentralisation (involving NCBs). In this respect, irrespective of any (legitimate or not) concerns as to the adequacy and efficiency of the policies implemented by the ECB within the Eurosystem (and in particular with regard to the single monetary policy, especially since the onset of the two major crises discussed in this book[1]), from an institutional point of view there is no doubt that, in accordance with the provisions of primary EU law, these policies have been Europeanised and the ECB is the main actor in both strategic and implementation terms. This is in contrast to the institutional framework

[1] Such an assessment is outside the scope of this book.

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C. V. Gortsos, *European Central Banking Law*, Palgrave Macmillan Studies in Banking and Financial Institutions,
https://doi.org/10.1007/978-3-030-34564-8_11

governing financial stability, which contains elements of fragmentation, even after the establishment of the Banking Union (BU) and even with regard to significant credit institutions.[2]

(2) Nevertheless, concerns are often raised as to several institutional aspects of the ECB, and in particular in relation to its independence (an aspect discussed in relation to other central banks as well), its accountability and its communication with other EU institutions. Even though this is an issue not discussed further at length in this book (the focus of which is mainly on the tasks and powers of the ECB and the NCBs), the author generally fully supports the independence of central banks, to the extent that their objective includes the pursuit of price stability and, obviously, when coupled with appropriate accountability requirements (under the supplementary condition that the literacy of those to which central banks are accountable is adequate, in order to take full advantage of this requirement in a democratic institutional setting). Nevertheless, it should be stressed that the independence of the ECB and the NCBs—Members of the Eurosystem could be further (and substantially) enhanced if additional cooling-off requirements were to be established for the members of the GC in relation to their involvement in national policy-making (both *ex ante* and *ex post*).[3] This would potentially limit the perimeter of eligible persons but would definitely contribute to the breaking of any existing conflicts relating to the nexus between the political system and independent central banks.

### *11.1.2 The Link Between a More Robust EMU and a Well-functioning and Financial Stability-enhancing BU*

(1) The creation of the BU was *mainly* driven by the need to correct 'supervisory failures' in the banking system of the euro area Member States, with a view to enhancing its stability, thus eliminating 'market failures' in the form of negative externalities. Sound macroeconomic policies (both monetary and fiscal), nevertheless, are of equally primary importance for securing financial stability. The ongoing fiscal crisis in the euro area has demonstrated in a manifest way how unsound fiscal policies, a source of 'macroeconomic failure', may destabilise the financial system.

[2] *See* Sect. 11.1.2.

[3] On the existing rules, *see* Code of Conduct for High-Level ECB Officials, Article 17 (on this Code, *see* above in Chap. 6, Sect. 6.4.1).

In fact, fiscal crises tend to spread and become financial crises through several channels of transmission. A study of the Committee on the Global Financial System (the 'CGFS'[4]) identifies four such channels: the impact of negative sovereign ratings on (individual) bank ratings, losses incurred by banks from their sovereign debt holdings, the 'collateral/liquidity channel' and losses from state guarantees granted to banks (explicit and implicit).[5] Another channel, on top of the previous four, is the negative impact on the performance of bank loans (in the event of an economic recession).[6]

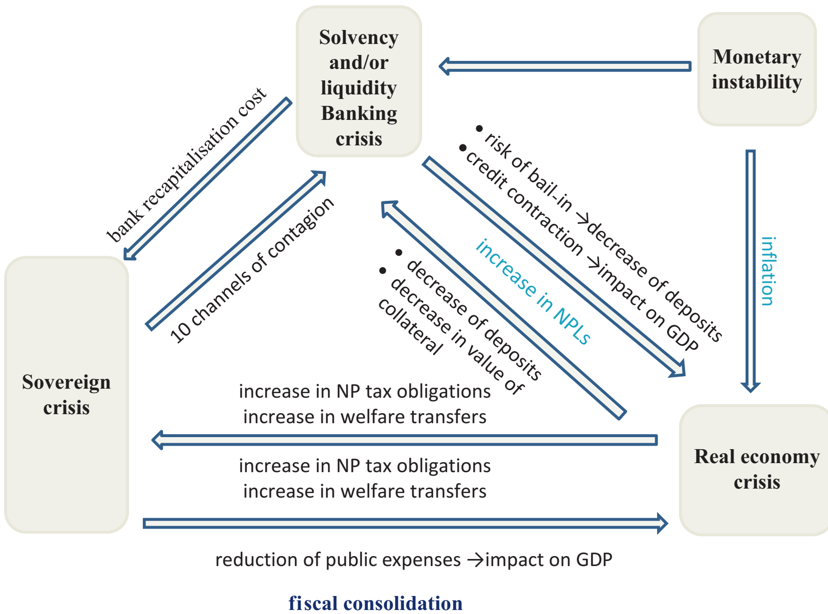
**Table 11.1** Channels of transmission from a sovereign crisis to the banking system

