



EUROPEAN CENTRAL BANK  
EUROSYSTEM

# ESCB Legal Conference 2020

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Chiara Zilioli



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# Introductory remarks

By Chiara Zilioli<sup>1</sup>

This book is very special. It is the product of an experiment, the first “Special Online Edition” of the ESCB Legal Conference, held in 2020. When, at the end of 2019, we put the programme together, with all the speakers, and selected the invitees, nobody imagined that a few months later the world would be transformed, by a tiny virus, into a very different place. And yet, despite everything, despite the evident impossibility of holding our treasured yearly conference at the ECB’s premises to meet with the legal and scholarly community, we dared to continue with our planning for both the conference and the book. And we succeeded, also in 2020, to be the catalyst for important legal discussions.

Since 2015, every year the Directorate General Legal Services brings together lawyers from central banks, European institutions, international financial institutions, academia and private practice for a legal conference. A rich programme covering the topical legal issues that the lawyers of the European System of Central Banks (ESCB) are experiencing in central banking and in supervision is developed every year. We alternate between a conference with an academic and judicial focus, which took place last time in 2019, and a conference with a more technical legal focus of specific interest to ESCB lawyers, of which a very good example is the one of this year, 2020, reflected in this book.

This year was a special year. We all missed the opportunity to meet in person at the ECB’s premises to exchange our views. But we did not give up. We adapted to the changed situation and trialled and experimented with a new online format for our conference, which was run over a series of dates, from 11 September until 2 November, and included six panels and two keynote speakers.

We were not sure it would work, as it was the first time we were using the technology, and our participants might find it difficult and artificial to have remote discussions. As it turned out, I was deeply impressed by the possibilities offered by this format: despite the constraints caused by the coronavirus (COVID-19) pandemic it enabled us to reach out to our audience of on average 150 participants, wherever they were located, to overcome the impossibility of meeting in person and to nevertheless continue our reflections and intellectual cross-fertilisation.

In accordance with our traditions, after the conference our thoughts and our intellectual exchanges have been preserved through the publication of a book.

It is with great pride that I can point out that this is the **sixth book we have published**, following our annual ECB and ESCB Legal Conferences. All these books are made freely available on the ECB’s website and provide a resource to whomever wishes to learn more about the legal issues encountered by the ECB and the ESCB.

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<sup>1</sup> Director General Legal Services, European Central Bank.

It has been said that books are the greatest weapons in the world. And a library is the greatest arsenal. I think we can safely say that we are now well placed to arm ourselves with the knowledge – and indeed wisdom – of our excellent contributors over the past six years.

Now, more than ever, we need this arsenal to face the challenges of our world. Not only did the ECB have to respond to the COVID-19 crisis in the short term; the global pandemic has also accelerated topics that were already simmering on the backburner. These include the digital transition, and the possible role of central bank digital currencies. They also include the climate emergency, sustainable finance, and the possible contribution of central banks to the vitally important steps to fight global warming. These were central topics at our conference, and not for the first time.

Even without the pandemic, central banks and supervisors face complex legal debates, especially in respect of accountability and transparency. The conference covered further facets of this debate, namely judicial review in a multi-level administrative framework, and the balance between transparency and confidentiality of supervisory information.

Moreover, ensuring a smooth benchmark transition and enhancing access to EU law and case-law present fascinating legal challenges that merit discussion, debate and reflection.

This book deals with various aspects of all these topics in a uniquely focused way, thanks to the contributions of true experts in these fields.

Let us arm ourselves with this knowledge!

Keynote speech



# Legal aspects of the ECB's response to the coronavirus (COVID-19) pandemic – an exclusive but narrow competence

By Yves Mersch<sup>1</sup>

## 1 Exploring the legal framework governing the ECB's actions: scope and general legal principles

Over the last few months, we have been dealing with an extraordinary and unprecedented situation created by the economic consequences of the reactions to the coronavirus (COVID-19) pandemic. In response, the European Central Bank has acted forcefully by adopting bold monetary policy and banking supervision measures.

When exploring the scope of our actions we are cognisant that the ECB has exclusive but narrow competence to define the European Union monetary policy for the purpose of maintaining price stability, according to Article 127(1) of the Treaty on the Functioning of the European Union (TFEU).<sup>2</sup> Moreover, the European Court of Justice has consistently held that the ECB enjoys broad discretion in defining monetary policy within its mandate to pursue the objective of price stability. Discretion without limits increases the risk of arbitrariness. Therefore, the Court has insisted on being able to control this discretion on the basis of the criteria that some refer to as the self-imposed constraints. Furthermore, we are bound to respect certain established legal principles. Our measures must be proportionate to the ECB's legitimate objectives. They must not undermine the spirit of the "no bailout clause" and must also comply with the prohibition of monetary financing, which is its monetary policy counterpart. Last of all, the principle of an open market economy in which resources are allocated efficiently must also be respected. These are the constitutional red lines for our actions.

Our bold monetary policy response to the pandemic provides ample liquidity and acts as a backstop: the liquidity provided via the targeted longer-term refinancing operations (TLTROs) and the pandemic emergency longer-term refinancing operations (PELTROs) both of which are supported by collateral easing measures, in addition to asset purchases through the continuation of our asset purchase programme (APP) and the launch of our pandemic emergency purchase programme (PEPP). These measures endeavour to respect the principles I have just mentioned in order to be legally sound.

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<sup>1</sup> Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the European Central Bank, at the ESCB Legal Conference, Frankfurt am Main, 2 November 2020.

<sup>2</sup> Article 127(1) TFEU. Further, according to Articles 3.1 and 12.1 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank, the ESCB defines and implements the monetary policy of the Union.



First, all the instruments deployed in response to the pandemic are provided for in primary EU law (Article 18.1 of the Statute of the ESCB): to achieve its objectives, the ECB may operate in the financial markets by buying and selling marketable instruments outright, and may conduct credit operations based on adequate collateral.

Second, the crisis measures taken pursue monetary policy objectives with due respect to the aforementioned “no bailout clause”. Without forceful action, the singleness of our monetary policy and the effectiveness of the transmission mechanism would have been put at risk.

Third, the measures we have taken are temporary, targeted and proportionate in nature.

We have decided not to apply the previously self-imposed constraints so that these measures can address the uncertainty of the evolving crisis. They are also designed in such a way that they should preserve market functioning and price formation mechanisms.

## 2 PEPP – a flexible instrument to fight the crisis within our mandate

I would now like to take a closer look at the legality of our most far-reaching and exceptional monetary policy decision, the launch of the PEPP. Let me first look at its features.

The PEPP was established to act first as a backstop to potential market disruption. In short, it has had a stabilising effect to counteract the market fragmentation that was unwarranted on the basis of the underlying economic fundamentals, and to safeguard the transmission mechanism. The PEPP also reinforces the ECB’s monetary policy stance. In so doing, the PEPP is a direct and targeted response to an “extraordinary and acute economic crisis”<sup>3</sup> and aims to ensure the ECB’s ability to fulfil its mandate under the circumstances. In contrast to the APP, Greek sovereign securities and shorter-maturity assets are eligible for PEPP purchases.

Notably however, “Due to these exceptional, fast-evolving...circumstances, the PEPP requires a high degree of flexibility in its design and implementation” as set out in the Decision implementing the PEPP.<sup>4</sup> Purchases under the PEPP continue to be guided by the capital key of the national central banks (NCBs) as for the APP. But the PEPP allows for fluctuations in the distribution of purchases over time, across asset classes and among jurisdictions. This flexibility has allowed us to effectively stave off risks to the smooth transmission of monetary policy. In this regard, the Governing Council, in its statement in March 2020,<sup>5</sup> highlighted that: “To the extent that some self-imposed limits might hamper action that the ECB is required to take in order to fulfil its mandate,

<sup>3</sup> Recital 3 of Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) (OJ L 91, 25.3.2020, p. 1).

<sup>4</sup> *ibid.*

<sup>5</sup> ECB press release of 18 March 2020: [ECB announces €750 billion Pandemic Emergency Purchase Programme \(PEPP\)](#).

the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks that we face. The ECB will not tolerate any risks to the smooth transmission of its monetary policy in all jurisdictions of the euro area.”

In view of the pandemic’s exceptional nature, we decided not to apply to the PEPP the same self-imposed public purchase limits that apply to the sovereign purchases under the APP. However, we will conduct purchases only to the extent this is necessary and proportionate to fulfil our mandate.

In short, the PEPP is a targeted, proportionate and temporary measure in response to the crisis triggered by the COVID-19 pandemic.

The legality of the PEPP is ensured for three reasons:

First, as noted above, the PEPP falls within the ECB’s mandate in that it pursues monetary policy objectives. As in the *Gauweiler* case,<sup>6</sup> the measures designed to preserve the monetary policy transmission mechanism may be regarded as seeking to maintain price stability. Let me add that the argument invoking the transmission mechanism cannot be used to ease credit risk premia which are due to the idiosyncratic economic and financial situation of a country.

Second, in accordance with the PEPP Decision, “Purchases shall be carried out...to the extent deemed necessary and proportionate”.<sup>7</sup> The proportionality assessment of the PEPP must be supported by economic analysis which shows that the measure: (i) is suitable for attaining the monetary policy objective in current and future environments; (ii) does not go beyond what is necessary in order to achieve this objective; and (iii) weighs up the various interests involved to prevent any disadvantages which are manifestly disproportionate to the objectives set.

In this context, the Governing Council assessed the PEPP’s potential impact and direct and indirect effects, and took into account comparative elements and counterfactual scenarios to ensure that it was “the most effective and efficient tool for providing additional monetary accommodation in the current environment”.<sup>8</sup> The Governing Council considered the PEPP to be the most appropriate instrument compared with a recalibration of standard policy tools, such as interest rate cuts.

In the *Weiss* judgment,<sup>9</sup> the European Court of Justice confirmed that the ECB must be allowed broad discretion in making these complex assessments, but within strict criteria. The PEPP complies with the proportionality principle as it is both suitable and necessary to attain the monetary policy objective. The PEPP contains important safeguards, such as stringent eligibility criteria also contained in the APP. However, on account of its flexibility, these stringent criteria are arguably fewer under the PEPP than under the APP. For this reason, the PEPP must be strictly temporary in nature

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<sup>6</sup> Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, EU:C:2015:400, para. 49.

<sup>7</sup> Article 4 of Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) (OJ L 91, 25.3.2020, p. 1).

<sup>8</sup> [Account of the monetary policy meeting](#) of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 3-4 June 2020.

<sup>9</sup> Case C-493/17, *Weiss and Others*, EU:C:2018:1000, para.73.



(the temporary nature also becoming a stringent criterion) and targeted to comply with those strict criteria.

Last of all, although the ECB decided not to apply issuer and issue limits, the allocation of public sector purchases will be guided by the capital key of the NCBs.

The PEPP's flexibility should not undermine the safeguards and limits set by the ECB in its purchase programmes to keep within the constitutional red lines mentioned above. Even if the extraordinary context of the crisis might lead to further reflection on some of these established principles, the ECB has made a public commitment to respect these red lines, and for good reasons. Importantly, PEPP purchases are separate from and cannot be consolidated with the APP purchases. This means that the PEPP remains a distinct monetary policy measure in comparison to the APP. In keeping with these safeguards, the APP will also not inherit the features of the PEPP.

The flexibility embedded in the PEPP cannot be unconstrained and we must ensure that the ECB continues to operate within the limits of its competence.

### 3 Collateral easing must be strictly temporary and not come at the expense of fragmentation

Another aspect of our response to the crisis was the unprecedented set of temporary collateral easing measures announced on 7 and 22 April respectively. The first package of pre-emptive measures facilitates banks' access to Eurosystem liquidity operations at favourable terms, including liquidity-providing operations announced to address the pandemic crisis. With the second package of measures, the ECB acted forcefully and promptly before collateral shortages could materialise owing to the effects of potential rating downgrades resulting from the COVID-19 outbreak.

Specifically as part of the first package, the Governing Council decided to extend additional credit claim (ACC) frameworks to include loans to corporates, small and medium-sized enterprises (SMEs) and self-employed individuals and households which benefit from public guarantee schemes adopted in the euro area as a response to the pandemic,<sup>10</sup> even if they lead to increased fragmentation temporarily. Further measures included applying a temporary 20% general reduction to collateral valuation haircuts. The ECB also reduced the ACC loan level reporting requirements for banks and adopted a waiver to accept Greek sovereign debt instruments as eligible collateral in Eurosystem credit operations.<sup>11</sup>

The economic shock from the COVID-19 crisis is amplified through its adverse effect on the value of banks' collateral.<sup>12</sup> As part of the second targeted package of

<sup>10</sup> See ECB press release of 7 April 2020: [ECB announces package of temporary collateral easing measures](#).

<sup>11</sup> Guideline (EU) 2020/515 of the European Central Bank of 7 April 2020 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2020/21) (OJ L1 110, 8.4.2020, p. 26).

<sup>12</sup> [Improving funding conditions for the real economy during the COVID-19 crisis: the ECB's collateral easing measures](#). Blog post by Luis de Guindos, Vice-President of the ECB, and Isabel Schnabel, Member of the Executive Board of the ECB, 22 April 2020.

measures, the Governing Council decided to grandfather the eligibility of marketable assets and the issuers of such assets that fulfilled minimum credit quality requirements on 7 April 2020 in the event of a deterioration in credit ratings decided by the credit rating agencies accepted in the Eurosystem, as long as the ratings remain above a certain credit quality level. This would ensure continued collateral availability, which is crucial for banks to provide funding to firms and households during the current challenging times.<sup>13</sup>

In the same vein, under the general collateral framework, the Governing Council: i) removed the minimum size threshold for domestic credit claims (Article 93 of the General Documentation<sup>14</sup>); ii) increased the concentration limit for unsecured bank bonds to 10% per issuer banking group (Article 141 of the General Documentation<sup>15</sup>); and iii) reduced by 20% the haircuts applied to non-marketable assets.<sup>16</sup>

The legality of these measures is ensured through compliance with all the generally applicable principles I mentioned above. More specifically, their legality is safeguarded by virtue of the risk management measures with which they are associated, to ensure that the Eurosystem would not suffer losses if the collateral were realised. In this way, the ACCs which are not loss sharing like the standard monetary policy instruments, can be classified as “adequate collateral” in accordance with Article 18.1 of the Statute of the ESCB. Even though the tools we use are not new and had been deployed previously, we adapted them further during the current crisis. At the same time, our actions complemented other European or national policies, such as the provision of public sector guarantees on the fiscal side. Taken together, these measures have reinforced the effectiveness of liquidity support offered to the real economy.

We should ensure, however, that the collateral easing measures do not inadvertently lead to further fragmentation and the re-introduction of a Tier-2 collateral framework. More importantly, they should respect the level playing field throughout the euro area. It is true that the expansion of the ACC frameworks can increase the overall complexity and opacity of the ACC collateral landscape. The country-specific legal and institutional features of these frameworks could give rise to additional legal risks in relation to our collateral framework. Therefore, as with the PEPP, it is crucial that our collateral easing packages are designed as strictly temporary measures that will remain in place until September 2021 or only as long as the direct consequences of the pandemic are with us.

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<sup>13</sup> ECB press release of 22 April 2020: [ECB takes steps to mitigate impact of possible rating downgrades on collateral availability](#).

<sup>14</sup> Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (General Documentation Guideline) (ECB/2014/60) (recast) (OJ L 91, 2.4.2015, p. 3), as amended.

<sup>15</sup> *ibid.*

<sup>16</sup> Decision (EU) 2020/506 of the European Central Bank of 7 April 2020 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework and Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework (ECB/2020/20) (OJ L 109, 7.4.2020, p. 1).

## 4 Ample liquidity: refinancing operations (TLTRO III, PELTROs)

Also in keeping with our mandate, I would like to briefly mention that we have been able to rely on the traditional tools we have at our disposal. To a large extent, it was SMEs which suffered the severest economic hit with the onset of the pandemic. In order to support bank lending to SMEs, the ECB decided<sup>17</sup> in March to make changes to our existing refinancing operations. These include an increase in the borrowing allowance and removal of the maximum bid limit on all future operations, changes to the early repayment option, and a temporary reduction in interest rates. The ECB also introduced new pandemic emergency longer-term refinancing operations (PELTROs) which feature a maturity of one year and are not linked to lending requirements, unlike the TLTROs which contain this conditionality. Both measures aim to provide credit to the banks and the real economy.

As a result, we have seen a surge in the provision of credit in support of the real economy as well as a related knock-on effect on asset prices.

## 5 EUREP

Moreover, as a further response to the crisis, the ECB decided to set up a new backstop facility, called the Eurosystem repo facility for central banks (EUREP), to provide precautionary euro repo lines to central banks outside the euro area. Such repo lines are provided against adequate collateral, consisting of euro-denominated marketable debt securities issued by euro area central governments and supranational institutions. Thus, EUREP is in line with Article 18.1 of the Statute of the ESCB and falls within the ECB's mandate. EUREP will be available until June 2021.

EUREP addresses possible euro liquidity needs in case of non-euro area market dysfunction resulting from the COVID-19 shock. Commercial banks outside the euro area might have to sell significant amounts of euro-denominated securities in order to generate euro liquidity which they cannot obtain in the money market. These sales would negatively affect the euro-denominated securities market which might, in turn, negatively affect the euro area commercial banks and thereby the smooth transmission of ECB monetary policy within the euro area. Thus, EUREP aims at avoiding that the smooth transition of the ECB's monetary policy is negatively affected and is accordingly within the mandate of the ECB.

Furthermore, the significant international role of the euro is promoted by the ECB through EUREP. The success of the euro and its growing international role has led to commercial banks and entities which use the euro being dependent on the availability of euro liquidity. As a consequence, in times of market disturbance owing to the COVID-19 pandemic, it is important that the ECB fulfils its responsibility as the institution which can make available the euro liquidity needed not only to the

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<sup>17</sup> Decision (EU) 2020/407 of the European Central Bank of 16 March 2020 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2020/13) (OJ L 80, 17.3.2020), p. 23) ("TLTRO-III").

commercial banks in the euro area,<sup>18</sup> but also to foreign central banks so that they can provide euro liquidity to their monetary policy counterparties.<sup>19</sup> Under the EUREP framework, the Eurosystem may elect to provide euro liquidity to more foreign central banks via the ECB directly, via some euro area NCBs or via the Bank for International Settlements, if necessary.<sup>20</sup>

## 6 Supervisory measures – the need for an innovative approach to tackle the crisis

I would now like to look at the supervisory side, where the ECB has had to take an innovative approach to tackling the crisis.

As I mentioned earlier, what is true for our bold monetary policy response to the pandemic is also true for our supervisory response: our measures are exceptional and temporary and within the regulatory boundaries of the internationally agreed framework.

The ECB was one of the first supervisory authorities to recommend that all banks under its supervision restrict their dividend distributions in the light of the impact of the COVID-19 pandemic. Soon after our announcements in March, other supervisory bodies around the world followed suit with similar measures. While not binding, most banks have followed the ECB's recommendation. The recommendation exceptionally has adopted a "one-size-fits-all" approach owing to the current economic uncertainty banks are experiencing, leaving them quite simply unable to forecast their medium-term capital needs accurately. We will review this recommendation at the end of 2020, and unless we conclude that the banks' capital projections remain clouded by exceptionally high uncertainty, we should revert to our usual supervisory practice of assessing the planned distribution of dividends on a bank-by-bank basis, taking into account the safety and resilience of the banking system as well as the preservation of its intermediation function at a time of deteriorating asset quality and increased capital consumption.

Another new development concerns the leverage ratio. On the basis of the amendments to the Capital Requirements Regulation,<sup>21</sup> ECB Banking Supervision has allowed significant credit institutions to exclude central bank exposures from the calculation of their leverage ratios until July 2021. ECB Banking Supervision has cooperated with and sought the views of the ECB's central bank function in order to tailor the scope of this temporary exemption so that it covers only those claims on the central bank that are related to the implementation of monetary policy.

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<sup>18</sup> In other words, the Eurosystem's monetary policy counterparties.

<sup>19</sup> That is, to the commercial banks in countries outside the euro area and outside the EU.

<sup>20</sup> ECB press release of 25 June 2020: [New Eurosystem repo facility to provide euro liquidity to non-euro area central banks](#). See also: [Eurosystem repo facility for central banks \(EUREP\) - FAQ](#).

<sup>21</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1), as amended.

The measures in relation to dividends and the leverage ratio, as well as the other measures providing temporary capital, liquidity and operational relief to banks, are exceptional measures which are justified as long as the impact of the COVID-19 crisis continues to be felt. We may also decide to discontinue some of these measures, as we did for some of the operational relief measures in July. As with our monetary policy tools, we are closely monitoring the situation and we will review our approach on a regular basis.

Independent of the ECB's actions, banks need to perform proper risk management, acknowledge the recognition of impairments, and book an appropriate level of provisions.

## 7 Enhanced need for central bank digital currencies in the crisis?

I would now like to turn briefly to the subject of central bank digital currencies and how the pandemic has had an impact on them.

Although the pandemic has reduced consumer demand for non-essential, proximity consumer services, it has not eliminated the need for fund transfers to cater for essential, everyday economic exchanges. By reducing demand for non-essential, proximity consumer services and by encouraging the use of electronic payment solutions, the pandemic may boost interest in the issuance and use of innovative forms of cash. Of the various alternatives that public monetary authorities are mulling, the most innovative would be some form of central bank digital currency (CBDC). Central banks began exploring the prospect of issuing CBDCs well before the onset of the pandemic, so as to minimise fund transfer and settlement times and costs, reaffirm the role of central banks as monopoly issuers of money, promote the international role of their currencies, reduce credit risk in the financial system and discourage cash-hoarding.

Legitimate as they are, the arguments that the pandemic has brought to the table in favour of CBDCs need not tip the scales in favour of immediate action in the direction of their issuance. Many legal, operational and policy issues around CBDCs remain unresolved, standing in the way of a transition from traditional cash to digital currencies. The issues in question will continue to exercise the minds of the ECB, the euro area NCBs, and of central banks the world over, as they explore, further, the benefits and costs of CBDCs and elaborate on the various possible CBDC issuance and distribution scenarios.

## 8 Conclusion

Let me conclude.

In the blink of an eye, the coronavirus pandemic and the response to it placed the global economy in an induced coma. The ECB has acted forcefully and well within its

mandate. Our crisis response shows that our legal framework is flexible, but only up to a certain point. The efficiency of our response has been strengthened by the concurrent reaction on the fiscal side which is more useful than excessively stretching the monetary policy mandate.

Our crisis measures must be temporary and targeted. They are justified only in the light of the exceptional circumstances seen during the pandemic. Extraordinary times require extraordinary action. As the crisis evolves and subsides, the ECB will reconsider its tools and supervisory practices.

Panel 1

Enhancing access to EU law and  
case-law





# Introduction to the panel on enhancing access to EU law and case-law

By Per Nymand-Andersen<sup>1</sup>

## 1 We need a Data Schengen – including for law!

The digital transformation in economics and finance is reshaping the financial market landscape. It is also having an impact on the European frameworks that we have established for ensuring a prudent, sound and safe financial system – one in which financial actors can offer products and services on a level playing field in the pre-trading, trading and post-trading markets. But how do we ensure that the legal system remains agile and proactive in fostering and enabling the digital transformation for the good of society, while at the same time ensuring a secure, robust financial market for consumers, financial actors and the real economy?

European Union (EU) law, national law and case-law together represent a complex, interconnected jungle of written text law, interpretations of the law, judgments of disputing parties and national interpretations of common law. Meanwhile, the use of 24 official languages in the European Union adds significantly to this complexity and presents a challenge to overall consistency and quality<sup>2</sup>. Access to the legal systems and rules of modern democracies has been a rich source of knowledge and insight throughout the ages and is indeed a fundamental human right.

Facilitating this access to and use of the legal framework is therefore a mandatory requirement for lawyers. This goes far beyond providing easy access: it also means enhancing legal literacy and the use of legal documents by citizens and the general public at large. After all, it is a legal requirement for citizens to know the law. But is the law written in a language which is understandable for citizens?

The digital transformation is particularly relevant when it comes to modernising the legal system so that lawyers embrace the opportunities of data<sup>3</sup> digitalisation. This means for instance taking advantage of data science methods to dynamically link laws and case-law and order them into simple networks of hierarchical structures, with multiple layers and interconnectedness of the structures and across countries and languages within the European Union and through time. Doing so would create an EU-wide legal innovation knowledge centre for private, public and research purposes. This in turn would not only foster easy access to the EU legal framework but also save

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<sup>1</sup> Adviser, Directorate General Statistics, European Central Bank.

<sup>2</sup> Irish has been an EU official language since 2007, previously not used for legislation though the process to translate also the legislation into Irish is a challenge. On 3 December 2015, the European Council announced that it would draft a regulation that would increase the number of areas in which Irish translation is required, with an aim of ending the derogation phase completely by 1 January 2022.

<sup>3</sup> “Data” refers to both numeric and textual values.

time and professional resources. In addition, it would improve the understanding and use of this legal framework by citizens at large.

Ultimately, textual data and numerical data are simply data, and should be open to all.

Just take the example of Google Translate, which uses data science techniques to calculate probabilities as a basis for mapping text across languages and providing users with alternative suggestions, thus establishing a collaborative digital platform for enhancing the learning phase of the machine learning technique and improving translation quality for next-time users. We have to embrace the advance of technology – and we must understand the mechanism in order to discuss the legal and ethical implications and to develop the necessary frameworks for digitalisation and its application in society.

In a similar vein, data science methods are also particularly relevant and can be applied by lawyers: textual analytics and artificial intelligence are providing the modern lawyer with new ways to take advantage of digitalised databases and advanced analytical tools. Natural language processing techniques have made it possible to develop intelligent screening of national law documents and to link these documents into new networks that facilitate legal research. Meanwhile, data visualisation – the graphical representation of information – makes it easier to drill down and identify connections between EU law, national law and case-law. In this new digital legal environment, modern lawyers can swiftly obtain an overview of the relevant legal documentation – something that previously required significant experience, knowledge and time. These new techniques generate efficiency, efficacy and timeliness in the legal system and in our societies at large. They may well also significantly reduce the time to market in the ever-complex world of case-law.

To give another specific example – and taking advantage of the fact that one of our panel members is from the Publications Office of the European Union – I am a member of the jury for the EU Datathon: an EU-wide public competition for developing innovative applications in support of EU open data. Among the winning teams last year was 'The Smartfiles Network' from Austria. This team won its challenge by building an application creating a network of EU and national court rulings using available PDF files, thereby helping lawyers to connect up national and EU law. But why are the court rulings released in PDF files in the first place? PDF files may once have been a pioneering format for computer storage for replacing stacks of papers – but they are certainly not easy to re-use and do not comply with machine-readable open data requirements for modern societies. Legal text has to be made available so it can be easily read/scanned using machine-readable formats to swiftly find the relevant 'needle in the haystack' and to link it with other relevant case studies elsewhere, as otherwise it remains cumbersome, manual and almost impossible to find for any experts.

The lack of digital adoption within many areas of the legal system may even be viewed from the outside as preventing modern societies from becoming more efficient.

Facilitating digital access to the legal framework remains a complex task. It is only feasible if there is a borderless central access point within the EU – where legal texts,

data and metadata are well organised and structured, with uniform semantic tagging, and where these texts and data are digitally available so as to enable machine reading. A central access point of this kind requires a clear governance structure. Only by systematically building such open databases will we be able to align citizens, markets and society more closely. What is more, databases of this kind are a crucial way for the European Central Bank and other organisations to fulfil their accountability and transparency objectives, to build and increase trust in the EU treaties and to facilitate access to and understanding of the EU and national legal systems.

The continuous growth of legal data further highlights the importance of viewing legal documentation as a strategic asset for society and of treating it accordingly. This means finding enablers to ensure a structured approach to this textual documentation and to make it easily accessible in digital machine-readable datasets that can be used by public and private firms in a borderless way – and as a public good.

In a digital world, the concept of national boundaries becomes obsolete to the use of digital data and content, as to some extent our digital footprints are everywhere and are exploited. There is a need for the EU to enhance the international collaboration among Member States and beyond to establish a new common set of rules and guidelines for fostering the borderless market for digital data and to develop digital data strategies and regulations, including common sanction regimes and timetables. In other words, with this concept in mind, national governments would collaborate to develop a common set of rules, including detailed standards and identifiers, and to ensure the mandatory implementation of these rules at national level.

In 2020, the European Commission issued a communication on a European strategy for data<sup>4</sup> with the aim of initiating steps for creating a single market for data within the European Union. While very general, it is a step in the right direction. The strategy for data is part of a broader digital package which includes initiatives on the use of artificial intelligence. This has to be adopted into the EU legal framework including efforts to develop a new ethical framework and guidance for the application of artificial intelligence in modern societies. Who is liable for an accident involving a car that is driven automatically using sensors that rely on artificial intelligence? The car manufacturer, the IT programmer, the software company, the producer of the sensors or the driver? Relying on machine-generated decisions will drive the digital market for the foreseen future.

A single market for data requires the free flow of digital data across borders. This must be based on an EU data governance concept for facilitating access by public and private entities, while complying with data protection rules under the General Regulation on Data Protection (GDPR)<sup>5</sup>.

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<sup>4</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, [A European Strategy for data](#), (COM/2020/66 final).

<sup>5</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council 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, and repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016, p.1).

The European strategy for data is also of utmost importance for the EU legal system to become adopters and facilitators for the free movement of digital data of a legal nature. While we may not have to be in front of the curve, we may wish to be on the curve.

While the EU is a single economic area, there are different digital data maturities in public services and significant national barriers to the free operability and flow of data within Member States. These barriers are manifold and relate to imbalances in intellectual property rights, competition law, data protection, digital infrastructures, digital preparedness, the availability of registers and standards within the public and private sectors.

Further developments in infrastructure frameworks, governance and security are crucial for the safe and efficient interoperability and exploitation of such digital data. There are also practical limitations on exercising the rights protected by the GDPR relating to current general digital data and legal literacy.

The EU Commission should take a proactive stance to facilitate and support the digital transformation within the EU and national legal systems, thus proactively contributing to an open data strategy for Europe.

We are living in exciting times – and it does not stop here. As digitalisation continues, let us move forward to build the enablers and framework for the free movement of digital data within a new Data Schengen universe!

# Enhancing access to EU law and case-law

By Maria Westermann<sup>1</sup>

In the era of open data, the European Publications Office in Luxembourg has upgraded its legal database. Legal counsel and the general public alike can now obtain insights and navigate the EU body of laws in a user friendly and easy to retrieve fashion. Building on case studies and concrete technologies, the panel will display the new possibilities and unveil upcoming trends and challenges.

## 1 Introduction

For access to law in Europe, it is not enough to give access to the individual acts. The acts belong to a context. To give an understanding of the legal framework, it is necessary to see interdependencies and interactions between legal documents, such as the hierarchy and how the acts are interpreted by case-law, which is why the relations between acts is one of the most important parts of the legal information. In a European context, the interactions between the European Union (EU) legal framework and the legal framework of the Member States is becoming more and more important. With this background, the Publications Office of the European Union (Publications Office) is looking into ways, on the one hand, to make the access to EU law more user friendly and, on the other hand, to improve the linking between EU law and the law of the EU Member States.

The legal acts of the EU are published in the Official Journal of the European Union (OJ), which is managed by the Publications Office. The workflow includes that the authors send the documents to the Publications Office for publication. The documents are stored in a repository called the Cellar and made available on the EUR-Lex website. The documents published in the OJ are mostly available in the 24 official languages of the European Union<sup>2</sup>, or in 23 languages as there is a derogation for Irish which is gradually being phased out<sup>3</sup>. In addition, there are legal documents available on EUR-Lex which are not published in the OJ, for example case-law from the European Court of Justice, documents within law-making procedures, consolidated

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<sup>1</sup> Head of Unit at the Publications Office of the European Union, Directorate C - Access to and reuse of public information.

<sup>2</sup> Bulgarian, Croatian, Czech, Danish, Dutch, English, Estonian, Finnish, French, German, Greek, Hungarian, Irish, Italian, Latvian, Lithuanian, Maltese, Polish, Portuguese, Romanian, Slovak, Slovenian, Spanish and Swedish. See Article 1 of EEC Council Regulation No 1 determining the languages to be used by the European Economic Community (OJ 17, 6.10.1958, p. 385).

<sup>3</sup> Council Regulation (EU, Euratom) 2015/2264 of 3 December 2015 extending and phasing out the temporary derogation measures from Regulation No 1 of 15 April 1958 determining the languages to be used by the European Economic Community and Regulation No 1 of 15 April 1958 determining the languages to be used by the European Atomic Energy Community introduced by Regulation (EC) No 920/2005 (OJ L 322, 8.12.2015, p. 1).

versions of legal acts, summaries of EU legislation and certain documents related to national law.

Behind the scenes, all legal data is stored in and available via the Publication Office's central datastore, the Cellar. The total volume of the legal data available in the Cellar amounts to 36.5 terabytes (TB)<sup>4</sup>. There are 1.3 million legal documents published and if you calculate each language version separately, there are 12.4 million language expressions.

In addition to providing the formal publication of the OJ and a comprehensive access for the public to EU law, the Publications Office shows some statistics on the EUR-Lex website. However, it is also one of our tasks to provide that data so that re-users have the possibility to build applications based on the data or use it for different types of insights, for example:

- to see which policies have the most new legislation and how this changes over time;
- to train tools of machine translation;
- to see, via the relations between the legal documents, how they are divided into clusters;
- and for lawyers, to see which is the most cited case-law – and how this changes over time.

## 2 Access to national law

There are two main types of documents related to national law which can be found on the EUR-Lex website. First, the national transposition measures – legislation adopted by Member States to implement EU directives into national law. The Member States notify the measures to the European Commission, and the titles and references of all measures are available on EUR-Lex. Furthermore, 12 Member States have agreed to publish their national transposition measures on EUR-Lex either directly as text or as a link to the text on a national website, which makes it easier for users to find this content.

Second, you can access national case-law relevant for the Lugano Convention<sup>5</sup> and the related framework, which the contracting states are obliged to communicate. This covers the area of jurisdiction, recognition and enforcement of judgments in civil and commercial matters. Not only the original judgments are available, but also a summary of each judgment in English, French and German.

In addition, the Publications Office manages a search form on the separate website N-Lex<sup>6</sup> where you can search directly in the national databases for access to law in

<sup>4</sup> One terabyte corresponds to 1 000 000 MB.

<sup>5</sup> See Article 3 of Protocol 2 to the [Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters](#) (OJ L 339, 21.12.2007, p. 3).

<sup>6</sup> <https://n-lex.europa.eu/n-lex/>.

the EU Member States. It includes a common search form for the official EU languages as well as links to legal databases of countries that are not members of the EU.

### 3 Metadata and legal analysis

The amount of data and the different use cases shows the need to have a structure for the information linked to the legal content, and this is why there is **metadata** connected to the legal documents. Metadata is data (information) that provides information about the data.<sup>7</sup>

The authors send the legal documents to the Publications Office already together with a set of metadata, including author, date of adoption and type of document. Then, for the documents published in the OJ, an external contractor carries out a validation and further enrichment of the metadata within two working days from the publication. This includes among other things certain dates, information about relations between documents and tags indicating to which topic/policy area the document belongs. After that, a quality control is done in-house in the Publications Office.

In order to fulfil its purpose, it is important to structure the metadata in a way that humans as well as machines can understand it. Therefore, the Publications Office has created **authority tables** (or NAL – Named Authority Lists) for the different types of metadata. For each entry, the tables consist of a code, which is machine readable, and labels in each of the 24 official languages of the EU. Sometimes the codes are understandable for humans, based on the English label for the concept. For other items, such as EuroVoc, which is a thesaurus used for indexing and covering the activities of the EU, it is just a number, with no semantic value at all. The labels are used for the search and the display on the website. The Publications Office manages many different authority tables and publishes them on the EU Vocabularies website<sup>8</sup> in a machine-readable format. If you are interested in languages, those **authority tables** can be quite fascinating, as they include translations in 24 languages of, among other things, document types, the institutions, names of the EU treaties and also frequencies – which is a table with 30 different adverbs to represent frequency.

Consistency is key for the quality of metadata. The resource which is the basis to guarantee consistency of the document information is what we call the Legal Analysis Methodology. It includes the instructions we give to our contractor to guide them as to which metadata to attach to the different document types. Those instructions are very important in order to really understand the legal data, and I will give one example. One of the dates that is part of the metadata is the “Date of document” (in FR *Date du document*). Now, this does not have a legal definition, but still it is important information, as it is a date used in the search and if you want to sort the search results in chronological order. So, what is the methodology for applying the date of document? Some documents have this date in the title, such as legal acts and decisions of the Court of Justice, but in order to cover all types of acts, the methodology gives a

<sup>7</sup> See the definition in [Merriam-Webster](#).

<sup>8</sup> <https://op.europa.eu/en/web/eu-vocabularies>.

definition that is quite complicated. The document date can be the date of signature (EU acts adopted by ordinary legislative procedure); date of adoption (acts adopted by other procedures); date of vote (parliamentary resolutions or opinions/resolutions adopted by the European Economic and Social Committee (EESC) or the European Committee of the Regions (CoR)); date of consolidation (applicability of the last amendment included in a consolidated act); or, if none of the above is available, date of publication. Which one it is of those dates you see in each specific case is indicated with an annotation. For the future, we are working on making the Legal Analysis Methodology directly available to the public and to re-users, as this helps to increase the understanding of the information given on the website and the legal data for those who really want to go into the details.

Another example of how the metadata is used for the display and for simplifying the access to legal data is what we call the “In force indicator”. On the website, you can find an indication in green if the legal act is in force, in yellow if an act is not in force because it has not reached its date of effect and in red if an act is no longer in force, because we are after the date of end of validity for the act. You can also choose to include only acts that are in force in your search results, and the in force indicator is the basis for statistics on which acts are in force. So far it sounds simple, but as always, the devil is in the detail. What, for example, if an act never comes into force, because it is repealed before the date of effect? This is the kind of question the legal analysis team in the Publications Office are examining to find the best answer, in cooperation with stakeholders in the European Institutions.

## 4 Future developments in the context of the digital European legal space

The concept of European legal space describes the interdependencies between different legal orders that operate in the EU – mainly EU law and national law, but also other systems such as the one created by the European Convention on Human Rights. The complexity of the European legal space makes it difficult for citizens and businesses to understand the full extent of their rights and obligations and to fully benefit from the internal market. It is therefore important to eliminate barriers to smooth navigation through the whole body of law applicable within the EU, which is why it is one of the Strategic Objectives of the Publications Office to create a digital European legal space.<sup>9</sup>

The aim of this objective is to provide an easy and comprehensive access to all law applicable within the EU by connecting EU law and national law, facilitating understanding of EU law and national law and fostering the role of EUR-Lex as the reference point for EU legal information.

When it comes to **access to all law applicable within the EU**, one important issue is the language barrier. For acts of national law, which are only available in national languages, the trend goes towards more and more use of machine translation as a

<sup>9</sup> Publications Office of the European Union Strategic Objectives 2017-2025, Revision June 2020, Luxembourg, 2020.



way of improving the understanding of the documents. This is why we are implementing a translation service for those documents, using the tool eTranslation. Already now, it is possible to translate the titles of the national transposition measures on the website, which is helpful if you are looking for information in a language you do not understand. The quality and the speed of the translations is increasing rapidly, which is why, for the future, we will implement the eTranslation tool so that you can translate also the full text of the documents when they are available. The implementation will be done in such a way that it will be an active choice of the user to use the machine translation and a disclaimer will point out that the translated text is not an official translation.

We are also planning to implement a search using the European Legislation Identifier (ELI)<sup>10</sup>. ELI is a project with the purpose to give a semantic identifier to legal acts and increase the interoperability between legal systems. It is governed by an expert group of the European Council and it is created on different building blocks giving a common but flexible framework for identifiers and metadata for legislation. The first pillar of ELI is to give each act an identifier that is at the same time human and machine readable and which also works as a URI – which you can use to find the act on the internet. 12 Member States have implemented this solution and also the Publications Office has fully embraced this approach on EUR-Lex for EU legal acts. The ELI URI as it is implemented on EUR-Lex is very powerful, as with some manipulations, you can use it to find different language versions, specific file formats or the version in the OJ or the updated consolidated version as it is applicable today. In the future, you will be able to also use the ELI to find and make reference to the subdivisions of an act. Details on how Member States and the Publications Office have implemented ELI can be found on the ELI register on EUR-Lex.<sup>11</sup>

One of the projects with the purpose of **facilitating the understanding of EU law** concerns improvements of the access to consolidated texts of EU law. On the one hand, there will be a timeline, where you can more easily navigate between different consolidated versions. On the other hand, we are investigating how to make the consolidated versions available at an earlier stage, if we can further automatise the process and start the consolidation before the modifying act (amendment or corrigenda) has been published in the Official Journal.

With the purpose of **developing EUR-Lex as the reference for EU legal information**, the Publications Office is opening up to work closely with authors to provide specific access to different collections of documents. The work, together with the ECB, to create a specific page for the ECB legal framework<sup>12</sup> has been a very good experience, and we will continue to cooperate to further improve the page.

We are also investigating how to create a version of the EU legal acts which will include a hyperlink whenever the act includes a reference to another legal act. This service will be based on the tool **Ref2Link**<sup>13</sup>, which has been developed by the Legal

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<sup>10</sup> Council conclusions of 6 November 2017 on the European Legislation Identifier (OJ C 441, 22.12.2017, p. 8).

<sup>11</sup> <https://eur-lex.europa.eu/eli-register/implementation.html>.

<sup>12</sup> <https://eur-lex.europa.eu/browse/institutions/bank.html>.

<sup>13</sup> <https://joinup.ec.europa.eu/collection/justice-law-and-security/solution/ref2link>.

Service of the European Commission. The tool uses text mining to recognise the references to other acts in a document and based on this information it automatically creates hyperlinks. This means that when you read the document, it will be possible to directly navigate to referenced documents by simply clicking on the hyperlink. In the future, when we have ELI subdivisions implemented on EUR-Lex as described above, the link will lead to the subpart of the document, for example the article which is referenced.

# Establishing the foundation for visual navigation: the ECB legal framework in EUR-Lex

By Valérie Saintot<sup>1</sup>

Words are the favourite medium of expression for lawyers. Advances in digital technologies and the development of natural language processing and other text mining technologies have extended the application of data science and artificial intelligence to the legal world. Now it is not only words that have a place; quantitative data and information and knowledge visualisation have also become useful techniques to enhance lawyers' ability to express themselves.

It is not only because the technology is available that it should be used by lawyers just for the sake of it and in and of itself. However, embracing technological progress helps legal departments and firms to strive for excellence, stay ahead of legal developments and, aware of topical issues, mitigate risks and increase productivity. The law exists to regulate and accompany societal developments. These developments have become more complex, with more focus placed on technological and digital aspects. Using digital technologies and data science to support lawyers in their work is not a fad; it is a trend which is here to stay. The impetus to change the way digital technologies have an impact on the work of lawyers has led to the widespread recruitment by law firms of new profiles such as legal data analysts, legal technologists and legal design thinkers. It has resulted in the offer of new services for legal operations and knowledge management. This also enables new ways of practising the law both by law firms and by in house legal counsels, as well as the digitalization of the access to justice and the possibility of litigating before virtual courts.

These new developments allow new ways to use data, information and knowledge to usefully assist lawyers in promoting a better understanding of the law for themselves and others. The benefits of embracing new ways of exploring the law, gaining and propagating insights, in particular through the use of knowledge visualisations, have spread across various sectors of the legal profession. Visualisation can help make legal operations more effective and efficient. It offers new ways of producing advice to support decision-makers. It has found a space in supporting the work of litigators before the courts to map complex threads of arguments. Visualising complex lines of arguments ahead of writing the court submissions or to have a clear strategy to plead using diagrams and other graphic representations have grown in number over time. In addition, data science offers the prospect of a shift towards a more predictive access to justice, enabling the arguments

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<sup>1</sup> Head of the Legislation Division, Directorate General Legal Services, European Central Bank. The author wishes to thank F. Lulić, E. Corallo and G. Di Matteo for their legal and technological contributions to this paper, as well as M. Paternost-Bajec, T. Filipova, A. Sega and C. Sæbye and the colleagues in the Legislation Division of the ECB for their contributions to the project of publishing the ECB framework in EUR-Lex, which went live on 15 June 2020.

and outcomes pronounced by certain judges or courts to be anticipated by analysing past judgments, arguments and outcomes. Bearing these developments in mind and contemplating how the future use of technology could better help legal counsel in their work, a first step at the ECB was to make its legal framework fully available in a single legislative database in order to move towards a better exploration and retrievability of the relevant knowledge.

## 1 Introduction

For two decades, the ECB legal framework has been published on the ECB website and partially in the European Union's legislative database called "EUR-Lex". Since 15 June 2020, this framework is published in EUR-Lex and is therefore now more widely available to all potential users. Furthermore, the EUR-Lex database serves to index and categorise legal documents, thereby making it easier to have an overview and interconnect and retrieve them. In addition, having the ECB legal framework published in EUR-Lex may facilitate future developments and applications of digital technologies, including artificial intelligence and machine learning.

EUR-Lex offers the following: i) a more advanced use of an EU-wide legal taxonomy; ii) the use of metadata and correlated functionalities; iii) the feeding of EU-wide technical vocabularies; iv) and the use of the features available in EUR-Lex, helping users not only to access the law but also the case-law in one place. Last, but not least, EUR-Lex offers multiple possibilities to interlink EU law and case-law. Through this new approach, the ECB legal framework is made even more widely accessible to experts, academics and citizens alike.

The explanations outlined below give some context to the project of ensuring that all ECB legal public documents are published on EUR-Lex (1.1). They retrace the legal, statistical and design considerations in transitioning from one digital space to the other and bring forth some reflections on the necessary clarity in terms of data governance when exploring the law from a quantitative perspective (1.2).

### 1.1 Initiatives for using the power of visualisation in the legal field

The projects presented below show that the trend to make the law more visually accessible is growing and has multiple expressions and purposes. What unites these diverse projects is the drive to nurture understanding for a domain that is often perceived as one which is rather inaccessible without profound expertise. These examples are just a few of the many developments existing in the area of making the law more accessible.

Each of these projects has different purposes depending on the angle of the initiators and target audiences. Some projects aim at monitoring law-making. Other projects aim at interactively navigating case-law online. The set of examples is neither complete nor systematic. They are brought together to show the diversity of perspectives and opportunities provided by visualisation in the legal field. These

approaches are also being progressively integrated into the curricula of law faculties and schools, and every new university semester sees its bouquet of offerings in this area expand.

With respect to the making of the law, projects arranged by academia offer interactive online interfaces to follow and explore law-making, almost in real time. The first project is an initiative from the University of Washington and is called “Legislative Explorer”. It displays the pattern of law-making from start to finish and visualises the journey from draft to law. One of the purposes affirmed by the project owners is to better understand policy and law-making. The second project is an initiative from Sciences Po Paris called “La Fabrique de la Loi” (“Law Factory”), which covers the laws adopted in France since 2008. Law Factory gives access to visual timelines, shows the journey of draft laws between Parliament chambers and offers the possibility of consulting original texts and proposed amendments. These two projects are a direct contribution to the practice of democracy, enabling accountability and transparency in action.

With respect to navigating case-law online with a visual interactive interface, a project from Harvard Law School deserves to be mentioned. It encompasses 360 years of United States case-law and aims to publish all US court decisions and make them available online. Metadata such as case name, citation, jurisdiction and dates can be accessed freely. The website offers an application programming interface (API) – which provides a platform for communicating with different software – to users so that they can connect law and digital technologies in new ways to explore case-law in more depth. This in turn facilitates the core work of lawyers. To date, it appears that this project sets a benchmark and is among the most advanced examples of case-law online search tools.

