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.

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]

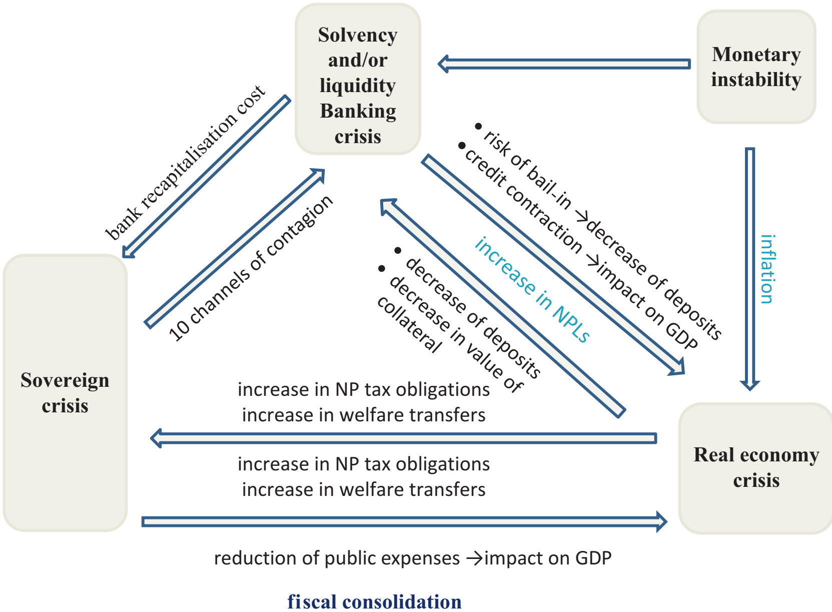
Table 11.1 Channels of transmission from a sovereign crisis to the banking system

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 • Euro area • Euro area	• *National governments* • *Indirectly by the ESM* • 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* 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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