| *Direct channels* | *Indirect channels of transmission* |
|---|---|
| Impact of negative sovereign ratings on (individual) bank ratings and hence to their funding conditions in wholesale markets | Negative impact on the performance of bank loans [in the (most probable) event of a related recession] |
| Losses incurred by banks from their sovereign debt holdings | Liquidity shortage in the economy, negatively affecting bank liquidity |
| The 'collateral/liquidity channel' | Decline in deposits held by households and non-financial corporations |
| Losses from state guarantees granted to banks (explicit and implicit) | |
| The 'risk aversion channel' (rise in investors' risk aversion may increase the *premia* demanded on banks' securities and hence reduce their funding availability—generalised decline in asset prices, triggering losses) | |
| Impact on banks' non-interest (fee and trading) income | |
| Crowding-out effects on banks' debt issuance (up to the point that markets are closed for both the sovereign and the banks) | |
| Close correlation between sovereign and financial CDS indices | |

[4] On the CGFS, which was set up in 1971 by the G10 Central Bank Governors as the 'Euro-Currency Standing Committee' and was the first international financial forum established, *see* Gortsos (2019), pp. 104–107.

[5] See Committee on the Global Financial System (2011). For more details, *see* also Basel Committee on Banking Supervision (2011) and Shambaugh (2012), pp. 157–162 and 187–190.

[6] For an overview, *see* also Table 11.1 and Graph 11.1.




**Graph 11.1** The channels for the transmission of crises between the financial system, the real sector of the economy and macroeconomic policies

(2) As a result, the improvement (even at an optimal point) of the functioning of the BU on the basis of the legislative and other proposals discussed above is *per se* not sufficient for achieving the objective of financial stability; macroeconomic stability is a *conditio sine qua non* as well. According to Section III of the Basel Committee's 'Core Principles for Effective Banking Supervision' of September 2012, the existence of sound and sustainable macroeconomic policies is one of the preconditions for such supervision.[7] It is thus expected that the full adoption and implementation of the Commission's proposals of 6 December 2017[8] on the deepening of the EMU will pave the way for the necessary institutional arrangements which are necessary in order to enhance efficiency in the conduct of macroeconomic (and mainly fiscal) policies in the euro area

[7] This Report was issued in 1997, revised in October 2006 and then again in September 2012; it is available at: https://www.financialstabilityboard.org/2012/09/cos_061030a.

[8] *See* Chap. 4, Sect. 4.1.2.

and are of primary importance for a sustainably smooth operation of the banking (and generally financial) system of participating Member States and the euro area as a whole. In that sense, the link between a more robust EMU (under the current circumstances by establishing, in particular, a Fiscal Union[9]) and a well-functioning BU, which would in turn enhance financial stability, seems to be indispensable.

### *11.1.3 The ECB as Monetary and Banking Supervisory Authority*

(1) The ECB's function as supervisory authority over credit institutions in participating Member States (due to the supervisory centralisation in the euro area, at least, since 2014) is expected to have multiple positive effects. Without doubt, the ECB has the necessary expertise to discharge supervisory tasks over euro area credit institutions—and is thus deemed both efficient and credible by market participants—particularly taking account of its unquestionably successful contribution to the response to the recent international financial crisis, and its significant contribution to the handling of the ongoing fiscal crisis in the euro area as well. This 'accumulated' credibility, at least initially, should also benefit the conduct of its new supervisory tasks, even though 'reasoning by analogy' is not always efficient. The risk of 'national capture' in supervision is expected to be lower.[10] In any case, the smooth interaction between the national competent authorities (NCAs) and the ECB, especially within the context of joint supervisory teams, will definitely determine the Single Supervisory Mechanism (SSM)'s success. In that respect, and in order to adequately fulfil its tasks within the SSM, the ECB is (still) developing a 'supervisory culture', whereby it is necessary to duly take into consideration the particularities of the different national banking systems and to maintain a firm relationship with NCAs.