## 1.2 A database dedicated to legal publications

From the 1960s onwards, the European Commission has worked on making EU legislation accessible using advanced sets of metadata, striving to interconnect the vast corpora of EU law. The evolution of technology created several waves leading to the introduction of different online platforms over time. One of the first interinstitutional platforms was called CELEX (Communitatis Europae Lex). It became available online in 1997 under the name of EUR-Lex (Europae Lex). The responsibility for building and developing EUR-Lex was entrusted to the Publications Office of the European Union, which was originally set up in 1969.<sup>2</sup> EUR-Lex contains EU law, case-law, and other relevant documents.

From its establishment until 15 June 2020, the ECB has had a hybrid publication policy. The ECB’s legal acts and instruments were published on the ECB’s website under the “Legal Framework” section and to a large extent in EUR-Lex. As of 15 June 2020, published ECB legal acts and instruments can now be found in EUR-Lex. They are categorised according to the applicable classifications, metadata and vocabulary for legal acts and instruments published in EUR-Lex.

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<sup>2</sup> Decision 69/13/Euratom/ECSC/EEC of 16 January 1969 establishing the Office for Official Publications of the European Communities (OJ L 13, 18.1.1969, pp. 19-22).

The corpus of acts has been expanding over time. In order to benefit from the functionalities offered by EUR-Lex, ECB legal acts or instruments that were only published on the ECB’s website had to be manually uploaded to EUR-Lex and given the appropriate metadata in order to be retrievable there. One of the goals was to have a single and integral repository of ECB legal acts and instruments. Another was to facilitate the possible use of knowledge management technologies in the future, in turn retrieving content from the database.

To prepare for a more advanced use of EUR-Lex to navigate and retrieve knowledge, five main levels of activity are necessary, as displayed in Table 1 below.

**Table 1**  
Digitalising legal knowledge management

<b>LEVEL 1: centralising</b>	All publicly relevant output is compiled in one database
<b>LEVEL 2: classifying</b>	Classification and metadata taxonomies applied at document level
<b>LEVEL 3: retrieving</b>	Title, text and metadata become searchable
<b>LEVEL 4: analysing</b>	Data science tools can be applied to the legal database
<b>LEVEL 5: augmenting</b>	AI may be used to understand, predict and improve legal output

Source: Saintot, ESCB Legal Conference 2020

Level 1 involves centralising the corpus of legal documentation in a single place. For publication in the database, each document needs to be classified according to pre-set metadata which correspond to the Level 2 activity. Using existing pre-set metadata empowers users to query and retrieve published information via the Level 3 activity. The first three levels are rather straightforward and self-explanatory. They are somewhat machine-based and require marginal expert intervention to define the concept and control the quality of the implementation.

At Level 4, legal knowledge is crucial for defining the governance of the data-driven analytical work conducted. At Level 5, advanced technological skills and understanding of both legal knowledge and data science are necessary. Each level includes and transcends the previous one(s). To operate at Level 5 and use more advanced technology, it is necessary to have the first four levels soundly in place, curated and maintained on an ongoing basis.

After working to bring its publications in EUR-Lex all the way to Level 4 as described in Table 1 above, the ECB started to introduce a visual navigation tool as explained below.

## 2 Scope of the ECB legal acts published in EUR-Lex

EU law and case-law are published in EUR-Lex. The ECB-dedicated pages in EUR-Lex also have a dual typology of documents published, namely ECB legal acts and instruments (2.1) as well as a compilation appearing under “case-law” (2.2).

## 2.1 ECB legal acts and instruments in scope

The ECB may adopt legal acts and legal instruments to fulfil its mission<sup>3</sup>. The six types of legal documents described in Table 2 below follow different publication rules and practices.

**Table 2**  
ECB legal acts and instruments<sup>4</sup>

LEGAL ACTS					
Type of act	Legal basis	Decision-maker	Effect	Publication	
Regulations	Article 132 TFEU Article 34 ESCB Statute	Governing Council	Binding	Mandatory	
Decisions		Governing Council or Executive Board	Binding on their addressees	(i) Not mandatory (ii) In practice published	
Recommendations				Non-binding	
Opinions		Governing Council		Non-binding	
LEGAL INSTRUMENTS					
Type of act	Legal basis	Decision-maker	Effect	Publication	
Guidelines	Article 12 ESCB Statute	Governing Council	Binding on ESCB central banks	(i) Not mandatory (ii) In practice published	
Instructions		Executive Board	Binding on ESCB central banks	(i) Not mandatory (ii) In practice NOT published	

Source: Saintot, ESCB Legal Conference 2020

In addition, other legal documents are published in the ECB-dedicated pages in EUR-Lex and are comprised of i) memoranda of understanding, ii) agreements (international, interinstitutional, internal to the European System of Central Banks (ESCB)), iii) letters relating to ECB opinions, and iv) draft national legislation relating to ECB opinions.

## 2.2 Case-law documents published in EUR-Lex and on the ECB-dedicated pages

Creating a collection of court documents relevant for the ECB's mandate is motivated by future digital developments aspiring to connect law and case-law from within EUR-Lex as a single source of official and up-to-date versions, together with the ECB internal corpus of legal knowledge, if and when APIs become available.

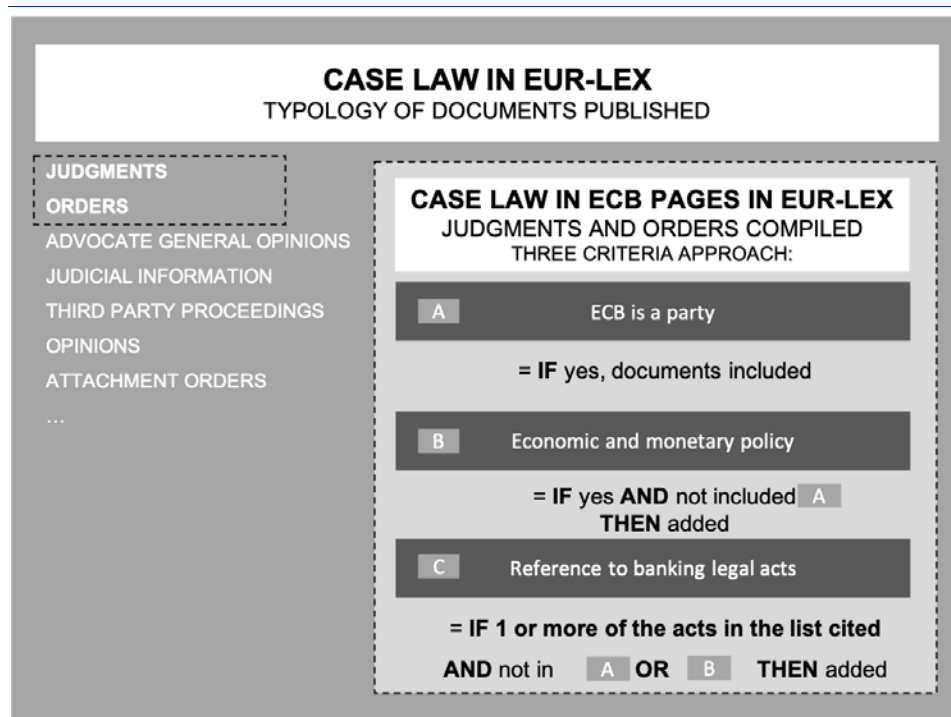
Analyses were conducted to define the scope and types of documents included in the compilation. Figure 1 displays the features relating to case-law documents published in EUR-Lex in general and the subset of these documents included in the ECB-dedicated pages in the case-law search bar.

<sup>3</sup> European Central Bank (1999).

<sup>4</sup> For more details, see European Central Bank (2019).

**Figure 1**

Selection criteria to define the scope of ECB case-law pages in EUR-Lex



Source: Saintot, ESCB Legal Conference 2020

The overview of documents published in EUR-Lex in which the ECB appears as a party (either the defendant or applicant) are presented below.

**Table 3**

EUR-Lex case-law with ECB as a party to the procedure

TYPOLGY	QUANTITY	ECB DEFENDANT	ECB APPLICANT
<b>Total</b>	361	343	18
<b>Judgments</b>	91	87	4
<b>Orders</b>	57	53	4
<b>Advocate General's opinions</b>	12	9	3
<b>Judicial information</b>	201	194	7

Source: Saintot, ESCB Legal Conference 2020  
Note: information as of 1 September 2020

Four main case-law document types (judgments, orders, Advocate General's opinions and judicial procedural information) are displayed.

The ECB-dedicated pages in EUR-Lex and covering case-law related documents have a slightly adjusted scope in comparison to the general pages publishing case-law in EUR-Lex as visualised in Figure 1. First, where the ECB is a party, it concentrates on two types of documents, namely judgments and orders. Second, it includes all case-law documents published under the subject matter “Economic and monetary policy”. Third, there are other cases and procedures where the matters dealt with are of strong interest to the ECB, particularly in the area of banking supervision. The choice to add such cases was made to enhance access to relevant case-law. It has



been defined using the citations of ten legal acts of direct relevance to the work of the ECB in the field of Banking Supervision, as listed in the footnote<sup>5</sup>. This resulted in an adapted scope of the documents compiled in the ECB-dedicated case-law pages in EUR-Lex.

**Table 4**  
Case-law compilation in the ECB-dedicated EUR-Lex pages

TYPOLGY	QUANTITY	ECB DEFENDANT	ECB APPLICANT
Total	215	120	8
Judgment	132	81	4
Order	83	39	4
Advocate General's opinion	Not included	n/a	n/a
Judicial information	Not included	n/a	n/a

Source: Saintot, ESCB Legal Conference 2020  
Note: as of 1 September 2020

The above described criteria and decisions used to define the list of the documents displayed are based on their subjective relevance viewed from the perspective of the ECB legal counsel. The scoping of these pages may evolve over time depending on the user needs and possible feedback received in the future.

### 3 The ECB's visual navigation interface in EUR-Lex

The visual navigation created for the ECB's dedicated space in EUR-Lex focuses on five types of legal acts: regulations, decisions, recommendations, guidelines and opinions. It also primarily concentrates on a general understanding of the ECB legal

<sup>5</sup> **Regulations:** [Regulation \(EU\) No 1093/2010](#) of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, pp. 12-47); [Regulation \(EU\) No 575/2013](#) of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, pp. 1-337); [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, pp. 63-89); [Regulation \(EU\) No 468/2014](#) of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, pp. 1-50); and [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 and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, pp. 1-90). **Directives:** [Directive 94/19/EC](#) of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (OJ L 135, 31.5.1994, pp. 5-14) (no longer in force); [Directive 2002/87/EC](#) of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council (OJ L 35, 11.2.2003, pp. 1-27); [Directive 2013/36/EU](#) of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, pp. 338-436); [Directive 2014/49/EU](#) of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, pp. 149-178); and [Directive 2014/59/EU](#) of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, pp. 190-348).

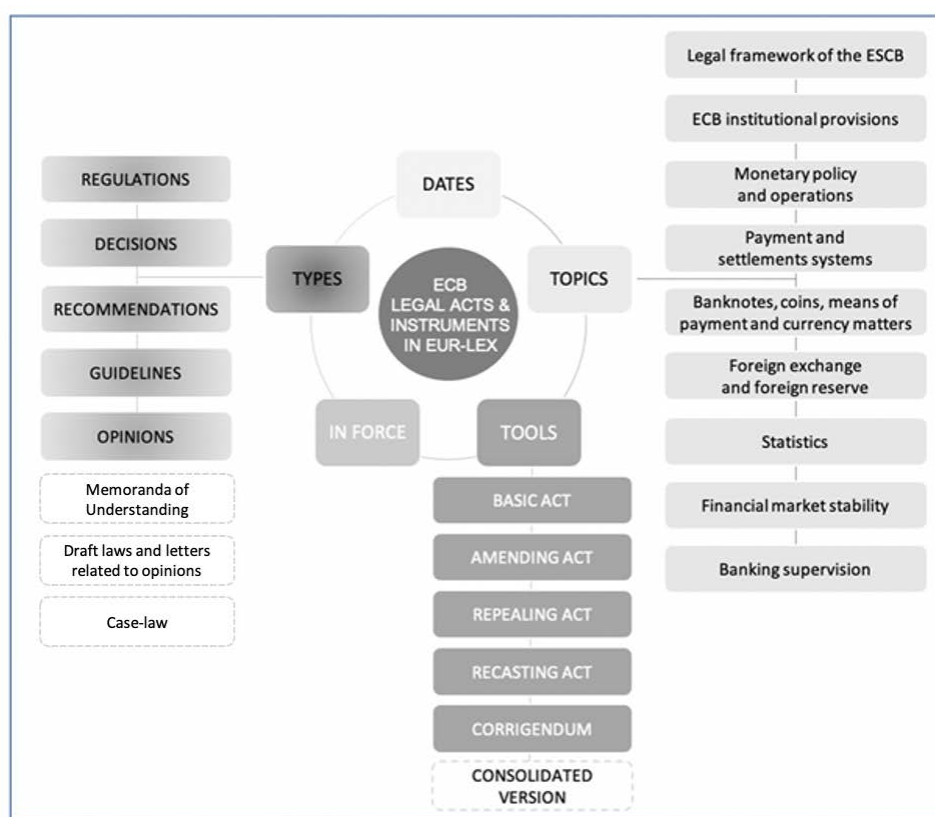
framework. In the future, other aspects may complement these first entry points. To create the visual navigation interface, an inventory of what to include, as well as certain statistical rules had to be defined (3.1). Some basic legislative data visualisation principles were also established (3.2).

### 3.1 Inventory of key features and statistical rules

Figure 2 displays the bigger picture on the basis of which the visual navigation on the ECB-dedicated pages in EUR-Lex has been created. Five attributes are relevant: date, topic, tool, “in force” (status of act) and type.

**Figure 2**

Legal acts and instruments published on the ECB-dedicated pages in EUR-Lex



Source: Saintot, ESCB Legal Conference 2020

While date, topic and “in force” status are self-explanatory aspects, the type of legal acts is explained in subsection 2.1, while a typology of legislative interventions is defined in Table 5 below. Legislative interventions cover tools i) introducing new legal provisions (basic act), ii) amending existing ones (amending act), iii) deleting existing acts (repealing act), iv) bringing dispersed legal provisions together in one document (recasting act) or v) correcting errors (corrigendum).

**Table 5**  
Typology of legislative interventions

TYPOLGY	ELEMENTS OF DEFINITION
<b>BASIC</b>	A basic act lays the legislative foundation for a given legal topic. It is basic in the sense that it does not change a previous act but rather introduces rights and obligations.
<b>AMENDMENT</b>	An amending act introduces changes to an existing act but cannot contain autonomous substantive provisions <sup>6</sup> . It takes the same form as the act it amends.
<b>RECAST</b>	When a significant number of changes to an act have accumulated, the preferred method is recasting. This means publishing a new legal act which incorporates in a single text both the amendments made and the unchanged provisions. The recasting improves legal clarity and certainty. It permits the adoption of a single legislative text which simultaneously amends and codifies the new and unchanged provisions of the earlier act and repeals the outdated act <sup>7</sup> .
<b>REPEAL</b>	Repealing removes a legal act from the legal framework. It is necessary to adopt a repealing act when provisions of an act or an act as a whole become obsolete. Acts that have expired past the point of the validity date do not need to be repealed.
<b>CORRIGENDUM</b>	For minor editorial errors or clear omissions and typos that were noticed after adoption, a corrigendum is used. Corrigenda are published under the same number as the legal act they are referring to and are included in the consolidated version of that act. Corrigenda are published in the language version where the error was found.
<b>CONSOLIDATED TEXT</b>	For acts that have been amended several times, the Publications Office of the European Union publishes a non-binding text containing the basic act and incorporating all amendments and corrigenda.

Source: Saintot, ESCB Legal Conference 2020

Before introducing the visual navigation and programming the interface, EUR-Lex counted each document published as one item. This approach was logical and unproblematic until one attempted to interpret what the quantities connected with different types of acts could mean. For example, upon consulting the database, one would see the quantity of “111” corresponding to the label “regulations”. Unless one is knowledgeable about the ECB legal framework, one might conclude that the ECB has adopted 111 regulations, while another possible reading might be that 111 ECB regulations are in force. To qualify the number 111 requires defining whether acts are in force or not and to which typology of legislative intervention they belong.

Building on the above elements, Table 6 below summarises the way the query programmed for “ECB regulations in force” was spelled out. It reproduces the string of filters combined to generate the quantitative figure reported in the visual navigation interface.

<sup>6</sup> Interinstitutional Agreement of 22 December 1998 on common guidelines for the quality of drafting of Community legislation (OJ C 73, 17.3.1999, pp. 1-4).

<sup>7</sup> Interinstitutional Agreement of 28 November 2001 on a more structured use of the recasting technique for legal acts (OJ C 077, 28.03.2002, pp. 1-3).

**Table 6**

Query to generate the list of ECB regulations in force used in ECB visual navigation

QUERY FOR EXPERT SEARCH IN EUR-LEX	
<code>DTS_SUBDOM=ECB_ACTS AND DTC=false AND FM_CODED=REG AND REP=REP AND VV=TRUE AND XC&lt;TODAY</code>	
<b>CODES</b>	ACTIONS
<b>FM_CODED</b>	Designation of a document type (REG for regulation)
<b>REP=REP</b>	Instruction to show only basic acts (i.e. not amending or corrigenda)
<b>VV=true</b>	Instruction to show only acts that are marked as "in force" in EUR-Lex
<b>XC &lt; today</b>	Instruction about the date, i.e. to show the count on the day before today

Source: Saintot, ESCB Legal Conference 2020

One of the data governance decisions was to focus on the “acts in force”. The rationale behind this was a user-centric approach. Users are interested in swiftly accessing the relevant legal content in force for their immediate perusal. The query string presented in Table 6 creates an instruction to the database which runs every time the user activates it. In this way, users are always presented with the up-to-date list of legal acts and instruments in a fully automated manner.

From a governance perspective, each of the visual and interactive graphs is programmed with a similar logic. The code of the queries is visible in EUR-Lex and can be adjusted or replicated as required. Codes are run automatically, without any input from the user.

### 3.2 Legislative data visualisation principles

As with any other data visualisation project, legislative data visualisation needs to ensure that the visualisation adds value, not confusion. A few definitions help us to keep sight of the visualisation objectives.

Table 7 below defines and exemplifies three important concepts: data, information and knowledge in the context of the ECB visual navigation in EUR-Lex. Being clear about the different concepts helps us to appreciate the added value of legislative data visualisation and the role of legal knowledge as a starting point. The example described above with regard to ECB regulations is used for the purpose of defining data, information and knowledge in context.

**Table 7****Data, information and knowledge applied to ECB regulations**

TOPIC	DATA	INFORMATION	KNOWLEDGE
<b>Definitions</b>	Data are symbols or non-interpreted facts. The machine can compute with no or limited expert intervention.	Information is data in connection and in context. The machine is essential yet requires a taxonomy created by an expert.	Knowledge is information that is processed by the mind and is the result of human cognitive processes. Expert-based decision-making is a must in order to select what to compute and display.
<b>Example: ECB regulations (August 2020)</b>	111 documents have the label "regulation"	44 in force 20 not in force 30 amendments 34 basic acts 47 corrigenda	25 regulations are (i) basic acts (ii) and in force This figure was chosen to be used for visual navigation.

Source: Saintot, ESCB Legal Conference 2020

It is important that the figures displayed in the different graphs make sense without a lot of textual explanations. The purpose was to factually represent reality and to enable the legal framework to be considered from a different perspective, giving the bigger picture by types of acts, topics, etc. and over time. The visuals were not meant to trigger debate. This explains why the initial graphs published were essentially bar charts. Various prototypes were tried out and could have worked if the goal was a provocative commentary on the legislative activity of the ECB. One concrete example was displaying the number of ECB opinions on draft national legislation. This led to the choice not to display the visual information as a map of the European Union. Such visualisation might have triggered unhelpful controversies, adding no value to the understanding of the framework or its navigability. Another dimension was the colour-coding of the graphs. Coherence and neutrality should always be the defining criteria for legislators. More work will be needed on this aspect in the future.

## 4 Overview of two decades of ECB legal acts and instruments

With reference to the definitions, counting rules and data visualisation good practices described above, some of the graphs published in the ECB-dedicated EUR-Lex space are presented below. When consulted online, these graphs are interactive. By clicking on each bar, the compilation of the corresponding published documents appears and can easily be consulted. Four examples are set out below and relate to the types of acts published (1), the main legal topic areas (2), the development by types of acts over time (3), and a zoom into ECB legal opinions (4).

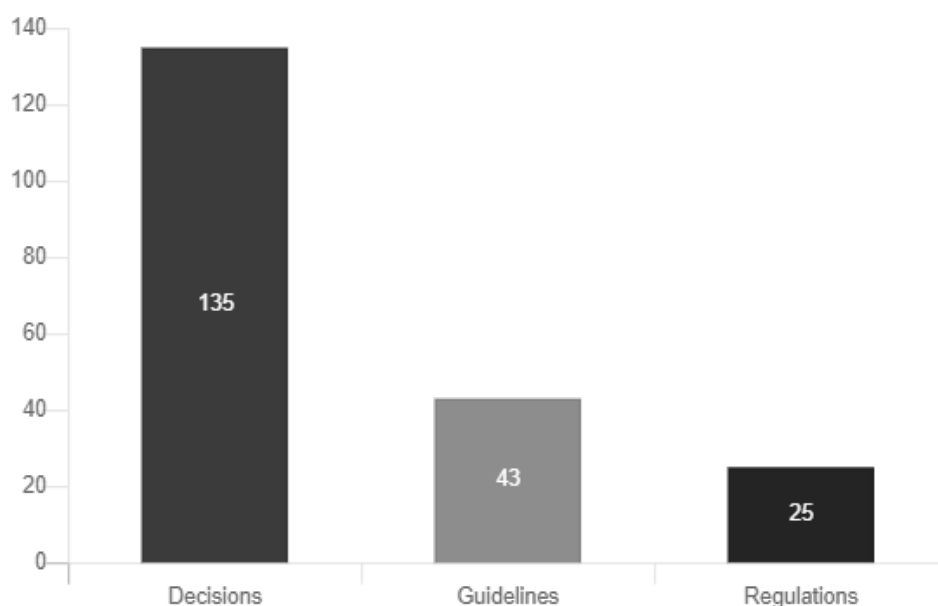
### 4.1 Exploring the ECB legal framework through the lens of the types of acts

Looking at the ECB legal acts and instruments published in EUR-Lex from a solely quantitative perspective can provide some insights on various issues. It can help us to understand how quickly the legal framework adjusts to the economic, financial and monetary challenges that the ECB has had to face. It can also help us to observe

trends in the types of acts more in use according to the legal domain regulated. Depending on the legal effects that a particular type of legal act has, it can underline how much is done at the ECB level to fulfil its mandate and how much is done at the level of the Member States in a particular area of law.

### Chart 1

ECB legal acts in force (regulations, decisions and guidelines).



Source: Eur-Lex  
Note: as of 1 September 2020

By sorting the legal framework in these categories, the foundation is there to go one step further and look for patterns in the underlying data. For example, it is possible to draw some insights about correlation between legal act type and the legal domain in which the ECB is active. Out of 25 regulations in force, the vast majority fall under two major fields – statistics (12) and banking supervision (7). By contrast, decisions are much more diversified, spreading across many different topics. Still, we can identify three topics that comprise approximately half of all decisions – institutional provisions (26), monetary policy and operations (23) and banknotes and coins (23) – to deal with matters involving the ECB's core tasks.

The ECB adopts other types of legal acts and instruments than the three represented in Chart 1 above. The most abundant type are the ECB's opinions on proposals for EU legislation and draft national legislation. They are not binding and in practice are addressed to the national or EU consulting authority. Thus, these were deemed to be a separate topic altogether and are examined at a later stage. Following a similar rationale, recommendations as non-binding acts were also left out of this overview.

Regulations as the legal act of highest order and direct impact was the category retained for this first visualisation. When it comes to general applicability and binding nature, regulations are joined by decisions and guidelines, as presented above.

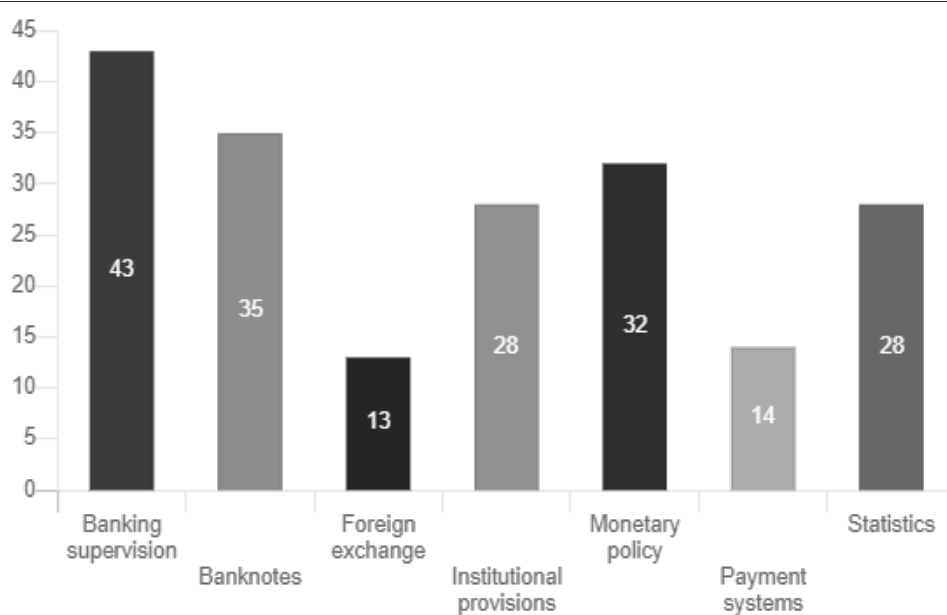
The interactive visual navigation means that users do not have to spend time learning how to use the advanced search function in EUR-Lex in order to access compilations with set parameters. Users can simply find the bar in the chart that matches their interest (via a combination of the most common parameters such as legal act type, subject matter topic or publication year), click on it and be redirected to the list of documents that are included in each bar's content. This logic applies all the graphs displayed in the ECB's visual navigation subpage on EUR-Lex.

#### 4.1.1 Exploring the legal framework from a topical perspective

The ECB adopts legal acts and instruments in several domains as displayed in Chart 2 below. It also adopts legal acts on institutional matters. To avoid overwhelming the user, the choice was made to focus on core areas of the ECB's mandate and to display these domains in alphabetical order. These cover the same domains as those appearing in the information architecture that can be found and navigated in the menu on the left on the ECB-dedicated pages in EUR-Lex.

**Chart 2**

ECB basic acts in force by legal topic



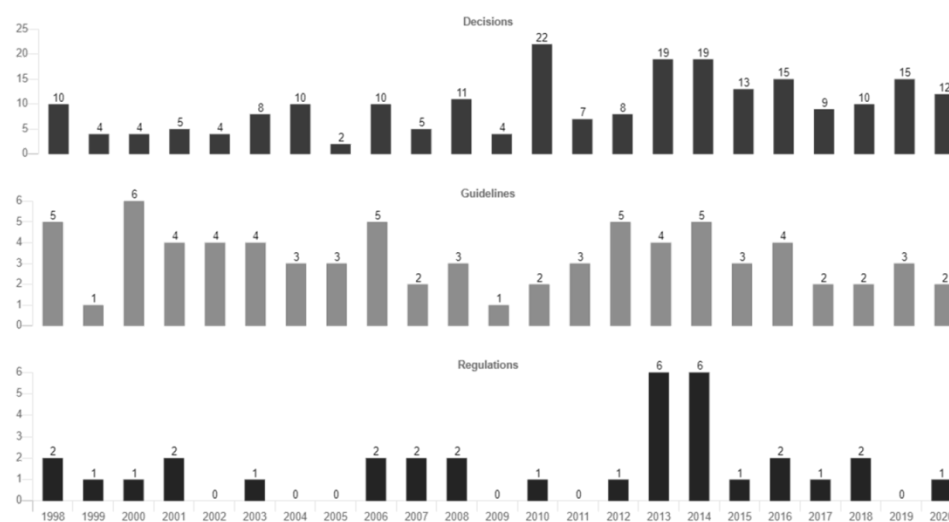
Source: Eur-Lex  
Note: as of 1 September 2020

Further exploration becomes possible when narrowing the analysis beyond the higher level, and future developments may require deeper and more detailed analysis.

A timeline view of the evolution of the ECB legal framework can be found in Chart 3 below.

**Chart 3**

**ECB legal acts year-by-year (regulations, decisions and guidelines)**



Source: EUR-Lex  
Note: as of 1 September 2020

Chart 3 is a kind of histogram of what has happened in the monetary, financial, economic and banking supervision fields over the last two decades. It shows the same three types of acts as in Chart 1, this time laid out over time, starting from 1998, when the European Monetary Institute (EMI) was transformed into the ECB. An additional driver was to mark the twentieth anniversary of the adoption of the euro as the common currency in 2020 (the visual navigation was rolled out on 15 June 2020). This provided an impetus to show the ECB’s legislative activity on a year-by-year basis.

In order to keep in check with our main guiding principle of “what would make most sense for users to see and access?”, it was concluded that clarity should be maintained by keeping amending acts and corrigenda out of the scope. To represent legislative activity over the past years, the “in force” parameter was left out. This means that the bars in Chart 3 would show all the binding acts allocated according to the relevant year of adoption, regardless of whether they have since expired or otherwise been repealed. The graphs rely in EUR-Lex data that are dynamically updated as new ECB legal acts are adopted and published.

The display chosen for Chart 3 is in line with the type of visualisation (vertical bars) established in Chart 1 and maintains its colour coding. This allows for consistency of the visual grammar so that users can, in an instant, find the type of legal act that they are interested in. One chart gives access to a list of active legal acts and the second one to historical developments.

#### 4.1.2 ECB legal opinions

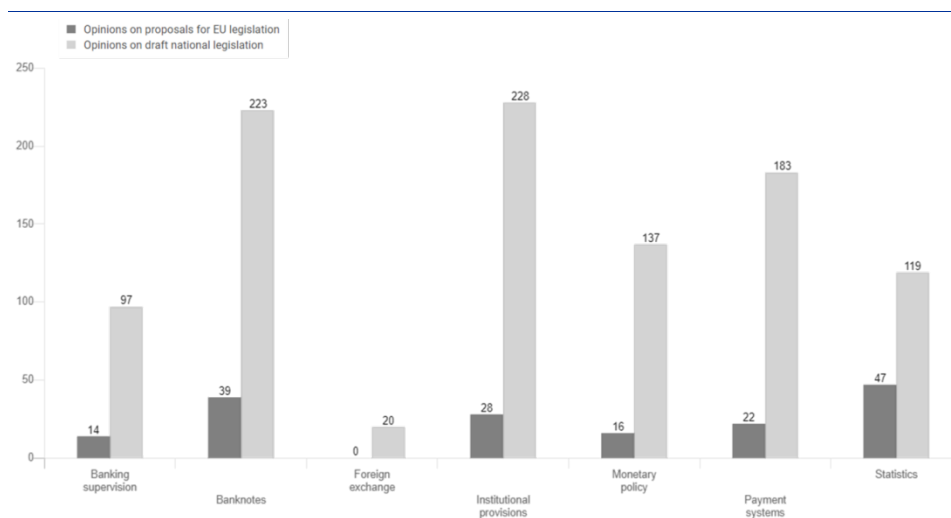
All relevant documents relating to ECB opinions are now published in EUR-Lex. This includes the draft national law (where relevant) and the technical drafting comments



accompanying some ECB opinions on proposed EU legislation. It may also include the letters to consulting authorities if they are issued.

As shown in Chart 4, ECB opinions cover the same legal domains as other ECB legal acts and instruments. However, the visual navigation offers a different view. First, it differentiates opinions on draft national legislation and draft EU legislation. Second, it gives an overview by legal domain: banking supervision, banknotes, foreign exchange, institutional provisions, monetary policy, payment systems and statistics.

**Chart 4**  
ECB opinions on different legal topics



Source: EUR-Lex  
Note: as of 1 September 2020

Finally, it also displays the number of opinions adopted by five-year periods as shown in Table 8.

**Table 8**  
ECB opinions over time

	EU opinions	National opinions
1998 - 2003	47	164
2004 - 2009	62	335
2010 - 2014	64	435
2015 - 2019	40	232
2020	2	17
<b>Total</b>	<b>215</b>	<b>1183</b>

Source: EUR-Lex  
Note: as of 1 September 2020

Combining these different views helps users to understand the activity and efforts invested by the ECB to contribute to building a coherent legal framework in Europe.

## 4.2 Making the most of EUR-Lex

For non-expert and advanced users, it is recommended to create a profile in EUR-Lex in order to benefit from its useful features. It is easy and convenient to create tailor-made collections of legal acts and instruments as well as case-law compilations.

Users can also download smart PDF topical compilation of documents which retain active links to the law and case-law in EUR-Lex. By having an active profile in EUR-Lex, the compilations can be saved to the profiles and are automatically kept up to date. Users can also set alerts to keep themselves informed about changes to the legal acts that matters to them.

The best practice is to avoid working from legal acts and instruments downloaded and saved on one's personal computer, which could rapidly become out of date, leading to errors in referencing.

## 5 Conclusion

Observation and experience as traditional ways of “knowing” by lawyers will be progressively complemented by technology able to apprehend an amount of data that no human mind can process in the same time and with the same results in terms of quantity, diversity and speed. Data and visualisation can help augment the capabilities of lawyers and thereby support them in delivering services to their clients.

While embracing digital advances, numerous questions remain open. Can the law be “data-ified” and for what purposes? What can be classed as “nice but useless” gimmicks, and what makes sense to work on and develop? Zeno-Zencovich (2018)<sup>8</sup> promotes caution in the way data and visualisation should be mobilised in the legal arena. There are pitfalls one needs to be aware of yet, using our critical minds, data and visualisation can add value to understanding and navigating the law. Developing a detailed understanding of the needs and interests of all parties involved – legislators, experts, academics and citizens – will enhance and facilitate progress in this new field for the greater good, enabling users to experience transparency and accountability in law-making.

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<sup>8</sup> See Zeno-Zencovich (2018).

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# Enhancing access to EU law: Why bother?

By **Dimiter Toshkov**<sup>1</sup>

In the past years access to EU law has been significantly enhanced via services such as EUR-Lex. This development not only allows for easy retrieval of individual legal acts, but for collecting information about the evolution of EU law in the aggregate as well. This contribution argues that by charting and analysing the evolution of the body of EU law over time, we can understand better the nature and development of the EU as a political system. The text examines the legislative productivity of the EU over the past 15 years as an illustration. Further, it showcases recent examples of the use of novel data-analytic techniques to analyse the body of EU law for the purposes of understanding the EU legal system, the institutions, and the polity that produced the legal acts. The contribution concludes by arguing that it is important to transmit basic facts and insights about the evolution of EU law and law-making to the general public as well, in order to counter the threat of Euroscepticism and perceptions of democratic deficit in the EU.

## 1 Introduction

In the past years access to EU law has been significantly enhanced. Services, such as EUR-Lex, the Legislative Observatory of the European Parliament, and the CURIA database of the Court of Justice of the European Union offer relatively easy access to thousands of legal acts, preparatory documents and case law produced by the EU institutions. EUR-Lex in particular has incorporated other databases (such as PreLex) and new classes of documents (such as national implementation measures) to build a vast and ever-so-complex library of legal and other acts related to the functioning of the EU, broadly construed as a multi-level system of governance.

These developments allow not only for easy retrieval of individual legal acts, but for collecting information about the evolution of EU law in the aggregate as well. Most of the time, as legal experts and social scientists, we tend to study individual legal acts: the processes leading to their adoption, their legal meaning and their practical implications. But law is also important in the aggregate. The evolution of the body of law in its totality can tell us a lot about politics and society. The pace of growth of legislative output is informative both about the expansion of the polity and about the health of its institutions. The varying distribution of the type of legal acts produced is indicative of broader changes of power between different institutions and levels of government. Analysing the changing density and types of linkages between different legal acts, jurisprudence and national implementing measures can provide insight about the shifting focus on legislative activities and policy actions.

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<sup>1</sup> Associate Professor at the Institute of Public Administration, Leiden University.

Studying the evolution of law in the aggregate is especially important when it comes to understanding a relatively young political organization, such as the European Union. Even if the first European Communities were established almost 70 years ago now, the EU as such is much younger, especially compared to its Member States. New polities face different challenges of gaining the legitimacy and trust of their citizens compared to established ones, where legitimacy comes through well-institutionalized socialization channels. Moreover, for young polities, the evolution of their law is extra relevant as an indicator of the expansion of their competences and the reach of their influence.

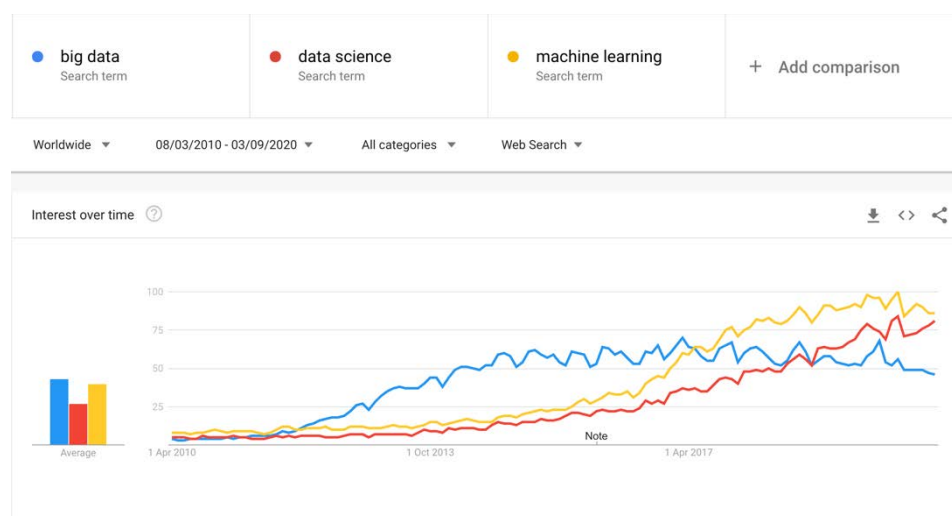
This contribution argues that by charting and analysing the evolution of the body of EU law over time, we can understand better the nature and development of the EU as a political system. To illustrate this, first, I examine the legislative productivity of the EU over the past 15 years in an effort to show the type of insights one can gain by considering EU law in the aggregate, as made possible by services such as EUR-Lex. Then, I review recent examples of the use of novel data-analytic techniques to analyse the body of EU law for the purposes of understanding the EU legal system, the institutions, and the polity that produced the legal acts. The contribution concludes by arguing that it is important to transmit basic facts and insights about the evolution of EU law and law-making to the general public as well, to counter the threat of Euroscepticism and perceptions of democratic deficit in the EU.

Much of what will be discussed comes at the intersection of law, social science and data science. The issues raised are similar to ones we can find under the rubrics of law and big data, natural language processing, machine learning and artificial intelligence. Even if the totality of EU law and related documents can reach into the millions of observations, the contribution avoids the term 'big data'. This is not only because the term 'big data' is getting out of fashion, as we can demonstrate with 'big data' from millions of Google searches (see Chart 1).

### Chart 1

#### Popularity of internet search terms for big data, data science, and machine learning

March 2010 – September 2020



Source: Screenshot based on data from Google Trends, retrieved 10 September 2020.

More importantly, the contribution argues that much insight can be gained by relatively simple methods, such as data visualization and established techniques for causal inference, that do not need to rely on state-of-the-art big data or artificial intelligence technologies employed elsewhere.

When it comes to the law, seeing the forest is as important as examining individual trees. Due to services such as EUR-Lex, this is becoming easier than ever, and in a climate of Euroscepticism, it is rather relevant as well.

## 2 Legislative productivity in the EU

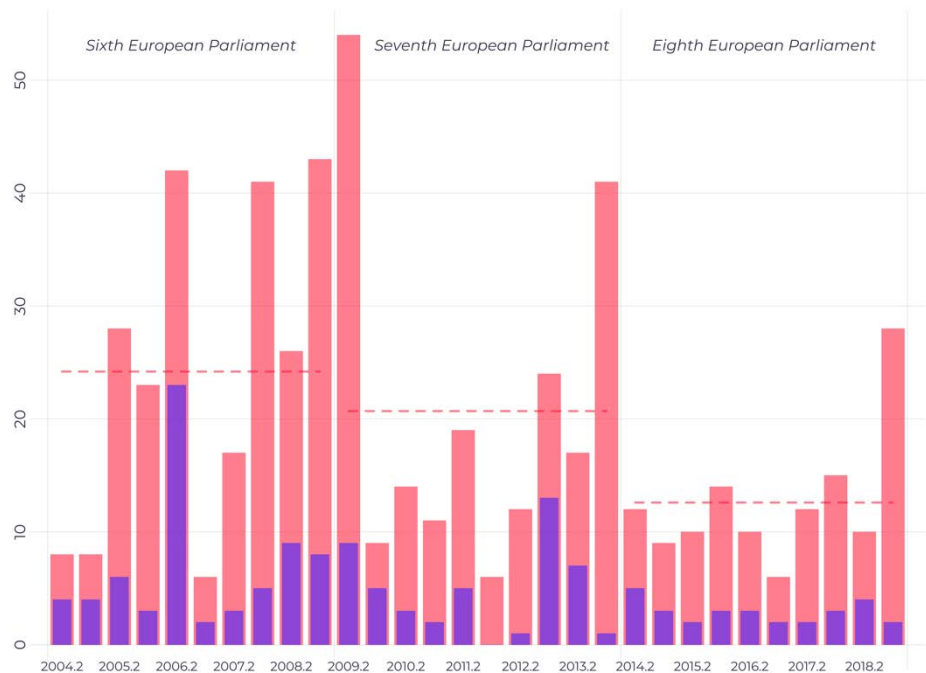
To illustrate the insights one can get from examining closely the evolution of EU law, this section looks into the trends in the number of different legislative acts produced over a period of 15 years, covering three different terms of the European Parliament (EP) and European Commissions.

The analysis aims to provide answers to simple questions, such as: How many important new laws has the EU adopted recently? Is the production of EU law ever-increasing? How is the mix of different legal acts changing?

### Chart 2

#### Legislative output of the European Union, 2004-2019: Directives

Blue bars show the number of directives adopted by the Council per semester. Red bars add directives adopted by the Council and the European Parliament (EP). The dashed horizontal lines show the averages per EP term.



Source: Own extraction from EUR-Lex, retrieved June 2019.

As will become clear shortly, the answers to these simple questions are anything but simple – much depends on subtle definitional differences, and the answers are often counterintuitive as well.<sup>2</sup>

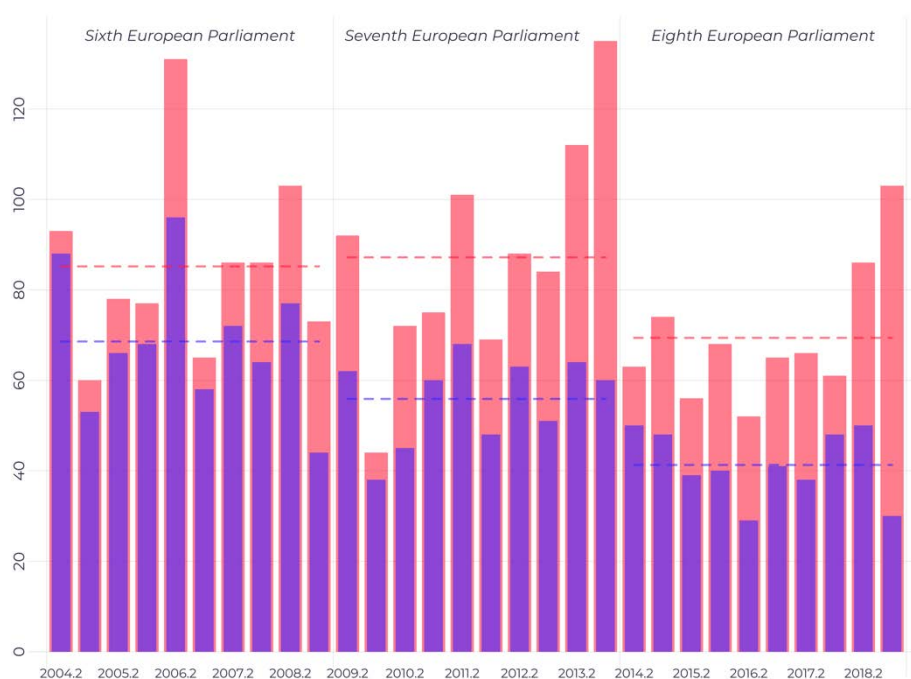
Chart 2 presents the evolution of directives between 2004 and 2019. Directives are a landmark type of legal act in the EU, which has been used before to give legal form to some of the most important initiatives of the EU in the past. The chart shows that there has been a significant drop in the number of directives adopted by the EP and/or the Council over the past 15 years. The drop had started already in 2009, but it is especially pronounced between 2014 and 2019 during the term of the 8th EP. The total number of directives adopted by the EP and the Council during the 6th EP term is 175, which drops to 161 during the 7th EP term, and to 97 for the 8th EP term.

Part of the decline in the number of adopted directives can be explained by a switch to regulations as a favoured legal form for important new legislation, which is a significant development, because directives provide EU Member States with more leeway about how exactly to implement the EU rules.

### Chart 3

#### Legislative output of the European Union, 2004-2019: Regulations

Blue bars show the number of regulations adopted by the Council per semester. Red bars add regulations adopted by the Council and the European Parliament (EP). The dashed horizontal lines show the averages per EP term.



Source: Own extraction from EUR-Lex, retrieved June 2019.

But the shift from directives to regulations is not enough to account for the overall drop in legislative productivity. When we look at regulations (Chart 3), we also see a drop.

<sup>2</sup> This section draws on my [blogpost](#) 'Is the legislative expansion of the European Union grinding to a halt?', available at EUROPP European Politics and Policy.

The total number of regulations adopted by the Council and/or the EP in the period 2004-2009 is 852, which falls to 694 in the period 2014-2019 (the drop is due mostly to the decrease in the number of regulations adopted by the Council alone).

The pattern is more complex when it comes to decisions, which comprise a very diverse set of legal instruments under the same label – some have general applicability and others have a specific addressee, many are limited in their duration, and a large part concern matters of rather narrow interest.

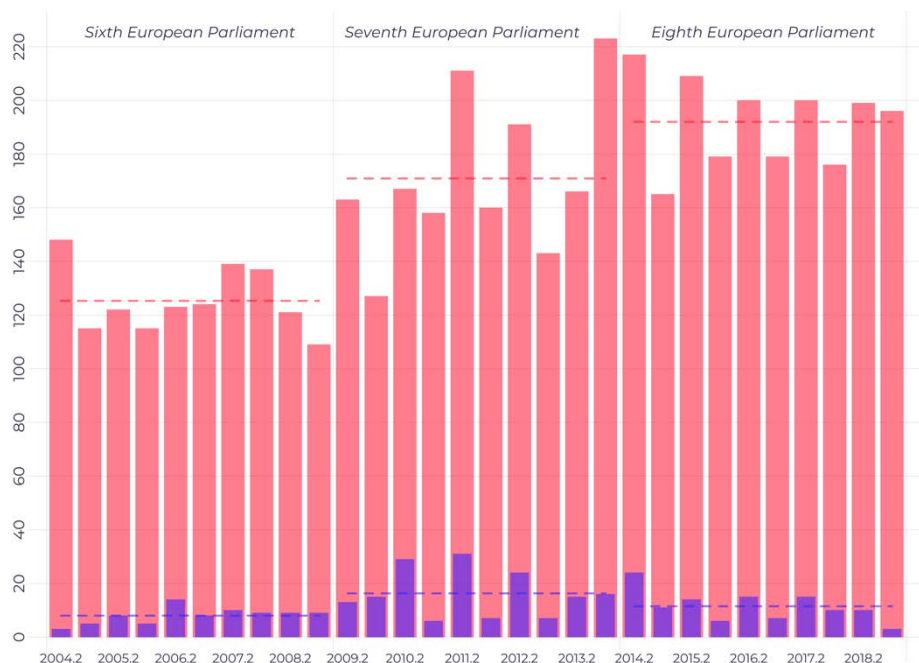
Chart 4 shows two diverging developments: the number of Council-only decisions increases significantly (from 1,173 to 1,546 to 1,805 over the past three EP terms), but the number of decisions adopted with the involvement of the EP decreases (from 163 in the period 2009-2014 to 115 in the period 2014-2019).