(2) Conferring supervisory competences over financial system participants to a monetary authority generally raises concerns of conflicts of

[9] On this aspect and, in particular, the economic rationale and the design challenges of such a union, *see* indicatively Thirion (2017) (containing, *inter alia*, a comprehensive literature review).

[10] Carletti and Dell' Ariccia (2015) are sceptical about this expected lower risk, using as a basis a model which explores how a supranational institutional design affects the incentives of national supervisors (like the 'spokes' in a wheel) to collect appropriately information on behalf of the supranational supervisor (serving as the 'hub').

interests, particularly calling into question the ECB's ability, as monetary authority, to consistently pursue its primary objective of maintaining price stability. There is no doubt that the separation of monetary policy and banking supervision functions, a key principle under Article 25 SSMR, is a safeguard embedded into the new framework in order to avoid such conflicts and any ensuing potential reputational risk for the ECB. It remains, nevertheless, to be seen how well this separation will operate in practice.

(3) One cannot preclude the (undesirable) eventuality of one or more systemically important financial institutions under ECB supervision becoming insolvent in the first few years of the ECB's term of office as supervisory authority, which might also be attributed to a deficient performance of its duties. In such a case, the ECB's reliability as an efficient monetary authority would be seriously called into question (not only in terms of substance, but mainly from a political point of view), with all the negative consequences that this would entail for the sustainability of the euro area. This aspect of reputational risk is, of course, a visible risk for all central banks with statutory competence on micro-prudential supervision over credit institutions and it is one of the main concerns with regard to the assignment of such competences to the latter. Ultimately, the *onus* of the efficient performance of the extensive range of tasks that have been conferred on the ECB will be on the ECB itself.

## 11.2 The Partial Europeanisation of the Bank Safety Net and Proposals for Improvement

### *11.2.1 Introductory Remarks*

(1) In Sect. 11.1.1, the institutional framework governing banking stability contains several elements of fragmentation (which the author describes as 'partial Europeanisation of the bank safety net'), even after the establishment of the BU and even with regard to significant credit institutions. This fragmentation is not only manifested by the fact that the powers which have been transferred at EU level are divided between the ECB, the Board, the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB) in the context of the SSM, the Single Resolution Mechanism (SRM) and the European System of Financial Supervision. Apart from the fact that the recapitalisation of credit institutions (to the

extent it is still permissible) is mainly a national competence (with the exception of the facilities provided, directly or indirectly, by the ESM), there are several other aspects in relation to which the predominance of national elements raises concerns of efficiency.[11]

(2) The first two elements relate directly to the ECB and its role in the provision of last-resort lending within the Emergency Liquidity Assistance (ELA) mechanism and the provision of liquidity in resolution (discussed in Sects. 11.2.2 and 11.2.3, respectively). Another important missing element in the architecture is the harmonisation at EU level of the rules on the winding up of credit institutions. In particular, the regime for the winding up of insolvent credit institutions is governed by Directive

**Table 11.2** The partial Europeanisation of the 'bank safety net' (even) with regard to significant credit institutions

| *Financial policy instruments* | *Scope of application* | *Level of action* (italics *denote a national element)* |
|---|---|---|
| Granting and withdrawal of authorisation | Euro area (+Member States under close cooperation) | ECB within the SSM (also applicable to less significant credit institutions) |
| Macro-prudential oversight | EU | ESRB and ECB (specific tasks) |
| Micro-prudential supervision | Euro area (+Member States under close cooperation) | ECB within the SSM (with regard to the specific tasks conferred on the ECB) |
| Recovery planning and early intervention | Euro area (+Member States under close cooperation) | ECB within the SSM |
| Recapitalisation by public funds | • EU<br>• Euro area<br>• Euro area | • *National governments*<br>• *Indirectly by the ESM*<br>• Directly by the ESM ('DRI') |
| Drawing up of resolution plans, assessment of resolvability and resolution | Euro area (+Member States under close cooperation) | SRB within the SRM *(since 1 January 2016)* |
| Winding up | EU | *National administrative or judicial authorities* |
| Deposit guarantee | EU | *National deposit guarantee schemes*<br>European Deposit Insurance Scheme (EDIS) *(proposal)* |
| Last-resort lending ('ELA') | Euro area | *National central banks members of the Eurosystem* |

[11] For a summary, *see* Table 11.2.

2001/24/EC (as in force). This legal act, which also governs the reorganisation of credit institutions, does not provide for a minimum harmonisation of national reorganisation measures and winding up proceedings. It mainly introduced the principle of mutual recognition, whereby (as applied to winding up proceedings) the administrative or judicial authorities of the home Member State are solely competent to decide on the opening of winding up proceedings concerning a credit institution, including its branches established in other Member States.

The debate on setting up the BU did not touch upon the prospect of amending this regime. Accordingly, credit institutions' winding up proceedings remain national and are expected to remain so at least for the foreseeable future), also activating the repayment procedure of national deposit guarantee schemes (albeit upon an ECB decision for the withdrawal of an authorisation).[12] This aspect became nevertheless topical in June 2017, when the Board decided not to take resolution action in respect of two Italian credit institutions, namely Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. For both, the Board assessed that, while the two first conditions for resolution action were met, the public interest criterion was not satisfied.[13]

(3) Finally, it is useful to point out that the institutional framework governing banking stability must constantly be assessed in relation to whether the four major gaps and sources of inefficiency, in the author's view, in terms of regulatory and supervisory mechanisms are checked: the potential for supervisory and regulatory failure, favourable treatment in times of crisis for systemically important financial institutions, regulatory arbitrage, and regulatory and supervisory 'overshooting', also in times of crisis.

[12] It is noted that, under the DGSD, in the vast majority of cases, the repayment procedure of DGSs is activated by a decision to withdraw a credit institution's authorisation and wind it up, rendering its deposits 'unavailable' and activating the repayment procedure of *national DGSs*.

[13] See Chap. 9, Sect. 9.2.3. These credit institutions are currently subject to winding up under the insolvency proceedings of Italian law, which does not prevent the bail-out of senior creditors. In addition, on 25 June 2017, the Commission made public its decision to approve state aid of 17 billion euros to facilitate their liquidation under Italian law on the condition that shareholders and subordinated debtholders were bailed-in in accordance with the burden-sharing requirements laid down in accordance with the '2013 Banking Communication'. The Commission approval of state aid for market exit of the two credit institutions is available at: https://europa.eu/rapid/press-release_IP-17-1791_en.htm. On this aspect, *see* more details in Grünewald (2017), pp. 299–302.

### *11.2.2 Towards a Revision of the Existing ELA Mechanism*[14]

*Differentiation According to the Significance of Credit Institutions*
As already mentioned,[15] the completion of the BU presupposes the provision of last-resort lending directly by the ECB, under the 'Emergency Liquidity Assistance Mechanism'" (ELA). Until the entry into operation of the SSM, the question of which central bank would act as lender of last resort for solvent credit institutions in the euro area was of course quite complicated. This was mainly due to the fact that monetary policy was (and still is) implemented at supranational level by the ECB, while micro-prudential banking supervision was exclusively carried out at national level (either by NCBs or by independent administrative authorities). The entry into operation of this mechanism, however, places this question on new ground. In this vein, it is appropriate to look into the scope for differentiation on the basis of the significance of credit institutions exposed to liquidity risk. In particular, less significant credit institutions, which remain in principle under the direct micro-prudential supervision of NCAs, should reasonably continue to have access to the ELA mechanism, as currently in force. On the contrary, as regards significant credit institutions which are now under the direct micro-prudential supervision of the ECB, the eventuality of the ECB acting as a lender of last resort gains particular importance.[16] This eventuality has quite recently (22 February 2018) been raised by the President of the ECB, Mario Draghi, as well, at the ECON meeting of 22 February 2018, where he stated the following: "The ELA policy should be changed and I personally have argued several times for a centralisation of ELA. This is a remnant from a past time, but to change it we ought to have the agreement of all the members of the governing council, namely all countries in fact. They have to decide that they would abandon this remnant of national sovereignty in monetary policy, because that is what it is."