Overall, the conclusion that appears is that the 8th EP has not been very productive, in terms of legislation, having adopted 493 legal acts, for a 23% decline from the 637 adopted by the previous 7th EP. Even more importantly, over the five years of its tenure the 8th EP has adopted only 59 new, rather than amending, directives and regulations (for 2009-2014, the number is 95), as Chart 5 shows.

#### Chart 4

##### Legislative output of the European Union, 2004-2019: Decisions

Blue bars show the number of decisions adopted by the Council per semester. Red bars add decisions adopted by the Council and the European Parliament (EP). The dashed horizontal lines show the averages per EP term.



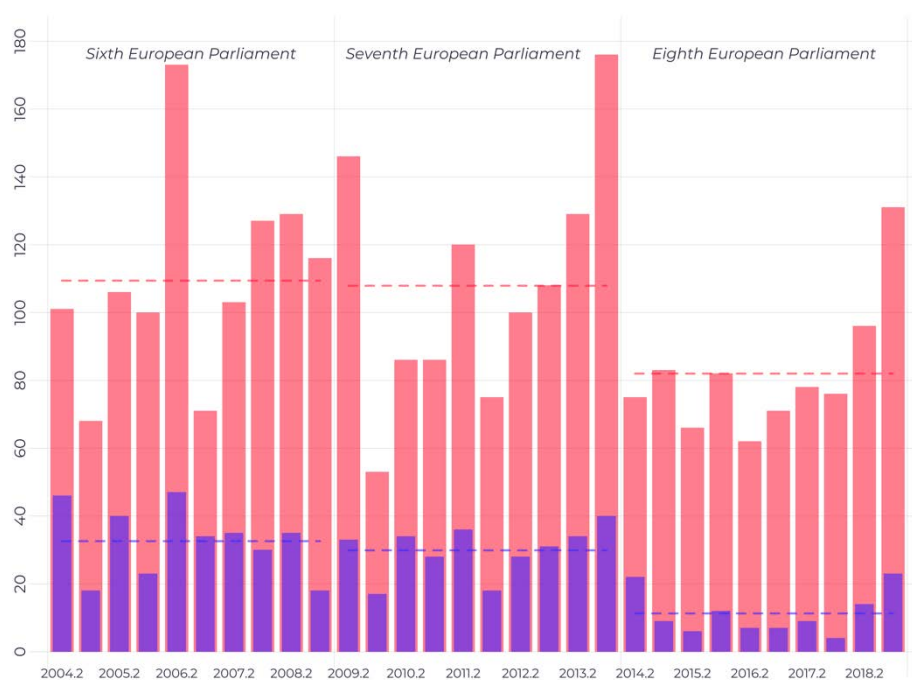
Source: Own extraction from EUR-Lex, retrieved June 2019.



## Chart 5

### Legislative output of the European Union, 2004-2019: New and amending main acts

Red bars show the number of directives and regulations adopted by the EP and/or the Council. Blue bars show only new (non-amending) acts. The dashed horizontal lines show the averages per EP term.



Source: Own extraction from EUR-Lex, retrieved June 2019.

A new legal act indicates that the EU is legislating in a new area, while amending legislation only modifies rules in areas where the EU already has established its presence. In other words, the great deal of legislative activity in the past five years has gone into maintaining and updating existing legislation rather than expanding the reach of the EU into new areas and issues.

We can sum up the results of the exploration of legislative production in the EU so far: (1) overall, legislative productivity in the EU is declining over the past decade; (2) directives, as an important legal act unique to the EU, are used much less often than before, (3) there are very few new (non-amending) acts adopted, which indicates a slowdown if not a halt of the expansion of the EU into new areas of regulatory activity.

These are important results that shed the recent evolution of the EU in new light, but some caveats are necessary. First, the quantity of legislation is not necessarily an indication of importance. That's why it is important to consider different types of legislation separately. In the social scientific literature there are also attempts to quantify the importance of legislation, for example by reference to the recitals preceding the legal text or to the prominence of the legal act in the media. But none of these attempts are entirely successful in measuring such a slippery concept.

Second, the reduction in legislation produced can be considered a conscious strategy on behalf of the European institutions to decrease regulatory red tape. Such a

development is in fact in line with the proclaimed goals of the [Better Regulation](#) programme of the European Commission, which aims to reduce the regulatory burden and simplify legislation. However, the number of legislative proposals that have been scrapped as a direct result of the programme is very small, and even these might have been blocked for political reasons before being abandoned in the name of better regulation. Moreover, regulatory simplification often *demands* legislative action in order to amend existing acts or adopt new legislation.

More generally, the numbers and trends presented above invite questions about what explains the changes in legislative output of the EU over time. There is no shortage of potential answers, in addition to the deregulation initiatives of the Commission, such as (a) less effective political gamesmanship of the Commission in shepherding legislative proposals through the inter-institutional decision-making procedures in the EU; (b) political gridlock in the Council of Ministers, which now brings ministers from countries and political parties with ever more diverse preferences; or (c) the increasing (until recently) Euroscepticism of the general public in many EU Member States.

Using aggregate data on EU law, some of these hypotheses have been explored, and intriguing relationships have been found between, for example, public opinion and legislative productivity in the EU. The next paragraph will briefly review some of these studies to illustrate how insights provided by data visualization and exploration generate more formal work examining the causal relationships behind the trends.

For example, there is by now a large literature in political science that studies policy responsiveness in the EU: the relationship between public support for (further) integration and legislative output, as an indicator of the expansion of EU competences and activities. Using vector autoregression (VAR) models, Toshkov (2011) finds that up until the mid-1990s there was a rather close correspondence between the shifts in public support for European integration and the amount of new important legislative acts produced by the European institutions. Importantly, shifts in public opinion were predictive of shifts in legislative production, but not the other way round. And the relationship becomes much weaker in the 2000s. These results have been confirmed by additional studies by Bølstad (2015) and others, who have looked into the responsiveness to public opinion of particular institutions, such as the Council (Hagemann et al. 2017) or the Commission (Häge & Toshkov 2011, Williams and Bevan 2019) or in individual policy areas (Rauh 2019, Rauh 2020).

A related literature examines the factors that explain agenda setting – the process of societal problems gaining the attention of policy-makers before they can be addressed with legislative and other policy measures. Data used for studies of agenda setting look into the proposals for legal acts made by the European Commission or the content of the conclusions of the European Council (Alexandrova et al. 2016). Using statistical methods, these studies find that both structural factors (such as rising inflation, unemployment or immigration pressures) as well as public perceptions of the importance of different problems influence the agenda of the European institutions.

The legislative and other activities of the European Central Bank (ECB) have not been examined in such analyses of agenda setting, public responsiveness, and legislative

productivity, but given the trends in trust in the ECB (Bergbauer et al. 2020), it would be intriguing to see what the analyses will show.

### 3 Analysing the body of (EU) law with new data-analytic techniques

The studies discussed in the previous section make use of the data on EU legislation and other documents, such as European Council conclusions, and they rely on the opportunities offered by EUR-Lex and other databases to create time-series of particular types of legal acts that operationalize appropriately the theoretical constructs of interest (e.g. important new laws). But increasing ease of access to the body of EU law, including the texts of the legal acts, allows for more complex analyses as well, which make use of novel data-analytic techniques for network analysis, natural language processing (NLP), automated classification, and others. In this section of the contribution, I will briefly present examples of such analyses, with the aim to showcase what is already possible to do with data on EU law and to indicate promising avenues for future research.

In a recent article in *European Union Politics*, Fjelstul (2019) introduces a dataset of EU legislation retrieved from EUR-Lex and other sources that contains over 365,000 documents with more than 900,000 connections between them. He models the body of EU law as a network and examines connections between primary law, secondary law, EU and national case law, and national implementing measures. Koniaris et al. (2018) present a different way of using network analysis in the legal domain by building a model based on EU legal sources.<sup>3</sup>

In another application of network analysis, Senninger et al. (2020) study the coordination patterns inside the European Commission by looking at the interrelationships between DGs based on the coordination of legislative proposals. They find that in some cases, the role distribution in coordination tasks is highly skewed (e.g. between DG SANTE and DG GROW), while in other cases it is more evenly balanced (e.g. between DG CNECT and DG MOVE).

One important area of research in EU studies is the study of implementation of EU law. Legal transposition is a step in the process of implementing EU directives, which has created significant difficulties for national administrations to conduct and for the European Commission to monitor. One of the challenges is related to identifying national legislation that is relevant to the transposition acts and to compare the texts of the EU legislation and the national transposition acts. Nanda et al. (2019) use unsupervised and supervised text similarity systems for automated identification of national implementing measures of European directives. The results are far from perfect but indicate some promise.

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<sup>3</sup> Some of the efforts to connect different parts of the EU universe of legal and other documents do not seem to be functional or updated anymore, e.g. the ones described in Agnoloni et al. 2017 and Winkels 2019 (last checked September 2020).

Scholars have developed measures for text similarity between documents and have devised methods for automatically scoring large collections of texts based on their similarity. These have been applied to the study of jurisprudence changes, for example in analysing the German Constitutional Court's opinions on Europe (Dyevre 2020). Some of these methods provide relatively high correlations with expert scores assessing the same phenomena of interest. Text similarity can also be compared to the similarity of citation networks of the different legal acts to assess the 'distance' between them (Moodley et al. 2019).

One important area of ongoing research at the intersection of law and data science is the automatic classification of legal acts into substantive (policy) categories and classes (Filtz et al. 2019, Chalkidis et al. 2019). The rich meta-data contained in EUR-Lex, as well as the use of LEI (legislative identifiers, see Francart et al. 2019), provide a useful testing ground for the development and assessment of such methods. Again, results are promising, although in absolute terms these methods still do not provide very reliable output.

Another area of interest supported by NLP is the analysis of sentiment of (transcribed) speeches and other texts. For example, Schumacher et al. (2016) analyse the positive and negative emotions contained in speeches of European political elites, including the presidents of the ECB and the European Council. They also examine whether structural factors, such as economic growth impact (in different ways) the sentiment expressed in speeches of leaders of different institutions. Baerg (2020) examines in a recent book how and why central bankers change their speech, and the effects of these on economic phenomena.

Sentiment analysis has also been used to study the rhetoric of European executives with regard to European integration (Rauh et al. 2019). The findings are that European Commissioners on average employ more positive language than national leaders. The language used by national leaders, but not of Commissioners gets more negative as public Euroscepticism increases during the Euro Crisis. With regard to the complexity of messages, however, over the course of the Euro Crisis the messages of national leaders have become much clearer, while those of the EU Commissioners have not.

Another challenge for empirical research at the intersection of law and political science is the measurement of discretion, or the amount of leeway contained in the provisions of different legal acts. While scholars have developed measures of discretion and applied these to the manual scoring of legal documents, there are recent efforts to use NLP for the same goal (Hurka and Steinebach 2020). In a related effort, Anastasopoulos et al. (2020) use a supervised machine learning (ML) framework to identify legal provisions that delegate authority or impose constraints on national administrations and the EC. NLP has also been explored as an option facilitating the analysis of compliance with financial reporting regulation by automated analysis of financial texts (Lewis and Young 2019).

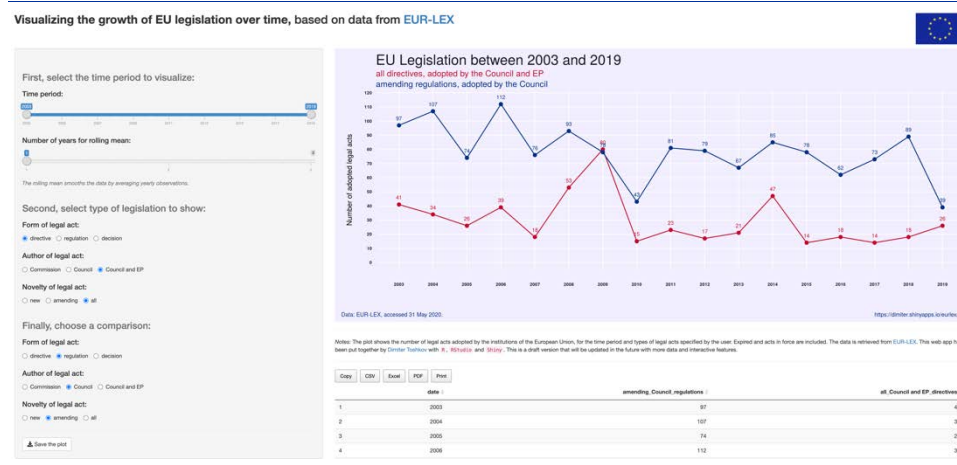
Machine learning has also been used to predict court decisions, so far with rather limited success, for example when it comes to decisions of the European Court of Human Rights (Medvedeva et al. 2020).

While EUR-Lex provides excellent built-in search functions, it is still difficult to access the database programmatically (with scripts rather than manually) to retrieve search results. A recent, new package for the popular software for statistical computing and data analysis R aims to change this by providing access to EUR-Lex from within R (Ovadek 2020). This is a promising development because it can save researchers efforts to export search results from EUR-Lex before having to import them in R (or other software for analysis and visualization), with the associated risks of errors. Provided that the functions in this package offer complete and reliable access to the data in EUR-Lex, it can speed up considerably the process from research idea involving the analysis of EU law to the final research output.

An example of the possibilities to engage with the body of EU law from within R, I have developed a prototype interactive data visualization of EU law with the help of Shiny: another R package for building interactive web apps. Chart 6 shows a screenshot from the app, which is available at <https://dimiter.shinyapps.io/eurlex/>. The user can specify the time period of interest (for now between 2003 and 2019), the form of the legal act to show (directive, regulation or decision), the author (Commission, Council, or Council and EP acting together), as well as the novelty (new or amending). In the future, more functionality will be added (for example, filtering by subject area of the legal act) and the scope of the data will be extended to cover a longer time period and acts produced by other institutions, such as the European Central Bank.

**Chart 6**

### An interactive web app for exploring the evolution of EU law



Source: Based on data extracted from EUR-Lex, retrieved June 2019.  
 Note: This is a screenshot from the interactive app, which is available at <https://dimiter.shinyapps.io/eurlex/>

## 4 Conclusion

In the legal profession, there is a deep and, overall, well-justified distrust of big data applied to Law. In an influential article, Devins et al. (2017) state: ‘What Big Data offers is, in many ways, opposed to rule of law traditions’ (p. 360). This verdict is indeed quite appropriate for many hasty applications of big data or machine learning methods to areas of interest to the Law, such as for predicting sentencing in the US. However, it should not be taken to mean that analysing the body of law in the aggregate cannot

deliver inferences about the political systems that produce the laws and the societies that need to apply them. To the contrary, we can, and should, use responsibly new open data and data-analytic techniques to gain insights about the law. Hopefully, this contribution provided convincing demonstrations of the potential of such applications.

When it comes to the case of the EU, it is even more important that we communicate the basic facts about the nature and evolution of EU laws and policies to the broader public, and not only to the audience of legal experts, policy-makers and social scientists.

Whatever we think about the causes and solutions to the perceived lack of legitimacy of the EU and its institutions among broad segments of the European population, it is undeniable that this perceived democratic deficit constrains in important ways the future of European integration. Regular people (including young people and students) know very little about the EU, as surveys of public opinion such as Eurobarometer, regularly show. Citizens lack basic knowledge about the institutions, about how EU rules are made (and by whom), and it can only be expected that they know even less about the evolution of EU legislative output over time. Yet, lack of knowledge leads to widespread stereotypes, for example that the EU is run by faceless bureaucrats in Brussels, and misperceptions, for example that the number of EU rules is growing all the time.

Such misperceptions fuel Euroscepticism and distrust in the EU, undermining the process of European integration. In this respect, providing easier access to EU law is an important step in a process that can make the EU and its activities more familiar to experts and to citizens as well. New applications of data-analytic techniques such as network analysis, automated natural language processing, and AI-powered classification can provide knowledge about the inter-connectedness of the universe of legal documents and how its evolution interacts with the broader social and political contexts. But simpler things, such as data visualization, can provide a fresh look onto the EU as well, especially if provided in an engaging way.

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## Panel 2

Benchmark rate transition and continuity  
of contracts: UK, US and EU  
developments



Bram van der Eem

European Central...



SHARP

# Introduction to the panel on benchmark rate transition and continuity of contracts: UK, US and EU developments

By Bram van der Eem<sup>1</sup>

Two years ago, at the 2018 edition of the ESCB Legal Conference, we discussed the role of central banks as benchmark administrators.<sup>2</sup> Now as then, despite the current extraordinary circumstances, benchmark rate reform remains globally one of the most hotly debated financial law topics. However, in the meantime we have reached the next phase of the reform process.

So, let us remind ourselves of what is at stake. As is generally acknowledged, benchmark rates are essential for the smooth functioning and efficiency of financial markets. They are referenced in many financial contracts such as mortgages, money market contracts, floating rate securities and derivative instruments. They are also used to value balance-sheet items. The number and volume of the different types of contracts which reference benchmark rates is extremely high. It has for instance been estimated that the EURIBOR<sup>3</sup> underpins more than €180,000 billion worth of contracts.<sup>4</sup> As regards LIBOR, the Federal Reserve System has estimated that it is being used in contracts with a staggering value totalling USD 200 trillion.<sup>5</sup>

It is unsurprising that benchmark rates are also important for central banks. This is so because the rates are used for the operationalisation and monitoring of the transmission of their monetary policy. Besides, the existence of properly functioning benchmark rates is also considered to be of key importance for financial stability. The absence of robust and reliable benchmarks might trigger financial market disruptions with, in turn, a possible significant adverse impact on the transmission of monetary policy decisions and the ability of central banks to contribute to the smooth conduct of policies relating to the stability of the financial system.<sup>6</sup>

Cases of malfunctioning of benchmark rates in the past have laid bare their shortcomings and set in motion a reform process involving both public authorities and the private sector.<sup>7</sup> A first phase with several investigations led to recommendations on how to address the identified weaknesses<sup>8</sup> and the publication by the Board of the International Organization of Securities Commissions (IOSCO) of its 2013 report

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<sup>1</sup> Head of Section, Financial Law Division, Directorate General Legal Services, European Central Bank.

<sup>2</sup> European Central Bank (2018).

<sup>3</sup> EURIBOR – euro interbank offered rate. LIBOR – London interbank offered rate.

<sup>4</sup> See the European Money Markets Institute's webpage: [About EURIBOR](#) (last visited in December 2020).

<sup>5</sup> See the Federal Reserve Bank of New York's webpage: [Transition from LIBOR](#) (last visited in December 2020).

<sup>6</sup> See the European Central Bank's webpage: [What are benchmark rates, why are they important and why are they being reformed?](#) (11 July 2019).

<sup>7</sup> van der Eem (2018).

<sup>8</sup> See most notably Financial Stability Board (2014).

entitled “Principles for Financial Benchmarks”<sup>9</sup>. These principles serve as a set of best practices for benchmark administrators and contributors of data for the production of benchmarks, while constituting also a global standard followed by local legislators and regulators when adopting binding regulations for their jurisdictions.

This was followed by the introduction of binding legislation in several jurisdictions. The 2016 EU Benchmark Regulation<sup>10</sup> established a regulatory framework for benchmarks applicable across the European Union, with rules aimed at improving the governance of the benchmark process, enhancing the quality of input data and methodologies used by administrators and establishing a regime for the authorisation, registration and supervision of benchmark administrators, as well as a third country regime. Only administrators that comply with the Regulation can be authorised and/or included in a register maintained for that purpose by the European Securities and Markets Authority (ESMA). Financial markets, in turn, are in principle only allowed to use benchmarks provided by administrators registered accordingly.

As it became clear that administrators of several important benchmark rates faced significant challenges to ensure the sustainability of their rates in compliance with the newly adopted regulatory frameworks, and in view of the importance of interest rate benchmarks for monetary policy transmission and financial stability, central banks deemed it necessary to step in and develop their own alternative risk-free rates to complement existing benchmarks and serve as backstops. An example of this is the euro short-term rate (€STR), which the ECB has been publishing since October 2019.<sup>11</sup> Similarly, since 2016, the Bank of England is the administrator of the sterling overnight index average (SONIA), a widely-used interest rate benchmark and the reference rate for sterling overnight index swaps<sup>12</sup>. Meanwhile, the Federal Reserve Bank of New York has extensive experience in serving as an administrator and producer of reference rates, having done so since the 1950s.<sup>13</sup>

In Europe, the working group on euro risk-free rates, a private sector working group for which ESMA, the Belgian Financial Services and Markets Authority, the European Commission and the ECB act as observers, recommended in September 2018 that the €STR be used as the risk-free rate for the euro area.<sup>14</sup> The working group was established to identify and recommend risk-free rates that could serve as an alternative to current benchmarks used in financial instruments and contracts in the euro area. Since its recommendation for the €STR, it has shifted its focus to supporting the market with the transition to the €STR. Similar working groups have also been established in other countries, such as the United States and the United Kingdom.

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<sup>9</sup> IOSCO (2013).

<sup>10</sup> Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

<sup>11</sup> The €STR is governed by Guideline (EU) 2019/1265 of the European Central Bank of 10 July 2019 on the euro short-term rate (€STR) (ECB/2019/19) (OJ L 199, 26.7.2019, p. 8). See also [Overview of the euro short-term rate \(€STR\)](#) on the ECB's website.

<sup>12</sup> See the Bank of England's webpage: [SONIA interest rate benchmark](#).

<sup>13</sup> See the Federal Reserve Bank of New York's webpage: [Reference Rates](#).

<sup>14</sup> See the ECB's webpage: [Working group on risk-free rates](#).

This brings us to the current phase of benchmark reform on which the panel discussions focus: the benchmark rate transition process. Put simply, the issue here is how it can be ensured that the references to a specific benchmark rate (such as LIBOR or EONIA<sup>15</sup>) used for pricing in millions of contracts and transactions can be changed into a reference to another benchmark interest rate without this causing major disruption and without a wave of litigation. This question, which may at first sight seem straightforward, has caused sleepless nights and headaches for many in the financial sector, supervisors and lawmakers alike.

Both the private and public sectors are playing their part to foster a smooth transition process, with market working groups established under the aegis of public authorities, such as those referred to above, supporting the market, while legislators are also actively considering and implementing reforms to support transition. In this respect several issues still need to be conclusively resolved. How will smooth transition mechanisms and continuity of contracts be ensured? What respective roles will market participants, legislators and other public authorities play? How will the regimes in the different jurisdictions interact? How can a wave of litigation be avoided?

These are all very interesting questions to be discussed in the contributions by Sarah Jane Hlášková Murphy, Iliana Lani, Joanna Perkins and Thomas Baxter. Sarah Jane sets the scene from an EU perspective and zooms in specifically on the contractual aspects of the ongoing transition. Iliana discusses the respective roles of market participants, supervisors and the legislator in the transition process in the EU. Joanna considers the transition process from the UK perspective and, finally, Thomas focuses on the dollar reference rate transition.

Let me conclude with a health warning for the readers of this conference book. What we address here is an area in full motion with further material developments expected to occur the coming time. These contributions should therefore be understood as a snapshot. Perhaps we can once more take stock of our topic in two years' time, hopefully then under more benign circumstances.

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<sup>15</sup> EONIA – euro overnight index average.







# Benchmark rate transition and continuity of contracts: EU developments

By Sarah Jane Hlásková Murphy<sup>1</sup>

Following the initiation of investigations and enforcement actions regarding serious cases of benchmark manipulation and the decline in liquidity in key interbank unsecured funding markets, we have seen a number of significant changes in the landscape in which benchmarks are administered, used and supervised in global financial markets.

In 2014 the Financial Stability Board (FSB) published a series of recommendations to reform and strengthen major interest rate benchmarks<sup>2</sup>, supported by a report of the Market Participants Group.<sup>3</sup> Following the recommendations of the FSB to reform interbank offered rates (IBORs), central banks have stepped in to provide risk-free rates. The European Central Bank (ECB) launched its own risk-free rate – the euro short-term rate (€STR) in October 2019, following action taken by the Federal Reserve Bank of New York, the Bank of England and the Bank of Japan, among others. In addition, central banks, in cooperation with regulatory authorities and the private sector, have established working groups to recommend potential alternatives to IBORs and to propose strategies for a smooth and effective transition to new risk-free rates and for dealing with legacy contracts. In this changing landscape, policymakers have kept under review the legislative framework that governs provision and use of interest rate benchmarks and the role of the authorities competent for supervision and enforcement.

Against this background, there are a number of legal issues which warrant close consideration. First, what conditions need to be met for a smooth transition from IBORs to alternative rates to support continuity of contracts, ensure compliance with regulatory requirements and minimise the risk of legal challenge and litigation? Second, what role should be played by the legislator? In particular, what implications do legislative changes have for the other stakeholders, including the private sector, central banks and regulatory authorities? In this chapter, I will analyse these questions from an EU perspective, noting that colleagues from the United States and the United Kingdom will contribute from the perspective of their own jurisdiction. Iliana Lani from the European Securities and Markets Authority (ESMA), in her paper “The role of market participants, supervisors and legislators in interest rates reform”, also explores the issues in the EU from her perspective as a supervisor.<sup>4</sup>

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<sup>1</sup> Lead Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> Financial Stability Board (2014), [Reforming Major Interest Rate Benchmarks](#).

<sup>3</sup> Market Participants Group on Reforming Interest Rate Benchmarks (2014), [Final Report](#).

<sup>4</sup> ESCB Legal Conference 2020.

# 1 Background

Before turning to the legal analysis, it is important to take account of the key developments which have taken place in the European Union in order to reform interest rate benchmarks, as well as to support the transition to new risk-free rates and the continuity of legacy contracts. This update is provided and reflects developments as at September 2020.

## 1.1 Review of the Benchmarks Regulation

The first key development was the enactment by the European Parliament and Council of the Benchmarks Regulation,<sup>5</sup> together with the preparation of a range of implementing and delegated acts<sup>6</sup> based on the Benchmarks Regulation. The Benchmarks Regulation has already been amended twice, namely to introduce a regulatory framework laying down minimum requirements for EU Climate transition benchmarks and EU Paris-aligned benchmarks at Union level<sup>7</sup> and to appoint and grant ESMA the necessary powers to act as the authority competent to supervise administrators of critical benchmarks *from 1 January 2022* and to recognise third-country benchmark administrators.<sup>8</sup>

The European Commission also commenced a review of the EU rules on financial benchmarks, launching a public consultation in the fourth quarter of 2019 and a roadmap for feedback in March and April 2020. The aim of the proposal was twofold: (i) to ensure a smooth transition to reformed and/or replacement rates set by central banks; and (ii) to ensure that EU businesses making use of benchmarks published outside the European Union can continue to have access to those rates.<sup>9</sup>

In July 2020 the Commission published the outcome of this review – a proposal for a regulation to amend the Benchmarks Regulation.<sup>10</sup> The proposal recognises that the cessation of LIBOR<sup>11</sup> has become a realistic prospect, with the UK Financial Conduct

<sup>5</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation EU No 596/2014 (OJ L 171, 29.6.2016, p. 1).

<sup>6</sup> Note a total of nine Commission Implementing acts and 14 Commission Delegated Regulations in force based on the Benchmarks Regulation.

<sup>7</sup> Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (OJ L 317, 9.12.2019, p. 17).

<sup>8</sup> Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds (OJ L 334, 27.12.2019, p. 1).

<sup>9</sup> European Commission (2020a), [Inception Impact Assessment](#).

<sup>10</sup> European Commission (2020b), [Proposal for a Regulation of the European Parliament and of the Council amending Regulation \(EU\) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation](#).

<sup>11</sup> LIBOR (London interbank offered rate).

Authority (FCA) communicating its intention to stop supporting contributions to LIBOR after 2021 through its influence or legal powers.<sup>12</sup> Although the Benchmarks Regulation grants powers to competent authorities to inhibit the sudden cessation of a critical benchmark,<sup>13</sup> it does not address the risks to continuity of contracts that arise from cessation itself. To mitigate the risk of contractual uncertainty and frustration and the ensuing risk to financial stability, the Commission now proposes amendments to the Benchmarks Regulation that will empower it to designate a replacement benchmark where the cessation of publication may result in significant disruption in the functioning of financial markets. The replacement benchmark would replace all references to the benchmark that has ceased to be published by operation of law where the relevant financial instruments, contracts or performance measurements for an investment fund contain no suitable fallback position. When designating a replacement benchmark, the Commission would be required to take into account the recommendation by the alternative reference rate working group. In addition, the proposal would amend the Benchmarks Regulation to empower the Commission to designate certain foreign exchange benchmarks that are administered outside the European Union. As these would fall outside the scope of application of the Regulation, EU users could continue to use them after the transition period.

This chapter will evaluate the implications of the Commission's proposal on designation, as published in July 2020, in Section 3 below. It is of course noted that the proposal is expected to change in the course of the legislative procedure.

## 1.2 Reform of the interest rate benchmarks denominated in euro

The second key development is the work undertaken to reform or replace interest rate benchmarks denominated in euro. Like the US and UK authorities, the ECB, together with the European Commission and ESMA, has been closely involved in long-running work in support of efforts to reform EONIA and EURIBOR<sup>14</sup>. It became, however, clear that the administrator of EONIA and EURIBOR, the European Money Markets Institute (EMMI), faced significant challenges to ensure the compliance of these critical benchmarks with the requirements of the Benchmarks Regulation. The Governing Council of the ECB announced in September 2017 that it would develop a euro unsecured overnight interest rate based on money market statistical data already available to the Eurosystem.<sup>15</sup> The decision was firmly grounded in the important anchoring role that benchmarks play in contracts in financial markets and in the operationalisation and monitoring of the transmission of the ECB's monetary policy. The "euro short term rate", or €STR, has been published since 2 October 2019, in accordance with the ECB's Guideline on the euro short-term rate.<sup>16</sup>

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<sup>12</sup> Bailey, A. (2017), [The future of LIBOR](#); Bailey, A. (2019), [LIBOR: preparing for the end](#); Schooling Letter, E. (2019), [Next steps in transition from Libor](#).

<sup>13</sup> Benchmarks Regulation, Article 21 (Mandatory administration of a critical benchmark) and Article 23 (Mandatory contribution to a critical benchmark).

<sup>14</sup> EONIA (euro overnight index average); EURIBOR (euro interbank offered rate).

<sup>15</sup> See the [decision of 20 September 2017](#) regarding provision by the Eurosystem of a new unsecured overnight interest rate and ECB (2017), [press release](#).

<sup>16</sup> Guideline (EU) 2019/1265 of the European Central Bank of 10 July 2019 on the euro short-term rate (€STR) (ECB/2019/19), OJ L 199, 26.7.2019, p. 8.

### 1.3 Working Group on euro risk-free rates

Following the Governing Council's decision, the ECB was also involved in establishing the working group on euro risk-free rates<sup>17</sup> (WG RFR) in February 2018, together with the Financial Services and Markets Authority (FSMA), ESMA and the European Commission. These public institutions have observer status in the working group, which is led by the private sector, comprising 21 credit institutions as voting members. The group recommended on 13 September 2018 that the €STR be used as the risk-free rate for the euro area and is now focused on supporting the market with the transition.<sup>18</sup>

### 1.4 Reform of EONIA

Transition efforts in the European Union were initially focused on the replacement of EONIA with the €STR. As a risk-free rate, the €STR is not a direct substitute for EONIA, which measured interbank lending using a different methodology and data. The simple replacement of EONIA with the €STR would result in a change in the valuation of the transactions and contracts tied to the rate. To address this issue, there is a need for a "spread adjustment" to reflect the difference between the two rates. In order to facilitate the move by market participants to replace EONIA with the €STR, the WG RFR recommended that EMMI reform the EONIA methodology from its panel-based methodology to the €STR plus a spread for a limited period of time.<sup>19</sup> In line with this recommendation, EMMI has published EONIA under this reformed methodology since 2 October 2019 and will continue to do so until 3 January 2022, when the recalibrated EONIA will be discontinued.<sup>20</sup>

### 1.5 Reform of EURIBOR

The transition for EURIBOR has, however, followed a very different path. Although the FCA has announced that firms cannot rely on the continued publication of LIBOR as a reference in financial contracts as the current voluntary agreement between the FCA and LIBOR panel banks will end after 2021,<sup>21</sup> EURIBOR will continue to exist alongside the €STR for the foreseeable future. This follows from the decision of the FSMA in July 2019 to authorise EMMI under Article 34 of the Benchmarks Regulation for the provision and administration of EURIBOR, following the work that was undertaken to develop a hybrid methodology for the benchmark.<sup>22</sup>

<sup>17</sup> See further the information on the ECB's [website](#) on the working group on euro risk-free rates.

<sup>18</sup> ECB (2018), [press release](#).

<sup>19</sup> Working group on euro risk-free rates (2019a), [Recommendations](#).

<sup>20</sup> European Money Markets Institute (2019a), [press release](#). The spread of 8.5 basis points was calculated by the ECB on 31 May 2019 and reflects the historical difference between the underlying interests of the interbank lending rate for EONIA against the wholesale borrowing rate for the €STR.

<sup>21</sup> Bailey, A. (2017), *op. cit.*

<sup>22</sup> European Money Markets Institute (2019b), [press release](#). The methodology consists of a waterfall, which prioritises the use of real transactions whenever available and appropriate. In the absence of such transactions, it relies on other related market pricing sources to calculate the benchmark.

## 1.6 Current assessment of progress in transition

Taking account of these developments, the FSB continues to assess and report on the progress made on benchmark transition.<sup>23</sup> Although it has observed that clear progress has been made in promoting the use of risk-free rates, it also draws attention to a number of challenges. It notes that there has been progress in derivatives and securities markets, which is arguably made easier by the global nature of the market, the transition needs to accelerate in lending and securitisation markets, which may be more regional. The FSB also noted that there can be challenges in raising awareness among the wide range of cash market users.

In a recent report of the FSB and the Basel Committee on Banking Supervision,<sup>24</sup> the FSB continues to identify the key concerns relating to LIBOR transition from a microprudential perspective as arising from legal, prudential, conduct and litigation risks, as well as from operational, hedging and accounting risks. It also draws attention to the macroprudential risk that may arise from heightened volatility or disorderly functioning in LIBOR markets arising from the uncertainty about the future of LIBOR. It notes that many of its recommendations may be considered by jurisdictions to reduce reliance on other IBORs.

From a legal perspective, it is of particular interest to note that several jurisdictions have identified certain types of LIBOR exposures which cannot be transitioned or which will be very difficult to transition<sup>25</sup>. The most commonly cited measure to mitigate these risks is the expectation of legislative action at national or, where applicable, the supranational level.

The following section will examine the key aspects of the legal risks which arise in the EU context in further detail.

## 2 Continuity of contracts – a precondition for a smooth transition

The core legal issue that arises in the context of transition concerns the conditions that need to be met for a smooth transition to risk-free rates in contracts and financial instruments referencing IBORs. In particular, what factors will support contractual continuity, ensure compliance with regulatory requirements and minimise the risk of legal challenge and litigation? These factors may vary, depending on (i) whether a contract or instrument is new, or whether it is a legacy contract, concluded before or after the date of application of the Benchmarks Regulation on 1 January 2018; (ii) which benchmark is referenced in the contract or financial instrument; and (iii) the relevant market segment (derivatives, securitisations, lending, securities, cash, etc.).

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<sup>23</sup> Financial Stability Board (2019), [Reforming major interest rate benchmarks, Progress report](#).

<sup>24</sup> Financial Stability Board and Basel Committee on Banking Supervision (2020), [Supervisory issues associated with benchmark transition](#).

<sup>25</sup> *Ibid.*, p. 21.

The scale of the issue cannot, however, be underestimated. As at the third quarter of 2019, euro area significant institutions had more than 50 million contracts outstanding that referenced EONIA, EURIBOR or LIBOR (with most referencing EURIBOR). Loan contracts accounted for more than 40 million of these outstanding contracts, but there are also more than ten million deposit contracts and more than one million derivatives contracts.<sup>26</sup>

Based on contracts reported to ECB Banking Supervision, the total notional exposure exceeded €110 trillion, predominantly through derivatives.<sup>27</sup> EURIBOR is by far the most commonly referenced rate and EONIA has fewer contracts linked to it. However, there are still more than one million deposit contracts referencing EONIA and more than €5 trillion of notional exposures through derivatives contracts. Relatively few contracts reference LIBOR, but euro area significant institutions hold more than €40 trillion of notional LIBOR exposures through derivatives contracts, mostly linked to the USD LIBOR.

These assessments refer to the holdings of banks supervised under the Single Supervisory Mechanism (SSM), hence these figures are illustrative only and do not represent the picture across the market in the European Union as a whole.

These factors are examined from an EU perspective as follows.

## 2.1 New contracts

Turning first to new contracts and instruments, what should a financial institution do when entering into a new contract or issuing a new instrument which references EONIA or EURIBOR?

### 2.1.1 New contracts referencing EONIA

As noted above, EONIA has been published under a reformed methodology since 2 October 2019, but the cessation date of 3 January 2022 has already been specified. Clearly, this raises a particular issue for instruments which mature after this date.

In its EONIA to €STR legal action plan,<sup>28</sup> the WG RFR has recommended that the market participants should consider avoiding entering into any new contracts referencing EONIA, in particular where they mature after 31 December 2021. It can be expected that referencing the €STR instead of EONIA will mitigate the risk that the cessation of EONIA will change the economics of the contracts and give rise to potential contractual disputes.

However, where new contracts still reference EONIA and mature after 31 December 2021, it is necessary to ensure that the contractual documentation includes robust

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<sup>26</sup> European Central Bank (2020a), [Supervision newsletter](#).

<sup>27</sup> Ibid.

<sup>28</sup> Working group on euro risk-free rates (2019b), [Recommendations](#).

fallback arrangements which provide for the reference rate to switch upon the permanent discontinuation of EONIA. In this context, the WG RFR has recommended the €STR plus a spread as the EONIA fallback rate for all products and purposes.<sup>29</sup>

This approach aligns with the IOSCO Principles for financial benchmarks, which encourage contracts or instruments that reference a benchmark to have robust fallback provisions in the event of material changes to or cessation of the benchmark.<sup>30</sup> It also aligns with the legal requirement in the European Union for supervised entities entering into certain contracts to use a benchmark to produce and maintain robust written plans setting out the action they would take in the event that a benchmark materially changes or ceases to be provided. This action must also be reflected in supervised entities' contractual relationships with clients.<sup>31</sup>

These measures serve to support contractual continuity and ensure compliance with regulatory requirements, where applicable, thereby minimising the risk of legal challenge and litigation.

If we look at the impact assessments that have been carried out by ECB Banking Supervision, a large majority of significant institutions (approximately 75%) assess the risks relating to renegotiation of contracts linked to EONIA as small or negligible. This is reflected in the ECB's horizontal assessment that the banks have focused more on the transition from EONIA to the €STR than on the reform of EURIBOR.<sup>32</sup>

## 2.1.2 New contracts referencing EURIBOR

Turning to EURIBOR, the challenge of ensuring the compliance of the benchmark with the Benchmarks Regulation has been met for present purposes by EMMI as administrator and provider of the benchmark. As a result, market participants can continue to use EURIBOR for the foreseeable future<sup>33</sup> and are not yet compelled to select an alternative benchmark or risk-free rate for new contracts or instruments. But it is still in line with the IOSCO Principles to ensure that contracts or instruments that reference EURIBOR have robust fallback provisions, as well as a regulatory requirement for supervised entities that are a party to contracts and instruments referencing EURIBOR, in case EURIBOR materially changes or ceases to be provided.<sup>34</sup> Such an outcome cannot be excluded in the long term if it proves over time that there are insufficient levels of transaction data and more frequent reliance

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<sup>29</sup> Ibid.

<sup>30</sup> Board of the International Organisation of Securities Commissions (2013), [Principles for Financial Benchmarks](#), Principle 13.

<sup>31</sup> See Article 28(2) of the Benchmarks Regulation.

<sup>32</sup> European Central Bank (2020a), *op. cit.*

<sup>33</sup> See Maijor, S. (2019), [speech](#) stating that "the authorisation of EURIBOR in July 2019 by the FSMA is certainly a key step forward, confirming that the new hybrid methodology is robust, resilient and transparent. I believe that the new hybrid methodology measures the same underlying interest of the previous methodology of EURIBOR, just in a better, BMR-compliant way. Indeed, the authorisation of EURIBOR allows EU supervised entities to continue using EURIBOR for the foreseeable future".

<sup>34</sup> This is a legal requirement for EU supervised entities, but also recommended for all users of EURIBOR in the Report with high-level recommendations for fallback provisions in contracts for cash products and derivatives transactions referencing EURIBOR. See Working group on euro risk-free rates (2019c), [Report](#).



needs to be placed on “Level 3” of the hybrid methodology involving data from related markets or the panel banks’ judgment.

There continues, however, to be a high degree of uncertainty as to what rate could be used as a fallback for EURIBOR. The WG RFR is looking at identifying fallbacks for EURIBOR based on the €STR and to date has recommended a methodology to calculate a forward-looking term structure that would be based on the future €STR derivatives market.<sup>35</sup> The extent to which this proposal would be viable depends on the development of this market and the adequacy of the data that would be produced. The WG RFR is also analysing backward-looking methodologies and is working on a EURIBOR legal action plan to guide market participants in their contract amendments. The paper by Iliana Lani, “The role of market participants, supervisors and legislators in interest rates reform”, provides a detailed overview of the current status of this work.<sup>36</sup> Many market associations are closely involved in adapting their documentation to reflect the requirements of the Benchmarks Regulation.<sup>37</sup>

Notwithstanding the steps taken to support contractual continuity and ensure compliance with regulatory requirements, we are not yet close to a position of legal certainty, where the selection of an alternative benchmark could be relied upon in case EURIBOR materially changes or ceases to be provided.

Whilst this conclusion is drawn from a legal perspective, it is also consistent with the findings of the ECB’s horizontal stocktake on the impact of benchmark reforms and the preparedness of banks supervised under the SSM. In their responses, banks identified communication with counterparties to EURIBOR contracts as the greatest challenge, recognising the difficulty of agreeing with counterparties on how to incorporate fallback language into contracts if EURIBOR is not available or materially changes in the future.<sup>38</sup>

## 2.2 Legacy contracts

The issues that arise in relation to legacy contracts are, however, even more difficult to resolve than those which arise in relation to new contracts. Legacy contracts are those contracts which reference EONIA or EURIBOR, but continue in force after the transition period in the Benchmarks Regulation. They may have no fallback language or fallback language that yields an unacceptable outcome. For example, the contract may have contemplated the temporary unavailability of the rate, without addressing the possibility of a permanent cessation or any difference in the underlying interest represented by the possible replacement rates. In these contracts, a material change or cessation in the rate is likely to result in changes to the pricing of the original

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<sup>35</sup> Working group on euro risk-free rates (2019a), op.cit.

<sup>36</sup> ESCB Legal Conference 2020.

<sup>37</sup> See the brief description of market association work on EURIBOR Fallbacks, in Working Group on euro risk-free rates (2020), [Understanding EURIBOR fallbacks](#), Annex 1.

<sup>38</sup> European Central Bank (2020a), op. cit.



transaction, which in turn can be expected to heighten the risk of legal challenge and litigation.<sup>39</sup>

### 2.2.1 Legacy contracts referencing EONIA or EURIBOR

The problem is pronounced in relation to certain asset classes where the procedures for amending the contracts raise difficulties or it may even not be possible to change the relevant terms. These are the so-called “tough legacy” contracts. Some of these contracts may have been entered into before 1 January 2018, which means there is no regulatory requirement for the contract to include fallback provisions, hence limited incentive to amend the terms.

The issues, however, vary depending on the market sector. There has been extensive work undertaken by market associations on EONIA and EURIBOR fallbacks,<sup>40</sup> which means that in certain market sectors, such as derivatives, market participants have been assisted in incorporating recommended changes into their documentation to provide primary fallbacks for the reference rate in the event of the cessation of an interest rate benchmark. Other products, such as retail mortgage products, may be subject to consumer protection laws which require customers to provide their prior explicit consent to changes or impose other regulatory restrictions on pricing terms.

This means that “tough legacy” contracts are susceptible to the risk that one of the parties may seek to terminate the contract on the grounds of frustration, in the event of a material change or discontinuation of the reference rate.

### 2.2.2 Litigation risk – recent case-law of the Court of Justice

The problems related to retail products are clearly illustrated by recent case-law of the Court of Justice of the European Union,<sup>41</sup> which provided a preliminary ruling on the question of whether a term of a mortgage loan agreement specifying the agreed interest rate was void on account of its alleged unfairness.<sup>42</sup> In this case, the Court ruled that if a national court finds that a term referring to a statutory index for calculating the variable interest rate applicable to a mortgage loan contract with a consumer is unfair, it can replace the term with another index provided for under national law. The replacement can be ordered, if the mortgage loan agreement at issue is not capable of continuing in existence without the term and if the annulment of the agreement would expose the consumer to particularly unfavourable consequences. The ruling establishes clearly that if a bank seeks to change a term of

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<sup>39</sup> This is more likely in the event of a contract pre-dating 1 January 2018 when the Benchmarks Regulation started to apply or products not covered by the Benchmarks Regulation. It is noted that contracts entered into prior to 1 January 2018 that fall within the scope of the Benchmarks Regulation are expected to be amended where practicable and on a best efforts basis (see European Securities and Markets Authority (2020), [Questions and answers](#), Question 8.1 added in December 2017).

<sup>40</sup> See the brief description of market association work on EURIBOR Fallbacks in Working Group on euro risk-free rates (2020), *op. cit.*

<sup>41</sup> Case C-125/18, *Mark Gómez del Moral Guasch v Bankia S.A.*, EU:C:2020:138.

<sup>42</sup> In accordance with Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ L 95, 21.4.1993, p. 20).

a mortgage loan agreement (or arguably if it fails to change a term) referring to an agreed interest rate and the term is judged as unfair, it is possible for the national court to replace the term with another rate provided for under national law. Whether or not national legislatures have provided for a replacement rate, which is to apply in the absence of other arrangements established by the parties to the contract, may well vary from Member State to Member State. However, the case could be understood as setting a certain disincentive for supervised entities to amend consumer contracts. If the court can replace a rate that is judged as unfair, it could be better to adopt a “wait and see” approach in case the legislator steps in to provide for the replacement rate.

### 3 A legislative solution for legacy contracts – a way forward to smooth the transition?

Secondly, what role should be played by the legislator? What implications do legislative changes have for the other stakeholders, including the private sector, central banks and regulatory authorities?

#### 3.1 European Commission consultation on the reform of the Benchmarks Regulation

The Commission has sought answers to these questions, launching a public consultation on the review of the Benchmarks Regulation in the fourth quarter of 2019 and a roadmap for feedback in March and April 2020. The aim of the proposal was twofold: (i) to ensure a smooth transition to reformed and/or replacement rates set by central banks; and (ii) to ensure that EU businesses making use of benchmarks published outside the EU can continue to have access to those rates.<sup>43</sup>

The outcome of this review was published in summer 2020, comprising a proposal for a regulation to amend the Benchmarks Regulation.<sup>44</sup>

##### 3.1.1 What are the key elements of the proposal?

The key elements of proposed amendments to the Benchmarks Regulation warrant close consideration.

First, the proposal would grant power to the European Commission to designate a statutory replacement benchmark where the cessation of publication may result in significant disruption in the functioning of financial markets. This represents a significant change against the Commission’s initial thinking on the issue, as it had initially considered enhancing the powers of the authorities competent for the

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<sup>43</sup> European Commission (2020a), op. cit.