[14] This proposal is based (with due adjustment and updating) on the author's paper referred to as Gortsos (2015b).

[15] *See* Chap. 4, Sect. 4.1.2.

[16] The need for a differentiation depending on the "systemic significance at European level" of credit institutions has been pointed out in Schoenmaker (2000), p. 221, with reference to Prati and Schinasi (2000), well before the recent institutional developments. If the proposal below were to be adopted, it would obviously also apply to less significant credit institutions that the ECB decides to subject to its direct micro-prudential supervision, and to credit institutions in Member States which establish a close cooperation procedure.

*The Advisability for the ECB to Act as Lender of Last Resort for Significant Credit Institutions*

(1) As regards the *advisability* for the ECB to act as lender of last resort for significant credit institutions, conditions have changed. The arguments in favour of this power remaining with NCBs for as long as the conduct of other policies aimed at safeguarding the stability of the European banking system is decentralised have been weakened.[17] This is not only true because their micro-prudential supervision has mainly (with regard to the specific tasks laid down in the SSMR) been transferred to an EU level but also because the same applies to the resolution of such credit institutions under the Single Resolution Mechanism Regulation (SRMR).

(2) A point of concern in this context is potential conflicts of interest within the ECB arising from its function as monetary authority *and* lender of last resort, on the one hand and banking supervisor on the other (this applies to central banks in general[18]). Apart from any burden-sharing considerations (which are outside the scope of this book), it is noted that this point of concern has been addressed in Article 25 SSMR with the creation of 'Chinese walls' between the ECB's monetary and supervisory functions. It is expected that these will also apply if the ECB were to assume the power of lender of last resort.[19]

(3) As a result, there are stronger arguments in favour of the ECB acting as lender of last resort for significant credit institutions short of liquidity established in euro area Member States. Such an approach is fully consistent with the fact that several components of the bank safety net, used with a view to safeguarding the stability of the European banking system, have already been 'Europeanised'. Accordingly, the author argues that the ECB being lender of last resort for significant credit institutions is one of the necessary elements of a complete BU.[20]

[17] For an overview of these arguments, *see* Schoenmaker (2000), pp. 219–220.

[18] *See* indicatively Goodhart and Schoenmaker (1993).

[19] On the aspect of burden sharing, Lastra and Louis (2013, pp. 90–91) state: "(…) if the ECB makes losses it will be for the NCBs and, indirectly, their respective States to come and help. (…) The ECB faces a particular problem in that there is not one government but seventeen governments [note: today nineteen] standing behind and that therefore losses on LOLR loans (if the situation turns out to be of insolvency not illiquidity) will ultimately be borne by the (…) Member States under the current institutional setting. No doubt the LOLR [lender of last resort] role tests the limits of the mandate of the ECB in the pursuit of its objectives and hence the ambiguity that surrounds the provision of ELA."

[20] *See* Gortsos (2015a), p. 29 and Brescia Morra (2014), citing De Grauwe (2013).

(4) As to the sequence of potential further developments, in the author's opinion the establishment of the EDIS is not a precondition for the ECB to assume direct responsibilities with regard to the ELA. DGSs are activated in the cases where the relevant administrative authorities make the determination that a credit institution's deposits have become 'unavailable', leading to the withdrawal of its authorisation (by the ECB) and its winding up by national administrative or judicial authorities (without resolution). Their activation is a consequence of a credit institution's insolvency. The activation of the ELA, on the other hand, is linked to credit institutions' temporary liquidity problems. The two policy instruments are dealing in principle with different types of crises, which are *not necessarily* linked. Hence, the decision to elevate the ELA at the ECB level could well be taken independently from the decision to create the EDIS.

*The Feasibility of the ECB Becoming a Lender of Last Resort for Significant Credit Institutions*

The crucial point still is the legal basis (i.e. the *feasibility* of the ECB's being lender of last resort). The argument that the ECB may not intervene as lender of last resort in the euro area for lack of an *explicit* relevant provision in the TFEU and the ESCB/ECB Statute is contestable for the reasons stated later.

*On the financial stability mandate*: With regard to the ECB's financial stability mandate, it is noted that the primary objective of the ESCB is, according to Article 127(1), first sentence TFEU, maintaining price stability. It is also true that this Article does not make any explicit reference to financial stability. On the other hand, Article 127(5) TFEU governing the ESCB's contribution to ensuring the stability of the financial system has a major shortcoming, since (literally) it only refers to the division of relevant competences between the ECB (mainly submission of opinions) and the NCAs.[21] Finally, Article 127(6) TFEU, the legal basis of both the SSM's and the ECB's involvement in the *macro*-prudential oversight of the financial system, in accordance with Regulation (EU) No 1096/2010 in the context of the ESRB, can also not be taken into account, since its reach is confined, as already mentioned, to the specific tasks concerning policies relating to the *(micro-)*prudential supervision of credit institutions.[22]

[21] *See* Lastra and Louis (2013), p. 79, and Lastra (2015), p. 254; on Article 127(5) TFEU, *see* Chap. 3, Sect. 3.1.2.

[22] On the absence of a primary mandate content and scope of application of this article (*ex* Article 105(5) TEC, carried over *verbatim* to Article 3.3 ESCB/ECB Statute), *see* Smits (1997), pp. 338–355.

Accordingly, Article 127 TFEU does not seem to provide a solid legal basis for a primary financial stability mandate. Nevertheless, is has been argued (correctly in the author's view) that financial stability, as a secondary mandate, is implied in the monetary authority of the ECB, given the functional relation between price and financial stability, albeit confined by Article 127(5) TFEU.[23] In the author's view, this reinforced by Article 127(1), second sentence TFEU, according to which the Eurosystem must support the general EU economic policies with a view to contributing to the achievement of the EU objectives as laid down in Article 3 TEU, without prejudice to the objective of price stability.[24] The establishment of the internal *market* is such an objective according to Article 3(3), first sentence TEU. It can thus be reasonably argued that the provision of last-resort lending by the ECB for the proper functioning of the banking system, which is an (important) segment of the internal market, can definitely contribute to the attainment of this objective, provided that the primary objective of price stability is not compromised.

The ECB's heavy involvement during the recent (2007–2009) international financial crisis as well as the current euro area fiscal crisis has rendered the preservation of the financial system's stability, the underlying reason for providing last-resort lending and a *conditio sine qua non* for the smooth functioning of the internal market, a *de facto* major objective. It is not convincing that during these crises the ECB could act in the way it has acted, even in the absence of a clear financial stability mandate, and then resort to the lack of mandate as a justification for its inability to act as lender of last resort, given that the latter is just one aspect of the arsenal for maintaining financial stability. This line of argumentation lacks consistency. In any case, the author notes a comment made by Lastra and Goodhart (2015): "Is it appropriate to keep such arrangement [i.e. the current ELA] in place when de facto, only the ECB can provide emergency assistance to the institutions that it now supervises? Moreover, when no treaty amendment is needed to establish the missing fourth pillar of banking union, but merely a change in interpretation, is it practical to follow the existing practice?"[25]

*On the appropriate instruments to be used*: The author supports the view that Article 18.1, second indent, ESCB/ECB Statute (even broadly

[23] *See* on this Psaroudakis (2018), pp. 155–156.

[24] *See* Chap. 5, Sect. 5.1.1.

[25] Lastra and Goodhart (2015), p. 16.

interpreted[26]) may serve as a solid legal basis as regards the instruments to be used.[27] According to Smits: "The absence of lender-of-last-resort (LOLR) support from the text of the ESCB Statute does not make the authority of the ECB to grant it, or to authorize the provision of such support by NCBs, questionable. It is submitted that, under Article 18.1, second indent, the capacity of the ECB and the NCBs to act as lenders of last resort is subsumed."[28] As a matter of fact, the conditions for application of this Article are fulfilled in the case of ELA. In particular, the provision of the ELA definitely constitutes a credit operation with credit institutions. Lending by NCBs under the ELA is currently provided, as already mentioned, under adequate collateral. The eligibility of the assets to be used as collateral, the valuation of, and any haircuts applied to, the collateral provided, and (where applicable) details on the guarantee to be provided and the terms of any contractual safeguards could be adapted accordingly.[29]