<sup>44</sup> European Commission (2020b), op. cit.

supervision of benchmarks, such as the power to mandate the continued provision of a critical benchmark using a different methodology.<sup>45</sup>

Second, when designating a replacement benchmark, the Commission would be required to take into account, where available, the recommendations of the alternative reference rate working group working under the auspices of the central bank responsible for the currency in which the interest rates of the replacement benchmark are determined (i.e. the WG RFR for benchmarks denominated in euros, the Alternative Reference Rates Committee in the United States for US dollars and the Working Group on Sterling Risk-Free Reference Rates in the United Kingdom for Sterling).

Third, the proposal sets out the trigger events pursuant to which the Commission may exercise its power of designation. These require the competent authority to act, by publicly announcing that the capability of the benchmark to measure the underlying market or economic reality cannot be restored, or that the administrator has ceased or will cease to provide the benchmark permanently or indefinitely. The administrator's own announcement of cessation may also trigger the exercise of the Commission's power.

Fourth, the proposal delineates the scope of application. All contracts which reference the benchmark which has ceased to be published and contain no fallback provisions, or no suitable fallback provisions are within scope. The Benchmarks Regulation only applies, however, to contracts to which a supervised entity is a party. Contractual parties can opt out of the application of the statutory successor rate by agreeing on a different rate or on suitable fallback provisions.

Last, competent authorities of supervised entities are required to monitor whether the designation of a replacement rate minimises contract frustration or any other detrimental effects on economic growth and investment in the Union. This is an important measure to assess the effectiveness of the proposed changes in practice.

### 3.2 What are the advantages of the legislative intervention?

The issue of whether the legislator should adopt a wider legislative initiative, allowing for the redenomination of benchmarks in private contracts, is one which has accompanied the debate on benchmark reform since its inception. To date, the Union legislator has aligned with the FSB's initial recommendation that authorities should encourage industry and work with administrators to support reform initiatives in the private sector.<sup>46</sup> Consequently, the Benchmarks Regulation does not provide for the orderly transition from a benchmark to a replacement rate; it specifies that competent authorities have the power to withdraw the authorisation of a critical benchmark and order its administrator to stop publishing it, without there being arrangements in place for its replacement.

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<sup>45</sup> European Commission (2020a), op. cit., Section B.

<sup>46</sup> Financial Stability Board (2014), op. cit., p. 59.

My own assessment is that the legislative intervention is, on balance, well tailored to address the problems that have arisen at the present juncture. It is important that it focuses on the issues arising in relation to “tough legacy” contracts. By narrowing the scope of application, the proposal ensures that parties should renegotiate wherever possible, such that the designated replacement is only relied upon where renegotiation is not possible prior to cessation. Although the proposal is aimed primarily at contracts with Union supervised entities which reference LIBOR, the power to designate a replacement rate is framed neutrally and could apply to contracts referencing other benchmarks where the relevant conditions are met.

In addition, it is noteworthy that the Commission considered and rejected an approach whereby amendments to the Benchmarks Regulation would have provided the competent authority of the administrator with regulatory powers to change the methodology for the provision of the benchmark (referred to as “conversion powers”).<sup>47</sup> The limitations of this approach have been pointed out by other regulatory authorities. According to the FCA “methodological change may be desired by some market participants, but may not be feasible (for instance the administrator may not have access to robust input data in the relevant currency), and instead publication may cease”.<sup>48</sup> It certainly cannot be excluded that a regulator’s decision to mandate a specific methodology may give rise to litigation for misuse or abuse of discretionary powers, in view of the limits on the margins of discretion that can be exercised by European agencies.<sup>49</sup>

By implementing the changes in the Benchmarks Regulation and centralising the power with the Commission to designate a statutory replacement benchmark, the proposal is directly applicable and avoids the risk that divergent measures might be taken by legislators or competent authorities in Member States.

The ECB’s opinion on the legislative proposal<sup>50</sup> is also positive, observing that:

“...this a helpful additional tool whose utilisation would fill the legal vacuum that would be left in respect of contracts with supervised entities as defined in Article 3(17) of Regulation (EU) 2016/101151 (hereinafter referred to as ‘Union supervised entities’) that reference a benchmark whose cessation would significantly disrupt the functioning of financial markets in the Union and where the relevant contracts do not provide for or have no suitable fall-back reference rate. This would help to mitigate the risk of contract frustration and the risk to financial stability which might result from the cessation of such a benchmark.”

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<sup>47</sup> See further European Commission (2020b), *op. cit.*, Impact Assessment at Section 3.3.1.

<sup>48</sup> See the information on the “Benchmarks Regulation – proposed new powers” on the Financial Conduct Authority’s [website](#).

<sup>49</sup> C-9/56 and C-10/56, *Meroni v High Authority*, EU:C:1958:7 and 8.

<sup>50</sup> [Opinion](#) of the European Central Bank of 18 September 2020 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation (CON/2020/20) (OJ C 366, 30.10.2020, p.4).

<sup>51</sup> Article 3(17) of Regulation (EU) 2016/1011 includes within its definition of supervised entities credit institutions, investment firms and certain other categories of financial institution.

### 3.3 What are the disadvantages of the legislative intervention?

At the same time, the proposed amendments to the Benchmarks Regulation are a blunt instrument. They will automatically replace references to a benchmark that has ceased to be published with another benchmark by operation of law. The replacement rate may or may not represent the bargain that the parties to the contracts would have struck had they been able to amend their contract. From a litigation perspective, it is not possible to exclude that parties may seek to find ways to challenge the safe harbour that the Commission has proposed.

However, as the choice of statutory successor rate remains open, it is difficult to assess the risks entailed in the fallback on an unspecified rate. The Commission is required to take into account the recommendations of the relevant working groups. In this respect, the ECB's opinion carefully observes that the recommendations issued in this context are entirely those of this private sector working group and the ECB does not accept any responsibility or liability for their content. It will be important to ensure that the recommendations of the working groups are precise with respect to the main elements of the new reference rate, together with the spread adjustment that is necessary if the rate provides an economically different outcome to the original rate, in order to ensure the recommendation is capable of implementation. Any qualifications with respect to the appropriateness of the rate (e.g. to specific categories of contract) would also need to be clearly specified in the working groups' recommendations.

Lastly, it is noted that the proposal would limit the scope of contracts affected to legacy contracts to which a Union supervised entity is a party. Extending the scope of the contracts to which the proposal would apply (e.g. to where the contract is governed by the law of an EU Member State) would further minimise the risk that divergent measures might be taken in relation to contracts referencing interest rate benchmarks, particularly of a cross-border nature.

## 4 A supervisory solution for key risks relating to benchmark reform – another way forward to smooth the transition?

Although the clear focus in the current debate is on the role that should be played by the legislator, the complementary role that prudential supervisors have played in relation to benchmark reform should not be overlooked.

### 4.1 Action taken by ECB Banking Supervision

ECB Banking Supervision has written to CEOs of euro area banks supervised under the SSM seeking assessments of the key risks relating to benchmark reform and a detailed action plan to mitigate those risks, address pricing issues and implement the necessary process changes.<sup>52</sup> They have also carried out a horizontal assessment of

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<sup>52</sup> Letter on banks' preparation with regard to interest rate benchmark reforms and use of risk-free rates, 3 July 2019.

these banks' preparedness for benchmark rate reforms, finding that the focus has been on addressing the transition from EONIA to the €STR, rather than on addressing the risks related to the possible future discontinuation of EURIBOR and the need to incorporate fallback arrangements in contracts. In addition, the report concluded that although banks were aware of the potential risks involved in benchmark reform, their action plans and the development and implementation of mitigating actions were generally behind schedule.

In the light of this, the ECB Banking Supervision has published a report<sup>53</sup> setting out good practices for the benchmark rate transition and identifying legal risk, particularly with regard to contract law in different jurisdictions and the issue of contract continuity, as a core risk or challenge.

## 5 Conclusion

In conclusion, although significant efforts are underway to ensure the conditions are in place for a smooth transition to reformed interest rate benchmarks or risk-free rates, we cannot always expect all stakeholders to act in concert with us. On the one hand, public authorities have sought to support the private sector in the transition, with the ECB taking on the role as administrator of the €STR, providing guidance on the banking supervision side, and supporting the WG RFR together with ESMA and the European Commission. At the same time, the private sector still faces considerable challenges to amend contracts to provide robust fallback arrangements across all market segments. The Union legislator wants to see contractual parties working towards implementing their own fallback arrangements to support a smooth transition, stepping in to provide a backstop only where this fails. At the same time – at least in relation to consumer contracts – the Union judiciary has left it open for the courts to replace the rates that the contractual parties have agreed to. Although litigation risk would be mitigated by the proposed legislative intervention, it cannot be excluded in the transition to reformed interest rate benchmarks.

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# The role of market participants, supervisors and legislators in interest rates reform

By Iliana Lani<sup>1</sup>

## 1 Introduction

Following extensive benchmark reforms over recent years, the continued existence of some of the major benchmark rates is no longer guaranteed. Financial market participants, supervisors and legislators have to prepare for transition, and to tackle the significant legal issues this entails. The scale of the challenge means that the best way forward is to ensure the availability of a range of solutions, together with ongoing cooperation between the public and private sector, both within and across jurisdictions.

This contribution focuses on the work within the European Union (EU), in which the European Securities and Markets Authority (ESMA) has been closely involved. The contribution will cover three main topics:

1. the role of the Working Group on Euro Risk-Free Rates in the interest rates reform;
2. the importance of contract continuity for EURIBOR products; and
3. the evolving regulatory environment.

## 2 Overview of the Working Group on Euro Risk-Free Rates

Some of the milestones already achieved by the Working Group on Euro Risk-Free Rates, were already explored in the other contributions on this topic. Thus, this contribution will take a step back and spend a few words on how these results were achieved.

At the end of 2017, ESMA, the ECB, the European Commission and the Belgian regulatory authority, the Financial Services and Markets Authority (FSMA) started a dialogue on the reform of interest rates in the euro-area. The outcome of this dialogue was the establishment of the Working Group on Euro Risk-Free Rates.

The Working Group on Euro Risk-Free Rates is an industry group composed by market participants, in which ESMA, the ECB, the European Commission and the

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<sup>1</sup> Head of the Ratings, Indices and Securitisation Department at the European Securities and Markets Authority.



FSMA participate as observers. The Working Group is a joint effort between the public and the private sector. As already mentioned, this cooperation between the public and the private sector is a fundamental aspect of the interest rates reform in the EU as well as in other jurisdictions.

Similar working groups exist all over the world.<sup>2</sup> However, focusing on Europe, it could be argued that this Working Group is the main engine behind the interest rate reform in the euro area.

It represents a forum in which financial firms from different Member States can openly brainstorm on how to achieve sounder euro interest rates. At the same time, the presence of public authorities ensures that the direction of travel is in line with the one indicated by the Financial Stability Board<sup>3</sup> and is in compliance with the applicable EU laws, notably the EU Benchmarks Regulation<sup>4</sup>.

The *modus operandi* of the Working Group is to consult the public before the issuance of any recommendation. In this way all stakeholders can contribute to the content of the final recommendations.

### 3 EURIBOR fallback provisions: the next milestone for the Working Group

From ESMA's perspective, the main regulatory and supervisory focus now is the inclusion of fallback provisions in contracts referencing interest rates.

Fallback provisions are contractual provisions that specify:

1. the trigger events for a transition to a fallback rate;
2. the fallback rate; and, if needed,
3. the spread adjustment to align the fallback rate with the rate being replaced.

The inclusion of fallback provisions in contracts is necessary to ensure that benchmark users comply with Article 28 (2) of the EU Benchmarks Regulation.

In July 2019 the Working Group delivered a final recommendation on *the EONIA to €STR legal action plan*<sup>5</sup> which includes the identified fallback provisions to be used in EONIA contracts. The transition from EONIA to €STR has been successfully designed by the Working Group and it is in the process of being implemented. In fact, the discontinuation date for EONIA is already set for 3 January 2022.

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<sup>2</sup> The US, the UK, Japan, Canada and Switzerland are among the countries in which working groups of this kind were established.

<sup>3</sup> See the work of the FSB on [Financial Benchmarks](#), available on the FSB's website.

<sup>4</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

<sup>5</sup> [Recommendations](#) of the Working Group on Euro Risk-Free Rates on the EONIA to €STR legal action plan, 16 July 2019.

On the other hand, the work in relation to EURIBOR fallbacks is still ongoing.

EURIBOR plays a central role in financial markets, and it is also an important building block of contracts, including retail contracts like mortgages. Because of their mortgages, millions of European citizens across different Member States are exposed to EURIBOR.

In July 2019 EURIBOR was authorised<sup>6</sup> under the EU Benchmarks Regulation by the FSMA. This authorisation allows EU supervised entities to continue using EURIBOR.

In January 2022 ESMA will substitute the FSMA as supervisor of EURIBOR and currently ESMA does not anticipate its discontinuation. This, however, does not diminish the importance of the inclusion of fallback provisions in EURIBOR contracts.

Considering that many counterparties to these contracts are European households, and not professional investors, we do not think that supervised entities can afford to take the minimum risk of contract frustration vis-à-vis EURIBOR products. They should instead follow the recommendations of the Working Group as soon as they are available.

The final recommendations on the EURIBOR fallback provisions are now the top priority of the Working Group and should be published at the beginning of 2021. In advance of this, the Working Group already published two consultation papers on 23 November 2020.

**The first consultation paper**<sup>7</sup> covers the preferred EURIBOR fallback rate for each relevant asset class. While the fallback rate will surely be based on €STR, the Working Group is currently assessing both the forward-looking and the backward-looking term structures.

The choice between a forward-looking term structure and the backward-looking one is a complex decision. The mechanics of very different types of EURIBOR contracts, such as interest rate swaps and mortgages, must be considered thoroughly.

The debate on forward-looking methodology versus backward-looking methodology is also taking place in other working groups across the world: this is a real global debate. Because of the complexity and importance of this issue, it is crucial that the stakeholders provide their feedback during the consultation of this paper.

This first consultation paper will also gather comments about the preferred spread adjustment to be applied over the term structure. The spread adjustment is needed to avoid potential value transfers upon activation of the fallback rate and, as you can imagine, it is something that market participants follow with great interest.

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<sup>6</sup> FSMA, [press release](#): The FSMA authorises EMMI as administrator of the European Benchmark, 3 July 2019.

<sup>7</sup> [Public consultation](#) by the Working Group on Euro Risk-Free Rates on €STR-based EURIBOR fallback rates, 23 November 2020.

**The second consultation paper**<sup>8</sup> covers the set of trigger events that, if materialise, contracts would switch from EURIBOR to the fallback rate plus the spread adjustment. Two main principles have been followed:

First, trigger events should be objectively drafted in precise terms and refer to publicly known events, such as the publication of an official statement by the supervisor of EURIBOR.

Second, the set of trigger events should apply to all asset classes in the same manner. This is to avoid triggers mismatch between contracts that are related to each other, such as loans and the relevant hedging products.

One of the challenges currently the group is facing is to make sure that this set of triggers is consistent with the changing regulatory environment.

Jointly, the two consultation papers cover all the elements composing the EURIBOR fallback provisions, which are:

1. fallback rate;
2. spread adjustment; and
3. trigger events.

The final recommendations on EURIBOR fallback provisions are expected in the first quarter of 2021 and, once published, they will represent surely one of the main achievements of the Working Group.

For ESMA the inclusion of effective fallback provisions in EURIBOR contracts is a supervisory priority. Once the final recommendations are published, together with national supervisors we will monitor the compliance<sup>9</sup> of EU supervised entities vis-à-vis EURIBOR contracts.

## 4 The evolving regulatory environment

With regard to the evolving regulatory framework in which the interest rates reform takes place, the following developments can be noted.

The European Commission recently published a proposal to amend the EU Benchmarks Regulation<sup>10</sup>. The UK Government has taken a similar legislative initiative<sup>11</sup>.

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<sup>8</sup> [Public consultation](#) by the Working Group on Euro Risk-Free Rates on Euribor fallback trigger events, 23 November 2020.

<sup>9</sup> Article 28(2) of the EU Benchmarks Regulation.

<sup>10</sup> Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation, Brussels, 24 July 2020, COM(2020) 337 final.

<sup>11</sup> [Financial Services Bill 2019-21](#). See also: [Benchmarks Regulation - proposed new powers](#), available on the FCA's website.

The European Commission proposal may become EU law as early as the end of 2020. The text is currently being finalised, following the announcement of agreement between the Council of the EU and the European Parliament<sup>12</sup>. Pending such finalisation, and on the basis of the European Commission's proposal, we can already assess the impact that this legislative initiative might have on the interest rates reform in the euro area.

The proposal includes a new power for the European Commission that is intended to address the risks posed to the EU financial system by the discontinuation of LIBOR<sup>13</sup>. However, it cannot be excluded that in the future this new proposed power may also be used for other systemically important benchmarks.

So, how does this new power work?

In a nutshell, the European Commission is given the power to designate a *statutory replacement benchmark* that would replace the contractual reference to a benchmark in cessation<sup>14</sup>. This power should be used when the cessation of that benchmark would result in significant disruption of the functioning of the EU financial markets.

In other words, in order to use this power, the cessation of the benchmark must represent a financial stability risk for the EU. Moreover, the *statutory replacement benchmark* should affect only those contracts that contain no fallback provisions.

In designating the statutory replacement benchmark, the European Commission should consider the recommendations of the relevant working group<sup>15</sup>. The fact that the proposal explicitly refers to the recommendations of the working groups stresses how the public and the private sectors really complement each other in this process.

From this point of view, the final recommendations on EURIBOR fallback by the Working Group on Euro Risk-Free Rates become even more important because the European Commission, in the unlikely scenario of EURIBOR discontinuation, will follow these recommendations when applying the *statutory replacement benchmark*.

The proposed power is designed to avoid litigation in relation to contracts in which viable fallback provisions cannot be included. These are the tough legacy contracts. Most of these tough legacy contracts are outside the scope of the EU Benchmarks Regulation, for instance business loans or contracts dating before 2018.

On the other hand, contracts including sound fallback provisions are not covered by the proposed new power. Therefore, the effort by the industry to include fallback provisions into EURIBOR contracts should not be discontinued, in particular for the contracts that are within the scope of the EU Benchmarks Regulation, such as mortgages.

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<sup>12</sup> Council of the EU, [press release](#): Council endorses new rules addressing cessation of financial benchmarks, 9 December 2020.

<sup>13</sup> See recital 4 of the European Commission proposal.

<sup>14</sup> See Article 23a (2) of the European Commission proposal. In particular, reference is made to "financial instruments, financial contracts and measurements of the performance of an investment fund", i.e. to the instruments, contracts and investment funds in scope of the EU Benchmarks Regulation.

<sup>15</sup> See Article 23a (3) of the European Commission proposal. For instance, this would cover the recommendations by the American group in relation to US dollar LIBOR.

Finally, it should be highlighted that the proposed power can be used only after the relevant supervisory authority (for example currently the FSMA and from 2022 ESMA for EURIBOR) decides on the discontinuation of the benchmark. In fact, only when the supervisor has exhausted its remedial actions<sup>16</sup> to reform the benchmark, the European Commission may consider the use of the *statutory replacement benchmark*.

If I could share with you my preliminary reaction to this draft proposal, it would be a positive one.

This is because it fills a real vacuum in the EU Benchmarks Regulation. The current Regulation does not envisage a comprehensive mechanism for orderly cessation of systemically important benchmarks. The approaching end of LIBOR has highlighted the need to complement the regulatory framework with a new tool to be used by the public sector in case of need.

## 5 Conclusion

The interest rates reform presents significant legal challenges. Contract continuity is surely one of them. The interaction between supervisory and legislative actions across different jurisdictions is another challenge, notably in relation to LIBOR.

The public and private sector are moving forward in the interest rates transition and entering a defining moment. Legislators in the EU and in other jurisdictions are complementing existing regulatory frameworks to ensure that financial stability is safeguarded in all scenarios.

Working groups on risk free rates are finalising their recommendations to provide market participants with common standards to ensure the continuity of contracts throughout the interest rate reform.

The interest rates reform is a multi-year effort. As previously mentioned, by the end of 2021, the supervision of EURIBOR will be ESMA's responsibility. ESMA stands ready to fulfil its enhanced mission and to cooperate with stakeholders from both the public and the private sector to ensure the accomplishment of the interest rate reform in the EU.

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<sup>16</sup> See Articles 21 and 23 of the EU Benchmarks Regulation.

# Benchmark rate transition and continuity of contracts

By Joanna Perkins<sup>1</sup>

## 1 Introduction

When it comes to the Sterling LIBOR transition, it is important to remember that LIBOR does not exist purely in the ether, ready to be bucketed into currencies by the markets. LIBOR also has a tangible geographical link to the United Kingdom of Great Britain and Northern Ireland (UK). The administrator, Ice Benchmark Administration (IBA) and contributing panel banks are situated in London and subject to regulation and oversight by UK competent authorities. There are two further ways in which geography is relevant, beyond the mere question of currency. The first is the prevalence of English law in cross-border financial contracts, the second is the pre-eminence of London as a global financial centre and the presence within the jurisdiction of so many financial institutions dealing in LIBOR products. These three factors, which I shall touch on in turn, mean that a fourth consideration, Brexit, which deeply affects the way in which benchmarks will be regulated in London, is an issue that looms large in LIBOR transition, across all currencies.

## 2 Background

Following scandals which emerged in 2012 concerning market manipulation of the London Interbank Offered Rate (LIBOR) and Euro Interbank Offered Rate (EURIBOR), the Financial Stability Board (FSB) undertook a review of the Interbank Offered Rate (IBOR) benchmarks. This culminated in a report, *Reforming Major Interest Rate Benchmarks*, published in July 2014 which concluded that the following. First, existing IBOR benchmarks and other potential interest reference rates based on unsecured bank funding costs should be strengthened by underpinning them to the greatest extent possible with transaction data. Second, alternative, nearly risk-free rates (**RFRs**) should be developed and participants in the derivative markets should be encouraged to use these rates in place of the IBORs. The Report recommended significant changes to the IBORs to anchor the rates more fully in transactions.

By 2017, significant milestones had been reached in the field of benchmark reform, including the passage of significant legislative initiatives in Brussels and London, a change of control in the administration of LIBOR, and the establishment by national authorities. However, this had not yet solved the fundamental problem of the markets' dependency on a rate purporting to represent a severely diminished transaction base

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<sup>1</sup> Joanna Perkins is Chief Executive of the Financial Markets Law Committee (FMLC), London. I am grateful to Venessa Parekh who manages work undertaken by the FMLC on LIBOR for her help with the research for this article.

in unsecured interbank lending. Authorities then appeared to acknowledge the insuperability of the challenges still facing the project to reform and rehabilitate LIBOR when, in July 2017, the UK's Financial Conduct Authority (FCA), which had hitherto been prepared to exercise statutory powers of compulsion vis-à-vis panel banks in order to support LIBOR, announced that it would not guarantee the survival of LIBOR after the end of 2021.

In the years since, the FCA and Bank of England have actively overseen banks' contingency planning for this development and have themselves published guidance regarding transition deadlines, including confirmation that the issuance of LIBOR referencing cash products should cease at the end of Q3 2020. However, in light of the significant disruption caused by the COVID-19 pandemic, the Working Group on Sterling Risk-Free Reference Rates (**RFRWG**), an industry-led working group which also comprises ex-officio members from the FCA and the Bank of England, issued a statement on 29 April 2020, extending the recommended deadline for LIBOR-referencing loans. It included the following milestones:

- by the end of Q3 2020, lenders should be in a position to offer non-LIBOR linked loans;
- from the beginning of Q4 2020, lenders should include clear contractual arrangements to facilitate conversion before the end of 2021; and
- the issuance of new sterling LIBOR-referencing cash products with a maturity extending beyond 31 December 2021 must cease by the end of Q1 2021.

The industry groups established by the Bank of England, Federal Reserve and Swiss National Bank to examine the case for transition to RFRs have now each identified a preferred RFR for interest rates payable on transactions in their respective currencies. In April 2017, the RFRWG announced the Sterling Overnight Index Average (**SONIA**) as its preferred RFR for use in sterling derivatives and relevant financial contracts on the back of reforms to the methodology announced earlier by the Bank of England. The Federal Reserve's Alternative Reference Rates Committee (**ARRC**) selected the Secured Overnight Financing Rate (**SOFR**) as its preferred alternative reference rate. Finally, the National Working Group on Swiss franc reference rates, established by the Swiss National Bank, recommended the Swiss Average Rate Overnight (**SARON**) as an alternative benchmark to Swiss franc LIBOR.

Since the announcement, transition planning by banks and regulators has pressed ahead, although no successor rate has been adopted on a market-wide basis yet and market engagement around the question of establishing term rates of different maturities has proven particularly challenging. Given the volume of contracts, funds and instruments which depend on LIBOR as a reference rate or for valuation purposes, the discontinuation of the rate is likely to have a very significant impact.



### 3 Oversight of IBA and Panel Banks by the FCA

A key aspect of transition planning by regulators had been to focus on an orderly wind-down of the existing LIBOR benchmark. In March of this year, the FCA and Bank of England wrote jointly to banks using LIBOR to say that the FCA had secured agreement from panel banks to keep contributing to the benchmark until the end of 2021, adding that “this will give users time to switch to alternative rates before LIBOR is discontinued.” Continuing to rely on LIBOR after this point, they said, will create a number of risks. One of these is a lack of clarity over the legal position and interest payments due for contracts that refer to LIBOR.

What is important about that message is that the signatories used the word “discontinued”. When, in 2017, Andrew Bailey first announced that the FCA would be withdrawing support for LIBOR and ceasing its efforts to secure cooperation from panel banks, commentators were swift to observe that he had said IBA could of course continue to produce LIBOR if they wanted to, and were able to do so. IBA reportedly stuck firmly to the idea that Dollar LIBOR certainly, and possibly also Sterling LIBOR, would and could be sustained beyond 2021. The expression by competent authorities of their assumption that LIBOR will be discontinued is relatively new. It may have come as a surprise to some, but it should not have done, since the broad thrust of benchmark regulation is that benchmark integrity can only be guaranteed when it is representative of an underlying market which is both deep and broad. Unsecured interbank lending in London is not that market.

What is interesting about this new emphasis on discontinuance (whether it was inevitable or not), however, is NOT that it affects the practical challenges facing LIBOR users — it probably doesn’t — but that it may affect optionality for a transition pathway and legal outcomes.

As to the question of the transition pathway, when the FSB undertook a review of transitioning LIBOR in 2014, their Market Participants Group (MPG) identified four broad categories of transition: (i) a seamless reform of the calculation methodology; (ii) a market-led transition to a pre-existing alternative; (iii) a regulator-led transition to a new tailor-made successor rate; and (iv) a so-called hard cut-over involving the withdrawal of the LIBOR benchmark at a predetermined date.

In 2014, there was considerable resistance to the idea of a hard cut-over but nonetheless, if LIBOR now has an end date, that is where we find ourselves. There are both pros and cons, as the MPG identified. The disadvantages are that, if there is a failure to transition the market as a whole to a clear successor rate, the withdrawal of LIBOR will lead to widespread chaos, possibly involving frustrated legacy contracts; disrupted hedging arrangements; a squeeze on liquidity; discrepancies in fund valuations and uncertainty about banks’ balance sheets. Fortunately, the risks of this failure are being reduced and resolved by strong regulatory action in the promotion of alternative rates and by the prospect of legislation in several key jurisdictions. The advantages are, first, that it focuses the invisible singular mind of the markets — with an apologetic nod to Adam Smith and Friedrich Hayek — on the need for preparation and, second, that the interpretation and application of legacy contract terms that reference LIBOR becomes clearer. If there is no LIBOR, a court must either hold the

instrument frustrated — which it will be very reluctant to do — or it must identify an express or implied intention to adhere to the successor rate. On the other hand, if LIBOR were to continue in a fundamentally weakened and disavowed state there would be finely balanced arguments around the meaning and intention of core contractual terms which it might be difficult to settle consistently across the markets. I am going to call this possibility the “Problem of Schism” because like the election of rival Popes — Urban VI and Clement VII — it has the potential to prove disastrous for the system as a whole.

The remaining point to note under the heading “LIBOR oversight” is that the British Government announced in June that it would introduce legislation — a prospective Financial Services Bill — to give the FCA powers to direct IBA (as the administrator of LIBOR) to change its methodology for the compilation of LIBOR<sup>2</sup>. This, it was said, was intended to address, in particular, the issue of so-called “tough legacy” contracts, i.e., the category of contracts that really cannot be transitioned. They include situations where the necessary consent for transition cannot be obtained from bondholders or syndicated lenders, among others. The Bill was published in October. Clauses 8 to 19 grant the FCA greater powers to compel the continued publication of benchmarks, to prohibit the use of benchmarks, and to oversee the orderly “wind-down” of benchmarks, including, where necessary, by imposing requirements as to the methodology and input data. The additional provisions will ensure that the FCA takes regular soundings as to the representativeness of critical benchmarks and, where it reaches a determination that a benchmark is non-representative, that it will consider whether to “designate” the benchmark, with the result that its use is prohibited by supervised entities in new contracts. Thereafter, in respect of a designated benchmark, the FCA is given the power to make rules concerning its continued use in certain legacy contracts.

The FCA's new powers would thus permit the publication of a “Transition LIBOR” in respect of the wind-down of legacy contracts. While this may create a welcome safety net for some, there is also an evident risk that it may — if not drafted carefully — give rise to mixed messages in regard to successor rates, setting Transition LIBOR up against other successor rates being used by market participants and raising the Problem of Schism, to which I just referred. Among other things, this could potentially impact the way in which courts imply terms into contracts which do not contain adequate fall-backs.

The FCA has said it will focus on legacy contracts on a currency by currency basis and not necessarily use the powers in respect of all currencies. The new Bill contains provisions, in Clause 18, regarding “umbrella benchmarks” which have versions in different currencies and tenors. The broad objective of this clause is to disaggregate umbrella benchmarks as far as the other provisions are concerned so that the different currency and maturity versions may be altered, sustained or terminated independently of one another.

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<sup>2</sup> [Financial Services Bill 2019-21](#), available on the UK Parliament website.

## 4 English governing law

The Financial Markets Law Committee (FMLC) has written extensively about the application of English legal doctrine to the situation of benchmark withdrawal, and that commentary is available on the website ([www.fmlc.org](http://www.fmlc.org)), so only a brief summary will be provided here. First, frustration of contracts is a remote but not negligible concern. Second, the common law recognises implied contractual terms which may assist in some cases to transition a contract away from a failed benchmark and onto a successor rate. Third, contracts will not be frustrated where the parties can be said to have allocated the risks of withdrawal by establishing fall-backs, by incorporating relevant termination provisions or by allocating liability. None of that, however, is to say there will not be litigation which alleges frustration. Even a weak claim can be litigated and there is a lot at stake.

However, what we are more likely to see than litigation involving claims of frustration, are claims alleging that the “wrong” rate has been implied or incorporated into legacy financial contracts, causing the lender or the borrower loss, or that the contract has/has not come to an end on its own terms. One means by which this could occur involves situations in which the existing contract terms refer generally to a “successor rate” or “a rate chosen by the lender” and there is disagreement between the parties about what that rate might be, and/or which choices are reasonable, in a world of splintering alternatives to LIBOR. Another means by which it might occur involves the use of public authorities’ statutory powers to imply benchmarks into contracts upon the demise of LIBOR, potentially giving rise to claims of deprivation, breach of human rights or manifest unreasonableness against the authority in question where the transition is perceived to have effected a wealth transfer. No comment is made here on whether such claims would be successful, or even establish a prima facie case to answer. A third source of litigation may be fallbacks. The fallbacks incorporated into legacy contracts on market standard terms have typically referred, for instance, to a poll of reference banks. These fallbacks were largely designed to deal with a temporary hiatus in the availability of a benchmark, not its permanent demise. To the extent that these fallbacks persist in some contracts — notwithstanding a market-wide exercise to replace them in standard terms — they may give rise to litigation regarding their interpretation and operation. A fourth source of litigation could be other ancillary contractual terms in contracts, having to do with major operational disruption, material adverse change and/or force majeure. It is possible that the application (and non-application) of these clauses may be in dispute between the parties.

The details of the Financial Services Bill discussed above had not yet been made public at the time of the Conference, but it was noted at the time that, where contracts are governed by English law, no matter the currency, it is strongly arguable that they will incorporate any new definitions of LIBOR which are created directly or indirectly by the Financial Services Bill when it is enacted and enters into force. This raises the question, discussed further below, of how the putative existence of a Transition LIBOR will impact other initiatives to incorporate successor rates into legacy contracts.

## 5 UK-regulated Financial Institutions

The continuing efforts by the FCA to persuade firms to make the transition in a prudent, timely and effective manner requires action along three broad axes: inventory assessment; the adoption of contractual triggers and fallbacks; and the implementation of safe systems and governance controls. All three are being vigorously pursued by larger firms in the wholesale financial markets, who have been actively considering how to deal with their LIBOR inventory for some time. The FMLC has recently published a comment paper on six options for firms and regulators in dealing with legacy contracts, including repapering; legislation; redirecting the LIBOR01 publication pages; incorporating successor rate language into contracts; and adopting a new rate in a protocol<sup>3</sup>. The FMLC favours action to redirect the publication pages for LIBOR to new Term Rates based on RFRs but—for new contracts, at any rate — this is not compatible with the thrust of the Financial Services Bill, which will prima facie lead to the publication of a time-limited “tough legacy-only” Transition LIBOR on those pages when enacted.

Meanwhile, firms have noted that Brexit has implications for the provision of new successor rates to UK supervised entities by administrators based outside the UK. The onshoring process has resulted in a statutory instrument which largely reflects the EU Benchmarks Regulation (BMR)<sup>4</sup>, adapted to the British context. This means that the successor rates to Yen, Euro, Swiss Franc and Dollar LIBOR will be third country rates as far as the UK is concerned. This could result in challenges for both the third country administrators and the UK supervised entities wishing to rely on those benchmarks, although these challenges will be significantly reduced, if not altogether eliminated, in the case of central bank administered rates. In recognition of these challenges, the Financial Services Bill amends the UK version of the BMR to ensure continued market access to third country benchmarks until end-2025.

## 6 SONIA

Turning now to the SONIA benchmark.

The journey to be taken by firms along the Sterling transition pathway began in earnest in January 2020 when the RFRWG published priorities for firms requiring the promotion of new products using SONIA compounded in arrears and tangible measures to shift derivative volumes on to SONIA.

Also, in January 2020 the RFRWG provided a term rate use case paper, which discussed the pros and cons of establishing a forward-looking SONIA term rate for use in the markets. The preference shared by most regulators is that financial products should move onto SONIA calculated in arrears and then compounded in place of

<sup>3</sup> FMLC, [Report: LIBOR Transition—Issues of Legal Uncertainty](#) (23 October 2020), available on the FMLC's website.

<sup>4</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

term-rates. Some products however including about 10% of the Sterling loan market would not be able to transition to SONIA compounded in arrears and would according to the RFRWG need a term SONIA reference rate, called a TSRR. The conclusion of the RFRWG was that a TSRR would be particularly valuable for new loans with smaller corporates as well as for legacy contracts.

Accordingly, four data companies were mandated to produce alternative rates to Sterling LIBOR and three have produced beta versions which are currently being run for a test period and scrutinised by the Bank of England.

Although it is clear that the regulators' view is that the use of a TSRR should be carefully limited there is no doubt that many market participants see it optimistically as a replacement for term Sterling LIBOR. What is unclear is the degree to which any TSRR that is produced by the beta testing process and the so-called "Transition LIBOR" which the FCA will be empowered to require IBA to produce for the purposes of the Financial Services Bill, are one and the same thing in the case of Sterling. On balance this seems unlikely in most cases because it would involve other firms making their data or product available to IBA but one of the competitors in the race for a TSRR is ICE, the parent company of IBA and ICE is also working on a term dollar RFR. There must therefore be a concern that ICE has an advantage in its race to produce the TSRR given that it may be the only provider that can also produce a Transition LIBOR for the purposes of the Financial Services Bill.

Regardless, there is inevitably a set of issues that the FCA will face in exercising its powers under the Bill around the problem of convergence and/or divergence between the value of legacy contracts moved onto synthetic Sterling LIBOR and the value of similar products in the wider market, which may have moved to SONIA compounded in arrears plus a fixed or floating spread adjustment (long talked about as "Synthetic LIBOR") or the TSRR.

The Scylla and Charybdis that those with influence over transition, including the FCA, Bank of England and the RFRWG, must navigate is between market divergence and convergence. Divergence in successor rates may cause some disruption. Well-run markets are a series of finely tuned instruments which are constantly seeking neutrality and balance. The key to balanced books, an optimal regulatory capital position, the neutrality of efficient intermediation and minimal (unanticipated) exposure is, more often than not, effective hedging. A splintering of successor rates to LIBOR puts individual hedging arrangements and the matching of "back-to-back" contracts at risk. On a grand scale, this could cause significant disruption. But attempts to engineer convergence can leave parties with a wealth transfer that they did not intend and to which they have not consented. A move by public authorities to force contracts onto one rate rather than another more plausible or widely accepted rate could potentially expose public authorities to judicial review or to claims that a party's rights have been infringed by a disproportionate deprivation of its property. This is a remote but not entirely negligible possibility.

In addition to these key steps that have been taken along the LIBOR transition pathway in London this year, there has been determined and productive work by

regulators, legislators, industry bodies and market participants in Brussels, Frankfurt and New York.

Most recently, the International Swaps and Derivatives Association (ISDA) published the Fallback Supplement to the 2006 Definitions and the IBOR Fallbacks Protocol, which in combination will see new fallbacks incorporated into new and legacy contracts on market standard terms, where adopted.

The IBOR Fallbacks Supplement updates rate options in the 2006 ISDA Definitions to include new risk-free rate fallbacks for the five LIBOR currencies together with eight other IBOR benchmarks. The Supplement, when it becomes effective on 25 January 2021, will implement these risk-free rate fallbacks into the terms of new transactions and the Protocol will enable adhering parties to implement these fallbacks into the terms of legacy transactions. The Protocol will amend legacy transactions so that upon the occurrence of a permanent cessation trigger or pre-cessation trigger, a robust risk-free rate fallback will apply in place of the contractual LIBOR rate. A pre-cessation trigger is constituted by an announcement by the FCA that the relevant LIBOR rate is not, or as of a specified future date will no longer be, representative and that representativeness will not be restored. This is significant and important because it provides an “exit ramp” for legacy contracts which might otherwise end up stuck on Transition LIBOR in a future world where the FCA chooses to impose a new methodology on LIBOR and the anticipated permanent cessation trigger does not materialise.

When the Protocol fallback is triggered, the contract will revert to a term-adjusted nearly-risk-free rate for the relevant currency plus a spread adjustment. The term-adjusted rate will be the overnight RFR compounded in arrears over an accrual period corresponding to the tenor being substituted (e.g. 1, 3 or 6 months). The spread adjustment will be the historic median difference between the relevant LIBOR rate according to currency and tenor and the term-adjusted RFR over a five-year look-back period.

This is a welcome safety net. Protocols, however, are not an absolute panacea. They may only work for bilateral transactions and are currently only available in respect of derivative documents. Protocols will not mitigate the uncertainty referred to above in respect of linked and matched transactions unless the terms of a protocol for one asset class are replicated for other asset classes. So, the problem of “tough legacy” persists and must be addressed by other means.

As far as public authorities are concerned, the European Commission has published a proposal to amend the BMR so as to ensure, inter alia, that regulators have adequate tools to guide and accommodate the transition avoiding contract frustration and financial instability.<sup>5</sup>

When in force, this legislation will give the European Commission powers to mandate the use of a statutory replacement rate (**SRR**) in relevant contracts if a major

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<sup>5</sup> Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation, Brussels, 24 July 2020, COM(2020) 337 final.



benchmark used in the EU, such as LIBOR, is discontinued or becomes unrepresentative of its underlying market. The SRR will automatically replace the outgoing benchmark by operation of law in all contracts which are: (i) “financial instruments, financial contracts and measurements of the performance of an investment fund”, as those terms are defined in the BMR (meaning that loan agreements other than consumer loan agreements would be excluded, but loan-linked agreements, such as hedging transactions, could be in scope qua financial instruments), and (ii) lacking any suitable fallback provisions (i.e. **tough legacy contracts**). According to the recitals and the preamble to the proposal, the contracts must also be: (iii) entered into by one or more BMR “supervised entities”, although this restriction does not appear from the draft Articles, other than indirectly by reference to the definitions of “financial instruments” and “financial contracts” in the BMR.

The differences in the respective UK and EU approaches could potentially create difficulties where contracts exist between UK and EU entities in the absence of careful coordination. For example, as the FMLC recently noted, LIBOR could be theoretically extant under English law as a screen rate but “in cessation” as a methodology and/or as a measure of London interbank unsecured lending rates and therefore replaceable by the SRR within the EU. In the case of cross-border contracts, the question of what the terms of the contract mean should be decided according to governing law of the contract, which entails that the SRR will not be automatically incorporated into a contract with an EU supervised entity where that contract is governed by English law and that may cause a surprising and possibly chaotic result as far as the entity itself is concerned. Further, there may be some confusion as to whether the EU provisions impliedly derogate from the choice of law rules in Article 12 of Regulation (EC) No 593/2008 on the law applicable to contractual obligations (the **Rome I Regulation**)<sup>6</sup>, which provide that the interpretation and performance of a contract is governed by its applicable law.

Contracts involving EU entities with overseas elements could, in theory, be subject to competing interpretations as to which floating price can be strongly supported (the screen price established under the Financial Services Bill or the SRR), leading to confusion and possible litigation.

This concern is exacerbated for market participants by the fact that other jurisdictions, including New York, have introduced legislation to incorporate a successor rate by operation of law into contracts. The legislation, which was introduced in the New York Senate in November, will establish, for the purposes of any dispute, that a recommended benchmark replacement is a commercially reasonable substitute to LIBOR.<sup>7</sup> It will, for example, override existing fallback language that references a LIBOR-based rate and instead require the use of the legislation’s recommended benchmark replacement. While this does not raise factual questions about whether LIBOR has been discontinued, the application of the legislation may be questioned in cases where, as described above, there are conflicting positions taken between regulators in the EU and UK about whether or not LIBOR has been discontinued. The

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<sup>6</sup> Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) (OJ L 177, 4.7.2008, p. 6).

<sup>7</sup> [Senate Bill S9070](#) (introduced on 28 October 2020), available on the New York State Senate website.



legislation would also prohibit a party from refusing to perform its contractual obligations or declaring a breach of contract as a result of LIBOR discontinuance; override existing fallback language that references a LIBOR-based rate and instead require the use of the legislation's recommended benchmark replacement; nullify existing fallback language regarding reference banks polling; and insert the recommended benchmark replacement as the LIBOR fallback in contracts that do not have any existing fallback language. It has been reported that federal legislation along similar lines is being considered.<sup>8</sup>

The FMLC has expressed the view that careful coordination between regulators in the EU, UK and third countries around the discontinuance of LIBOR and the exercise of any powers to alter the identity of the benchmark and/or the terms of financial transactions is essential to avoid significant market confusion.

## 7 Conclusion

The prospective demise of LIBOR has thrown up unprecedented issues for the financial markets. Although there are many historical examples of altered and discontinued benchmarks, none have been as significant, pervasive or as entrenched as LIBOR. In this respect, the forthcoming transition bears a closer resemblance, perhaps, to past instances of currency transition — such as the creation of the Euro — than to prior instances of benchmark withdrawal. It should be no surprise, then, that eight years of investigation, planning and research by regulators, legislators, industry associations and individual market participants have not yielded a “one size fits all” solution to transition. LIBOR is an umbrella rate for a variety of different currencies, and each have their own idiosyncrasies, liquidity profiles and characteristic markets. It makes sense, then, that successor rates for the different currencies will in future be administered in their sovereign jurisdictions, although this may conceivably import additional basis risk in certain cross-border markets. LIBOR is also an umbrella rate for a variety of different tenors, which exacerbates the risk inherent in the transactions in which it is anchored. It makes sense, then, that that instruments should transition onto overnight rates which measure markets that are deep, liquid and nearly risk free, although this will import a new risk — the risk that the transition itself brings about an unintended wealth transfer in respect of legacy contracts. And, LIBOR is an umbrella rate for a variety of products and markets — including syndicated loans, corporate loans, retail mortgages, derivatives, bonds, notes and cash products — which all have very different maturity and risk profiles. Again, it is logical that different instruments, markets and sectors should adopt different solutions in transition, even though this raises the spectre of new challenges for financial risk management.

Given all this market diversity, it also should not surprise us that there is no single appropriate response to the legal risks of transition. Legislation, protocols, regulation and even reliable opinions all have their part to play in securing a stable financial future without LIBOR. What matters is not that we all reach the same destination, take

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<sup>8</sup> Smith RM, [Congress readies surprise 'tough legacy' Libor fix](#) (9 November 2020), available at Risk.net.

the same path or occupy the same vehicle but that we coordinate carefully so that there is safe passage for all.

# The Transition from US Dollar LIBOR from a US Perspective

By Thomas C. Baxter, Jr.<sup>1</sup>

## 1 Introduction

This contribution will address the transition from LIBOR to an alternative benchmark from the perspective of a practitioner in the United States. Consequently, the focus will be on US Dollar LIBOR (USD LIBOR), and not on the transition issues associated with the other four interbank borrowing rate (IBOR) currencies, the Euro, Pound Sterling, Swiss Franc and Yen.

At the outset, it is important to reference two features of USD LIBOR. First, the US Dollar is the principal medium of exchange for international transactions, and it is commonly used in many different transaction types, from derivatives to loans to securities. It is estimated that there are some USD 200 trillion in instruments outstanding that are referenced to USD LIBOR. This characteristic distinguishes USD LIBOR from the other IBORs, and the eye-opening USD 200 Trillion number gives rise to financial stability concerns.

Second, the cessation of USD LIBOR presents issues concerning new instruments and so-called legacy instruments. For new instruments, the cessation of USD LIBOR means that this benchmark needs to be replaced with another benchmark. As is well known, the Alternative Rates Reference Committee (ARRC), which operates under the sponsorship of the Federal Reserve Bank of New York, has recommended a near risk-free rate called the Secured Overnight Financing Rate (SOFR), as its preferred alternative benchmark. SOFR is an overnight rate derived principally from repurchase agreement transactions in US Treasury and Federal agency securities.

USD LIBOR, by comparison, is currently expressed in seven different “tenors”, ranging from overnight to 12 months. Further, in all of its tenors, USD LIBOR is an unsecured rate that measures the marginal cost of funding among a discrete group of 16 so-called “panel banks”. The panel banks provide the benchmark administrator, ICE Benchmark Administration, with data regarding actual transactions and, in some cases, their expert judgment with respect to what rate they might obtain to satisfy funding needs across a given time period. Given what USD LIBOR currently measures, some have questioned whether or not a risk-free rate is an appropriate alternative reference rate to use for certain types of instruments, including loans.

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<sup>1</sup> Thomas C. Baxter, Jr., is a member of Sullivan & Cromwell's Financial Services Group, and frequent lecturer at programs sponsored by the Uniform Commercial Code Institute, the Department of Justice's Advocacy Institute, the American Bar Association, the American Law Institute, the Bank Administration Institute, the Practising Law Institute, the Federal Financial Institutions Examination Council and similar organizations.

For legacy instruments, there are other complicating factors. A legacy instrument is an instrument referenced to USD LIBOR that was issued before the expected cessation date but that matures after the expected cessation date. Now, there are some legacy instruments whose drafters were prescient and envisioned a scenario where USD LIBOR would go away.