### *11.2.3 Liquidity in Resolution: A Potential Enhanced Role for the ECB*

*The Issue at Stake*

(1) Even though the existence for a credit institution under resolution of sufficient liquidity to meet its obligations is an essential part of an effective resolution, both the SRMR and the Single Resolution Fund (SRF) Agreement do not contain provisions in relation to the provision of liquidity (and the resulting stabilisation) after the decision has been taken by the Board to resolve a credit institution (and, as the case may be, its group)

[26] The author highlights the extreme caution with which the ECB (just like central banks in general) accepts to perform tasks and powers that are based on an expansive reading of regulatory provisions. A case in point is that Lastra (2012) mentions (p. 9) the recourse to Article 14.4 ESCB/ECB Statute as a legal basis for the ELA as a result of 'a restrictive reading' of the ECB's tasks by the ESCB (*see* also Lastra and Goodhart (2015), p. 16).

[27] Lastra (2015, p. 378) expresses the view that this ECB competence could also be based on the subsidiarity principle (TEU, Article 5(3)), since amidst a crisis ECB action is more effective than action by NCBs.

[28] Smits (1997), p. 269 (under (I)), with reference to Louis (1995), p. 59; see also Lastra (2015), p. 378.

[29] This is a solid safeguard against potential conflicts of interest between the two ECB functions.

either as a going-concern [i.e. by application of the (open-bank) bail-in resolution tool provided for in Article 27 SRMR, in order to ensure its recapitalisation] or by application of the gone-concern resolution tools (i.e. sale of business and bridge institution tool, Articles 24 and 25, respectively).[30] The only reference to this[31] is made in recital (100) (first and second sentences), which reads as follows: "There are circumstances in which the effectiveness of the resolution tools applied may depend on the availability of short-term funding for the entity or a bridge entity (…). Notwithstanding the role of central banks in providing liquidity to the financial system even in times of stress, it is therefore important to set up a fund to avoid that the funds needed for such purposes come from the national budgets." It is also noted/reminded that, in accordance with Article 8, resolution plans must be drawn up upon the assumption that central bank emergency liquidity assistance *or* central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms are not permitted.[32]

(2) On the basis of the above-mentioned, if a credit institution is not in a position, after a resolution action, to cover its potential increased liquidity needs (mainly due conditions of deposits outflow after the bail-in, market volatility and information asymmetries concerning its viability) through internal liquidity sources (such as cash and other liquid assets available for sale or use as collateral) access to the market for borrowed funds or resort to the (standard) monetary policy operations of the ECB,[33] access must be ensured to alternative public sector 'backstop funding (i.e. liquidity) mechanisms': the available financial means of the SRF and access to the central bank lending of last-resort facilities.

[30] When resort is made to the sale of business tool, the liquidity problems may be less severe, to the extent that the acquiring credit institution may be in a better position to fund its liquidity potentially heightened liquidity through internal resources or access to capital markets.

[31] *See* also Article 50(1), point (c) SRMR.

[32] Ibid., Article 8(6), fifth sub-paragraph.

[33] In this respect, it is noted that, in accordance with Chapter IV of the ESCB/ECB Statute on the achievement of the Eurosystem's objectives (*see* above in Chap. 7, Sect. 7.1.2), the ECB and the NCBs conduct open market operations and offer standing facilities to credit institutions. A recapitalised credit institution can raise liquidity through these standard monetary facilities, upon meeting the relevant eligibility criteria and being able to pledge eligible collateral, which must be of such a (high) quality. However, it is questionable whether, after its resolution, such a credit institution would have sufficient amount of collateral eligible for Eurosystem funding.

(3) The above-mentioned concerns have been raised at a global level by the FSB in its 2016 Guiding Principles "on the temporary funding needed to support the orderly resolution of a global systemically important bank ('G-SIB')". According to these principles, a credit institution's ability to use private sources of funding in resolution depends, *inter alia*, on *first*, the timing of resolution action; *second*, the amount and quality of available collateral to the extent of asset encumbrance prior to resolution; *third*, the prevailing macroeconomic environment, including market liquidity; *fourth*, market confidence towards the recapitalised credit institutions; and *finally*, the existence of an effective public sector backstop funding mechanism.[34] In relation to the latter aspect, the principles provide that such a mechanism must meet specific characteristics, especially in terms of being able to cover the liquidity needs of several credit institutions in case of a systemic crisis and operational capability to grant liquidity in time to address liquidity gaps of the institutions concerned. Furthermore, the backstop funding mechanisms must provide temporary funding under strict conditions in order to mitigate ensuing moral hazard risks.[35]

*Alternative Public Sector Backstop Funding Mechanisms for the Euro Area*

*On the two alternatives*: A first alternative public sector backstop funding mechanism for the euro area would be the SRF. Pursuant to Article 73 SRMR, the Board may contract for the SRF borrowings or other forms of support from institutions, financial institutions or other third parties offering better financial terms at the most appropriate time in the event that the amounts raised by *ex ante* and extraordinary *ex post* contributions (in accordance with Articles 70–71 SRMR) are not immediately accessible or do not cover the expenses incurred by the use of the SRF in relation to resolution actions.[36] In addition, the common backstop to the SRM for

[34] Financial Stability Board (2016), pp. 9–11.

[35] Ibid., pp. 11–14.

[36] This proposal was made by the Commission in its Report of 30 April 2019 on the application of the BRRD and the SRMR, at p. 7, acknowledging, however, that the amounts of borrowings would be limited (COM(2019) 213 final, 30.4.2019 (available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190430-report-bank-recovery-resolution_en.pdf). In this Report, it is also remarked that in non-participating Member States as well as third countries (such as the USA), the provision of liquidity support in resolution is foreseen either with no limits or with limits well above those possible within the BU, often with the possibility of increases.

the SRF could also be used.[37] Its ultimate legal basis being Article 74 SRMR, this backstop, even when adopted, is, nevertheless, not expected to have the necessary funding capacity.[38]

Alternatively (or concurrently), use of last-resort lending facilities can also be envisaged. As already mentioned, in this respect, available for the euro area is the ELA, which is not provided by the ECB, but under the *main* responsibility of the NCB of the euro area Member State where the credit institution is established. Hence, the provision of such assistance is at the sole discretion of NCBs, on the condition, however, that the ECB has not prohibited it under Article 14.4 ESCB/ECB Statute. Provision of ELA is allowed during the resolution phase, provided that the following three conditions are met: *first*, there is a credible prospect of recapitalisation within the next six months, where the minimum thresholds for CET1, Tier 1 and Total Capital ratios are not met; *second*, the credit institution concerned has sufficient collateral; and *third*, insolvency proceedings have not been initiated.[39]

*On the role of the ECB in particular*: In relation to liquidity in resolution, the ECB is currently discussing a new instrument for granting Eurosystem Resolution Liquidity (the 'ERL'), the activation of which should be based on specific rules. Furthermore, the instrument should provide that the financing is temporary and is replaced by private funding once the credit institution concerned restores its access to capital markets. Potential losses could be minimised if funding from this mechanism has a high priority in national insolvency rankings.[40] This debate is closely linked to the still unsettled above-mentioned issue on whether the ELA, in cases of resolution or in general, should be centralised at the level of the ECB.

[37] *See* on this De Groen (2018).

[38] *See* Chap. 4, Sect. 4.3.3. It is noted that while the combined funds of the SRF and the ESM's credit line is estimated at 120 billion euros, the liquidity support granted (only) for the restructuring of the banking group Hypo Real Estate exceeded 145 billion euros; *see*, in this respect, also König (2018). On Articles 70–74 SRMR, *see* Gortsos (2019), pp. 251–258.

[39] *See* European Parliament (2018), p. 2 and Mersch (2018). On liquidity in resolution under the existing EU law, *see* Ringe (2017), BBVA (2018), Demertzis et al. (2018) and Moullin et al. (2018).

[40] *See* European Parliament (2018), pp. 10–11.

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