For these instruments, the contingencies resulting in USD LIBOR's cessation are clearly articulated, and the alternative replacement benchmark is clearly stated. For these instruments, when USD LIBOR goes away, there is a simple solution to the alternative interest rate – you simply follow the contract's provisions because those provisions tell the parties what is to be done. But there are also many other instruments whose drafters were much less forward thinking. Some of these legacy instruments have been characterized as “tough legacy instruments”, a term describing an instrument where there is either no contingency for USD LIBOR going away or, if there is such a contingency, it produces an alternative reference rate that has a material adverse effect. One example of a material adverse effect is a clause in a floating rate instrument that converts the instrument into a fixed rate instrument when USD LIBOR is no longer published – typically by incorporating by reference the last-published USD LIBOR rate. The adverse effect is easy to see, because such a clause converts what the parties obviously intended to be a floating-rate instrument into a fixed-rate instrument.

## 2 Potential Problems When USD LIBOR Goes Away

As this is written, the currently anticipated cessation date for USD LIBOR is December 31, 2021<sup>2</sup>. Given that six months needs to be allowed for system changes to accommodate a new benchmark, there is not a great deal of time to fashion solutions to the problems in order to make a new benchmark operational, let alone to account for the complicating details of tough legacy instruments that are summarized below. I will describe some of the suggested solutions to these problems, but I also need to observe that all of these solutions are a work in progress.

### 2.1 New Instruments

Let me begin the analysis of new instruments by acknowledging the excellent work done by the ARRC. The ARRC has come forward with its preferred alternative benchmark, SOFR. SOFR is administered by the Federal Reserve Bank of New York, the highly respected operating arm of the United States central bank. SOFR is an excellent alternative benchmark because it is derived from a huge volume of actual transactions. This derivation renders it compliant with a key principle of the so-called

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<sup>2</sup> That said, the LIBOR benchmark administrator announced on 30 November 2020 that the 1 Week and 2 Month USD LIBOR settings would cease immediately following the LIBOR publication on 31 December 2021, and the Overnight and 1, 3, 6, and 12 Month USD LIBOR settings immediately following the LIBOR publication on June 30, 2023:  
<https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-Publishes-Consultation-on-Potential-Cessation-of-LIBOR-Settings/default.aspx>

IOSCO principles<sup>3</sup>, and this means it is not easily subject to manipulation. There is a paucity of actual transactions underlying the longer tenors of USD LIBOR. This requires some of the panel bank submitters to base their submissions upon expert judgment, and there is an understandable fear that expert judgment will be less accurate than a submission based upon actual transactions. The distrust of expert judgment is the fundamental reason that has led the official sector to push for a cessation of USD LIBOR.

It is sometimes said that the “devil you know is sometimes better than the devil you don’t.” To transition away from USD LIBOR, a rate that will be going away, a bank needs to transition to an alternative benchmark. Some market participants are uncomfortable with transitioning to a risk-free rate like SOFR for certain forms of transactions, fearing that they might be moving towards a different “devil”. These participants view SOFR as perfectly appropriate for derivative transactions, but find it to be lacking for other types of transactions, like loans. These participants note that USD LIBOR has been a huge commercial success over many years because of some of the rate’s inherent characteristics. First, they observe that USD LIBOR measures the marginal cost of funding to a discrete group of larger banking organizations that are internationally active. Thus, USD LIBOR provides a measure not of a single bank’s credit condition, but the credit condition of a group of banks. If you are a borrower and do not want to be susceptible to the changing credit condition of an individual bank, this feature of USD LIBOR can be very desirable. Second, in stressful conditions, the fact that USD LIBOR measures the banks’ funding cost provides a “natural” hedge to the lender. If the average cost of the banks’ funding should rise (and it typically does in times of stress), then the lender can pass along that cost to the borrower (assuming the interest rate in the instrument is a floating rate and not a fixed rate). Interestingly, some look at this feature with alarm, and consider it to be improper for the higher cost of funding to be passed along to the borrower. To the contrary, banks proposing a credit-sensitive rate look at increases in funding cost as part of the overall cost of lending; in the view of these banks, no one should be shocked to see higher cost being passed to the customer. After all, automobile manufacturers would pass along to car buyers the increased cost of steel, which would be reflected in the higher price of an automobile.

Now, some borrowers look at this feature of USD LIBOR as a disadvantage – they stand to have to pay the increase in funding costs through higher interest rates. However, the lenders favouring a credit-sensitive alternative respond that, if the situation were otherwise, lenders would not commit to provide credit if they could not recoup their rising funding costs.

Neutral observers of USD LIBOR tend to pause at one indisputable fact. For more than 50 years, USD LIBOR has been overwhelmingly popular as a reference rate. They tend to acknowledge that the popularity of the reference rate is attributable to its unique features which appeal to all users (lenders, borrowers, and investors), and point to its credit-sensitive characteristic. If that credit-sensitive feature is absent from an offered substitute, including SOFR, this could create problems.

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<sup>3</sup> See the International Organization of Securities Commissions (IOSCO), [Final Report on Principles for Financial Benchmarks](#), July 2013, available on the IOSCO website.

In large part because of these considerations, a number of well-regarded financial institutions have begun work to develop a credit-sensitive rate with features similar to USD LIBOR. They have obtained some support from the US official sector for a group called the Credit Sensitivity Group, which has a mandate to work towards the development of a dynamic credit-sensitive spread that might be added to SOFR to produce a more suitable benchmark for lending. The Credit Sensitivity Group has held several meetings, and it has operated under the sponsorship of the Federal Reserve Bank of New York. There are a number of vendors working to respond to the banks' request for an alternative credit-sensitive rate, including the existing administrator of USD LIBOR, ICE Benchmark Administration, and others, such as Ameribor, Markit, and Bloomberg.

Another issue associated with new instruments concerns the fact that SOFR is an overnight rate, while USD LIBOR is expressed in 7 tenors, ranging from overnight to 12-months. If one compares SOFR to 12-month USD LIBOR, one of the distinguishing characteristics is the term premium – credit extended overnight to a borrower is different than credit extended to the same borrower for one year, and holding everything else equal will necessarily result in some rate differential, currently measured in basis points but historically (when interest rates were higher) measured in a larger figure. As a result, benchmark users have made it clear that they would like to see the development of Term SOFR. As this is written, work is underway to explore whether a Term SOFR will be possible, and if so, whether a reliable Term SOFR rate might exist on or before December 31, 2021, the current anticipated cessation date for USD LIBOR. If so, this would address the term premium that exists between an overnight rate and rate predicated on a longer tenor.

Another important criterion for whatever benchmark replaces USD LIBOR is that the alternative reference rate needs to be IOSCO compliant. To be IOSCO compliant, a reference rate must satisfy the IOSCO principles. Among those principles are some that are directed toward what enabled USD LIBOR to be abused in the past, and to be manipulated by unscrupulous traders who realized a financial gain from such misconduct. There are two factors that are noteworthy. Perhaps the most important we have already mentioned – having a large number of actual transactions underlying the alternative reference rate. A large number of transactions makes it very difficult to manipulate the rate derived from such transactions. If a malefactor were to submit distorted information because of an improper motive, this would be but a “drop” in a large ocean, a drop not likely to make any difference. This explains why the IOSCO principles concentrate on a large data set, a data set like the data that underlies SOFR.

Of course, having a large volume of data supporting a reference rate is great protection against manipulation of the rate, but it might lead to other problems if the rate measures something that is not what the parties want. To put this simply, having an alternative rate that is robust, but not relevant, is not useful. This is one of the “issues” raised with a risk-free rate like SOFR. It cannot be easily manipulated which is good, but it measures lending that is risk free, which arguably is not relevant to commercial lending. If the cost outweighs the benefit, then SOFR is hardly the perfect substitute for USD LIBOR. And there is no one who argues that SOFR and USD

LIBOR are inter-changeable. Even the most zealous SOFR advocates admit that SOFR must be augmented by a spread adjustment if used to replace USD LIBOR.

Another aspect of IOSCO compliance is a cogent Code of Conduct. A cogent Code of Conduct that is enforced by the submitters of data is another way to provide a safeguard against a malefactor who might provide data because of an improper motive. This is another feature that the IOSCO principles contributed to the system of controls on benchmark production to improve the reliability of benchmarks and to prevent the kind of misconduct that we have seen in the past.

What can be said with respect to the current thinking about the transition from USD LIBOR for new instruments? In short, there is now one preferred alternative benchmark and that is SOFR. It is fully recognized that SOFR, being a risk-free rate, will need to be augmented with a spread adjustment to make it compatible with USD LIBOR. With respect to how that spread adjustment might be calculated, there are different ways to accomplish the objective. One popular method involves the calculation of an arithmetical average by looking back at the spread between USD LIBOR and a derived form of SOFR (SOFR was first published in April of 2018). The arithmetical average would be determined over the five year “look back” period, and then the spread adjustment would be added to SOFR to produce a USD LIBOR substitute.

The banks who are advocating for a credit-sensitive alternative are assiduously working to develop an IOSCO-compliant rate that would determine the average marginal cost of funding for a discrete class of banks, and for these banks, this alternative reference rate would become the replacement rate for USD LIBOR in new loans. There is also a variation on this approach, which would create a credit-sensitive “spread” measuring the marginal cost of bank funding, and add this spread to a Term SOFR rate, producing (in the view of proponents) a close alternative to USD LIBOR.

Regardless of what specific replacement benchmark is used for new instruments, there are also a whole host of operational issues that need to be tackled between now and the cessation date for USD LIBOR. Many of these operational issues relate to information technology, and the need to program internal systems at both lenders and borrowers so that mathematical and accounting systems may perform in accordance with expectations. The volume of work is substantial and must be done by both the bank and its customers. Further, the work needs to be finished before the USD LIBOR cessation date. In this regard, the overall effort is reminiscent of Y2K, and the herculean effort 20 years ago to get system changes implemented to avoid what was believed to be a potentially catastrophic system crash when the Millennium changed.

## 2.2 Legacy Instruments

There is good news and bad news regarding legacy instruments. Let us start with some of the good news.

Not all legacy instruments are considered to be tough legacy instruments. The call for a replacement for LIBOR is not new. It began in earnest at the Financial Stability Board



(FSB) six years ago, when the FSB published its seminal report calling for reform in 2014. Sophisticated market practitioners began to pay attention to the possibility that LIBOR would go away, and their legal advisors (some of whom contributed to the FSB's work, especially the work of the Market Practitioners Group) developed new language anticipating the end of LIBOR. These instruments not only acknowledged the need for an alternative benchmark, but the instruments also contained more detailed provisions that elaborated on the types of contingencies that would cause the substitution of an alternative reference rate. The drafters anticipated not only the fact of LIBOR no longer being published, but also anticipated that LIBOR might be declared by an official body to be "no longer representative".

The instruments that are tough legacy instruments, however, remain deeply problematic. One category of tough legacy instruments consists of instruments that are referenced only to USD LIBOR, as if the benchmark would last in perpetuity. For these contracts, it is "as if" no one could foresee LIBOR would ever go away. The result of such a lack of foresight is uncertainty about what will happen when LIBOR goes away, because we all know now that it will. In that circumstance, there will be a material term in the instrument that cannot be satisfied. You cannot pay an interest rate measured in LIBOR if the rate no longer exists. What will this mean? Does it mean that performance is excused? Does one party to the instrument fashion a suitable substitute, and impose the substitute on the other party?

The parties to the instrument can negotiate an amendment to the instrument that will provide a new benchmark, but that assumes a willingness to negotiate, and a capability to work in good faith to a resolution. In some securities, for example, USD LIBOR is used as a reference rate and there are laws like the Trust Indenture Act that require 100% of the holders to agree on an amendment of the interest rate. Obtaining a unanimous vote of holders in such circumstances is a practical impossibility, not only because some holders just will never be heard from, but also because certain hedge funds have acquired positions for the purpose of litigating and not for the purpose of engaging in good faith negotiation.

Another piece of very good news relates to the fact that as many as USD 190 trillion of USD LIBOR instruments are derivatives. For many of these, ISDA has developed a protocol that will provide the needed default rule. This protocol has also been the subject of so-called "business review letter" from the US Department of Justice, which provides a certain degree of protection under US competition laws for parties that use the protocol. Thus, banking institutions can work together in using the protocol, which is a very significant legal development.

Now for some of the bad news. This particular bad news relates to context – we are speaking about instruments referenced to USD LIBOR. While it is difficult to get a sense of the dimension of the problem, we believe that many of these tough legacy instruments have a choice-of-law and choice-of-forum clauses that select the laws of New York, or another state, meaning that the instruments will be governed by US law and the forum for dispute resolution will be a US forum. The United States has two distinguishing features that add to the risk that tough legacy instruments will cause litigation. One is the class action device, which makes litigation concerning LIBOR appealing to the so-called "plaintiff's bar". The other is the right to a trial by jury, which

likewise is appealing to the plaintiff's bar, especially in an environment that remains hostile to banks.

Another contextual feature concerns the fact that so many receivables in the United States are placed into securitization vehicles, where the receivables serve as a backstop for asset-backed securities. If the underlying instruments are tough legacy instruments, then it is probable that the issuer will need to select a replacement benchmark of some kind. It is not likely that the replacement benchmark will be a perfect substitute for USD LIBOR<sup>4</sup>, and that the insertion of the replacement benchmark in place of USD LIBOR will change in some degree the economics of the instrument. In the case of a loan, for example, a change of the economics in favour of the borrower will be good news to the borrower, but bad news to the investor who has acquired a security backed by the instrument with the now-lowered cash flow. In this situation, the trustee for the securitization with that instrument backing it will have an incentive to sue. On the other hand, if the change in the economics is in favour of the lender, then the borrower will have the incentive to sue (or the class of borrowers represented by a plaintiff's class action firm). Why? Because the borrower will be paying a rate that is higher than USD LIBOR.

These features of the alternative reference rate contribute to the risk of litigation. Further, there is anecdotal evidence that some hedge funds are acquiring tough legacy instruments with the expectation that they will be positioned either as investors or borrowers, and able to realize on the opportunity that LIBOR cessation presents. If, to use SOFR as an example, an issuer or a holder replaces USD LIBOR with SOFR plus a fixed spread, there is a high likelihood that the economics of the instrument will be changed. In the litigation that ensues to make up the economic difference with a money judgment, one may expect the plaintiff to focus on the fact that USD LIBOR and SOFR are fundamentally different from each other and measure different things. USD LIBOR represents the marginal cost of funding for a specific group of 16 banks. SOFR, in sharp contrast, measures the financing cost of repurchase agreements where the "security" is US government or agency securities. Further, one can expect that the plaintiff to point to certain points in time, like September 17, 2019, when the two rates materially moved in opposite directions. These specific situations could be viewed as probative that the two reference rates are fundamentally different in kind.

What kinds of cases can be expected? One type of case to be expected is the case to recover the change in the economics produced by the change in benchmark. Another case is more opportunistic and falls under the descriptive term "continuity of contract". Here, the plaintiff would argue that the instrument has been changed so materially that the entire contractual purpose has been frustrated. If such a case were to succeed, a court would declare the respective obligations to be frustrated and the debtor would no longer be obligated to pay the creditor. If large numbers of these cases were to be brought in multiple courts, confidence could start to erode in the financial system and produce a panic. The result could endanger financial stability.

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<sup>4</sup> It is possible that one or more of the vendors working on a credit sensitive benchmark will derive a substitute that comes close to perfection, perhaps even so close that the correlation between the two benchmarks will be close to 100%. If so, then the litigation risk diminishes considerably.

## 3 Potential Solutions When USD LIBOR Goes Away

Assessing the threat-environment associated with the transition from USD LIBOR has focused heavily on the tough legacy instruments and the litigation risk associated with these tough legacy instruments. As this is written, there appears to be a widespread consensus that the risks articulated in the prior section are clear and present. As a result, there are currently efforts underway to consider techniques to mitigate these risks. The principal techniques being considered are addressed here.

### 3.1 Extension of the Anticipated Cessation Date

One of the simplest techniques to address these risks is through an extension of the anticipated date for cessation. Let us start with a plainspoken observation by a Federal Reserve official. The official said that if you find yourself in a hole, one obvious thing is to stop digging. The fact is that many financial institutions are in a figurative “hole” with respect to tough legacy instruments. The absence of a good substitute for USD LIBOR has led to what might seem to be a paradoxical response – institutions have kept on issuing instruments referenced to USD LIBOR, even with the knowledge that USD LIBOR will be going away. The response becomes understandable given that many bank customers insist on USD LIBOR, in part because there is no suitable substitute rate with comparable features.

There is another point underlying the suggestion to stop digging. If a financial institution stops issuing instruments referenced to USD LIBOR, its overall inventory of USD LIBOR referenced instruments will soon start to decline naturally. This results from the fact that loans are re-financed, amended, or otherwise replaced by other credit, especially in an economic environment where rates are declining or near zero. The reduction in inventory is known as “roll-off”, and when an institution stops issuing USD LIBOR instruments, there is a natural roll-off. Of course, there is also a corollary to this – there will be no roll-off if the institution keeps on issuing new USD LIBOR referenced instruments.

This leads us to the discussion of a possible extension of the anticipated cessation date. If the cessation date were to be extended from December 31, 2021 to another future date, there would be more time to complete the development of an alternative reference rate (perhaps a credit-sensitive rate), and then institutions would begin using that alternative in new instruments instead of USD LIBOR. As that conversion progressed and USD LIBOR instruments rolled off, the number of tough legacy instruments would be reduced.

Interestingly, in the work done for the FSB in 2014 by the Market Practitioners Group, data was collected showing the beneficial effects of “roll-off”. The data demonstrates that, over a 3-5 year period, many instruments will roll-off, meaning that the debt using a specific reference rate will be re-negotiated, amended, paid off, or defaulted during the period. Consequently, if financial institutions stop issuing USD LIBOR instruments (and some already have), and the expected date for cessation of the USD LIBOR rate is extended say for several years, we might anticipate that the tough legacy problem

will become progressively smaller. With respect to the above-articulated financial stability concern, the overall number of instruments could become sufficiently small that there would no longer be such a concern.

In that respect, the recent suggestion that IBA may extend certain USD LIBOR benchmarks until 30 June 2023 (subject to consultation), can only be welcomed<sup>5</sup>.

## 3.2 Synthetic LIBOR

Another potential solution to the problem of tough legacy instruments is something called “synthetic LIBOR”. What is synthetic LIBOR? It is a descriptive term that is used to describe one solution to the problem of tough legacy instruments described above. Today, USD LIBOR is a number that is published on a screen, and many contracts describe USD LIBOR by reference to what is shown on a screen or in a well-known publication. Typically, the data provider is a technology/communications company like Reuters or Bloomberg, and the instruments we have been discussing are instruments that are referenced on a screen, or sometimes, through more traditional print means for communicating financial information, like the Wall Street Journal.

With respect to synthetic LIBOR, this legal fiction would be the product of a statute that would empower an official sector organization, say the Financial Conduct Authority in England, to require a benchmark administrator under its jurisdiction, say ICE Benchmark Administration, to publish LIBOR but to do so using a different methodology. Instead of producing USD LIBOR by processing the data submitted by the panel banks, the administrator would produce USD LIBOR by taking another reference rate (e.g., Term SOFR) and adding a spread adjustment. It would then publish the benchmark using technology platforms and the traditional print media, which would show USD LIBOR in exactly the same way as the rate had always been shown. However, the number shown as USD LIBOR would be produced in a different way. Users would take the number from screens like Bloomberg or Reuters and incorporate the number into their tough legacy instruments, exactly as the “old” USD LIBOR rate had been before synthetic LIBOR took its place.

One might ask, “how can this be?” The answer is to be found in statutory law. A statute would authorize an official sector body to compel the benchmark administrator to change its methodology but continue to publish the benchmark under “business as usual” circumstances. One key changed circumstance is that USD LIBOR would now be produced using a very different methodology; it would be the product of a risk-free rate and a spread adjustment. The benchmark would bear the same name – USD LIBOR – but it would be produced not by processing submissions from the panel banks but through an arithmetical calculation. Some also have suggested that those who adhere to the direction from the official sector and publish or use the synthetic rate should enjoy immunity from liability. Immunity would attach because these parties have done no more than adhere to a governmental directive.

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<sup>5</sup> See footnote 2.

It is also noteworthy that these techniques for addressing tough legacy instruments – an extension of the cessation date and synthetic LIBOR – could be used in sequence. They are not designed to be mutually exclusive. So, for example, one might extend the cessation for USD LIBOR, experience the benefits of “roll-off”, and then address the remaining tough legacy instruments that had not rolled off through the use of synthetic LIBOR.

### 3.3 Remedial Legislation

The last significant mechanism to address the problems we have been considering is through the use of statutory law. There are currently being considered statutory solutions in the United States, at both the state and the federal levels. While it is too early to address the details of such proposed legislation, it is possible here to cover the broad framework for the anticipated law reform.

In broad brush, the statutory solutions will cover three different topics. First, the revised statutory law will address the threat concerning the continuity of contract. As noted earlier, this phrase, “continuity of contract” references the prospect that a court might determine that the cessation of USD LIBOR has so fundamentally changed the expectations of the parties that there is no longer a meeting of the minds and the obligations created by the contract need to be voided.

As a general matter, in the view of the author, it is unlikely that US courts will find that there is no longer continuity of contract. Remedial legislation refuting the contention may be an example of extreme caution. While LIBOR cessation is a new topic, there have been cases decided in the United States courts dealing with failed banks that had, before failing and being closed by the bank supervisor, made loans referenced to their own “prime rate”. Obviously, when a bank has failed and been closed by its supervisor, the bank can no longer publish a prime rate. Courts that have been faced with litigation claiming that the contract referencing the closed bank’s “prime rate” has been frustrated have declined to make that determination. Instead, they have “borrowed” a prime rate from a similarly situated bank and have used the borrowed prime rate to calculate the interest due. These cases provide a kind of precedent that could be used to address a case involving the cessation of USD LIBOR, where no alternative reference rate is specified in the instrument. The court would borrow a comparable rate produced by another administrator.

Nevertheless, while the risk may be small that a court would find the entire contract frustrated, the risk that this might happen is not zero. And the result of such a low probability event could be devastating to an individual bank. Accordingly, one possible objective of a remedial statute could be to address continuity of contract/contract frustration, and to state plainly that the cessation of USD LIBOR does not create a frustration event that would excuse the obligor from its obligation to pay the obligee principal and interest calculated using another method.

Of course, this then leads to the obvious next question for such a court. If the contract is not frustrated, then what interest rate should be used if the contract specified only USD LIBOR and USD LIBOR is no longer in existence? This is the next topic for

consideration by a remedial law – the creation of a default rule to fill the void in the instrument created by USD LIBOR's cessation. Here, the failed bank rate cases are helpful precedent. The case law suggests clearly that a court should look for a comparable rate and use the comparable rate to strike the amount of interest that is due. But what rate should that be?

A statutory solution to the problem could be to specify the default rate that should be used. This could even be done by reference to the rate selected by some credentialed authority, like the ARRC or the Federal Reserve. It could also be accomplished by reference to certain statutory criteria, or to the type of instrument. For example, in the event of a derivative instrument governed by the ISDA protocol, the statute might reference the protocol, and whatever outcome would obtain by application of the protocol. In these cases, the statute itself would create a default to fill the void left in the instrument when USD LIBOR goes away. With respect to US legislation, one possible default rate would be SOFR, adjusted by a spread based upon some methodology that would be identified in the statute. It could be backward-looking and based upon a historical average, or it might be forward looking and based upon a spread derived through a formula.

This brings us to the third topic for possible treatment in a remedial statute. If a person uses the statutory default rate, can that person have liability? A statute could answer the question in the negative, and completely absolve a person from liability for selecting the statutory default rate that will substitute for USD LIBOR in a tough legacy instrument. Now, there is a very important reason why this needs to be limited to tough legacy instruments, and the reason is rooted in fundamental respect for the parties' freedom of contract.

For instruments that are not "tough legacy instruments", the parties will have foreseen the cessation of USD LIBOR and will have contracted in anticipation that USD LIBOR would be unavailable. Presumably, there is a precise "trigger" in the instrument for USD LIBOR's cessation. Common provisions would address both the fact that USD LIBOR is no longer published, and the other typical criterion is that an official sector body has determined USD LIBOR is no longer representative. If either of those triggers are tripped, then the contract will typically apply an alternative reference rate.

Let us envision that the instrument is a single-family mortgage that was referenced to USD LIBOR and USD LIBOR is no longer published. Let us assume this triggers a conversion to a replacement rate and the alternative rate selected in the mortgage note is a 12-month US Treasury rate known as "12 MAT". This particular instrument would not be a tough legacy instrument, and it would not need to be covered by the statutory default rule. Why? Because the parties anticipated that USD LIBOR would go away, and they agreed that, when it did, 12 MAT would replace USD LIBOR. There is nothing to be done. The contract has covered the situation and there is nothing needing a statutory remedy. Further, the selection of 12 MAT by the parties should be respected by a court, if one party to the contract should seek review.

This is to emphasize that the purpose of remedial legislation is to solve a particular problem or problems. For legacy instruments with good fallback language that includes the selection of a replacement benchmark, there is no problem to be solved.

The instrument is not a tough legacy instrument. If you are a financial firm issuing USD LIBOR instruments today, you should emphatically not be issuing tough legacy instruments.

In contrast, the legislative solution is intended to remedy the problems created by tough legacy instruments that have already been issued. Some of the problematic instruments may have been issued long ago, before the FSB foreshadowed the cessation of USD LIBOR in 2014. Some may have been issued later, by parties not familiar with the work of the FSB.

Before concluding this discussion of remedial legislation, it is crucial to mention briefly the topic of choice of law. USD LIBOR is the reference rate of choice in international transactions. Many international transactions create instruments that are USD LIBOR referenced but have nothing to do with the United States. While we believe the bulk of USD LIBOR referenced instruments are governed by New York law, we also know that many are not. Some of these are governed by English law.

If an instrument is governed by New York law, and New York enacts a remedial statute like what we have just described, the parties to the instrument will be covered by the statute. On the other hand, if the instrument is governed by other law, say the law of England and Wales, the parties to the instrument will not likely be bound by the provisions of the New York statute. New York is not the governing law. Consequently, when considering the benefits and the burdens of remedial legislation, it is crucial to consider the governing law.

## 4 Conclusion

The cessation of a reference rate – USD LIBOR – that is used in instruments totalling USD 200 Trillion is a matter of considerable public concern. The concerns relate to two different types of instruments, new instruments and legacy instruments. New instruments being issued should not continue to use USD LIBOR, or, if they do use it, new instruments should include good fallback language and a suitable alternative reference rate. Legacy instruments present different issues, especially if they are “tough legacy instruments”. For tough legacy instruments, there are potential solutions, including the possible extension of the anticipated cessation date, synthetic LIBOR, or taking advantage of a potential future statutory solution. One key factor here will be the governing law clause in the instrument.



### Panel 3

EU Taxonomy and action plan on sustainable finance: what uses may these have for the ESCB?



Iñigo Arruga Oleaga



György Várhelyi



EUROPEAN CENTRAL BANK  
EUROSYSTEM

# Introduction to the panel on the EU Taxonomy and action plan on sustainable finance: what uses for the ESCB?

By Iñigo Arruga Oleaga<sup>1</sup>

There is scientific consensus that most of the observed recent global warming on the Earth's surface results from human activities. To take one of the numerous explanations of this fundamental phenomenon of our time, this is how the Australian Academy of Sciences describes it:

“Climatic warming or cooling arises from changes in the flows of energy through the climate system that can originate from a number of possible driving factors. The main drivers that have acted over the last century are:

- increases in atmospheric CO<sub>2</sub> and other long-lived greenhouse gases (methane, nitrous oxide and halocarbons)
- increases in short-lived greenhouse gases (mainly ozone)
- changes to land cover (replacement of darker forests with paler croplands and grasslands)
- increases in aerosols (tiny particles in the atmosphere)
- solar fluctuations (changes in the brightness of the sun)
- volcanic eruptions.

Of these, solar fluctuations and volcanic eruptions are entirely natural, while the other four are predominantly caused by human influences. The human-induced drivers have been dominant over the past century ... In comparison ... the effects of solar variations on present global warming are small”.<sup>2</sup>

These conclusions, which represent the current scientific consensus, are consistent with the robust findings of the Intergovernmental Panel on Climate Change already since its Third Assessment Report back in 2001<sup>3</sup> (!), which indicates a relatively slow response of Humanity to climate change evidence. Indeed, only in very recent years has climate change gained worldwide attention.<sup>4</sup> We can probably link the beginning

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<sup>1</sup> Adviser in the Financial Law Division, Directorate General Legal Services, European Central Bank.

<sup>2</sup> See the Australian Academy of Science's webpage: [Are human activities causing climate change?](#)

<sup>3</sup> International Panel on Climate Change (2001), [Climate Change 2001: Synthesis Report](#).

<sup>4</sup> Clark, P. (2019), [Five things I've learnt about saving the world](#). The author describes how at the end of 2014 concepts and assumptions about climate change that are common in 2020 were still novelties at the Financial Times.

of the more widespread attention to climate change to the success of the Oscar-winning documentary “An Inconvenient Truth”<sup>5</sup> and the intensity of the discussion about climate change in government, media and academia to the “Fridays for Future” movement started by Greta Thunberg.

Climate change affects the whole Earth’s surface. In Europe, the European Commission has identified specific consequences for southern and central Europe, the Mediterranean, northern Europe and urban areas.<sup>6</sup> The European Parliament declared a climate and environment emergency on 28 November 2019.<sup>7</sup>

In these global and European contexts, the policies and activities of the European Union are being oriented towards a stronger relationship with the fight against climate change, similarly to European societies themselves. This is true not only for energy and agricultural policies,<sup>8</sup> for instance, but also for competition policy.<sup>9</sup> When it comes to EU macroeconomic policies, if the Union is to fight effectively against climate change, major structural change has become unavoidable.<sup>10</sup>

This immediately brings into play the fiscal policy of the EU and the climate change component within it. In terms of volume, the EU’s fiscal answer to climate change can be given by reference to the Multiannual Financial Framework (MFF) and the temporary recovery instrument Next Generation EU (NGEU). As the European Commission puts it: under the political agreement on 10 November 2020 between the European Parliament and the Council based on the Commission proposal from 27 May 2020, the European Council conclusions from 21 July 2020, together with proposals from the European Parliament, “... 30% of the EU budget, under both MFF and Next Generation EU, will be spent to fight climate change, the highest share ever of the largest European budget ever.”<sup>11</sup> Also, accordingly, NGEU will be financed largely through green bonds, which will represent one-third of the overall NGEU issuance.

Of course, the fiscal policy of the EU will also need to include, among others, a very significant carbon tax, which is generally considered an element sine qua non for greenhouse gas emission reduction. Carbon taxation, however, will not be sufficient. Rather, a complete sustainable transition policy will be necessary.<sup>12</sup>

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<sup>5</sup> [An Inconvenient Truth](#), a documentary on global warming.

<sup>6</sup> “Southern and central Europe are seeing more frequent heat waves, forest fires and droughts. The Mediterranean area is becoming drier, making it even more vulnerable to drought and wildfires. Northern Europe is getting significantly wetter, and winter floods could become common. Urban areas, where 4 out of 5 Europeans now live, are exposed to heat waves, flooding or rising sea levels, but are often ill-equipped for adapting to climate change”. See the European Commission’s webpage: [Climate change consequences](#).

<sup>7</sup> European Parliament [resolution](#) of 28 November 2019 on the climate and environment emergency.

<sup>8</sup> European Parliament (2019), [EU Environment and Climate Change Policies](#), p. 11.

<sup>9</sup> European Commission, [Competition policy and the Green Deal](#), Call for contributions.

<sup>10</sup> Andersson, M., Baccianti, C., and Morgan, J. (2020), [Climate change and the macro economy](#).

<sup>11</sup> [Questions and Answers](#) on the agreement on the €1.8 trillion package to help build greener, more digital and more resilient Europe. It is noted that the political agreement also pays specific attention to biodiversity protection.

<sup>12</sup> Rosenbloom, D., Markard, J., Geels, F.W., and Fuenfschilling, L. (2020), [Opinion](#).

Against this scientific and social background, this introduction presents two fundamental questions about the monetary policy of the EU, which is carried out by the institution responsible for that policy, the European Central Bank.

Should the EU's monetary policy pursue the fight against climate change?

If yes, how should the ECB pursue this fight, i.e. how will the ECB deliver?

There is nowadays a consensus about the answer to the first question. Indeed, the monetary policy of the ECB has to pursue the fight against climate change. This consensus is young but already solid. The ECB has made the fight against climate change a component of its ongoing review of the monetary policy strategy under the wider concept of “environmental sustainability”, along with financial stability and employment.<sup>13</sup>

Clearly, the ECB has done so because it considers that environmental sustainability is part of its mandate under Article 127(1) of the Treaty on the Functioning of the European Union (TFEU). Indeed, the wide mandate of the ECB – comprising a primary objective of price stability to be defined by the ECB itself and a secondary objective, without prejudice to the primary one, of supporting the economic policies in the Union with a view to contributing to the achievement of its objectives – has led the ECB to explicitly include environmental sustainability in its understanding of the mandate. In addition, this explicit inclusion is supported by the horizontal provision in Article 11 TFEU according to which environmental protection must be integrated into the definition and implementation of the EU's policies (thus including monetary policy), in particular with a view to promoting sustainable development.

The ECB has not yet defined the “environmental sustainability” that it is going to integrate in its monetary policy. Indeed, it is probably not necessary for the ECB to do so. The EU legislator has already established an exhaustive list of environmental objectives for the purpose of determining the environmental sustainability of a given economic activity. It has done so in the piece of legislation to which this Conference panel is devoted: the Taxonomy Regulation.<sup>14</sup> These environmental objectives are now well known: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.<sup>15</sup>

Thus, the Taxonomy Regulation is already of immediate use to the ECB and to the European System of Central Banks: by means of this Regulation, the fight against climate change (mitigation and adaptation), like the other above-mentioned environmental objectives, is included in the EU's definition of environmental sustainability. By bringing environmental sustainability explicitly into the ECB's

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<sup>13</sup> ECB press release: [ECB launches review of its monetary policy strategy](#), 23 January 2020.

<sup>14</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).

<sup>15</sup> Taxonomy Regulation, Article 9. See also recitals 23-34.

mandate, i.e. into the ECB's understanding of its mandate, the ECB has made the fight against climate change one of its components.

Going back to the second question raised at the beginning of this introduction, we have to admit that, while there is consensus about the need for the ECB's monetary policy to pursue the fight against climate change, also evidenced by the ECB's position on the matter, there is lesser consensus about how this is to be done. Or, more precisely, how will the ECB deliver on this part of its mandate? In principle, this delivery, similarly as with respect to any other component of the ECB's mandate, is easy to phrase, the ECB delivers in the fight against climate change when:

- the ECB ensures price stability as defined by the ECB, including with reference to the time horizon that it also decides upon; and  
(without prejudice to this price stability or through the ensuring of price stability)<sup>16</sup>
- the ECB contributes (tangibly) to achieving the Union's objectives.

These objectives are those of the European Green Deal including its numerical targets, in particular that of no net emissions of greenhouse gases by 2050.<sup>17</sup> The EU (European Council) has advanced in the determination of these targets. This will directly benefit the ECB's review of its monetary policy strategy, as it will have these updated targets as a reference. The EU is in the process of adopting greenhouse gas emission reduction targets of at least 55% by 2030.<sup>18</sup>

Of course, an active contribution of the ECB's monetary policy to the objectives of the EU in the fight against climate change (thus including the EU's numerical targets) will mean that the ECB does more than just closely follow climate-change related developments, including carbon taxation, with a view to ascertaining how these developments impact prices and/or the overall economy within a given horizon, in order to adjust the monetary policy to these circumstances.

Such an active contribution indeed means much more. It means choices within monetary policy based on differentiation. In the context of this active contribution, the ECB would ultimately favour, i.e. would privilege, in the design and the use of monetary policy tools and instruments including the acceptance of collateral and the relationship with Eurosystem counterparties, those activities which are considered sustainable under the Taxonomy Regulation. Other formulae are also possible in combination with the use of the Taxonomy Regulation including, for instance, the

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<sup>16</sup> It is outside the scope of this introduction to cover the question of whether the fight against climate change has to be made part of the primary or the secondary mandate, or a combination of both. These questions will be addressed in a publication of the author along with Marguerite O'Connell, which is in preparation.

<sup>17</sup> See the information on the European Commission's webpage: [A European Green Deal: Striving to be the first climate-neutral continent](#).

<sup>18</sup> Conclusions of the European Council, 15-16, October 2020. See, in particular, point 10 of the Council [press release](#): "To meet the objective of a climate-neutral EU by 2050 in line with the objectives of the Paris Agreement, the EU needs to increase its ambition for the coming decade and update its climate and energy policy framework. In that context, the European Council discussed the Commission's Communication on 'Stepping up Europe's 2030 climate ambition', including the proposed emissions reduction target of at least 55% by 2030, and the actions required to achieve that ambition".

maintenance by the ECB of monetary policy asset purchase portfolios with an overall footprint compatible with the EU's numerical emission reduction targets.<sup>19</sup>

In delivering the climate change component of its mandate, as for any other component of its mandate, the ECB will observe the principle applying to it under Article 127(1) TFEU, namely to act in accordance with an open market economy with free competition, favouring an efficient allocation of resources. This will also be the case for the principle of proportionality, which governs the action of the EU institutions.

Nonetheless, the ECB, in delivering on climate change, cannot ignore the circumstances of the coronavirus (COVID-19) pandemic just as it cannot ignore any major circumstances affecting the life of the Union. So far, the ECB's measures in response to the pandemic and, in particular, the pandemic emergency purchase programme, have frozen the green and non-green components alike of monetary policy at the pre-pandemic situation in order to contribute to the recovery of the EU's economy. As the EU will evolve gradually towards a greener exit from the pandemic, so will the monetary policy of the ECB.

The challenges for the monetary policy are enormous. However, along with private sector investment, it is primarily for the EU's fiscal policy – through its tools and instruments, which are more granular and varied and less blunt than those of the monetary policy – to carry the bulk of the EU action against climate change, as summarily discussed further above in this introduction. These fiscal tools and instruments have in addition a direct democratic legitimacy which is less obvious in the case of monetary policy tools and instruments.

Yet, without the participation of the monetary policy and other policies of the EU, the Union will not reach its targets in the fight against climate change, which is one of the fundamental challenges of our time, if not the most fundamental one. The conscience of the need for the monetary policy to participate in this endeavour has led to a new reading of previous concepts like, for instance, the “overburdening” of the monetary policy. In times of climate emergency, the monetary policy has to respond to a higher level of demands.

The three panellists cover respectively the following topics:

- a (new) legal understanding of the ECB's mandate, including the principle traditionally called the principle of neutrality of monetary policy, in the light of the climate emergency;
- how taxonomies around the world including the EU Taxonomy can help to create an environment for the development of sustainable finance; and
- how the ECB has already started to make use of the Taxonomy Regulation in its monetary policy framework and how this legal act can open concrete paths of action for monetary policy.

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<sup>19</sup> Schoenmaker, D. (2020), [Greening monetary policy](#). See also [A green recovery](#), blog post, April 2020.



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# EU Taxonomy, action plan & supervisory developments on sustainable finance: what uses may these have for the E(S)CB?

By Willem Bovenschen and René Lieshout<sup>1</sup>

## 1 Introduction

The Covid-19 pandemic has led to a devastating global health and economic crisis. Governments and central banks have responded with unprecedented financial measures and stimulus packages in order to help economies to sail through this crisis. Even in these challenging times we should not forget that climate change and environmental issues remain as urgent and vital as ever. The systemic risk posed by climate change to our economies and the financial system has not disappeared. To the contrary, the pandemic has reinforced this point. The tremendous disruption to our daily lives and the huge impact on our economies resulting from lockdown measures could be considered as a real-life stress test of what we might experience in an increasingly unstable climate or disorderly transition shock. The IEA's Global Energy Report estimates that as a consequence of the lockdown measures and the reduction in economic activity, CO<sub>2</sub> emissions will decline approximately 8% by the end of this year. And yet, to meet the Paris Agreement, we must reduce emissions by a similar order of magnitude every year for the next decade. Since the current experience is not to be repeated, the economic response to the pandemic should not be to rebuild the old economy with the climate risks it presents, but to act now to lay the groundwork for an orderly transition to a more sustainable economy and climate-resilient financial system – in other words a “green” recovery. Although it is up to the governments and legislators to take the first step and exploit the opportunities for such “green” recovery through their policies, there is an important role to be played by central banks and supervisors as well.

We will provide a brief overview of the taxonomy regulation, zoom in on the mandate of the E(S)CB and discuss some supervisory aspects in relation to sustainable finance and will end with some concluding remarks.

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<sup>1</sup> Willem Bovenschen and René Lieshout are lawyers within the Legal department of De Nederlandsche Bank NV. The presentation at the ESCB Legal Conference 2020 was held by Frank Elderson (at the time Executive Director De Nederlandsche Bank NV) on the basis of the content of this article.

## 2 Taxonomy

### 2.1 Objective of taxonomy

In this day and age, investors are more and more looking for sustainable investments. Issuers are trying to tap in on these investors by offering sustainable/green bonds. However, what can be truly considered as a “green investment”? Since there were quite a few bogus green claims from financial institutions the term “greenwashing” evolved.

Luckily, in March this year the so-called Technical Expert Group (TEG) published a report that provided the parameters for the European Commission’s “taxonomy” by setting clear rules on what can count as a “sustainable investment”. This EU taxonomy aims to help direct capital towards long-term environmentally sustainable activities and to prevent false claims on the environmental nature of an investment. On 22 June 2020, the EU Regulation on the establishment of a framework to facilitate sustainable investment<sup>2</sup> (widely referred to as the “Taxonomy Regulation”) was published in the Official Journal of the European Union (OJ), marking a significant step in the realisation of the European Commission’s Action Plan on Financing Sustainable Growth (the EU Action Plan). On 12 July, 2020 this Taxonomy Regulation entered into force. With this Regulation and the (inter)connected Disclosure Regulation,<sup>3</sup> new requirements will apply to financial institutions that offer financial products as “green” or “sustainable”, thereby helping direct capital towards long-term environmentally sustainable activities. In order to help investors and to prevent false claims on the environmental nature of an investment, the taxonomy is to provide clarity as to what can be seen as a sustainable activity. The taxonomy provides for a general framework for the development of an EU-wide classification system setting up the criteria for determining whether an economic activity qualifies as environmentally sustainable. In this respect, the taxonomy could be seen as sort of an “investment catalogue” that comprises a list of economic activities that qualify as sustainable activities.

In order to achieve all this, as of next year, financial products claiming to have an environmental objective or benefit will have to disclose to what extent they align with the EU’s taxonomy, instead of relying on their own standards or methodologies. For every product, disclosure is required indicating to which extent an investment is sustainable. Moreover, additional requirements will be applicable pursuant to the Disclosure Regulation. These also relate to the undertaking as a whole: how is sustainability included in the investment policy and governance? In addition, the EU Taxonomy should enable the development of future Union policies in support of sustainable finance and serve as a basis for other economic and regulatory measures

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<sup>2</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p.13).

<sup>3</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317 9.12.2019, p. 1).

to facilitate the shift of investment towards environmentally sustainable economic activities.<sup>4</sup>

## 2.2 Taxonomy of sustainable activities

The Taxonomy Regulation recognises six different environmental objectives. In order to qualify as ‘environmentally sustainable’, economic activities must substantially contribute to one or more of these environmental objectives. Articles 10 to 15 of the Taxonomy Regulation lay down the requirements for an economic activity to be considered as ‘substantially contributing’ to these objectives.

1. climate change mitigation: the activity contributes to greenhouse gas stabilisation consistently with the goals of the Paris Agreement, through e.g. renewable energy, increasing energy efficiency and increasing clean or climate neutral mobility;
2. climate change adaptation: the activity includes adaptation solutions that substantially reduce the adverse impact (or the risk thereof) of the current and expected future climate on either (i) other people, nature or assets or (ii) the economic activity itself, in each case without increasing the risk of an adverse impact on other people, nature and assets;
3. sustainable use and protection of water and marine resources: the activity substantially contributes to achieving the good status of water bodies or marine resources, or to preventing their deterioration when they are already in a good status, through certain prescribed means, including, for example, through wastewater management;
4. transition to a circular economy: the economic activity contributes substantially to waste prevention, re-use and recycling, through certain prescribed means, including, for example, by improving the recyclability of certain products;
5. pollution prevention and control: the activity contributes substantially to pollution prevention and control through certain prescribed means, including, for example, by preventing or (where that is not practicable) reducing pollutant emissions into air, water or land (other than greenhouse gasses);
6. protection and restoration of biodiversity and ecosystems: the activity contributes substantially to protecting, conserving or restoring biodiversity and to achieving the good condition of ecosystems, or to protecting ecosystems that are already in good condition, through certain prescribed means, including, for example, sustainable land use and management.

In addition to substantially contributing to one of the six objectives mentioned above the activity must also comply with each of the following criteria:

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<sup>4</sup> See Recital 16 of the Taxonomy Regulation.

- No significant harm: the activity must satisfy the "do no significant harm" principle: i.e. where an activity substantially contributes to one of the environmental objectives, it must also do no significant harm to any of the other environmental objectives. Hence, to qualify as environmentally sustainable', in addition to a substantial contribution to at least one environmental objective, no significant harm can be made to the other environmental objectives;
- Compliance with technical screening criteria: the activity must comply with technical screening criteria for each of the six objectives that will be specified by the Commission on the basis of the technical input of a multi-stakeholder Platform on Sustainable Finance. Please note that the establishing and updating of these technical screening criteria is an ongoing process that still requires a lot of work.
- Minimum social and governance safeguards: the activity must be carried out in compliance with a number of minimum social and governance safeguards as referred to in the Taxonomy Regulation.

The Taxonomy Regulation does not itself establish a label for sustainable financial products nor does it invalidate existing environmental labelling schemes of individual EU Member States. It also does not prevent new labelling schemes from developing (however, such schemes will need to be consistent with the criteria in the Taxonomy Regulation).

## 2.3 An overview of the Taxonomy Regulation

The Taxonomy Regulation entered into force on 12 July 2020. The delegated acts on the first two climate-related objectives (climate change mitigation and climate change adaptation) are required to be adopted by the Commission by 31 December 2020 and will apply from 1 January 2022. The delegated acts on the remaining four environmental objectives are required to be adopted by the Commission by 31 December 2021 and will apply as from 1 January 2023.

As from 1 January 2022 (or 1 January 2023 depending on the environmental objective) entities are to include in their non-financial statements, information on how, and to what extent, their activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. Such information must include:

- the proportion of turnover derived from products or services associated with economic activities that qualify as environmentally sustainable; and
- the proportion of capital expenditure and of operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable.

Furthermore, where a financial product invests in an economic activity that contributes to an environmental objective, the pre-contractual disclosures and periodic reports

shall include information on the environmental objective(s) to which the investment underlying the financial product contributes and a description of how and to what extent these investments are in economic activities that qualify as environmentally sustainable. This also applies to financial products that promote environmental characteristics. Pursuant to the Taxonomy Regulation, it is also mandatory, when disclosing information on a financial product, to be transparent (by means of a statement) on the extent to which the EU criteria for environmentally sustainable economic activities have been taken into account.

## 3 E(S)CB mandate

The primary objective of the Union's monetary policy is to maintain price stability. Without prejudice to that objective, the monetary policy of the EU is to support the general economic policies in the Union with a view to contributing to the achievement of its objectives. These Union objectives are laid down in Article 3(3) of the Treaty on European Union (TEU) that provides that the Union "shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment".

### 3.1 Primary objective

If taking into account environmental aspects were to be considered necessary for maintaining price stability, these aspects would form part of the primary objective. In such circumstances, consideration of environmental aspects is contributing to the maintenance of price stability and not environmental protection objectives as such. In such case, like all monetary policy measures, the measures incorporating environmental considerations should also observe the principle of proportionality and the principle of an open market economy with free competition.

Recently ECB Executive Board member Schnabel said the following in a speech: "The extent to which central banks should and can support the chorus of actions and commitments to limit the damages of global warming will also depend on whether, and how, climate risks – including physical and transition risks – may affect medium-term inflation dynamics as well as central banks' ability to protect price stability against large and persistent climate shocks in the vicinity of the lower bound.

In this context, further work is needed to assess whether climate risks will ultimately require a stability-orientated central bank to react pre-emptively and help accelerate, within its mandate, the transition toward a carbon-neutral economy."<sup>5</sup>

President Lagarde, in response to questions by members of the European Parliament, stated the following:

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<sup>5</sup> Isabel Schnabel – 'Never waste a crisis: COVID-19, climate change and monetary policy' (speech at the INSPIRE virtual roundtable 'Sustainable Crisis Responses in Europe' on 17 July 2020).

“Climate change is one of the most pressing global challenges facing society today. In my view, all public and private institutions should act, within their mandates, to address it.

I welcome the fact that the ECB collaborates with other central banks and supervisors globally in the Network for Greening the Financial System (NGFS). Central banks and prudential supervisors can contribute to facing the challenges which climate change poses and the work of the NGFS – as the first report demonstrates – is essential to understand how to best do it. In my view, the ECB should contribute substantively to this effort and devote significant resources to this process. This includes taking seriously the recommendations of the group and acting on them wherever possible without undermining the ECB’s price stability mandate and other objectives.

In view of the major impact that climate change may have on our societies, also central banks and prudential supervisors need to take climate change into account and reflect on the appropriate response to climate change.”<sup>6</sup>

Both statements are in line with what the NGFS has stated, namely that climate change and its mitigation will increasingly affect key macroeconomic variables for the conduct of monetary policy across many different time horizons. Consequently, the NGFS has recommended that central banks consider the possible effects of climate change on the economy. These effects may be relevant to monetary policy even if they only materialise beyond the conventional three- to five-year policy horizon. Central banks should acknowledge that climate change already is part of their monetary policy contexts. Since climate change may also affect the transmission channels of monetary policy the NGFS stressed the importance for central banks to conduct further in-depth analyses of the impact of climate change on transmission, not least because their credibility hinges on having a good understanding of the effectiveness of their policy instruments. Furthermore, the NGFS recommended that central banks assess the implications for risk management practices, as climate related shocks may affect the riskiness of their financial portfolios and market operations.

### 3.2 Secondary objective of Article 127(1) of the Treaty on the Functioning of the European Union (TFEU)

Without prejudice to the primary objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union, which include amongst others a high level of protection and improvement of the quality of the environment.<sup>7</sup> The ESCB's action should not amount to policy-making in the field of the environment, where the ESCB does not have a policy-mandate but only a supportive role. The recent and future policy initiatives following from the EU Action Plan (such as the Taxonomy Regulation) will enable the ESCB to exercise more effectively its supportive competence when it

<sup>6</sup> Report on the Council recommendation on the appointment of the President of the European Central Bank (C9-0048/2019 – 2019/0810 (NLE)) – Answers by Christine Lagarde to the questionnaire.

<sup>7</sup> Article 127(1) TFEU and Article 3(3) of the Treaty on the European Union.



comes to contributing to the achievement of a high level of protection and improvement of the quality of the environment.

Article 127(1) TFEU does not establish any standalone, independent legal obligation for the ECB to proactively pursue environmental objectives and it does not allow the ESCB to autonomously set environmental policies, but rather to contribute to their attainment by supporting the relevant economic policies in the Union when carrying out its tasks.

To what extent could or should the ESCB give preference to the environmental protection objective of the Union vis-à-vis other objectives of the Union including inter alia "full employment" and "balanced economic growth"? In this respect, the Treaties do not rank the objectives in a specific order. When exercising its supportive competence, therefore, the ESCB would need to do so with a view to contributing equally to all the objectives of Article 3 TEU, where possible, whereby it is sufficiently justifying its preference of one over the other. The ESCB may give preference to environmental protection objectives over other objectives of the Union to the extent that this preference reflects a prioritisation in the policies adopted by the Union. In the absence of such prioritisation, the ESCB is arguably left with discretion regarding the prioritisation of certain objectives, subject to the requirement that such prioritisation is justified after the balancing against other objectives of the Union and to the extent that such prioritisation does not amount to policy-making.

### 3.3 ESCB mandate conclusion

Article 192 TFEU provides that the responsibility for attaining the objectives of the Union policy on the environment provided by Article 191 TFEU lies with the Union's legislator, namely the Council and the Parliament.

Under its secondary objective the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union, which include amongst others a high level of protection and improvement of the quality of the environment. As the Taxonomy Regulation not only reflects a clear policy direction but also provides for clarity with regard to sustainable finance, such policy initiatives enable the ESCB to more effectively exercise its supportive competence when it comes to contributing to the achievement of a high level of protection and improvement of the quality of the environment. The relevance of the latter is related to the question whether taking into account environmental aspects can be considered necessary for maintaining price stability. If so, these aspects would form part of the ESCB's primary objective and are not to be considered as environmental protection objectives as such.

## 4 Supervision

How do climate-related risks affect supervision? Where do we stand, both in the EU and in the Netherlands, when it comes to the integration of climate-related risk

considerations into prudential supervision? What is the role of the (EU) Taxonomy Regulation?

## 4.1 Climate-related risk and supervision

Climate-related risks can translate into material financial risks for banks through two main channels of transmission: physical risk and transition risk. Both physical risks and transition risks may materialise on the asset side of a bank's balance sheet, in relation to the activities it carries out.

- Physical risk - Exposures are vulnerable to the physical consequences of changing weather, such as damage to real estate (collateral), or write-downs of companies whose property or processes are exposed to physical consequences of climate change.
- Transition risk - New climate policies (resulting in increasing regulation and standardisation), technical developments and/or shifts in consumer preferences may affect businesses' market value or creditworthiness. This means the risks associated with the transition to a low-carbon economy could lead to a write-down of loans to and investments in companies.

These risks can be drivers of conventional risk types, such as credit, market and operational risk. Failing to address these risks can also result in reputational and legal risks, which can materialise on both the asset side (e.g. pressures leading to early termination of a loan agreement) and the liability side of the balance sheet (e.g. many depositors who rush to withdraw their money).

Climate change poses new challenges to the risk management of banks. Both physical and transition risks can be characterised by significant uncertainty and nonlinearity, while their probability of occurrence may not be reflected in historical data. These challenges thus warrant timely and concerted actions by banks, but also by the wider private and public sector.

## 4.2 Developments in the EU

We will briefly highlight some of the recent developments with regard to the integration of climate-related risk considerations into prudential supervision in the EU.

As we all know, in March 2018 the EU Commission launched the EU Action Plan.<sup>8</sup> One of the three goals of this action plan was to “manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues”, set out in – inter alia – Action 8: ‘Incorporating sustainability in prudential requirements:

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<sup>8</sup> Please note that the European Green Deal of 2019 announced a Renewed Sustainable Finance Strategy, which will build on the 2018 action plan. As this new strategy has recently been published for consultation (and is hopefully expected soon), we will not further go into this.

“The Commission will explore the feasibility of the inclusion of risks associated with climate and other environmental factor in institutions’ risk management policies and the potential calibration of capital requirements of banks as part of the Capital Requirements Regulation and Directive. The aim would be to take into account such factors, where this is justified from a risk perspective, to safeguard the coherence and effectiveness of the prudential framework and financial stability. Any recalibration of capital requirements, based on data and the assessment of the prudential risk of banks’ exposures, would need to rely on and be coherent with the future EU taxonomy on sustainable activities.”<sup>9</sup>

This once more emphasizes the relevance of the aforementioned Taxonomy Regulation for the ECB when it comes to the integration of climate-related risk considerations into prudential supervision.

In line with the aforementioned EU Action Plan, in June 2019 the revisions of the CRR and the CRD (as part of the “Banking Package”) were published in the OJ. With regard to sustainable finance, the Banking Package includes a mandate to the European Banking Authority (EBA) to prepare i) a report on how to incorporate environmental, social and governance (ESG) risks into the supervisory process; and ii) a report on the prudential treatment of assets associated with environmental or social objectives. In addition, the Banking Package requires large institutions to publicly disclose information on their exposure to ESG-related risks.

In December 2019 the EBA published its “Action plan on sustainable finance”<sup>10</sup>, in which the EBA presents its plans with respect to the reports related to ESG factors and ESG risks as mandated to the EBA. The action plan also contains a few key policy messages on the topic of sustainable finance, in order to outline the EBA’s “high-level policy direction and expectations about ESG risks”. The EBA clearly encourages institutions to already take steps with respect to ESG risks (focussing on scenario analysis, strategy and risk management and disclosure) and not to wait until the legal framework and relevant reports are ready.

In May 2020 the ECB launched the public consultation of its draft ‘Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure’, which “[...] outlines the ECB’s understanding of the safe and prudent management of climate-related and environmental risks under the current prudential framework. It describes how the ECB expects institutions to consider climate-related and environmental risks – as drivers of established categories of prudential risks – when formulating and implementing their business strategy and governance and risk management frameworks. It further explains how the ECB expects institutions to become more transparent by enhancing their climate-related and environmental disclosures. This guide is not binding for the institutions, but rather serves as a basis for supervisory dialogue. As part of this supervisory dialogue, the ECB will discuss with institutions the ECB’s expectations set out in this guide in terms

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<sup>9</sup> COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan: Financing Sustainable Growth, p. 9.

<sup>10</sup> [EBA action plan on sustainable finance](#) (2019).

of any possible divergences in institutions' practices. The ECB will continue to develop its supervisory approach to managing and disclosing climate-related and environmental risks over time, taking into account regulatory developments as well as evolving practices in the industry and in the supervisory community."<sup>11</sup>

This guide is a great step for the ECB, which shows the ECB's commitment to making institutions more aware of the importance of climate-related and environmental risks. This an important milestone in the process of integrating climate-related risk considerations into prudential supervision, with hopefully many more to come.

### 4.3 Developments in the Netherlands

In the Netherlands, De Nederlandsche Bank (DNB) also strives to integrate climate-related risk considerations into prudential supervision. Over the last years DNB has published many studies, papers and researches<sup>12</sup> and integrating sustainability in supervision is in fact part of DNB's Supervisory Strategy 2018-2022.

Furthermore, DNB expects Dutch banks to take climate-related risks into account. Incorporating climate-related risks in banks' risk management is considered to be in line with Capital Requirements Directive IV (CRD IV)<sup>13</sup>, which in Article 74 stipulates that banks must have in place robust governance arrangements, including effective processes to identify, manage, monitor and report the risks to which they are or might be exposed to. This provision has been implemented in, among others, section 3:17 of the Financial Supervision Act (Wet op het financieel toezicht – 'Wft')<sup>14</sup>, which requires sound business operations in which financial risks are managed. Section 24a of the Decree on Prudential Rules for Financial Undertakings (Besluit prudentiële regels – 'Bpr')<sup>15</sup>, which expands on Section 3:17 of the Wft, also requires a bank to have in place robust, effective and comprehensive strategies and procedures to ensure that the level, composition and division of its own equity capital are in accordance with the size and the nature of the risks it faces not only in the short term, but also in the long term. In view of the long-term nature of climate-related risks, DNB considers this provision applicable with respect to climate-related risks. Articles 23 and 24 of the Bpr provide a more detailed explanation of this within existing governance, risk management and reporting processes. If climate-related risks are regarded as not material, for instance because an individual bank is not or could not be exposed to

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<sup>11</sup> ECB – 'Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure' (2020), p. 3-4.

<sup>12</sup> 'Waterproof? An exploration of climate-related risks for the Dutch financial sector' (2017).  
'Occasional Study: An energy transition risk stress test for the financial system of the Netherlands' (2018).  
'Values at risk? Sustainability risks and goals in the Dutch financial sector' (2019).  
'Indebted to nature – Exploring biodiversity risks for the Dutch financial sector' (2020).

<sup>13</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>14</sup> Wet van 28 september 2006, houdende regels met betrekking tot de financiële markten en het toezicht daarop (Wet op het financieel toezicht).

<sup>15</sup> Besluit van 12 oktober 2006, houdende prudentiële regels voor financiële ondernemingen die werkzaam zijn op de financiële markten (Besluit prudentiële regels Wft).

them, then an analysis describing why they do not impact its risk profile would be sufficient. Institutions are expected to be transparent about this in their reporting (e.g. in their ICAAP submission).

Recently DNB also published a 'Good Practice Document' on the integration of climate-related risk considerations into bank's risk management. DNB has assessed existing practices in the Dutch banking sector related to the management of climate-related risks and this document aims to share some of the good practises that were observed by DNB, with the intention to inform the banking sector as a whole. The good practices provide non-binding guidance on how banks can organise their processes and procedures to manage the climate-related risk related to their activities.

#### 4.4 Supervision conclusion

Climate-related risk can translate into financial risks for banks and poses new challenges to risk management of banks. There are a lot of developments, both in the EU and in the Netherlands, when it comes to the integration of climate-related risk into prudential supervision. At the moment, the legal framework (which is to rely on and be coherent with the EU Taxonomy) is being further developed, but there is already non-binding guidance in place. For supervisors that are looking for inspiration to accelerate their own efforts in this area, the NGFS recently published its "Guide for Supervisors. Integrating climate-related and environmental risk into prudential supervision"<sup>16</sup>.

### 5 Concluding remarks

The recent Taxonomy Regulation introduces a general framework for the development of an EU-wide classification system of environmentally sustainable activities, thereby creating more clarity for investors wishing to invest in sustainable activities or to promote environmental objectives. This is of particular interest to the ESCB in view of its mandate. In line with its mandate, the ESCB is required to support Union policies, hence concrete knowledge of what such policies entail is pivotal.

In addition to this supportive responsibility, there might also be a more important role for the ESCB. If taking into account environmental aspects can be considered as necessary for maintaining price stability, these aspects would form part of the ESCB's primary objective. In such circumstances, consideration of environmental aspects is contributing to the maintenance of price stability and not environmental protection objectives as such.

Even though the Treaties provide that the responsibility for attaining the objectives of the Union policy on the environment lies with the Union's legislator, namely the Council and the Parliament, there is always an important role for the ESCB. In short: under all circumstances the ESCB's secondary objective requires that, without prejudice to the

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<sup>16</sup> [NGFS Guide for Supervisors: Integrating climate-related and environmental risks into prudential supervision.](#)

primary objective of price stability, the ESCB supports the Unions policies on the protection and improvement of the quality of the environment. In addition to this there might, in our view, be circumstances where taking into account environmental aspects can be considered as necessary for maintaining price stability. This particular matter definitely needs to be reflected upon in more detail.

Within supervision the ECB (and the NCAs) can address climate change by focusing on the financial risks that are incurred by supervised entities.

Climate-related risk can translate into financial risks for banks and poses new challenges to risk management of banks. At the moment the legal framework (which is to rely on and be coherent with the EU Taxonomy) is being further developed, but there is already non-binding guidance in place with respect to the integration of climate-related risk into prudential supervision.

# Sustainable Finance: Global Opportunities and Challenges - A Fine Balance

By Shirmila Ramasamy<sup>1</sup>

## 1 Introduction

Financial markets play a vital role for the real economy – they provide financial solutions to tackle the world’s most pressing problems, including solutions to address income inequality and poverty. Even in the eye of the COVID-19 storm, financial markets have supported numerous coronavirus pandemic response efforts. Indeed, a heightened awareness of social issues related to healthcare and inequality has created more financing opportunities. Greater emphasis on sustainable finance may be one of the lasting outcomes of the coronavirus crisis.<sup>2</sup>

Channelling funds and investment towards sustainable activities is not only a priority under the current COVID-19 circumstances. Within the context of the United Nations Sustainable Development Goals (SDGs), significant reallocation of capital is needed to reach climate targets<sup>3</sup> alone. While the financial markets could be an important tool in this effort, market signals have not been incentivising capital allocation at the required rate. The potential for markets to act as a catalyst in this area is significant – particularly with clear, credible and easily comparable information on sustainable products and activities.

Numerous standards and frameworks have evolved in sustainable finance that provide guidelines, principles and best practice approaches for market participants in this context. The European Union (EU)’s comprehensive action plan to integrate sustainability into its financial policy framework is trailblazing. Within this action plan, the EU Taxonomy Regulation (EU Taxonomy) is a landmark regulation to create a common classification system for sustainable economic activities. By clearly defining what environmentally sustainable economic activities are, the EU Taxonomy will be an important tool for companies, investors, issuers, and project promoters working in the EU and beyond in their investment decisions on sustainable activities. Several other jurisdictions have also established, or are in the process of establishing, green finance

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<sup>1</sup> Shirmila Ramasamy is Senior Counsel in the Legal Vice Presidency of the World Bank. She is a capital markets lawyer who works on corporate finance matters and innovative financing mechanisms for targeted development priorities. She has been with the World Bank since 2008 and was part of the team responsible for the design and structuring of the International Finance Facility for Immunisation – a pioneer in sustainable finance markets – as well as a number of other financing initiatives including the Advance Market Commitments and the Pilot Auction Facility for Climate Mitigation.

<sup>2</sup> Moody’s - Coronavirus shrinks green bond issuance while spurring social bonds - 05 May 2020 and Sector In-Depth, Sustainable Finance - Global: Record sustainable bond issuance in second quarter as social bonds surge, MOODY’S INVESTORS SERVICE, 17 August 2020.

<sup>3</sup> IEA, [World Energy Investment 2019](#), IEA, Paris (2019).



strategies and taxonomies with an objective of creating more robust sustainable finance segments in their respective markets. These developments provide an opportunity for private investment to fill critical investment gaps.

Nonetheless, the multiplicity of frameworks and classifications presents some challenges. Within the context of globally interconnected financial markets, regulatory and policy fragmentation may cause undesirable complexity and inconsistency. Yet, a “one size fits all” approach with a single global regulatory framework is not a realistic target, nor should it be, given the relative differences of markets and the range of sustainable activities in different jurisdictions.

If, as anticipated, financial markets continue to fundamentally shift towards environmental, social and governance (ESG) investments in the post-pandemic era, there will need to be greater international alignment of finance policies and regulation to better support the transition to a sustainable economy. This will be a fine balance of credibility, comparability and certainty required for these markets to flourish, while also ensuring flexibility to cater to different market characteristics and goals.

This paper will cover the following aspects – (i) the imperative as well as the opportunities for sustainable finance to address climate risks and beyond, particularly in the context of COVID-19, (ii) the prevailing challenges faced by sustainable market players and related risks, (iii) the landscape of sustainable frameworks, principles and standards that has evolved in response to these challenges, (iv) the efforts towards a common classification of sustainable activities – the EU Taxonomy and beyond, (v) the road ahead for sustainable finance.

## 2 The imperative and opportunities for sustainable finance in the context of COVID-19

Significant amounts of capital reallocation and expenditure are needed for economies to transition to net-zero targets and meet goals of keeping a global temperature rise this century well below 2 degrees Celsius. Policymakers have estimated that there is an annual financing gap of USD 2.5 trillion through 2030.<sup>4</sup> Yet, as a consequence of the pandemic, energy investment activity alone fell at an unprecedented speed and scale in the first half of 2020. There was a reduction of one-fifth – or almost USD 400 billion – in capital spending compared with 2019: many companies reined-in spending, project workers have been confined to their homes, planned investments have been delayed, deferred or shelved, and supply chains interrupted.<sup>5</sup> The crisis has underscored existing vulnerabilities and created new uncertainties.

Even before the crisis, the flow of energy investments was misaligned in many ways with the world’s future needs. Market and policy signals were not leading to reallocation of capital at a scale that is necessary to support clean energy transitions. There was a large shortfall in investment, notably in the power sector, in many developing economies where access to modern energy is not assured. The pandemic

<sup>4</sup> See United Nations [press release](#) (SDG Business Forum, 25 September 2019).

<sup>5</sup> IEA, [World Energy Investment 2020](#), IEA, Paris (2020).

now has the potential to exacerbate these mismatches and take the world further away from achieving its sustainable development goals.

The value proposition for sustainable finance is clear – the potential value of sustainable business opportunities is seven times the cost of realizing them (USD 311 billion in costs; USD 2.1 trillion in opportunities).<sup>6</sup> Likewise, the Global Commission on Adaptation reported that USD 1.8 trillion of climate investment in five areas between 2020-2030 could yield USD 7.1 trillion in total net benefits.<sup>7</sup> However, there are many barriers to action. Most business financing decisions do not internalize climate change implications. In addition, short-term planning horizons lead to both under-allocation and misallocation of resources. Under-allocation occurs because future losses appear much lower than today's costs (due to discounting); misallocation occurs because successful short-term solutions may be inadequate in the future.

Today's crisis in some ways represents an opportunity for markets and policymakers to course correct. Financial markets are seeing a shift in demand for bonds that support COVID-19 response and recovery efforts— both general purpose and use-of-proceeds, issued under social/sustainability bond format. These now are due to outpace green bonds in 2020. In the second quarter of the year, a record USD 33bn in social bonds were sold to fund managers, almost double the USD 17bn issued in total in 2019. A record USD 19.1bn in sustainability bonds were also issued in the second quarter, compared with USD 48bn in total last year, according to Moody's. Issuances by the public sector and multilateral development banks to finance COVID-19 response efforts contributed significantly to these numbers. Examples include a €1bn, five-year social bond to finance public hospitals affected by the pandemic, issued by French public-sector lender Caffil; a USD 4.25bn three-year bond from the Inter-American Development Bank to help countries prepare and respond to Covid-19 and its impact; and the USD 8 bn five-year global benchmark bond issued by IBRD as sustainable development bond to address the human and economic impacts of COVID-19, the largest ever US dollar denominated bond issued by a supranational organisation.

Even given this rapid growth though, the sustainable bond market remains relatively small — making up only about 5 per cent of the total global bond market. Looking ahead, investment gaps are largest in areas currently with mixed or lower-level financial conditions – in other words, those areas with relatively high capital constraints in their economies and with the least-developed financial sectors. The imperative to promote sustainable markets is stronger than ever – specifically to remove key challenges for accurate assessment of risks and returns.

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<sup>6</sup> CDP, [Global Climate Change Analysis](#) (2018).

<sup>7</sup> Global Commission on Adaptation, [Adapt Now: A Global Call for Leadership on Climate Resilience](#) (2019).

### 3 Prevailing challenges in sustainable markets and related risks

Financial markets hinge on transparency - clear, credible and easily comparable disclosure. This is particularly relevant in the context of sustainable investments. Market participants must be able to easily assess how ESG factors of an activity being financed fit with identified strategies and sustainable investment guidelines and/or principles. Asset owners need to be able to differentiate products and they will need to have transparent data regarding product attributes. A common understanding of what is expected from financial products that offer exposure to sustainable investment themes is therefore critical - across asset owners, asset managers, other market participants and regulators. Yet, global financial market participants face a number of challenges in this regard.

First, a common understanding about each investment product is lacking - within each market, but also across different markets. For example, what is meant by “impact”, “ESG” and similar terms, and thematically, what is meant by labels such as “low carbon”, “ethical”, “socially responsible” and the like when applied to investment products? These can vary across markets thereby creating uncertainty. Guidelines or useful metrics are necessary to allow asset owners to better understand these products and strategies. This enables a better understanding and assessment of the connection between the product label and what is in the product.

Second, the need for better ESG disclosure practices by corporate issuers, not least because better aligned disclosures will drive better aligned data. Challenges include rationalizing different reporting initiatives, harmonizing reporting standards, and the convergence of multiple frameworks, data sets and scoring methodologies to allow more consistent comparisons and alignment of the sustainability of investments – at a corporate entity level but eventually globally as well. Investors rely extensively on mandatory financial and non-financial reporting, external ESG metrics and specialized third-party assurance, but there is no shared understanding of key ESG issues and that can have a material impact on the valuation of fixed income instruments.

Third, a consistent taxonomy of underlying activity is important to help the investment ecosystem understand more clearly what is meant by “sustainable” as it relates to specific core economic activities where policy makers would want to stimulate or direct investment. It relates not to entities or investment products but rather defines specific underlying activities that can affect sustainability objectives. For example, which activity substantially contributes to a sustainable objective such as climate change mitigation or the transition to a low carbon economy? Does the activity help to advance the SDGs? Without a common understanding across markets of the responses to these questions, markets struggle to identify and align sustainable investment priorities.

Last but by far not the least, inconsistency or lack of data is a considerable challenge. Investors use data available from a variety of providers (subscription and free data) and appreciate direct access to easy-to-use data. ESG data providers for corporates, multilaterals and sovereign issuers use different scoring methodologies and

standards. Data lags also remain a challenge and the relevance of data for ESG and bond performance is often not well understood.

Responding to this challenge, the World Bank recently launched a data portal that brings together key sovereign indicators that help investors track the ESG performance of sovereigns.<sup>8</sup> The platform is dynamic and continuously being expanded. It provides investors with country-level sustainability performance information to increase transparency and support investment aligned with sustainable development. Artificial intelligence and big data have the potential to improve the speed and quality of the data management processes for ESG evaluation, but the application of these technologies is still in its early stages. Data concerns remain a challenge to accessing sustainable finance and is particularly problematic for emerging markets.

The challenges identified in this section create a number of risks. Without clear, credible and easily comparable information related to financial products and underlying sustainable activities, there are chances that issuers are not appropriately managing ESG-related risks. “Green washing”, and now “social washing”, risks within sustainable markets are higher. While labelled instruments (“green bond”, “social bond”, “sustainable bond”) are a useful first step, much more critical is transparency and access to information and data that supports these labels. With improved data and technology, investors can extend their focus on risk management taking climate and social risks into account, and/or purposeful investing to include a wider range of investments.

## 4 Evolving landscape of sustainable frameworks and standards

As sustainable markets evolved over time, voluntary frameworks outlining principles, standards, best practices and guidelines for sustainable investing developed organically in an attempt to address some of the challenges described above. These voluntary frameworks, as well as increased regulatory policy focus, has contributed to an upswing in investor interest in sustainable investing. However, there is a risk that the multiple differentiated approaches that have emerged create complexity and confusion in sustainable markets.

There are a number of overlapping standards and frameworks guiding companies to disclose slightly different information, either as part of corporate reporting (reporting on exposure of corporate balance or financial portfolio to ESG factors) or ESG policy (reporting on ESG impact). These include the Sustainability Accounting Standards Board (SASB), the Task Force on Climate Related Financial Disclosure (TCFD), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), and more (see below). Each has particular strengths and discussion increasingly focuses on how this multiplicity of

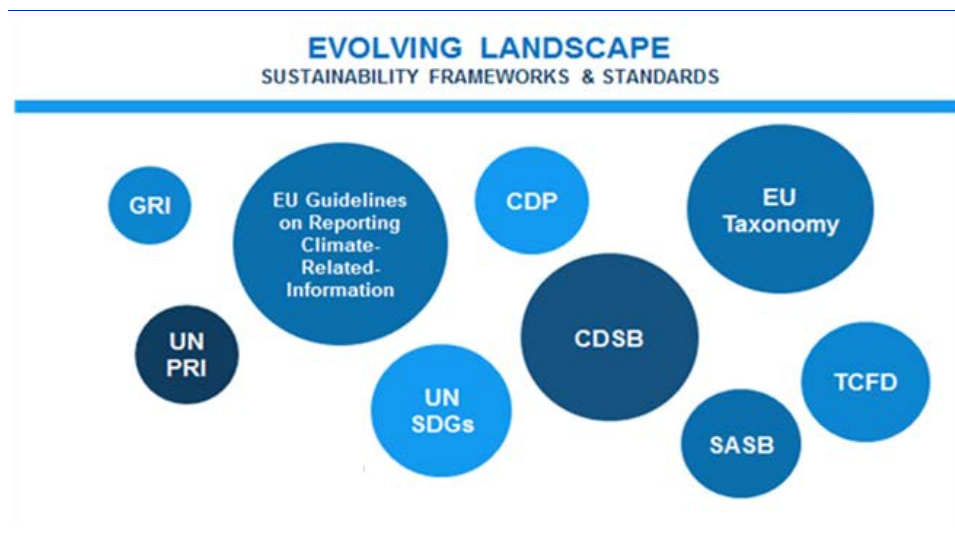
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<sup>8</sup> This [Sovereign ESG Data Portal](#) aims to provide governments and investors with information and tools that improve their understanding of sustainability criteria, including through natural capital accounting.

frameworks could be converged. In some cases, organisations use multiple frameworks for different reasons – since there are complementary aspects.

**Figure 1**

Overview of the main reporting frameworks and standards for ESG reporting



- **GRI:** The Global Reporting Initiative, formed in 1997, developed the first and most widely adopted [global standards for sustainability reporting](#). The GRI Standards are broader in scope than some of the other frameworks.<sup>9</sup>
- **SASB:** The Sustainability Accounting Standards Board published in 2018 a [set of standards](#) for 77 different industries, which identify the minimal set of financially material sustainability topics and their associated metrics for a typical company in a given industry. Focusing on financially material issues for specific industries, SASB is more granular in scope than some of the other frameworks. The standards aim to help companies and investors analyse the material ESG issues likely to affect a company's financial performance.<sup>10</sup>
- **TCFD:** The Task Force on Climate-related Financial Disclosures was set up in 2015 by the Financial Stability Board (FSB) of the G20 to develop voluntary guidelines for companies, banks and investors to use when disclosing climate-related financial risks and opportunities to their stakeholders. The [recommendations](#), issued in 2017, aim to help financial markets, including lenders, insurers and investors, better assess and price those risks and opportunities. While voluntary until now, TCFD-based reporting becomes mandatory in 2020 for all asset owners and managers signed on to the UN Principles for Responsible Investment.<sup>11</sup>
- **CDSB:** The Climate Disclosure Standards Board (CDSB) is an international consortium of business and environmental NGOs that has set forth a [framework](#)

<sup>9</sup> See [Global Reporting Initiative](#).

<sup>10</sup> See [Sustainability Accounting Standards Board](#).

<sup>11</sup> See [Task Force on Climate-related Financial Disclosures](#) (FSB).

for companies to report environmental and climate change-related information in their corporate financial reporting, such as the annual report. The organisation aims to enable companies to report environmental information with the same rigour as financial information in order to provide investors with decision-useful information to ensure resilient capital markets.<sup>12</sup>

- **CDP:** CDP (formerly the Carbon Disclosure Project) is a UK-based non-profit charity that runs a global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. Over 8,400 companies, 800 cities and 120 states and regions have reported through CDP on climate change, water security and deforestation. Each year, CDP takes the information obtained through its annual reporting process and scores companies and cities on their environmental performance.<sup>13</sup>
- **UN SDGs:** The [United Nations Sustainable Development Goals](#) is a collection of 17 goals adopted by the UN member states in 2015 to achieve the 2030 Agenda for Sustainable Development. The SDGs provide a blueprint for countries to achieve a more sustainable future, including ending poverty and hunger, improving health and education, combating climate change and protecting oceans and forests. While the SDGs were created for UN member states, the [UN Global Compact and GRI have joined forces](#) to help businesses report on the SDGs.<sup>14</sup>
- **UN PRI:** The United Nations launched in 2006 the [Principles for Responsible Investment](#), to help investors incorporate ESG factors into their investment and ownership decisions. The international network of investor signatories has grown from 100 to over 2,300, representing over USD 80 trillion in assets under management. The six principles are a set of voluntary investment principles, supported by 35 possible actions, that investors can use to integrate ESG into investment practice. The PRI has specifically [aligned its work with the UN SDGs](#) and has also made TCFD-based reporting [mandatory for its signatories in 2020](#).<sup>15</sup>
- **EU Guidelines on reporting climate-related information:** In June 2019, the European Commission published [guidelines on reporting climate-related information](#). The guidelines aim to give practical recommendations to around 6,000 EU-listed companies, banks and insurance companies that must disclose non-financial information under the Non-Financial Reporting Directive (NFRD).<sup>16</sup> They incorporate the TCFD recommendations as well as the EU Taxonomy. The goal of the guidelines is to help companies better report the impact their activities

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<sup>12</sup> See [Climate Disclosure Standards Board](#).

<sup>13</sup> See [Carbon Disclosure Project](#).

<sup>14</sup> See [United Nations Sustainable Development Goals](#).

<sup>15</sup> See [Principles for Responsible Investment](#) (United Nations).

<sup>16</sup> Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (OJ L 330, 15.11.2014).

are having on the climate as well as the impact of climate change on their business.<sup>17</sup>

- **EU Taxonomy:** The European Commission's Technical Expert Group on sustainable finance (TEG) has developed a classification system, or [taxonomy](#), for environmentally-sustainable economic activities. The taxonomy also provides guidance on the boundaries of negative impact with do-no-harm criteria. The political agreement EU co-legislators reached on the taxonomy regulation in December bolsters transparency. Companies that are obliged to report under NFRD will be required to disclose the share of their business/capex/assets that is taxonomy aligned.<sup>18</sup>

Over time, market players have also developed a range of voluntary standards aimed at promoting transparency and disclosure in the development of green, social, sustainability bond markets. Some of the most commonly referenced are the Green Bond Principles, Social Bond Principles, Sustainability Bond Guidelines, and Sustainability-Linked Bond Principles published by the International Capital Market Association. These market-based principles have provided useful frameworks and allowed for innovation in sustainable finance globally and were recently updated as an important additional step towards the expansion of the global sustainable finance markets. These updates include the June 2020 publication of the Sustainability-Linked Bond Principles (SLBP) and a 2020 update of the Social Bond Principles. With these updates, there is a clear response to the evolution of sustainable financing instruments - acknowledging the need for greater clarity on how these instruments are being deployed. Outside of the bond market context, there are also the Green Loan Principles and Sustainability-Linked Loan Principles published by the Loan Market Association promoting integrity in the development of the green and sustainability linked loan markets.

At the same time, regulatory policy has been developing, with different jurisdictions taking considerably different approaches. Some have chosen to introduce specific mandatory regulatory steps throughout the investment chain, including detailed disclosures. Others are focusing on greater transparency to the market while also reinforcing existing voluntary standards. Some supervisors have signaled an increased focus on the green market but without setting new rules yet. Finally, some jurisdictions seem keen to leave it to the market to develop and enforce its own standards.

Even amidst these differing national and regional regulatory approaches, there have been efforts to align specific categories of ESG disclosures. For example, in terms of climate-related disclosures, the Corporate Reporting Dialogue (CRD), a platform convened by the International Integrated Reporting Council, has been working on the "Better Alignment Project" to assess alignment on the disclosure principles of the TCFD among its participant standard-makers, such as SASB, GRI, CDP (formerly the Carbon Disclosure Project), the Climate Disclosure Standards Board (CDSB) and the International Integrated Reporting Council (IIRC).

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<sup>17</sup> [Guidelines on reporting climate-related information](#), European Commission (2019).

<sup>18</sup> [Final report on the EU taxonomy](#), TEG (2019).



The Better Alignment Project reported<sup>19</sup> the challenges faced by both issuers producing ESG reports and users of ESG information due to disparities in the various standards and the need for greater harmony among frameworks. That report outlines commonalities and differences with respect to TCFD recommendations among various frameworks and standards developed by its participants, which is intended to assist companies in understanding and implementing those recommendations. While the report leans towards developing a single standard on climate-related disclosures, it also notes the challenges posed by trying to apply a unified standard across a different markets and jurisdictions.

More recently, the GRI, SASB, CDSB, IIRC and CDP recently issued a statement<sup>20</sup> of intent to facilitate alignment among their respective disclosure standards, with the objective of creating a comprehensive and unified reporting system to reduce confusion among market participants. Shortly thereafter, the World Economic Forum (WEF) and leaders of the “Big Four” accounting firms (Deloitte, EY, PwC and KPMG) released a set of universal ESG metrics and disclosures with the aim of establishing a single, global ESG reporting standard. These two initiatives demonstrate market interest to improve the currently fragmented approach to ESG reporting.

In their joint statement, the GRI, SASB, CDSB, IIRC and CDP do not propose to create a new or merged framework or standard, but instead have suggested that the combination of their existing frameworks, standards and standard-setting processes can provide the basis for progress towards a comprehensive corporate reporting system. They expressed a commitment to providing joint market guidance on how the existing frameworks and standards can be applied in a complementary and additive way.

Meanwhile, the WEF in collaboration with the Big Four released a set of “Stakeholder Capitalism Metrics” that can be used to align mainstream reporting on performance against ESG indicators and track their contributions towards the SDGs on a consistent basis.<sup>21</sup>

Another important development in this area of standards and reporting is the call by the International Federation of Accountants for the creation of a new sustainability standards board that would exist alongside the International Accounting Standards Board (IASB) under the International Financial Reporting Standards (IFRS) Foundation.

All of these recent efforts clearly indicate the need and desire for greater clarity for investors and companies as they try to communicate their ESG performance effectively. How these parallel efforts will play out and whether one of these approaches becomes dominant internationally remains unclear. In the meantime, what do the wide variety of different public and private sector approaches that are

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<sup>19</sup> Corporate Reporting Dialogue, [Driving Alignment in Climate-related Reporting](#) (2019).

<sup>20</sup> CDP, CDSB, GRI, IIRC and SASB, [Statement of Intent to Work Together Towards Comprehensive Corporate Reporting](#) (2020).

<sup>21</sup> World Economic Forum, in collaboration with Deloitte, EY, KPMG and PwC, [Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation](#), White Paper (2020).

emerging mean for global sustainable markets, which hinge on clarity, credibility and - critically - comparability?

## 5 Towards achieving a common classification for sustainable activities

Establishing a taxonomy - a common classification or definition of what assets and activities serve (or do not serve) sustainability objectives - is often cited as a pre-condition for ensuring confidence in sustainable finance and achieving sustainability outcomes. Convergence towards commonly accepted definitions helps maximize the effectiveness, efficiency and integrity of financial markets. Taxonomies are also a foundational element of other policy work including risk measurement and disclosure. Successful implementation of a taxonomy framework by policymakers - and the adoption of this common language by the market - will be crucial both to growing the market for green finance, greening the broader market for finance and avoiding the risk of “green washing” and “social washing”.

Amidst the various voluntary frameworks identified above, as well as differing public and private sector approaches globally, the EU Taxonomy provides an opportunity for convergence in classification. Serving as a mandatory, EU-wide criteria for classifying economic activities as environmentally sustainable, it aims to standardize terminology within the growing universe of sustainable finance activities, products and related disclosures, starting with the “E” of ESG - environment. Private and public sector actors will use the EU Taxonomy in a range of both equity and debt based financial products, such as investment and mutual funds, insurance-based investment products, private and occupational pensions, and in insurance and investment advice.

The EU Taxonomy disclosure requirements vary by financial product and form part of a broader sustainability-related disclosure regime under the Regulation on Sustainability-Related Disclosures in the Financial Services Sector (Disclosure Regulation).<sup>22</sup> The Taxonomy Regulation amends the Disclosure Regulation and increases the amount of information that needs to be disclosed by financial market participants.<sup>23</sup> The Taxonomy Regulation and the Disclosure Regulation together will require financial market participants to provide specific disclosures for financial products that have sustainable investment objectives or promote environmental characteristics. For products that do not have sustainable investment objectives or promote environmental characteristics, a negative disclosure must be made.

In terms of disclosure specifically, the Disclosure Regulation imposes new ESG-related transparency and disclosure requirements on certain investment advisers and asset and fund managers, including alternative investment fund managers and firms providing portfolio management and investment advice, and may

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<sup>22</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019).

<sup>23</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020).

require such entities to conduct additional due diligence on sustainability risks and impacts related to their investments.

As with the Taxonomy Regulation, the Disclosure Regulation aims to avoid greenwashing and increase sustainability-related disclosures so that investors can better understand both the impact of their investments on sustainability and the impact of sustainability-related risks on their investments. Parties offering financial products in the EU will be required to make EU Taxonomy disclosures as part of pre-contractual and periodic reporting requirements that will apply to them under the Disclosure Regulation, including:

- How and to what extent they have used the EU Taxonomy in determining the sustainability of the underlying investments;
- To what environmental objective(s) the investments contribute; and
- The proportion of underlying investments that are Taxonomy-aligned, expressed as a percentage of the investment, fund or portfolio. This disclosure should include details on the respective proportions of “enabling” and “transition” activities, as defined by Taxonomy Regulation.

The EU Taxonomy will have far reaching implications by virtue of globally integrated capital markets.<sup>24</sup> The taxonomy will have an impact on international, non-EU market players despite there being no intention to bind non-EU countries/participants. The EU Taxonomy is expected to drive minimum global standards across sustainable finance markets. Its mandatory application, compared with the voluntary nature of other frameworks, is likely to draw interest from investors outside of the EU who are seeking reassurance that their investments contribute to sustainability and are concerned about greenwashing. Investors worldwide may use the EU Taxonomy to gauge whether an investment contributes to an “environmental objective”, such as climate change mitigation or adaptation. Investments in activities that would not qualify under the EU Taxonomy, but are touted as environmentally friendly, may be subject to more scrutiny by investors or regulators.

The EU Taxonomy may also influence international reporting frameworks over time even as other national markets develop their own classification systems. Japan’s Transition Finance Study group proposed the creation of a “transition taxonomy” and Canada and Malaysia are also currently developing their own classification systems. The World Bank also recently launched the “Developing a National Green Taxonomy: A World Bank Guide” aimed at helping regulators in emerging economies who seek to “green” their countries’ financial systems.<sup>25</sup>

Given the far-reaching implications of the EU Taxonomy beyond EU markets, a few aspects are worth discussing.

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<sup>24</sup> Parallel legislative amendments to existing legislation are currently underway to implement aspects of the EU Taxonomy and EU Disclosure Regulations. Under the proposed amendments to MIFID II for instance, firms will need to integrate sustainability into within suitability and product governance assessments. Asset managers and financial advisers will have to carry out mandatory assessments of their clients’ sustainability preferences.

<sup>25</sup> World Bank, [Developing a National Green Taxonomy : A World Bank Guide](#) (2020).

First, in its current form, the EU Taxonomy and disclosure regulations have been described by some as binary in approach - classifying economic activities as “green” and “non-green”. Sitting somewhere in between (and excluded from the EU Taxonomy) are those activities that comprise investments in products that “promote” “environmental characteristics” and that also contribute towards climate goals. Sectors and companies that do not meet “green” classification under the EU Taxonomy can still have the potential to become significant contributors to sustainability and help transitions to a green economy. Specifically, a binary approach may disincentivise investment in transition activities which may be critical in other regions. For example, large company groups with both “green” and “brown” assets may be prevented from receiving funding on all their projects under the taxonomy, with a further potential consequence being that over time “brown” assets, despite potential to transition to “green”, may become concentrated in the hands of those less concerned with sustainability. The paradox is that for as long as brown investments are profitable, they will attract investors primarily seeking yield and less interested in sustainability drivers.

Ultimately, the application of sustainable investment classifications across different markets globally requires a richer taxonomy — thereby enabling asset owners to report the climate pathway of their portfolios. This is particularly important given the mandatory nature of the EU Taxonomy, which, as opposed to a guidelines-based approach, limits the scope for what can ultimately be labelled as sustainable. For instance, there is a risk that some projects at the margin may fail to meet the criteria and create cliff effects to sustainable finance. While initially focusing only on “the greenest of green” investments, the EU Taxonomy may need to be expanded or joined by additional taxonomies to address transitional investments.

Second, application of the EU Taxonomy in practice will hinge upon publicly available ESG disclosures on investee companies. Consequently, the quality and availability of ESG data will be essential. However, as noted earlier, there is a lack of clear, credible, consistent and comprehensive ESG data for investors. This will make it difficult for firms to ascertain the extent to which a particular investment is sustainable. As a result, asset managers and financial advisers will likely face substantial challenges when trying to meet their client’s sustainable preferences – exposing themselves to potential liability risks along the way. Given the relative lack of data in emerging markets as well, this could potentially create further bifurcation of sustainable markets on the basis of data availability.

Last, but perhaps the most significant, is the risk that multiple, diverging taxonomies at the regional and national level will shift global markets further away from the goal of clear, credible and easily comparable disclosure and transparency of underlying sustainable activities.

As each system of classification is necessarily based on local environmental objectives that are relevant to each jurisdiction, there are different sectoral focuses as between taxonomies. For example, the EU Taxonomy is tailored specifically to European climate objectives and therefore agriculture related criteria focus more on greenhouse gas reduction rather than sustainable farming practices that would be

more material to the Asia Pacific region, such as reduced use of pesticides, biodiversity-friendly techniques and water conservation. The EU Taxonomy includes ICT, while others do not. The Climate Bonds Initiative includes the aviation sector, but this has not been included as yet in the EU Taxonomy.

Furthermore, these taxonomies vary in granularity. The EU Taxonomy provides metrics and thresholds in line with its decarbonizing strategy (zero emissions by 2050)<sup>26</sup>, whereas China's taxonomy, for instance, lists general activities and not specific technologies.

Even within each country, there has been some divergence in practice. For instance, with respect to green bonds, the People's Bank of China (PBOC) and the National Development and Reform Commission (NDRC) each *separately* issued criteria for green bonds in December 2015<sup>27</sup>, setting out eligible activities for the use of the proceeds from a green bond. These separate but overlapping taxonomies have co-existed side by side, making life more difficult for investors. Recently however, PBOC and the NDRC proposed to merge their green bond criteria to create a unified green bond taxonomy. Importantly, this development is the first time China's financial regulators and economic policymakers have decided to exclude "projects related to fossil fuels" from a green taxonomy – bringing China's taxonomy closer in alignment to the EU Taxonomy.

Despite these challenges, the EU Taxonomy provides a necessary base from which to build upon the development of a more harmonized, common classification of sustainable activities, both within Europe and around the globe. It is an important first step in a long road to supporting sustainable finance and exploiting potential **synergies** in different jurisdictions to harmonise green taxonomies.

## 6 The road ahead for sustainable finance

The heightened focus on ESG factors since COVID-19 will most likely support the continued growth of green, social and sustainability market instruments. While financing related to pandemic response efforts will subside as the worst of the crisis fades, an enduring focus on environmental and social issues will continue to prompt public and private sector issuers alike to consider instruments tied to specific sustainable projects. In the most recent significant example, Alphabet Inc., the holding company of Google, issued a USD 5.75 billion sustainability bond, the largest such corporate offering in history. Proceeds of the transaction will finance a wide array of projects in categories that include energy efficiency, clean energy, green buildings, clean transportation, circular economy and design, affordable housing, commitment to racial equity, and support for small businesses and COVID-19 response.

In terms of financial performance of sustainable instruments, credit risk profiles and issuance costs are broadly comparable to that of conventional instruments, though

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<sup>26</sup> See the [European Green Deal](#) project that aims to reach, inter alia, the objective of no net emissions of greenhouse gases by 2050.

<sup>27</sup> See the [PBOC](#) and the [NDRC](#) initiatives.

there are periods of outperformance – thereby improving the affordability of clean energy investments. For instance, ESG funds have demonstrated competitive financial performance in recent years and were found to be more resilient than their conventional counterparts to the financial impacts of the COVID-19 pandemic.<sup>28</sup> In the first quarter of 2020, ESG index funds outperformed their conventional counterparts in the face of the unprecedented COVID-19 pandemic and ensuing stock market decline. This resilience is attributable to the funds' ESG-driven investment strategies - mainly because of their focus on companies that have stronger ESG profiles/lower ESG risk.

More innovative, scalable products will be needed to accommodate the growing demand for sustainable investments. Markets are already moving in this direction with new types of instruments seeking to better tie financial performance to environmental outcomes – for example, the interest rates for a USD 2.5 billion Enel bond issued in 2019 are tied to goals for renewables capacity and emissions levels. Other examples include the Brazilian pulp and paper producer Suzano's oversubscribed USD 750 million carbon emissions-linked bond - the first of its kind for an emerging market firm - making it the market's second sustainability linked bond.

While more mandatory reporting and common classification frameworks may address certain challenges, it is still important to retain some flexibility to adopt the metrics most material to a given company or sector, and therefore avoid a "one size fits all" approach that is likely to be less helpful to investors and that may act as a barrier to innovative products in this sector. Most importantly, initiatives to improve the breadth and depth of ESG data should continue to be supported – particularly in emerging markets. A truly single set of global rules or standards for sustainable markets are unlikely to emerge in the near-term. Nevertheless, efforts should be made to develop a more cohesive set of standards by fostering alignment around product naming conventions, corporate issuer level disclosure, and the underlying economic activity.

Ultimately, the challenges within sustainable markets are indeed numerous, but then so are the opportunities and potential global gains.

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<sup>28</sup> See Jon Hale, [Sustainable Funds Weather the First Quarter Better Than Conventional Funds](#), Morning Star, 3 April 2020.

# EU Taxonomy and the monetary policy prism

By György Várhelyi<sup>1</sup>

2020 has been characterised by an unprecedented set of extreme events affecting the planet: economically, socially, geopolitically and, of course, in the sphere of public health. It will be remembered by most as the year of the coronavirus (COVID-19) pandemic. It might also be remembered as the year when the United States withdrew from the Paris Agreement adopted under the United Nations Framework Convention on Climate Change. But it is also the year in which the legal foundations of the EU taxonomy for sustainable activities were put in place; the year in which the President Elect of the United States vowed to re-join the Paris Agreement; and the year in which the European Green Deal Investment Plan and the Just Transition Mechanism were established. As the French saying goes: *l'espoir fait vivre!*

On 22 June 2020 Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (the “Taxonomy Regulation”) was published.<sup>2</sup> The Taxonomy Regulation is the much awaited first “action” of the European Commission’s 2018 action plan on financing sustainable growth. The Taxonomy Regulation establishes an EU classification system, or in Eurospeak a “taxonomy”, for sustainable activities.

The promise of the Taxonomy is great: to create a simple but broadly applicable framework to assess whether an economic activity qualifies as environmentally sustainable with a view to establishing the degree to which an investment in that activity is environmentally sustainable. In fact, the task was immense and complex given that some activities might mitigate climate change but would otherwise have harmful effects on the environment. As the Technical expert group on sustainable finance (TEG) stressed: “To ensure the broadest usability of the Taxonomy possible, the TEG had to arbitrate between granularity and flexibility as well as between complexity and clarity. A very granular Taxonomy, which uses precise metrics and thresholds, is expected to provide clarity and to minimise the risk of greenwashing. Nevertheless, there is a risk that requirements that are too granular and stringent lower the willingness of stakeholders to take up the Taxonomy, due mainly to the costs to access the necessary data and adapting their internal processes. On the other hand, more flexibility in the definition of screening criteria may facilitate the use of the Taxonomy but increase significantly the risk of divergent interpretations and greenwashing” and as often the end product is – as we will see – of a great complexity.<sup>3</sup> The end product is indeed very complex and will require further steps, in

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<sup>1</sup> Lead Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p.13).

<sup>3</sup> EU Technical Expert Group on sustainable finance (2019), [Taxonomy Technical Report](#), p 101.



the form of delegated acts and technical screening criteria, before it can become fully operational.

Yet the Taxonomy Regulation represents a milestone in the efforts of the EU towards sustainable finance and environmental protection. It will constitute an important tool for the ambitious targets to reduce EU greenhouse gas emissions by at least 55% by 2030<sup>4</sup> compared to 1990 levels and in fulfilling the legal commitment, taken in the “Climate Law”<sup>5</sup> for the EU to achieve climate neutrality by 2050 (referred to as “net-zero” greenhouse gas emissions).

Given the relative novelty of the Taxonomy a number of questions will require further assessment.

- What is a “green” asset<sup>6</sup> deriving from a sustainable activity?
- Will there be an independent appraiser or official “Taxonomy-compliance stamper”?
- Will there be sanctions if the asset changes colour and becomes non-green?
- Can the ECB favour green assets/issuers?
- Can the ECB disfavour carbon-intensive assets?
- How can risks related to environmental sustainability be translated into credit risk by the credit rating agencies?
- Could the ECB rely on environmental, social and governance (ESG) ratings?

This paper does not claim to provide a definitive answer to all these questions. It focuses on the uses that the Taxonomy Regulation may have for the European System of Central Banks (ESCB) and more particularly for the ECB<sup>7</sup>. The starting point of the discussion is necessarily to establish certain clarity as regards the ECB’s mandate to green its monetary policy instruments (Section 1). However, the main focus of this paper is on the practical uses of the recently published Taxonomy Regulation (Section 2) in the field of standard Eurosystem monetary policy credit operations (Section 3) and in non-standard monetary policy operations, in particular in outright Eurosystem asset purchases (Section 4).

Nonetheless, it must be emphasised that the Taxonomy Regulation could have uses for the ECB in many other areas, such as in the field of own funds invested by the ECB, the management of non-monetary policy portfolios and micro prudential supervision.

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<sup>4</sup> Proposed by the Commission. In October 2020 the European Parliament proposed a 60% reduction.

<sup>5</sup> The Commission’s proposal for the first European Climate Law aims to write into law the goal set out in the European Green Deal – for Europe’s economy and society to become climate neutral by 2050.

<sup>6</sup> The European Green Deal Investment Plan of 14 January 2020 announced that the Commission will establish an EU Green Bond Standard (GBS). The GBS should clarify what “green asset” means.

<sup>7</sup> For ease of reference this paper will focus on the ECB and will make reference only to the ECB.

## 1 Price stability and environmental protection: the Eurosystem prism

Recently there has been an extensive debate as regards the role central banks should play in the fight against climate change and more broadly environmental protection.<sup>8</sup>

The legal framework of the discussion revolves around the following provisions. Pursuant to Articles 119(2), 127(1) and 282(2) of the Treaty on the Functioning of the European Union (TFEU), the primary objective of the ECB is to maintain price stability. Without prejudice to that objective, the ECB is to support the general economic policies in the Union with a view to contributing to the achievement of its objectives, as laid down in Article 3 of the Treaty on European Union (TEU). Under Article 3(3) TEU, the Union shall work for “the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment”. According to Article 11 TFEU “[e]nvironmental protection requirements must be integrated into the definition and implementation of the Union’s policies and activities, in particular with a view to promoting sustainable development.” Article 37 of the Charter of Fundamental Rights of the European Union<sup>9</sup> provides that “[a] high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union and ensured in accordance with the principle of sustainable development”.

The debate on what these provisions mean for the ECB’s monetary policy essentially revolves around two schools of thought. The first school of thought argues that environmental protection should be part of the ECB’s primary objective of maintaining price stability. It advocates that climate change, if not addressed swiftly, may affect the economy in ways that pose material risks to price stability. From this perspective, both physical risks and transition risks associated with climate change can potentially cause abrupt changes in prices and thereby threaten price stability. An example of a physical risk in this context would be a climate change-related drought that causes a failure of supply chains and a corresponding shock to inflation. A transition-related risk could include the gradual scaling down of the diesel industry or reduction of business travel causing the aviation industry to scale down its activities. The down-scaling and progressive move towards other technologies will in turn impact the corresponding revenues coming from these businesses. This point of view sees both types of risk as having an impact on the primary objective of the ECB to maintain price stability.

It is, however, true that there could be a mismatch between the time horizon of the threat posed by climate change and the inflation target underlying the price stability

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<sup>8</sup> Flaherty, E. (2020), [Green Central Banking: Options for the ECB on Climate Change](#); Schumacher, K. (2020), [The shape of green fixed income investing to come](#); Bierman, B. (2019); Bolton, P., Despres, M., Pereira da Silva, L. A., Samama, F., and Svartzman, R. (2020), [The green swan: Central banking and financial stability in the age of climate change](#), in particular Chapter 4, pp.47-64; and Solana, J. (2019).

<sup>9</sup> OJ C 326, 26.10.2012, p. 391.

objective of the ECB as set by the Governing Council.<sup>10</sup> The recent catastrophic floods in the the Vallée de la Roya and Vallée de la Vésubie<sup>11</sup> and the ensuing significant costs for the French economy seem to highlight that unaddressed climate change risks clearly represent an imminent threat to price stability and, in any event, a threat that is quantifiable within the medium term just like the ECB's price stability objective.

A second school of thought argues that environmental protection is not within the ECB's primary objective to maintain price stability. However, even within that school of thought there is acknowledgement that the ECB must contribute to protecting the environment alongside other secondary objectives such as full employment. Thus, should measures addressing the risks posed by climate change not directly fall within the primary objective of price stability, then a straightforward reading of the text of the relevant TFEU provisions implies that the ECB is obliged in any event to support the general economic policies in the Union with a view to contributing to the achievement of the Union's objectives as regards environmental protection. If there was a conflict between the objective of price stability and environmental protection objectives, the objective of price stability must take precedence. If there is no conflict, the ECB must support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union, which include amongst others a high level of protection and improvement of the quality of the environment. In addition, the ECB, like all Union institutions, is in principle also required by Article 11 TFEU to "integrate" environmental protection objectives into the definition and implementation of its policies and activities. In this context "integration" means to "take into account" environmental objectives.

Against this background, two elements seem clear for both schools of thought: (i) the ECB does not have competence under the Treaties to act as a policymaker in the field of environmental protection, rather it enjoys only a supportive role; and (ii) the Union's environmental protection objectives will flow into the ECB's policies and actions, be it under its primary objective of maintaining price stability or the secondary objective to contribute to other objectives of the Union. I would highlight here that, unlike other policies of the Union, the environmental policies should flow into and have a strong impact on many other Union policies, starting with economic, employment and health policies.

To summarise: a monetary policy measure can legitimately aim to address a threat to price stability posed by climate change and remain within the ECB's primary objective. Without prejudice to the primary objective of maintaining price stability, a monetary policy measure can also and shall also seek to support and thereby have a beneficial impact on environmental protection and the other secondary objectives mentioned in Article 3 TEU.

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<sup>10</sup> The ECB's Governing Council adopted a quantitative definition of price stability in 1998: "Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%." The Governing Council clarified in 2003 that in the pursuit of price stability it aims to maintain inflation rates below, but close to, 2% over the medium term.

<sup>11</sup> These events happened on 2 October 2020 when the third Panel of the ESCB Legal Conference 2020 took place.

However, even if one agrees with these legal principles at institutional level, there remains a multitude of questions with regard to the operation of the Taxonomy Regulation and the role of the ECB.

## 2 A short dive into the EU Taxonomy Regulation

The framework established by the Taxonomy Regulation is a complex set of legislation comprising numerous EU legislative acts and delegated acts. Some of these acts have already entered into force, for instance the Taxonomy Regulation itself, some acts are being amended by the Taxonomy Regulation but such amendments will only apply at a later point in time, and some acts have not yet been adopted. The latter are a string of delegated acts including technical screening criteria. It is thus important to briefly present the Taxonomy Regulation, its aim, scope and timing before examining in general terms how it could impact the ECB *rationae personae*.

### 2.1 The EU Taxonomy Regulation: what is it?

The proposal for a Taxonomy Regulation was presented by the Commission in May 2018. Although the Taxonomy Regulation pre-dates the European Green Deal, it is an important facilitator of the Green Deal's sustainable economy reforms. The European Green Deal is an overarching framework and programme of actions to make the EU's economy sustainable. The environmental objectives of the Taxonomy framework and the economic sectors targeted for policy reform under the European Green Deal are consistent with each other.

The Taxonomy Regulation is also part of the EU environmental protection objectives. As mentioned above, it is an important tool for the ambitious targets to reduce EU greenhouse gas emissions by at least 55% by 2030<sup>12</sup> compared to 1990 levels and in fulfilling the legal commitment, taken in the "Climate Law"<sup>13</sup>, for the EU to achieve climate neutrality by 2050 (referred to as "net-zero" greenhouse gas emissions).

### 2.2 What qualifies as environmentally sustainable

The Taxonomy Regulation establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable. An economic activity shall qualify as "environmentally sustainable" under the Taxonomy Regulation if that activity:

- **contributes substantially** to one or more of the environmental objectives set out in the Taxonomy Regulation (climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources,

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<sup>12</sup> See footnote 4.

<sup>13</sup> See footnote 5.

the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems);

- **does not significantly harm** any of the above-mentioned environmental objectives;
- **complies with minimum safeguards** (e.g. the standards embedded in the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, with specific reference to the ILO Core Labour Conventions and the International Bill of Human Rights); and
- **complies with technical screening criteria** to be established gradually by the Commission.

In addition, disclosure and transparency are important components of the Taxonomy Regulation to ensure compliance with the Taxonomy standards. The Taxonomy disclosure obligations encourage the reporting of progress towards meeting the screening criteria as well as their achievement.

The Taxonomy can also be used on a voluntary basis by entities that are not within the scope of the Regulation, treating the criteria as a global benchmark to compare local activities to EU sustainability standards.

## 2.3 Scope and application date of the Taxonomy Regulation

The direct scope of the Taxonomy Regulation could be seen as relatively narrow as it does not apply generally to economic activities carried out in the European Union. In reality though, it encompasses a large number of private and public sector actors since it applies to:

- the Union and Member States when adopting public measures, setting standards or establishing labels for financial market participants, green financial products or green corporate bonds;
- financial market participants (e.g. AIFMs, UCITS, management companies and investment firms active in portfolio management<sup>14</sup>) offering financial products; and
- large companies required to provide a non-financial statement under the Non-financial Reporting Directive (“NFRD”, i.e. the “accounting directive” 2013/34/EU as amended by Directive 2014/95/EU)<sup>15</sup>.

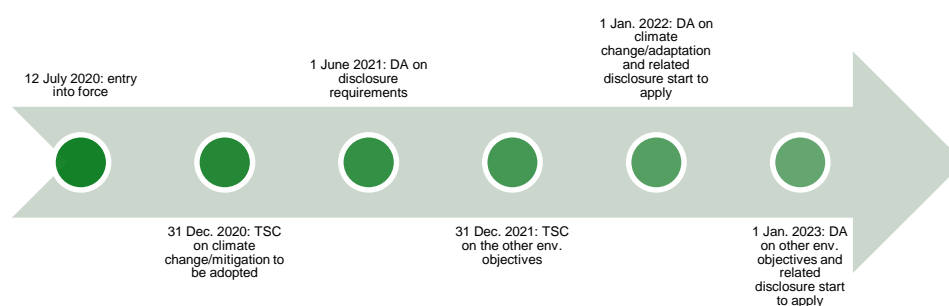
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<sup>14</sup> Alternative investment fund managers (AIFMs); Undertakings for the collective investment in transferable securities (UCITS).

<sup>15</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p.19). Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups ((OJ L 330, 15.11. 2014, p.11).

The Taxonomy Regulation entered into force on 12 July 2020. However, some of its substantive provisions will only become applicable in a staggered manner and will have to be completed by delegated acts. These provisions include inter alia the obligation on Member States and the Union to apply the Taxonomy framework when issuing requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as “environmentally sustainable” and the transparency obligations under the Taxonomy Regulation.

**Figure 1**  
Implementation timeline



The European Commission will have to adopt delegated acts (DA) in the form of technical screening criteria (TSC) for the objectives of climate change mitigation and climate change adaptation by the end of 2020. By 1 June 2021 the Commission will have to specify the content and presentation of the information to be disclosed pursuant to Article 8 of the Taxonomy Regulation (as discussed further below). Entities within the scope of the Regulation will need to provide their first set of corresponding disclosures from 1 January 2022 (for the 2021 reporting period). Subsequent delegated acts to be issued by the end of 2021 relating to the four other environmental objectives will require disclosure from 1 January 2023 (for the 2022 reporting period).

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (the “Disclosure Regulation”<sup>16</sup>), which is amended by the Taxonomy Regulation, will apply from 10 March 2021 (except for the instructions to the European Supervisory Authorities to develop technical standards, which are already applicable).

<sup>16</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019).

## 2.4 Scope of the Taxonomy Regulation as regards the ECB

As regards the Union institutions, including the ECB, the Taxonomy Regulation has two main dimensions: a substantive dimension having a direct impact and a disclosure dimension having an indirect impact.

As regards the substantive dimension, Union institutions are under an obligation to apply the criteria set out in the Taxonomy Regulation to “determine whether an economic activity qualifies as environmentally sustainable for the purposes of any measure setting out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable”.<sup>17</sup>

In view of this provision, one could argue that when setting out requirements for assets to be eligible either as collateral for monetary policy credit operations or for outright purchases, the ECB is obliged to “use” the Taxonomy Regulation. In other words, the ECB could not accept collateral labelled as green collateral if it was not compliant with the Taxonomy Regulation or would be limited in accepting green collateral defined by reference to another standard, for instance the Sustainable Development Goals which are part of the 2030 Agenda for Sustainable Development adopted by the UN General Assembly of the United Nations on 25 September 2015. The commitment of the Union and its Member States to the 2030 Agenda was confirmed by the Council on 20 June 2017.

It is submitted that this argumentation is flawed for two main reasons. First, Article 192 TFEU provides that the responsibility for attaining the objectives of the Union policy on the environment provided by Article 191 TFEU lies with the Union’s legislator, namely the European Parliament and the Council. Pursuant to Article 7 TFEU, the Union is to ensure consistency between its policies and activities, taking all of its objectives into account and in accordance with the principle of conferral of powers. According to the principle of conferral, the Union shall act only in the fields of competences conferred upon it by the Member States in the Treaties. It follows that, as already mentioned in the introductory paragraphs, the ECB only has a supportive competence in the field of environmental protection and has therefore no competence to set environmental labelling measures on its own.

Second, the ECB has exclusive competence in the field of monetary policy. When implementing monetary policy, the ECB does not itself determine whether an economic activity qualifies as environmentally sustainable. When setting eligibility requirements for assets accepted as collateral in Eurosystem monetary policy credit operations, the ECB primarily assesses the “adequate” nature of that collateral to protect it from losses in the event of a default of its counterparty. In other words, acceptance of a particular asset as collateral for Eurosystem monetary policy operations does not make the asset “environmentally sustainable”, it just enables a given counterparty to use it in credit operations with the Eurosystem. The same reasoning applies to outright purchases: by making a given asset eligible for purchases under one of its outright purchase programmes, the ECB does not label

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<sup>17</sup> See Article 4 of the Taxonomy Regulation.



that asset as environmentally sustainable. This reasoning holds true even in the case of green or sustainable assets, since the above eligibility criteria are not within the realm of environmental policy and are dictated by the objective of maintaining price stability.

As regards the disclosure dimension and indirect impact of the Taxonomy Regulation, Article 8 will impose new non-financial disclosure obligations on entities already required to provide a non-financial statement under the NFRD. The requirements differ between financial and non-financial companies. Some financial companies will also be subject to the financial market participant disclosure requirements under the Taxonomy Regulation.

For non-financial companies – mainly large listed companies having more than 500 employees<sup>18</sup> – the disclosure must include (i) the proportion of turnover aligned with the Taxonomy; and (ii) capital expenditure and operating expenditure aligned with the Taxonomy. Disclosure requirements are thus not directly applicable to the ECB but will be of great relevance indirectly as they will increase transparency in the market on the basis of a harmonised set of EU law sustainability criteria.

### 3 The use of the Taxonomy Regulation in the Eurosystem collateral framework

At the heart of the Eurosystem's monetary policy are refinancing operations, or Eurosystem monetary policy credit operations. The traditional monetary policy tool to steer inflation and the level of interest rates in the money market is achieved through collateralised refinancing operations – reverse transactions – executed primarily in weekly competitive tenders, referred to as the main refinancing operations (MROs). By adjusting the cost at which banks can borrow under the MROs – and under the ancillary three-month longer-term refinancing operations (LTROs) – the ECB can steer banks' marginal cost of refinancing and thereby influence the whole spectrum of market rates. From mid-2014 the Eurosystem introduced a series of targeted long-term refinancing operations (TLTROs). TLTROs established incentives for banks to pass on lower funding costs through lending rates as the amount that banks can borrow is linked to their loans to non-financial corporations and households.

These refinancing operations are by essence within the primary objective of the ECB since they steer interest rates towards the ECB's objective of price stability defined in 1998 (and further clarified in 2003) as follows: "Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%" over the medium term.<sup>19</sup> The question then remains whether the collateral used as security for these refinancing operations should or could be greener?

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<sup>18</sup> See Article 8(1) of the Taxonomy Regulation and point (1) of Article 2, Article 19a and 29a of (Directive 2013/34/EU) for more details.

<sup>19</sup> See footnote 10.

### 3.1 The notion of adequate collateral

Under Article 18.1 of the Statute, the ECB and the national central banks are empowered to conduct credit operations with credit institutions and other market participants, provided that lending is based on “adequate collateral”.

So far, the interpretation given to that concept and its objectives has been binary. First, the “adequate collateral” requirement means that the Eurosystem should aim not to incur losses in its monetary policy operations. More specifically, Eurosystem central banks should be in a legal position to realise all security provided as collateral without undue delay and in such a way as to entitle them to realise value for the credit provided, if the counterparty does not settle its negative balance promptly.

Second, it has also been broadly acknowledged that adequate collateralisation should support the smooth conduct of monetary policy. In other words, the effectiveness of monetary policy transmission is also a function of the extensiveness of the Eurosystem’s collateral framework.<sup>20</sup> This is especially true in the euro area which was created on the basis of pre-existing different collateral frameworks and which is still characterised by the presence of a great variety of collateral and counterparties. It also needs to be ensured that there is sufficient collateral available for banks to refinance their balance sheets, and it is true that green assets have comparatively smaller outstanding volumes to date. In other words, the acceptance of green assets cannot undermine the smooth conduct of monetary policy which contributes to ensure fulfilment of the ECB’s primary objective to maintain price stability. This nonetheless does not rule out the acceptance of green collateral alongside other assets or the premise that when presented with two reasonably similar collateral assets from a monetary policy transmission perspective, one green and the other non-green, the green one will be given preference.

However, the notion of adequate collateral is not defined by the Treaties and is left for the Governing Council of the ECB to define and apply more specifically. The question is whether environmental protection and climate change-related risks can be integrated into the application, in practice, of the notion of adequate collateral. It is now commonly accepted that climate change represents important physical and transition risks which are currently mispriced by the markets. This has been highlighted by Isabel Schnabel: “There is also broad agreement that climate risks continue to be mispriced in financial markets.”<sup>21</sup> The recent floods in France in the Vallée de la Vézubie<sup>22</sup> and Vallée de la Roya show that climate change can have extreme economic consequences locally<sup>23</sup> but also globally. According to the International Monetary Fund, a persistent increase in the average global temperature by 0.04°C per year, in the absence of mitigation policies, is estimated to reduce world real GDP per capita by more than 7% by 2100.<sup>24</sup> These physical risks are coupled with risks associated with the transitioning to a climate neutral economy. Corporations operating

<sup>20</sup> Bindseil, U., Corsi, M., Sahel, B. and Visser, A. (2017).

<sup>21</sup> Schnabel, I. (2020), [When markets fail – the need for collective action in tackling climate change](#).

<sup>22</sup> The author of this article is a frequent visitor to the Parc National du Mercantour and Lac du Boréon.

<sup>23</sup> The costs of these exceptional floods in the Southern part of France have been evaluated to approximately 1 billion euros by MP Eric Ciotti.

<sup>24</sup> Kahn et al. (2019), [Long-Term Macroeconomic Effects of Climate Change: A Cross-Country Analysis](#).

in carbon-intensive sectors might lose all or a significant part of their business should their clients decide to switch to using green manufacturers or products. As a result, their liabilities, e.g. issued corporate bonds, might be subject to depreciation. It follows that risk management considerations could lead the Governing Council to qualify currently ineligible assets which comply with the Taxonomy as adequate collateral, provided Taxonomy compliance also addresses these risk management considerations. In addition, the further acceptance of Taxonomy-compliant assets could also enable the ECB to contribute to the Union's objectives in terms of greenhouse gas emissions reduction and environmental protection. Obviously all aspects of the collateral would have to be assessed, including liquidity and overall legal protection in the event of liquidation.

It is, however, true that most Taxonomy-compliant assets, owing to their other non-Taxonomy related features (e.g. marketable debt instruments complying with all requirements set forth in the General Documentation<sup>25</sup>), are already eligible and the most difficult question will be whether these assets could benefit from a preferential treatment.

### 3.2 Should Taxonomy compliance lead to different treatment?

In practical terms, the Taxonomy Regulation could have many different uses for the ECB. This paper does not claim to assess all possible options available but will focus mainly on three: to expand the current list of assets eligible as collateral for Eurosystem monetary policy operations (paragraph 3.2.1); grant preferential eligibility treatment to Taxonomy-compliant assets; or impose unfavourable treatment on carbon-intensive assets (paragraph 3.2.2).

However the main question, which is actually outside the remit of a legal assessment yet nevertheless remains the cornerstone of this debate, is: would these measures really contribute to the EU's environmental policies? Would the eligibility or "better eligibility" of collateral for Eurosystem monetary policy operations help to reduce CO<sub>2</sub> emissions? This question is to be answered by economists. Some have argued that eligibility for outright purchases or as collateral in Eurosystem liquidity-providing operations increases the liquidity of the said assets which then translates into a higher security price and lower yields.<sup>26</sup> The cost of capital then decreases for the issuer of the security. The same mechanism seems to apply in the case of lower haircuts applied to Taxonomy-compliant collateral. But this reasoning presupposes that lower costs of capital for the issuer necessarily translate into lower CO<sub>2</sub> emissions or higher environmental protection.

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<sup>25</sup> Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (General Documentation Guideline) (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

<sup>26</sup> Nagel, S. (2016).

### 3.2.1 Expand the current list of eligible assets

Turning back to the purely legal angle, the Taxonomy Regulation could as a first step serve to justify the eligibility of new categories of assets. As indicated above, broad-based collateral frameworks are an essential feature of monetary policy transmission. Broad-based collateral frameworks have indeed helped to prevent large-scale liquidity-driven defaults of financial institutions in all major advanced economies. The Eurosystem could therefore legitimately broaden further its collateral base by including Taxonomy-compliant assets or otherwise green assets which would not yet be eligible because they do not fulfil all other eligibility criteria for Eurosystem collateral.

An example is the recent eligibility granted to bonds with coupon structures linked to sustainability development targets.<sup>27</sup> These bonds offer a step-up to investors where the issuer does not meet Taxonomy-based sustainability development targets. They were ineligible for Eurosystem monetary policy credit operations owing to risks associated with other step-up coupon structured bonds (i.e. bonds for which the coupon step-up is linked to a credit rating downgrade). The Governing Council considered sustainability development targets linked bonds adequate collateral with a different risk profile than those where the coupon step-up is linked to a credit rating downgrade. The General Documentation has been amended accordingly and will apply from 1 January 2021.

The following definition has been added to the General Documentation: “‘sustainability performance target’ (SPT) means a target set by the issuer in a publicly available issuance document, measuring quantified improvements in the issuer’s sustainability profile over a predefined period of time with reference to one or more of the environmental objectives set out in Regulation (EU) 2020/852 of the European Parliament and of the Council and/or to one or more of the Sustainable Development Goals set by the United Nations relating to climate change or environmental degradation”.<sup>28</sup> The definition builds on the Taxonomy Regulation but is not strictly restricted to assets which are Taxonomy-compliant since, as explained above, the Taxonomy Regulation is not yet fully applicable and the collateral framework is broad based and not restricted to environmental considerations (e.g. the objectives of the collateral framework are broader than assets which are Taxonomy compliant).

It remains to be further assessed, however, how far Taxonomy compliance could “cure” features which would otherwise lead to ineligibility? Could Taxonomy-compliant assets be accepted despite them not fulfilling minimum credit quality requirements?

### 3.2.2 Preferential treatment for Taxonomy-compliant assets

Several scholars advocate a “steering” or “tilting” in the allocation of the Eurosystem’s assets accepted as collateral towards low-carbon sectors, which would reduce the

<sup>27</sup> See the ECB press release: [ECB to accept sustainability-linked bonds as collateral](#), 22 September 2020.

<sup>28</sup> Guideline (EU) 2020/1690 of the European Central Bank of 25 September 2020 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework (ECB/2020/45) (OJ L 379, 13.11.2020, p. 77).

cost of capital for these sectors relative to high-carbon sectors.<sup>29</sup> In other words, Taxonomy-compliant assets could benefit from a preferential treatment in the collateral framework compared with non-compliant assets.

The principle of equal treatment is a general principle of EU law. It is enshrined in the Charter of Fundamental Rights of the European Union<sup>30</sup>, and it is one of the values on which the Union is founded.<sup>31</sup> The ECB and all Union institutions are required to comply with that principle as a superior rule of EU law protecting individuals.<sup>32</sup> The principle of equal treatment requires that comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified.<sup>33</sup>

The stated purpose of the Taxonomy Regulation is to establish the criteria “for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable”. Even though the Taxonomy Regulation does not set forth a list of carbon-intensive activities it does distinguish between activities which qualify as environmentally sustainable and all other activities. The application of the Taxonomy Regulation will thus enable a distinction between assets without constituting discrimination as the situation of these assets will no longer be comparable. The operational implementation of such a preferential treatment, within the Eurosystem collateral framework, seems nevertheless challenging.

The difficulty lies in the fact that the current Eurosystem collateral framework and, in particular, the haircut framework reflect risks associated with a liquidation scenario of the collateral. The liquidation scenario is itself based on asset types, issuer groups and the credit rating assigned to the asset, its issuer or the guarantor. This means that if a given counterparty defaults on its obligation to reimburse the Eurosystem at the stated maturity of the underlying monetary policy credit operation, the collateral it has submitted needs to be sold. Depending on the intrinsic qualities of the collateral to be liquidated and most prominently its liquidity, this exercise may take more or less time. To reduce the probability of losses during the liquidation period, a certain percentage of the collateral value needs to be deducted when accepting the collateral in the form of a haircut. Therefore liquidation-associated risks could lead to higher or lower haircuts. The haircut category will also take into account the credit rating assigned to the asset, its issuer or the guarantor which reflects their ability to pay back the debt and constitutes an implicit forecast of the likelihood of the debtor defaulting.

The Taxonomy does not address this issue directly and is certainly not risk based. Compliance with the Taxonomy does not guarantee that an asset will benefit from enhanced liquidity. It follows that it would be for credit rating agencies to reflect these

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<sup>29</sup> Schoemaker, D. (2019), [Greening monetary policy](#).

<sup>30</sup> See Title III (equality) of the Charter and in particular Articles 20 (equality before the law), 21 (non-discrimination), 23 (equality between women and men).

<sup>31</sup> Article 2 TEU refers to the principle of equality.

<sup>32</sup> See the judgment of 7 October 2015 in Case T-79/13, *Accorinti and Others v ECB*, EU:T:2015:756, paragraph 87; and of 24 January 2017 in Case T-749/15 *Nausicaa Anadyomène and Banque d'escompte v ECB*, not published, EU:T:2017:21.

<sup>33</sup> See the judgment of 13 July 2018 in Case T-680/13, *Chrysostomides, K. & Co. and Others v Council and Others* paragraph 441, EU:T:2018:486.

risks into their own assessment. So far there is still a certain lack of accurate, consistent and comparable treatment of environmental, social and corporate governance (ESG) credit risks by credit rating agencies. With a better mapping of the activities which are Taxonomy compliant and the increased transparency generated by the Taxonomy Regulation, it is expected that these risks will be better reflected in credit ratings. The European Securities and Markets Authority (ESMA) has recently published guidelines which could make these aspects of credit ratings more consistent and comparable.<sup>34</sup>

It has also been argued that the Eurosystem could take into account ESG ratings as opposed to credit ratings which are the only ones allowed under the current framework. The ESG ratings are more and more commonly referred to also by large issuers (e.g. KfW). However, these ratings are not assessing credit and liquidity risks, which are the main metric of the Eurosystem collateral framework. In addition, these ratings are not authoritative in the sense that they are not issued by ESMA or other publicly authorised or recognised agencies. ESG rating agencies do not rate Taxonomy compliance and are not recognised by any official public entity. Moreover, the ratings they issue are based on general ESG considerations which go well beyond the scope of environmental issues. In the absence of official recognition and consistent credit risk assessment associated with the ESG factors, the ECB cannot base collateral eligibility on the findings of such ESG rating agencies.

### 3.3 The Taxonomy Regulation as a tool for green TLTROs

It has also recently been proposed that the ECB could initiate “green TLTROs”. The essence of the proposal is that the interest rate on green TLTROs would be determined by the volume of green bank lending, e.g. energy-efficient housing renovations.<sup>35</sup> A preferential interest rate would then be calculated based on the volume of Taxonomy-compliant loans issued by the counterparty. The preferential rate would rely on the disclosure obligations set in Article 8 of the Taxonomy Regulation. From a legal standpoint, such use of the Taxonomy Regulation could certainly be considered further, but several observations can already be made.

The first observation refers back to the debate regarding the monetary policy objective pursued by such a measure. In this respect, the Governing Council of the ECB would first have to establish whether green TLTROs could form part of its primary objective to maintain price stability. It is now well-established case-law that in order to determine whether a measure falls within the area of monetary policy, it is appropriate to refer principally to the objectives of that measure. The instruments which the measure employs in order to attain those objectives are also relevant.<sup>36</sup> In the case of green TLTROs, the measure would arguably pursue the same objective as other “standard” TLTROs which “... are intended to assist in preserving favourable bank lending

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<sup>34</sup> European Securities and Markets Authority (2019), [Final Report: Guidelines on Disclosure Requirements Applicable to Credit Ratings](#), section 3.2., paragraphs 6 et seq.

<sup>35</sup> van 't Klooster, J., and van Tilburg, R. (2020), [Targeting a sustainable recovery with Green TLTROs](#).

<sup>36</sup> See judgments of 27 November 2012 in Case C-370/12, *Pringle*, C-370/12, EU:C:2012:756, paragraphs 53 and 55, and of 16 June 2015 in Case C-62/14, *Gauweiler and Others*, EU:C:2015:400, paragraph 46.

conditions and support the accommodative stance of monetary policy in Member States whose currency is the euro” and which “[i]n conjunction with other non-standard measures in place ... aim to contribute to a return of inflation rates to levels below, but close to, 2% over the medium term”.<sup>37</sup> In that respect, it must be made clear that green TLTROs could not be the only non-standard measure envisioned to contribute to a return of inflation rates to levels below, but close to, 2% over the medium term but they could well, in theory, form part of an overall package. As for the second criterion, the instrument which would be used by green TLTROs is clearly a monetary policy instrument listed under Article 18.1 of the Statute, namely a credit operation with credit institutions.

The second observation relates to the staggered application of the Taxonomy Regulation. The Taxonomy Regulation is not yet fully applicable and a number of delegated acts are necessary before it can apply in full from 2023 onwards. In particular, Article 8 of the Taxonomy Regulation on which the green TLTRO proposal is built will necessitate the adoption of a delegated act by the Commission specifying the content and presentation of the information to be disclosed pursuant to that Article (see Section 2 above). It is too early for green TLTROs to be based on the disclosure requirements set forth in the Taxonomy Regulation.

The third observation relates to the substantive provisions of the Taxonomy Regulation itself. Article 8 of the Taxonomy Regulation does not impose a classification of individual loans by the originating credit institutions. It requires the disclosure of (i) the proportion of a given entity’s turnover derived from products or services associated with economic activities that qualify as environmentally sustainable; and (ii) the proportion of capital expenditure and the proportion of operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable. It remains to be seen how the Commission’s delegated acts will further specify these obligations, but granularity will be of the essence if green TLTROs are to work also from an operational standpoint. More importantly, however, the Taxonomy Regulation is silent as to which competent authority would verify compliance with the criteria set therein, since it does not explicitly require any formal verification of Taxonomy-related disclosures. It seems difficult for the Eurosystem to rely on self-authenticated green loans for monetary policy purposes. Compliance with the Taxonomy should therefore be subject to verification, for instance by an independent third party. A scheme similar to that applied for simple, transparent and standardised (STS) compliance under the Securitisation Regulation,<sup>38</sup> combining self-verification with independent third-party verification, could also be envisaged.

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<sup>37</sup> Decision (EU) 2019/1311 of the European Central Bank of 22 July 2019 on a third series of targeted longer-term refinancing operations (ECB/2019/21) (OJ L 204, 2.8.2019).

<sup>38</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).



## 4 The use of the Taxonomy Regulation for outright purchases

The Eurosystem currently runs outright purchases under five different purchase programmes: the asset-backed securities purchase programme (ABSPP); the third covered bond purchase programme (CBPP3); the public sector purchase programme (PSPP); the corporate sector purchase programme (CSPP); and the recently launched temporary pandemic emergency purchase programme (PEPP). The ABSPP, CBPP3, PSPP and CSPP are together known as the asset purchase programme (APP). Green assets, to the extent they fulfil the specific eligibility criteria of the relevant purchase programme, are already eligible for purchase.

### 4.1 Scope of the Taxonomy Regulation as regards asset purchase programmes

At first sight, the scope of application of the Taxonomy Regulation to assets purchased under the APP or the PEPP could be seen as relatively narrow.

The Taxonomy Regulation will apply directly to measures adopted by Member States or the Union setting out requirements for “financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable”. As demonstrated above, eligibility criteria set for the purchase programmes should not fall within that category of measures. However, Union measures – such as the Green Bond Standard – will necessarily refer to the criteria set forth in the Taxonomy Regulation.

“Financial products” are narrowly defined in the Taxonomy Regulation by reference to the Disclosure Regulation. A financial product under the Disclosure Regulation means: a portfolio managed in accordance with that Regulation; an alternative investment fund (AIF); an insurance-based investment product (IBIP); a pension product; a pension scheme; a UCITS; or a PEPP. Such assets are currently eligible for purchase neither under the APP nor under the PEPP.

The meaning of “corporate bonds” is not defined in the Taxonomy Regulation either directly or by reference to another EU legal act. It follows that “corporate bonds” could be understood in the broad sense of bonds issued by corporations, be it financial or non-financial corporations. One would logically exclude from this definition asset-backed securities which are usually not issued by corporations but by a specially created investment vehicle which has acquired the pool of financial assets from the originator or seller. The issuer of the asset-backed security therefore usually does not have employees or genuine corporate operations beyond holding the pool of financial assets. It therefore remains questionable whether these assets could qualify as “corporate” bonds. Besides, asset-backed securities are securitisation products subject to specific rules under the Securitisation Regulation. Following the same logic, one could also argue that covered bonds – which are a very specific type of debt instrument and subject to specific rules – would not meet the definition of “corporate bonds”. These aspects would nevertheless merit further clarification. In any case,

government bonds and supranational bonds, which represent the bulk of the purchases under the APP and the PEPP, will not directly fall within the scope of the Taxonomy Regulation.

Nonetheless, the most substantial impact of the Taxonomy Regulation should be the increased disclosure requirements provided for in its Article 8 whereby entities will have to disclose (i) the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable; and (ii) the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable. The list of entities subject to this requirement is defined by reference to the NFRD and includes “undertakings which are subject to the obligation to publish a non-financial statement or a consolidated non-financial statement pursuant to Article 19a or Article 29a of Directive 2013/34/EU of the European Parliament and of the Council, respectively”. This definition comprises large public and private sector entities, including credit institutions and financial sector entities.

It follows that the Taxonomy Regulation, once fully applicable, will be instrumental as regards the ECB’s outright purchases in two respects. First of all, it will create a framework for establishing the degree to which an investment is environmentally sustainable. The EU Green Bond Standard should provide a response to the million dollar question: “but wait a minute, what is really a green bond?”, which has arguably hindered the expansion of a sizeable green bond market. Second, the Taxonomy Regulation, through its broad-based disclosure requirement, should also help to address the issue of “informational market failures”<sup>39</sup>. In other words, the absence of a clear, consistent and transparent globally agreed taxonomy accompanied by disclosure requirements has so far created a mispricing of assets.

But the question then is whether the ECB could buy more green bonds on the back of the new Taxonomy Regulation and the Green Bond Standard once fully applicable.

## 4.2 Could the Eurosystem buy more green bonds on the back of the Taxonomy Regulation?

Purchases of assets under the existing outright purchase programmes are primarily driven by the monetary policy objective pursued by the relevant programme. In the case of the APP that monetary policy objective has been defined as follows: “The APP aims to enhance the transmission of monetary policy, facilitate the provision of credit to the euro area economy, ease borrowing conditions for households and firms, and support the sustained convergence of inflation rates to levels below, but close to, 2% over the medium term, consistent with the ECB’s primary objective of maintaining price stability.”<sup>40</sup>. In that sense the underlying monetary policy justification for outright asset purchases differs from the one applied in respect of assets accepted as

<sup>39</sup> Schnabel, I. (2020), op. cit., [When markets fail – the need for collective action in tackling climate change](#).

<sup>40</sup> See recital 2 of Decision (EU) 2020/188 of the European Central Bank of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9) (OJ L 39, 12.2.2020, p.12).

collateral for monetary policy credit operations. Whereas for assets accepted as collateral the monetary policy objective is primarily to be sought in the underlying credit operation giving rise to the collateralisation, in Eurosystem outright purchases the purchase of the asset itself is the instrument enabling the fulfilment of the desired monetary policy objective. This is the reason why assets eligible as collateral constitute the core of assets eligible for purchase. But there are additional requirements with regard to purchases. In other words, the purchase of Taxonomy-compliant assets needs to be adequate in order to fulfil the monetary policy objective of the programme.

One should not, however, forget that under Article 127(1) TFEU, without prejudice to the abovementioned price stability objective, the ECB must support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union. The protection of the environment is clearly one of these objectives. But what would that mean for the conduct of a monetary policy asset purchase programme?

A simple example could be based on two bonds issued by a multilateral development bank which are both eligible for purchases under the APP or PEPP. Bond A is Taxonomy compliant while Bond B fails to meet that standard. Both Bond A and Bond B have similar maturities and do not contain differentiating features which would make any of these bonds less likely to contribute towards meeting the above-mentioned monetary policy objective. One could argue that, from a legal standpoint, the Eurosystem would need to give preference to Bond A if it can be demonstrated that by purchasing Bond A the ECB also contributes to the achievement of the EU's greenhouse gas emission reduction objectives. This preference could be exercised by purchasing the Taxonomy-compliant assets first before purchasing the non-Taxonomy compliant assets with similar features. It could also be envisaged to set specific benchmarks or targets for Taxonomy-compliant assets based on their availability in the market in order not to unduly distort this relatively small and nascent market. But it could also be considered to lift some of the self-imposed constraints in order to be able to purchase more Taxonomy-compliant assets.

However, considerations related to the question of the objectives pursued by the measures would also need to be complemented by compliance with general principles of EU law.

The principle of “market neutrality” is often presented as one of these principles and deriving from the more general principle requiring the ECB to act in accordance with the principle of an open market economy with free competition under Article 127(1) TFEU.<sup>41</sup> It is indeed true that Advocate General Wathelet referred to the principle of “market neutrality”, in his opinion in the *Weiss* case (C-493/17), as being part of the principle of an open market economy: “As the ECB and the Commission point out, to exclude the purchase of bonds with a negative yield from the PSPP would be contrary to the principle of market neutrality, which forms part of the principle of an open market economy with free competition, a condition of the ECB's activity pursuant to Article

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<sup>41</sup> The principle is enshrined in Article 119(1) and (2) TFEU.

127(1) TFEU”.<sup>42</sup> However, the meaning given to the principle is extremely heterogeneous and, in the view of the author, cannot be subsumed within a legal principle creating legal obligations. First, the Treaties neither contain nor envisage such a broad principle which would require the Eurosystem or other Union institution to remain “market neutral”, as it could have the potential of defeating any public policy aimed at steering the markets in a certain direction. This is of particular relevance in green markets characterised by a clear mispricing of climate risks, as Isabel Schnabel stated: “In the presence of market failures, market neutrality may not be the appropriate benchmark for a central bank when the market by itself is not achieving efficient outcomes”. Second, even if the two principles can in certain specific circumstances be confused, the requirement to act in accordance with the principle of an open market economy is clearly not imposing a strict prohibition on the actions of the ECB, such as would be the case for the monetary financing prohibition enshrined in Article 123 TFEU. There can be interference with the principle of an open market economy if it can be properly justified. In this specific case, it could be well justified by the objective and ambitious greenhouse gas reduction targets set by the EU for 2030 and 2050, especially if market neutrality results in purchasing carbon-intensive bonds which would undermine these objectives.<sup>43</sup> The justification for such interference should be proportional to the objectives pursued by the measure.

The principle of proportionality is in that sense crucial for the assessment and has gained increased scrutiny in the field of monetary policy.<sup>44</sup> The scrutiny has paradoxically even increased in the collective conscience since the recent judgment of the German Federal Constitutional Court (*Bundesverfassungsgericht*) in relation to the PSPP<sup>45</sup> which is not binding in the EU legal order. Without discussing the legal merits of the findings of the German Federal Constitutional Court – according to which if an interpretation of the Treaties by the Court of Justice of the EU is not comprehensible and must thus be considered arbitrary, a constitutional court is not bound to follow such interpretation – the judgment is of interest from the point of view of the emphasis it puts on the “cost-benefit assessment” (*Angemessenheit*) which, in the German constitutional tradition, forms part of the proportionality test.<sup>46</sup> In essence, the German Federal Constitutional Court argues that the review by the Court of

<sup>42</sup> Case C-493/17, *Weiss and Others*, EU:C:2018:1000. [Opinion](#) of Advocate General Wathelet, 4 October 2018.

<sup>43</sup> Honohan, P. (2019), [Should Monetary Policy Take Inequality and Climate Change into Account?](#), in particular: “Were the short-term money market interest rate the only instrument available to the central bank, it might be easier for the bank to ignore moderate side effects of its policies on goals unspecified in its mandate. Achieving the primary objectives takes priority. But with the wider set of tools now available, it may be possible to adjust the mix to improve side effects without compromising on the primary objectives.”

<sup>44</sup> See Case C-62/14 *Gauweiler and Others*, notably para. 66: “It follows from Articles 119(2) TFEU and 127(1) TFEU, read in conjunction with Article 5(4) TEU, that a bond-buying programme forming part of monetary policy may be validly adopted and implemented only in so far as the measures that it entails are proportionate to the objectives of that policy.”

<sup>45</sup> BVerfG, Judgment of the Second Senate of 05 May 2020, - 2 BvR 859/15 -; - 2 BvR 1651/15 -; - 2 BvR 2006/15 -; - 2 BvR 980/16.

<sup>46</sup> “In applying the principle of proportionality, German law distinguishes between the elements of suitability (*Geeignetheit*), necessity (*Erforderlichkeit*) and appropriateness (*Angemessenheit*) (cf. BVerfGE 16, 147 <181>; 16, 194 <201 and 202>; 30, 292 <316 and 317>; 45, 187 <245>; 63, 88 <115>; 67, 157 <173>; 68, 193 <218>; 81, 156 <188 and 189>; 83, 1 <19>; 90, 145 <172 and 173>; 91, 207 <221 et seq. >; 95, 173 <183>; 96, 10 <21>; 101, 331 <347>; 120, 274 <321 and 322>; 141, 220 <265 para. 93>.” BVerfG, Headnotes to the Judgment of the Second Senate of 05 May 2020 - 2 BvR 859/15 -; - 2 BvR 1651/15 -; - 2 BvR 2006/15 -; - 2 BvR 980/16.

Justice of the principle of proportionality is rendered meaningless “given that suitability and necessity of the PSPP are not balanced against the economic policy effects – other than the risk of losses – arising from the programme to the detriment of Member States’ competences”. In doing so the Federal Constitutional Court seems to confuse the principle of conferral which sets limits to the Union competences and the principle of proportionality which governs the use of such competences by the Union. In any event, such an interpretation of the principle of proportionality is not binding in the EU legal order and the position of the Court of Justice on the matter is quite clear, namely that acts of Union institutions should be appropriate for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary to achieve those objectives.<sup>47</sup> The assessment of the Court of Justice with regard to the German concept of *Angemessenheit* is much less intrusive as it is limited to asserting whether the “ECB weighed up the various interests in play so as to actually prevent disadvantages from arising, when the programme in question is implemented, which are manifestly disproportionate to the programme’s objectives”. The standard set by the Court of Justice is therefore much closer to the French administrative law concept of *excès de pouvoir* or the Italian law concept of *eccesso di potere*. That being said, the judgment of the German Federal Constitutional Court is of interest as regards the new paradigm it might entail<sup>48</sup> and the emphasis put on the social and economic impact of monetary policy which ought to include environmental considerations as well.

President Lagarde has referred to a “benefit-cost” analysis of the impact of outright purchases instead of the focus put by the German Court on side effects<sup>49</sup>. Purchases of Taxonomy-compliant assets or green bonds under the existing outright purchase programmes should beneficially impact the weighting of the interests at hand. Physical and transition risks represent a clear threat to our societies, and favouring green assets in the APP and PEPP could have a positive weight in the benefit-cost assessment. In the above-mentioned example, if the purchase of Bond A and Bond B have the same monetary policy effect, the purchase of Bond A in preference to Bond B (e.g. first before purchasing the non-Taxonomy compliant asset) would be required on the basis that Bond A weighs better in the benefit-cost assessment and overall reduces the eventual side effects which might be associated with the purchase of bonds which are more carbon intensive. This latter aspect will also help to alleviate the current scarcity of green assets and the resulting necessarily limited amount of green bonds that the Eurosystem will be able to purchase.

As Patrick Honohan<sup>50</sup> has recently expressed: “A voluntarist approach could start from the axiomatic (and plausible) position that inequality and climate change are bad: policy that reduces them, all other things being equal, is to be preferred on ethical grounds”. The lawyer would add that it follows from the Treaty that, under the said

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<sup>47</sup> See *Gauweiler and Others*, para. 67.

<sup>48</sup> Goldmann, M. (2020).

<sup>49</sup> “Well, your question helps me, reframing a little bit for you, the cost-benefit – and I was tempted to say the benefit-cost because there are a lot more benefits than costs – of our PEPP”, C. Lagarde, ECB Press Conference, 4 June 2020.

<sup>50</sup> Honohan, P. (2019), op. cit.

condition of “all other things being equal”, such preference is also a legal requirement and not only an ethical one.

Looking ahead, the European Commission has announced that it will aim to issue EUR 225 billion of green bonds as part of its Next Generation EU recovery fund (approximately 30% of the overall envelope). These bonds will be eligible both as collateral for monetary policy operations and also for outright purchases under the PSPP and the PEPP. These bonds being in the supranational bonds category will also benefit from a higher purchase limit in the PSPP, namely 50%. It follows that the greening of the Eurosystem's purchase programmes is underway.

## 5 Conclusion

The Taxonomy Regulation, once fully applicable and supplemented by the relevant delegated acts, has the potential to be a useful tool for the Eurosystem. It has the potential to address informational market failures and the mispricing of green assets. It also has the potential to enable the Eurosystem to distinguish truly green assets from others when accepting collateral or purchasing assets outright. It shall serve as a prism revealing the true colour of assets.

“Any one who has common sense will remember that the bewilderments of the eyes are of two kinds, and arise from two causes, either from coming out of the light or from going into the light, which is true of the mind's eye, quite as much as of the bodily eye ...” Plato, the allegory of the cave.

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Panel 4

Central bank digital currencies



# Introduction to the panel on central bank digital currencies – in the distant future or tomorrow?

By Otto Heinz<sup>1</sup>

## 1 Introduction

I think this virtual panel format is very appropriate for the subject matter at hand – central bank digital currencies (CBDC). It is a novel, somewhat untested area: the audience, the customers, are not here with us, they are physically disconnected from the panel. Yet the discussion is of real value and serves the purpose in another, novel form just the same way as a physical panel would have done. So virtual panels are the right format for discussing CBDC just as a traditional conference setting is for discussing cash.

Over the last few months, we have dealt intensively with this very forward-looking topic in the ECB. Intriguingly, the work intensified just at the same time as the coronavirus (COVID-19) crisis was taking its toll on the economy. At times it was quite difficult to work on the future when we also had to tackle the current situation with the ongoing pandemic. But, again, it was somehow appropriate as this pandemic situation just accelerated the road to digitalisation and the use of online payments instead of cash, which in turn made the question of CBDC even more relevant. I recall one morning still in February, we sat with the relevant experts together in an office and we were guessing when a digital euro could become reality. The opinions were very wide ranging, from “eight years”, “ten years”, “15 years” to “never” – we did not really have a clear picture. Back then the Financial Times wrote about the “great bluff” of central banks as regards central bank digital currencies,<sup>2</sup> claiming that central banks do not really mean to actually implement the project. I presume, if we had to guess again, that we would now be mentioning clearly closer timeframes. In any case, hopefully after the panel discussions we can better define our views on this, also considering that earlier in October the ECB published the report of the Eurosystem High-Level Task Force on the subject matter, signalling to the public that it takes CBDC very seriously.<sup>3</sup>

Actually, October 2020, when this panel met, was a momentous one for central bank digital currencies as there had been some important developments worldwide.

First, the Bank for International Settlements (BIS) and seven major central banks from around the world the Bank of Canada, the ECB, the Bank of Japan, Sveriges Riksbank, the Swiss National Bank, the Bank of England, and the Federal Reserve

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<sup>1</sup> Head of the Financial Law Division, Directorate General Legal Services, European Central Bank.

<sup>2</sup> Arnold, M. (2019), [Central bank talk of launching cryptocurrencies is all bluff](#).

<sup>3</sup> European Central Bank (2020), [Report on a digital euro](#).

System (Board of Governors) – published a report on foundational principles and core features of central bank digital currencies.<sup>4</sup> Whilst none of the central banks made any decisions regarding CBDC, the report nevertheless signalled some important common ground as regards the principles around central bank digital currencies.

- All central banks involved acknowledge the need for the co-existence of CBDC with cash and other types of money in a flexible and innovative payment system.
- They all saw CBDC with the role to support wider policy objectives (without singling out a particular objective).
- All central banks were mindful of the need not to unintendedly harm monetary and financial stability through the issuance of CBDC and placed high priority on this aspect.
- Finally, they all saw as a central consideration of the exercise to promote innovation and efficiency.

Given the different political and cultural preferences of central banks and their varying legal backgrounds, their future approaches to CBDC are likely to show some marked differences. It is nevertheless noteworthy that these central banks are working together on this matter and have managed to identify such common ground.

## 2 Blueprint for a digital euro

In addition to the BIS report, also individual central banks have published their own findings on CBDC, for example the Bank of Japan<sup>5</sup> and the ECB. On 2 October 2020 the ECB published a report on the possible issuance of a digital euro, prepared by the Eurosystem High-Level Task Force on CBDC and approved by the Governing Council.<sup>6</sup> As this was a first comprehensive publication by the ECB on the matter, setting out its initial views on CBDC, it was decided to follow it up with a public consultation by the ECB on user preferences. The public consultation launched in October 2020<sup>7</sup> is seeking the views of the public in general and also that of the professional audience and other stakeholders.

The main topics covered by the Eurosystem report include the possible scenarios that could trigger the need to issue a digital euro; potential side effects; legal considerations; the different possible design options; and finally it also tackles technical and organisational issues.

The report gives a working definition on a digital euro as a central bank liability made available in digital form for use in payments by citizens and firms. This definition gives away one of the most important and likely design features, i.e. that a digital euro would

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<sup>4</sup> Bank for International Settlements (2020), [Central bank digital currencies: foundational principles and core features](#).

<sup>5</sup> Bank of Japan (2020), [The Bank of Japan's Approach to Central Bank Digital Currency](#).

<sup>6</sup> European Central Bank (2020), op. cit. See also the dedicated page on the ECB's [website](#).

<sup>7</sup> See the [public consultation](#) and further information on the ECB's website: [Hubpage: A digital euro](#).

also cover retail. It is also clarified that, similarly to other major central banks, the ECB envisages such a currency as complementing, not substituting, cash, if and when the issuance of a digital euro is deemed to be necessary. Furthermore, importantly it was also stated that its implementation would rely on synergies and cooperation with the industry.

A digital euro has not been deemed necessary so far, but the report already highlights the main scenarios that could trigger such a need.

- The first one sounds a bit like a catch-all scenario when providing that new payment needs in Europe could be satisfied with a risk-free digital asset.
- Significant decline in the use of cash as a means of payment in the euro area could also serve as such a trigger point.
- Finally, the business case for a digital euro would immediately strengthen if a private digital currency, say Libra, was used and raised regulatory or financial stability concerns. Similarly, if in the euro area another digital currency was extensively used, say for the sake of irony a digital pound, it would also be likely to trigger a digital euro.

The subject matter is unique in many ways, and one of the intriguing features is the fact that, despite all the preparations, it is not entirely clear why actually it would be needed and what triggers the need. But surely this aspect as well will further evolve in the coming months.

The report also sets out some of the foreseeable side effects of having a digital euro issued, including:

- the impact on the banking sector, including its role and its funding, on financial stability;
- on monetary policy (which is potentially controversial in a negative rate environment);
- on the ECB balance sheet that is expected to be bigger and possibly more fragile with a digital currency issued; and
- finally, on weaker currencies that could be more marginalised and lose significance.

These are all significant issues with a potentially significant (external) impact; hence they deserve commensurate attention. Personally, I believe the “make or break” for the project is to find satisfactory solutions to deal with the issues having an impact on the banking sector. This is particularly relevant in the euro area where the role of banks is relatively speaking more significant than in many other parts of the world – and where banks often struggle in an over-banked environment with negative rates and with new and dynamic fintech firms pushing in their space.

The Eurosystem report also covers some of the legal preparatory work we have been carrying out in the background. From these issues clearly the most important, the “one

million euro” question, is whether there is a legal basis for the issuance of a digital currency in the Treaty on the Functioning of the European Union (TFEU) without the need for amendment that would be very difficult and would surely take years. We are cautiously optimistic that there would not be a need for such a Treaty change. Of course, immediately thereafter the next question is which of the possible legal bases already in the TFEU could be relied upon – which is not an easy exercise either.

In addition, there has been a host of other legal issues examined internally for the purposes of the report. For example, the legal assessment covers the legal tender status of a digital currency, its exchangeability with cash and the possibility of restricting its use. The legal implications of different key design features we also covered. In addition, it was also examined if and how key pieces of EU legislation, such as the Directives on payment services, on e-money, on settlement finality and on anti-money laundering, or the general data protection Regulation, would apply to the ECB as issuer of the digital currency. Other legal topics included supervision of intermediaries and oversight of the infrastructure involved with the distribution, holding and transfer of a digital euro, the intellectual property related issues, and various other private law questions.

After this short introduction let us turn to the panel composed of an impressive ensemble of four speakers, and in fact all of them have been involved with the Eurosystem report. Two of them are admittedly not lawyers, but this combination of economists and policymakers with lawyers is necessary in order to give a complete picture of the matter in the context of the euro area. There are still different design options and policy decisions to be made and they are interdependent with the legal considerations. Accordingly, Valérie Fasquelle and Ulrich Bindseil, the economists in the room, give the policy context around the motivation of the Eurosystem and the different design options. Thereafter our two lawyers, Phoebus Athanassiou and Panagiotis Papapaschalis give their legal assessment on the basis of the work of the Eurosystem legal task force that has been analysing the matter in recent months. As you will see in both the policy and legal contributions, one of the key, if not the key distinction is between the wholesale and private CBDC.

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# Issuing a digital euro

By Ulrich Bindseil<sup>1</sup>

Central banks are entrusted with the fundamental task of issuing money.<sup>2</sup> A task founded on trust in the issuer which ensures that citizens have access to simple, secure and risk-free means of payment that can be used on a large scale. Today many Europeans take this for granted and quickly embrace new digital payment means that enter the payments market. In the digital age, user-friendliness and speed direct the choice of consumers – a trend that is also seen in the payments market. Cash has for long been the preferred choice of payment for many in the euro area, but electronic payments are slowly taking over and with this trend new payment initiatives are entering the market.

From 2016 to 2019 the proportion of cash payments decreased from 79% to 73% of all physical retail payments. This trend has accelerated during the coronavirus (COVID-19) pandemic, and a vast majority of consumers expect to continue to use digital payments as often as they do now or even more often in the future.

As cash payments decline, a further increase in the uptake of international card schemes and solutions such as payment wallets and apps developed by large technology firms is seen. Crypto-assets such as Bitcoin have also entered the market as payment solutions and with them the issuer behind the payment means blurs. Payments may no longer need to be done via either central bank money or commercial bank money, and as a consequence the fundamental trust in money could be undermined.

Anticipating this digital trend and, as issuer of the euro, the ECB is exploring issuing a digital euro which could be used by all Europeans giving them easy access to a safe form of central bank money. A digital euro would complement cash and together these two types of money would be accessible to all, offering greater choice and easier access to ways of paying. In this article I explore why we are considering issuing a digital euro and what it could potentially look like.

## 1 Why should a central bank issue a digital currency?

In the fast-changing world, a digital euro could support the Eurosystem's objectives by providing citizens with access to a safe form of money. By issuing a digital euro, the Eurosystem would offer direct access to central bank money to all citizens and firms. Today central bank money is cash and deposits held by banks on central bank accounts. A digital euro could expand this access and allow citizens and firms to make payments with a simple, risk-free and trusted digital means of payment, accepted

<sup>1</sup> Director General Market Infrastructure and Payments, European Central Bank.

<sup>2</sup> This article draws on the findings of the [Report on a digital euro](#) (European Central Bank (2020)), published by the ECB on 2 October 2020. The report was prepared by the Eurosystem High-Level Task Force on central bank digital currency and approved by the Governing Council.



throughout the euro area thus preserving the public good that the euro provides to European citizens.

Aimed at a potential issuance of a digital euro, if the need should materialise, the Eurosystem has analysed scenarios where a digital euro could be a viable option in order to achieve its objectives related to core central bank functions and the general economic policies of the EU. It should be noted that materialisation of a specific scenario does not necessarily warrant issuance of a digital euro to the extent that alternative solutions are available.

The Eurosystem's analysis shows that a digital euro could be issued:

1. to support the digitalisation of the European economy and the strategic independence of the European Union;
2. in response to a significant decline in the role of cash as a means of payment;
3. if there is significant potential for foreign central bank digital currencies or private digital payments to become widely used in the euro area;
4. as a new monetary policy transmission channel;
5. to mitigate risks to the normal provision of payment services;
6. to foster the international role of the euro; and
7. to support improvements in the overall costs and ecological footprint of the monetary and payment systems.

Whether or not to issue a digital euro has not been decided, but it is important to explore and assess the benefits, risks and operational challenges to be prepared should one or more of the scenarios materialise. In this vein the effects of issuing a digital euro need to be understood and analysed, so that potential negative consequences can be avoided.

## 2 Potential effects of a digital euro

What would the consequences of issuing a digital euro be for the balance sheet and the core tasks and functions of the Eurosystem? In the Report on a digital euro, the consequences have been further assessed in order to derive requirements that the digital euro should meet irrespective of which specific future scenario materialises.

First, a digital euro should be designed so as to avoid potential undesirable consequences of its issuance, thereby limiting any adverse effects on monetary policy and financial stability, and on the provision of services by the banking sector, as well as mitigating possible risks.

Second, the excessive use of the digital euro as a form of investment and the associated risk of sudden large shifts from bank deposits to the digital euro should be avoided. The digital euro should be available via supervised intermediaries, while IT

project risks (for example, project delays or unexpected costs) should be minimised. The Eurosystem should aim at complying with regulatory standards even when exempted, unless it is clearly in the public interest not to do so.

Finally, the digital euro should be an efficient way to achieve the Eurosystem's goals in comparison with alternatives. Conditions should be established for using it outside the euro area and, last, digital euro services will need to be highly resilient to cyber threats.

## 3 What could a digital euro look like?

The design of a digital euro could take many forms, but it is essential that it meets the core principles of the Eurosystem. The report identifies two overall broad types of digital euro: offline and online. These types are compatible with each other and could be offered simultaneously to the extent that they both satisfy the core principles and meet the general requirements identified. In addition a number of considerations need to be taken into account, such as what would be the access model used? How would privacy requirements be treated? How to avoid that a digital euro is used as a large-scale investment? And how would a digital euro be transferred between entities? I'll address these questions one by one.

### 3.1 Access model

How would users access a digital euro? Users could access the digital euro either directly or through supervised intermediaries. If users have direct access, the central bank would need to provide end user-facing services, such as customer identification and support. These are tasks currently not done by the Eurosystem today. If users access the digital euro indirectly, i.e. through intermediaries responsible for the provision of such services, customer identification and support would be provided by the intermediaries and not the central bank.

### 3.2 Privacy requirements

Users' privacy is important for many consumers and firms. A digital euro would be able to protect users' privacy to various degrees, depending on the preferred balance between individual rights and public interest. Means of payment in current use already provide varying degrees of privacy, ranging from anonymous cash transactions to transactions requiring documentary verification or monitoring via bank accounts. If the legal identity of digital euro users were not verified when they access services, any ensuing transaction would be essentially anonymous. While that is currently the case for banknotes and coins, regulations do not allow anonymity in electronic payments and the digital euro must in principle comply with such regulations. Anonymity may have to be ruled out, not only because of legal obligations related to money laundering and terrorist financing, but also in order to limit the scope of users of the digital euro when necessary – for example to exclude some non-euro area users and prevent

excessive capital flows or to avoid excessive use of the digital euro as a form of investment.

### 3.3 Limiting the large-scale use of a digital euro as an investment

The amount of digital euro that individual users could hold would be kept within a range such that the overall value of the digital euro in circulation would remain below an aggregate threshold deemed reasonable. This would require every digital euro user to be identified at least during on-boarding: anonymity would not be possible in order to avoid the circumvention of restrictions by impersonating multiple users.

One option to be investigated would be to allow users to hold digital euro only up to an individual threshold at any given time. To ensure that a user can always receive a payment in digital euro and no information is disclosed on current individual holdings, a “waterfall” approach would be possible whereby any incoming digital euro in excess of the holding limit would be shifted automatically to the payee’s account in private money. However, this would require all payees to hold such an account. Demand for a digital euro could also be controlled through incentive schemes under which less attractive interest rates or service fees are applied when individual holdings exceed the aforementioned threshold. This would have the advantage of allowing users to decide how much digital euro they want to hold normally, while ensuring that holding amounts above the threshold would be less competitive than other forms of investment. This idea has been elaborated further in Bindseil (2020) and Bindseil and Panetta (2020).

### 3.4 Transfer mechanism

Another important question is how a digital euro would be transferred between users. A digital euro could be provided either through an account-based system or as a bearer instrument.

In an account-based system, users’ holdings would be recorded by a third party that would determine, on behalf of the payer and payee, whether a transaction is valid and would update the respective balances accordingly. This is the approach that agents follow nowadays to transfer funds from the bank account of the payer to the account of the payee and is the approach adopted by major electronic payment solutions. It would allow the central bank issuing a digital currency to control transaction flows (either directly or through supervised intermediaries). However, this method would require that the users or the central third party are online.

When using a bearer digital euro, the payer and payee would be responsible for verifying any transfer of value between them. This is how cash payments work, whereas applications to electronic payments are limited. A bearer digital euro would fall outside the direct control of the Eurosystem or its supervised intermediaries and would mean, among other things, that limits on holdings and on the value of

international transactions as well as restrictions on the target group of users could only be enforced at the payment device level.

### 3.5 Payment device

A digital euro could be provided as a web-based service and/or through dedicated physical devices such as smart cards. The first case could allow for a broad range of devices to be used (for example, computers, mobile phones and wearable devices) however, an internet connection would be necessary. The second case would require the payer and payee to have specific compatible devices that could also be used offline.

### 3.6 Availability and usability offline

An electronic payment that is not confirmed online – either through the network of users or in a central register – can still be considered final by relying on “trusted hardware” modules. Offline functionality avoids the sharing of transaction details with parties other than the payer and payee, enabling the digital euro to become a complement to cash and providing a back-up payment solution that is available in extreme situations. These modules are increasingly available to potential digital euro users in the form of smart cards, mobile devices and payment terminals. The payment could be settled immediately as a transfer of pre-funded units between the devices of payer and payee.

### 3.7 Remuneration

Why would a digital euro need to be remunerated? Remuneration would be needed for monetary policy reasons, but also for financial stability and structural reasons, such as to lower demand for digital euro for investment purposes and to prevent the Eurosystem becoming a large investment intermediary. Remuneration could also be considered an attractive feature for users, which would preserve the role of the euro in retail payments in a digital environment with alternative digital currencies, but this could be at odds with the monetary policy objective of the central bank. Moreover, when considering the features that would make the digital euro competitive relative to alternative digital payment instruments, its competitive advantages should be considered. A digital euro, as a Eurosystem liability, has less intrinsic risk compared with a deposit in a commercial bank. However, it is not the aim of the central bank to compete with commercial banks for financial stability reasons and given their important role in monetary policy transmission.

### 3.8 Parallel infrastructure

A digital euro based on infrastructures existing in parallel to those of other payment solutions could help to withstand extreme events such as cyber incidents and attacks, natural disasters, and pandemics. Parallel infrastructures for private payment solutions could provide this but would be costly, given the nature of payment systems as a network industry, and less likely to be introduced by private profit-oriented entities. Having a parallel infrastructure for the digital euro seems especially costly and unlikely if supervised intermediaries are involved not only in the on-boarding of users but also in the processing of their transactions. However, the decision to bear such costs should be based on the likelihood and magnitude of the extreme events under consideration. A parallel infrastructure would also run counter to the aim of issuing a digital euro in order to improve the cost and environmental footprint of payments.

### 3.9 Offline and online

Based on these considerations, I will now come back to the type of digital euro or whether or not a digital euro should be designed as offline or online.

An offline design could be used without third-party intervention and should therefore be made available only by means of specific user devices, which could be distributed and/or funded through supervised intermediaries and should be secure against both hacking and use by unintended persons. Offline digital euro transactions would be anonymous in principle and could only be remunerated with a fixed and non-negative interest rate. Moreover, limits on the use of the offline digital euro, including in relation to its potential anonymity feature, should be ensured by means of the appropriate technical constraints in the payment device. The characteristics of an offline digital euro would be fully compatible with those needed to enjoy the status of legal tender (for example, lack of additional costs for the prospective user and universal availability – no need for an internet connection). Finally, the infrastructure of an offline digital euro would de facto be parallel to that of other electronic payment solutions.

An online design of digital euro could be remunerated at a rate that varies over time. Remuneration would be a powerful tool for monetary policy applications and also to limit shifts from private money into the digital euro (although for this purpose it might interfere with monetary policy transmission). A digital euro that can be used online could feature advanced functionalities and provide opportunities for supervised private intermediaries to offer value-added services. Its use would not be tied to any specific device and access to all digital euro services could be controlled by the responsible parties (the central bank and supervised private intermediaries) at any time. However, an online digital euro would exclude the possibility of anonymity for users.

It should be noted that any digital euro for offline use would need to be managed online at some point in order to add funds to the device or withdraw funds, and the two types of digital euro can coexist.

## 4 Conclusion

Providing citizens with trusted and risk-free money for their payments is a core task of the Eurosystem. In the digital age, there is a need to ensure that consumers continue to have unfettered access to central bank money in a way that meets their needs. Consequently, the ECB's Governing Council has decided to advance work on the possible issuance of a digital euro accessible to all citizens and firms. A digital euro would be introduced alongside cash, it would not replace it.

As outlined in this article, the Eurosystem is exploring the benefits, risks and operational challenges of issuing a digital euro. Our analysis shows that, depending on the emerging scenario, different design cases can be examined. An experimental phase will be initiated to ensure that, if the need arises, the ECB will be ready to introduce a digital euro.

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# CBDC: how central banks approach innovation

By Valérie Fasquelle<sup>1</sup>

At a speech held in December 2019, François Villeroy de Galhau, Governor of the Banque de France, underlined the need for central banks to take up the challenges posed by innovation by exploring the issuance of a Central Bank Digital Currency (CBDC) as one of the possible options: “the creation of a new CBDC is neither a precondition for nor a guarantee of more efficient payments. However, we as central banks must and want to take up this call for innovation at a time when private initiatives [...] and technologies are accelerating, and public and political demand is increasing”<sup>2</sup>.

Indeed, the payment and financial sector is undergoing profound evolutions stemming from the digitalisation of the economy, the new needs of payments and settlements users, the expansion of new and promising technologies such as distributed ledger technology (DLT), the irruption of tech companies along with the traditional players and the development of crypto-assets to name the most important trends. In this context, central banks have to embrace change while preserving safety, stability and efficiency of the ecosystem. Among the conceivable set of tools at the disposal of central banks, the issuance of a digital euro is considered as a possible way to foster innovation in a climate of trust and to preserve monetary sovereignty.

Yet, a decision to issue a CBDC cannot be based on conceptual analysis alone and experiment is key as especially since analysis suggest different implementation models are possible. Experimentations do not pre-empt future decisions but help preparing them, by exploring technical feasibility, confronting use-cases to prospective users and thus favouring improvements and the comprehensive assessment of alternative options. They also allow involving external stakeholders when relevant and practicable.

In the area of retail CBDC, the ECB report on a digital euro<sup>3</sup> identifies four different models combining different options regarding the distribution model of a CBDC and the technologies used. These different models have to be tested in order to fully understand their advantages and limitations.

The Banque de France – as other central banks around the world – has started experimenting wholesale CBDC in partnership with the private sector. This concrete approach will also serve as a contribution to the Eurosystem insight on CBDC and inform upcoming decisions on the way forward.

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<sup>1</sup> Director of Infrastructures, Innovation and Payments at Banque de France.

<sup>2</sup> “Central bank digital currency and innovative payments”, speech by Mr François Villeroy de Galhau, Governor of the Banque de France and Chairman of the Autorité de contrôle prudentiel et de résolution (ACPR), at the ACPR, Paris, 4 December 2019.

<sup>3</sup> [Report on a digital euro](#), European Central Bank, October 2020.



This article starts with a presentation of the current trends in payment and financial infrastructures and explains how those evolutions have led central banks to explore the provision of CBDC as a complementary way to provide central bank money (part 1). The article then explores the possible designs of a retail CBDC going into the different options regarding the distribution mechanism as well as the back-end and front-end architectures (part 2). It then describes the approach taken by the Banque de France in the conduct of experimentations and how it could serve as a model for experimenting with retail CBDC (part 3). Finally, the article puts the discussion on CBDC in the context of strategic challenges (part 4).

## 1 Innovation and the implication for central banks

### 1.1 The digitalisation of the economy

For many years, digitalisation of the economies has been driving changes over all the economy. This trend has also concerned payments and settlement, and more broadly the financial sector.

In the retail payment landscape, the pace of change has been considerably accelerating in the recent years. This development has been driven by behavioural changes of consumers and technological innovation, and further accelerated with the Covid-19 epidemic and the subsequent social distancing. The use of electronic payment instruments and systems is increasing, partially due to the growing adoption of formerly expensive devices, along with the development of internet-based technologies and multi-functional technological devices at the basis of the growth of e-commerce.

Also in the financial industry, a growing digitalisation has allowed economies of scale and the optimisation of processes. Recently, DLT-based solutions for the tokenisation of financial assets have attracted a lot of attention and are advancing very quickly.

DLT and tokenisation in payments and financial markets are creating a wealth of opportunities to improve the functioning of market infrastructures, with new channels and methods to settle payments and exchange financial assets. This technology could also allow for a better tracking of transactions and of ownership, as elements of identification are directly included in the blockchain operating the exchange. It could also lead to an easier reconciliation of multiple individual registries by automating a lengthy process that requires today human intervention – and therefore allows decreasing the cost of financial transactions and the risk of errors. Automation could also enable the provision of new services, involving recourse to so-called “smart contracts”, such as processing conditional transactions hard coded in the DLT, thus without external intervention – use cases for these features range from international remittances to the payment of sales taxes. Finally, this technology could also be an opportunity to strengthen the resilience and integrity of payment systems by diminishing reliance on centralised infrastructures and creating redundancy, thereby reducing the risk of single point of failure.

The acceleration of innovation is concomitant with the incursion of new entrants in the financial landscape, which has long been dominated by traditional banks. The adoption of regulation on open banking, in particular, allowed smaller FinTechs to compete with established actors. As a result, FinTechs are now present along the payment value chain, especially in the retail market (e.g. remittance payments, mobile payments, stablecoin initiatives) but also in wholesale payments. The entry of BigTechs is changing the scale of changes since those companies have a global footprint and could therefore develop solutions that have the potential to be systemic.

These trends have in common to raise the question of the role of money and of central banks, while central bankers do primarily have two main goals:

1. Protect the monetary sovereignty and the action of public policies, i.e. fundamentally their ability to preserve and impose collective choices in terms of monetary and financial stability as well as the efficiency and fairness of the financial system; and
2. Make the most of technological innovations, while preventing the constitution of monopolies (including technology monopolies) and the fragmentation of solutions with limited interoperability, while promoting financial inclusion.

## 1.2 The role of central banks to foster innovation while preserving trust and safety

Central bankers obviously support digital innovation, acknowledging the numerous benefits for the financial sector that are associated with it. They are fully engaged in supporting but also taking part in this innovation.

Central banks acknowledge the benefits that could arise from digitalisation. To give some examples:

- Innovations could facilitate access to financial assets providing better financing for small and medium-sized companies.
- New payment services could be developed that are better tailored to digital consumer's needs.
- New financing and investment services for retail clients and small corporates could facilitate access to credit and enhance financial inclusion.
- Technology could increase security and offer greater resilience to cyber threats.

However, innovation can also lead to market fragmentation, monopolistic situations and consumer protection and financial stability risks. As shown by the emergence of “global stablecoin” initiatives, BigTech companies could be tempted to build their own financial infrastructure and “monetary” system, creating a host of financial risks as identified in the 2019 report of the G7<sup>4</sup>.

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<sup>4</sup> “Investigating the impact of global stablecoins”, G7 working Group on Stablecoins, October 2019.

Central banks are in charge of the smooth and stable functioning of the payment systems, which concurs to the protection of monetary and financial stability as well as efficiency and fairness of the financial system. As part of their mandate, central banks have a prominent role in creating an environment of trust and safety. Central banks aim to fulfil this role in their capacity as overseers, operators and catalysts. These functions allow central banks (i) to be involved in the process of financial innovation, (ii) to ensure that new technologies support market efficiency and financial inclusion, and (iii) to provide optimal conditions for private innovation to evolve in this direction.

Central banks take part in the reflexion on the legal, regulatory and oversight environment regarding payments and market infrastructures. Central banks' actions in this area should pursue avoidance of any risk of regulatory arbitrage based on the principle of "same activities, same risks, same rules".

As operators of payment systems, central banks also have to ensure their infrastructure remains efficient and favour technological innovations. As catalyst, central banks should support different types of technology solutions while avoiding possible fragmentation resulting from solutions with limited interoperability. In this role, central banks also have the objective to promote financial inclusion, as banks and technological companies do not usually have an incentive in that regard.

### 1.3 The place of central bank money in a changing environment

The paradigm that characterises modern monetary systems is based on the interaction between central banks and commercial banks. Central bank money, which is the safest settlement asset, is currently made available in the form of banknotes, coins as well as deposits by credit institutions in the books of the central bank. Central bank money coexists with commercial bank money, which consists of the amounts recorded in the accounts of customers in banks. In a functional monetary system, the currency issued by commercial banks and the currency issued by the central bank are freely convertible at par.

The coexistence of the central and commercial currencies does not mean the absence of specialisation. Indeed, central bank money and commercial money fulfil complementary roles, both contributing to the smooth functioning of the economy: central bank money as an anchor and guarantor of the stability of the monetary system, commercial money as a key instrument for financing the economy and as a privileged means of exchange between economic agents in a digitalised economy.

The use of central bank money as the ultimate settlement asset is at the core of the organisation of payments and the cornerstone of the transmission of monetary impulses to the economy. The late 2000s/early 2010s global financial crisis (GFC) reminded the importance of having a liquid and risk-free asset to settle financial transactions. The Principles for Financial Market Infrastructures of the Committee on Payments and Market Infrastructures (CPMI) and International Organisation of Securities Commissions (IOSCO) adopted in 2012 recommend "financial market infrastructures to conduct settlement in central bank money, where practical and available, to avoid credit and liquidity risks".

This paradigm has served our economies and citizens well. However, some of the innovations described above could directly or indirectly call this equilibrium into question.

First, the issuance of global stablecoins, as a private means of payment backed by a reserve fund without a fixed parity, may be similar to an attempt to create a private currency. The substitution, at least partially, of such crypto-assets for the central bank or traditional commercial currency as a settlement asset would raise significant risks from the point of view of financial stability and consumer protection. These assets offer weaker guarantees in terms of counterparty risk, liquidity risk and business continuity. Where certain crypto-assets try to disrupt the equilibrium, it is very important for central banks to preserve the role of central bank money as an anchor.

Second, the relative decline in the use of cash as a result of the digitalisation of the economy may also require actions to safeguard the role of central bank money as an accessible and public means of payment.

Those two developments invite central banks to reflect on the way they give access to the central bank money. The current functioning with two forms of central money, the banknote as a universally accessible retail mean of payment provided to the public, and reserves as perfectly liquid and safe assets to settle payments between financial institutions allowed to have accounts with the central bank, may have to evolve to ensure the continuous coexistence of central bank money and commercial bank money.

One of the possible options is the creation of a new type of central bank money, in addition to cash in physical form and commercial bank deposits held in the accounts of the central bank. This new type has yet to be developed, taking into account the different constraints resulting from its different uses. Central banks are thus facing urgent and strategic choices on payments that will have implications for financial sovereignty.

## 2 Key design issues for designing a retail CBDC

The Eurosystem has taken up the challenge and started a reflection on retail CBDC that is presented in the October 2020 ECB report on a digital euro. The report analyses the possible reasons to issue a digital euro and its potential effects. It also explores first functional design possibilities and technical approach.

This part analyses some key design options for a retail CBDC, i.e. the determination of the respective roles of central banks and the private sector and their cooperation in issuing and distributing the CBDC to end-users.

### 2.1 Distribution model

Central banks have a long and proven experience in developing and managing back-end infrastructures as operators of large interbank payment systems. By

contrast, central banks have a much more limited background in operating end-user access solutions, let alone distributing payment solutions to retail clients. Hence, a direct distribution model where central banks issue CBDC directly to retail clients would likely disrupt the balance within the financial system, changing in particular the repartition of roles between the public and private sector, and could not leverage on existing expertise within the central bank, which do not carry out such a function as operator.

An intermediated distribution model would on the contrary make use – at least partially – of the private sector already existing network and human resources, and combine their expertise in terms of customer support, notably their experience of client relationship, with central banks' competences in the development and maintenance of large-scale payment infrastructure. For all these reasons, it seems to be the reasonable and pragmatic way forward. Rather than giving intermediaries a role of mere gatekeepers, the intermediated model makes it possible for the commercial banks and other authorised private sector providers to develop new services linked to the use of the CBDC and build new businesses.

However, for the intermediated model to foster users' trust, central banks need to ensure that the intermediaries follow certain requirements that ensure the quality, security and accessibility of the services provided in the name of the central bank. When the underlying technical infrastructure and its interface with end users is provided by intermediaries, it should be designed to preserve the nature of the digital euro as if it would have been provided by the central bank directly.

## 2.2 The back-end infrastructure

Regarding the back end-infrastructure, central banks need to form an opinion on two major subjects: the level of centralisation of the infrastructure on which the digital euro would be issued and transferred and the form of a digital euro as an account-based system or a bearer instrument.

Regarding the infrastructure, it can be centralised, fully decentralised, or be an intermediary solution between these two, such as a partially decentralised or a hybrid model combining a centralised infrastructure with partially decentralised ones. In the first approach, digital euro transactions are recorded directly in the Eurosystem's ledger, whereas in a decentralised approach, the Eurosystem sets rules and requirements for the settlement of digital euro transactions that are then recorded by supervised intermediaries on behalf of end-users.

A fully centralised model would imply that all transactions are validated by the central bank and registered in its own ledger. This would require an important scaling in terms of infrastructure, and very robust security as this type of architecture is vulnerable to a single point of failure. At the other end of the spectrum, a fully decentralised solution, such as a public blockchain, does not seem to be compatible with the necessity for the issuance of a digital euro to remain under the operational responsibility, or at least operational control, of the Eurosystem.

In a partially decentralised solution, or intermediated model, the responsibilities could be split between the central bank and supervised intermediaries. For example, the infrastructure operated by the central bank would typically be responsible for the issuance of digital euro and the provision of a consolidated view on the circulation of the digital euro. Supervised intermediaries could be in charge of executing transactions on behalf of their customers, act as settlement agents, provide custody services to end-users and operate a front-end task such as authentication.

As regards the form a digital euro could take, the choice between an account-based solution and a bearer instrument comes down to an arbitrage between enhanced traceability, performance and efficiency on the one side and preservation of privacy and the possibility to conduct offline transactions on the other side. The account-based approach reproduces the current functioning and the organisation of electronic funds transfers. The use of accounts allows for high performances and uncomplicated monitoring of transactions but might be less innovative. With a bearer digital euro, the participant in a transaction that is at the receiving end would be formally responsible for the verification of the transfer of value, as in a cash payment. This would leave possibilities for offline payments in which no third party is involved. The use of a bearer instrument would have to be secured by sophisticated cryptographic tools in order to address the risks of falsification of transactions, double spending, and thefts of the instruments.

## 2.3 The front-end solution

The front-end solutions, or end-user access solutions, is designed to allow users to acquire, hold, spend and receive the digital euro in a user-friendly way. The front-end process involves also the following:

1. The management of customer identification and authentication, and specifically the Strong Customer Authentication (SCA) requirement defined by the Revised Directive on Payment Services (PSD2)<sup>5</sup>.
2. The implementation of Know Your Customer (KYC) procedures to on-board digital euro users and perform anti-money laundering and combatting the financing of terrorism checks in line with AMLD 5 requirements<sup>6</sup>.
3. The management of interoperability with other front-end solutions and the communication channels with the back-end infrastructure.

Depending on the choice of the distribution model and the back-end infrastructure, existing front-end solutions provided by the banking sector could be adapted so to

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<sup>5</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, p. 35).

<sup>6</sup> Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (OJ L 156, 19.6.2018, p. 43–74).

on-board a digital euro. The expertise of payment service providers and existing procedures for SCA and KYC could be implemented as they are. Obviously, this applies best to account based solution that function similarly to electronic payments. The accommodation of existing solutions to a bearer instrument would certainly require more far-reaching adaptations.

Furthermore, front-end solutions could also be combined with existing payment instruments, allowing end-users to choose from digital euro or commercial bank money when they enter a transaction. In that sense, the development of end-user solutions for a digital euro could be complementary to future projects such as the European Payments Initiative (EPI)<sup>7</sup>. Overall, it seems beneficial for the Eurosystem to capitalise on the private sector's proficiency in client management and allow for the private sector to integrate a digital euro in their customer solutions.

### 3 Learning by doing: the Banque de France experience with wholesale CBDC experiments

Reflection on a digital euro cannot be carried out only at a theoretical level, but must be nourished by public consultations, discussions with the financial industry and a comprehensive experimentation program.

The Eurosystem has decided to go this path. The Banque de France has previously collected some practical experience in the field wholesale CBDC experiments. This part offers some insight of past and ongoing experimentations that could serve as a source of inspiration for the experiments that have just been initiated at Eurosystem level to assess the case for a digital euro.

#### 3.1 Motivation and framework for the conduct of experiments in the field of wholesale CBDC

Several private projects are under way, especially in Europe, with the aim of helping financial markets to function more effectively and more smoothly. These projects focus on the creation and circulation of digital tokens intended to represent various types of financial assets. In this context, the launch of experiments on wholesale CBDC by the Banque de France is based on two motives:

- (i) Appraise the potential improvement in efficiency and fluidity of payment systems and financial infrastructure allowed by the introduction of a DLT. Expected results would inter alia be an easier reconciliation of transactions and a better tracking of the ownership of securities.

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<sup>7</sup> The EPI aims to create a unified payment solution for consumers and merchants across Europe, encompassing a payment card and a digital wallet and covering in-store, online and person-to-person payments as well as cash withdrawals.



- (ii) Determine the relevance of a revision of the condition under which central banks offer access to central bank money as settlement asset, in order to avoid a disorderly approach and heterogeneous adaptations of market infrastructures.

In this context, the Banque de France decided to launch experiments as a contribution to a broader discussion within the Eurosystem on the conditions under which they central bank money is provided for wholesale purposes.

In the selection of projects, the Banque de France has refrained from setting precise requirements and prescriptions for the selection of candidates, promoting instead an open approach towards the technologies, categories of partners (e.g. banks, market infrastructure operators), and financial instruments proposed for the experiments.

By contrast, the Banque de France has been mindful of a number of criteria in the application package, paying special attention to the security and robustness of the solution, as well as its overall compliance with the legal and regulatory framework. The experiments are carried out while conforming to all the applicable rules based on the different use case explored. Also, the experimentation framework has been conceived to avoid any legal as well as operational risks. The wholesale CBDC issued by the Banque de France during the experiments has no legal existence. It is only a representation of central bank money recorded on TARGET2 (T2) accounts<sup>8</sup> where final settlement effectively takes place. As defined in the experimentation framework, CBDC is issued on an intraday basis and does not involve any money creation. The operational and financial risk borne by the Banque de France is limited to gross negligence or wilful misconduct in the functioning of the cash accounts used during the experiments.

### 3.2 A first successful pilot in early 2020

Based on this approach, the Banque de France conducted a first pilot experiment in May 2020 alongside with Société Générale: FORGE. The actual transaction was successfully conducted on 14 May 2020. The operation consisted in a settlement of tokenised covered bonds (40 million euro) issued by Société Générale SFH against a tokenised euro issued by the Banque de France on blockchain.

The first pilot carried valuable lessons, such as the feasibility of Delivery versus Payment (DvP) of tokenised securities with a digital form of euro on blockchain.

Other experiments could help address unanswered questions, notably:

- The coupon detachment, the timing and setting of the issue programme, and the operating mode related to the management of securities transactions;
- The redemption of the security, its announcement and its materialisation;

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<sup>8</sup> See Guideline of the European Central Bank of 5 December 2012 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2) (ECB/2012/27) (OJ L 30, 30.1.2013, p. 1–93).

- The setting and recording of prices, both in the primary and in the secondary markets and its use in the calculation of margins and in hedging;
- The capture of flows for the calculation of hedges related to exposures incurred by counterparties;
- The management of flows (securities or cash) resulting from hedges entered into by counterparties.

Furthermore, the opportunity of increasing access to central bank money to certain market segments that do not settle in central bank money today should also be explored.

### 3.3 The Banque de France experimental program for 2020-21

In March 2020, the Banque de France launched a call for applications to experiment the use of CBDC for interbank settlements. The objective of these experiments is threefold. First, show how conventional use cases for central bank money, i.e. DvP and payment versus payment (PvP), can be achieved using CBDC. Second, identify the benefits of introducing a wholesale CBDC for the current ecosystem. Finally, understand how the issuance of CBDC could foster financial innovation.

Eight applicants<sup>9</sup> were selected in July 2020, covering a diversity of use cases (DvP or PvP), financial instruments (bonds, shares etc.), types of technologies, geographies (domestic as well as international partners) and ecosystem of users<sup>10</sup> (T2 participants, non-T2 credit institutions, financial intermediaries without T2 access).

The first experimentations with the chosen candidates have been effectively launched in September and will be carried out in the coming months. The results will serve as a contribution to the wider reflection conducted by the Eurosystem. Among practical questions linked to the specificity of each use case and the technology used, the experimentation will try to tackle some open issues.

Firstly, there is a need to identify the most beneficial degree of decentralisation to achieve balance between controllability, efficiency and security of CBDC. This choice has to take in consideration that the digital euro needs to be designed in such way as to be a central bank liability and prevent any creation by intermediaries, which probably implies some degree of centralisation. On the other hand, if a fully centralised model could not be entirely excluded, it the gains in terms of control and monitoring could be outweighed by the induced losses in terms of resilience of the overall system.

Moreover, the implications of the different forms that a CBDC could take, i.e. an account-based model and a token-based model, need to be better understood. The first one entails that a third party would record transactions and validate them, whereas in a token-based model the investor would be able to transact without

<sup>9</sup> Accenture, Euroclear, HSBC, Iznes, Liquidshare, ProsperUS, Seba Bank and Société Générale-Forge.

<sup>10</sup> As a condition to experiment, at least one T2 bank had to be part of the experimentation proposal.

instructing a third party. This design would imply a certain level of disintermediation of banks that are currently in charge of settling transactions in behalf of investors.

While the open questions around the distribution of wholesale CBDC are not identical to the many challenges posed by the issuance of a digital euro to citizens, the experience gained in one domain is useful for progressing on both fronts. First, the experimentations allow central banks to familiarise with new technologies and new concepts, e.g. tokens. Second, some of the developments conducted in wholesale experiments could be reused in the digital euro field, in particular as regard to the back-end infrastructure.

## 4 CBDC as an answer to current strategic challenges?

As highlighted in the first part, digitalisation of payments has become a major strategic challenge for Europe.

The emergence of global stablecoins raises significant challenges for public policy objectives. There is a risk that BigTechs build private infrastructures bypassing the current monetary and payment architecture that rest on the equilibrium between central and commercial bank money. If adopted on a large scale, global stablecoins could destabilise monetary sovereignty, by spreading significantly the use of private money in the economic system.

Without going into extreme scenarios, the perspective of a sort of relegation of banks to back office activities due to BigTechs engagement in various financial services and especially payments, could lead to a squeeze on domestic players margins, undermining their ability to innovate and maintain the infrastructures that are crucial to the smooth execution of payments and the resilience of the system.<sup>11</sup>

At the same time, an uncoordinated development of CBDCs meant as a response to private digital assets could disrupt the international monetary system. If they are developed on sole domestic considerations and lack interoperability, they could even further reinforce current inefficiencies in term of cross-border payments which are a breeding ground for initiatives such as Libra.

In this strategic context, issuing a digital euro might appear as a possible way forward for the Eurosystem in order to preserve its sovereignty in the field of payments, guarantee access to a form of central bank money and ensure that money remains a public good. If well balanced and harmoniously inserted within the financial system, a digital euro could provide citizens with access to a safe form of money in a fast-evolving digital economy, and contrary to private solutions, would not be tempted to monetize private data and could take into account the need for financial inclusion of vulnerable groups of society.

Concerning wholesale CBDC, it could be a necessary new way to provide central bank money if it can support better functioning and more stable financial markets, bringing

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<sup>11</sup> "BigTech in finance: Market developments and potential financial stability implications", FSB, December 2019.

the anchorage quality of the more secure and liquid asset. If the tokenisation of financial assets develops and DLT solution become more mature, central banks should stand ready to make central bank money also available in those ecosystems. Otherwise, it is likely that private solutions would emerge offering less secure settlement channels with a greater risk of liquidity fragmentation.

## 5 Conclusion

Central banks have the responsibility to preserve a climate of trust as one of the essential conditions to a safe and efficient payment system. The mission of the central bank thus involves the creation of the conditions for innovation and the preservation of trust in safe financial markets. The transformation of the payment landscape and the digitalisation of the economy are prompting central bankers to act as overseer, operator and catalyst in order to preserve the stability and efficiency of the payment system.

In response to digitalisation, central banks also reflect on their role as provider of central bank money both the retail and the wholesale space. A comprehensive assessment is needed to thoroughly understand the opportunities, risks and challenges associated with the introduction of a new form central bank money.

If central banks decide to revisit the conditions under which they provide their settlement asset, reflections cannot be carried only at a theoretical level but must also be nourished by public consultations, discussions with the financial industry and a comprehensive experimentation program involving the private sector. The experimental method that the Eurosystem decided to follow for the digital euro will help assess the advantages and drawbacks of different options and to settle for the most suitable set of parameters for this new form of money. In particular, the usability of DLT for decentralised settlement of retail transactions, its compatibility with existing infrastructure, or the relevance of a bearer-instrument regarding the risks it generates are matters on which field tests might prove the most useful. Furthermore, the value of experimentation is also to raise unforeseen question that generate in turn the need for in-depth studies.

The issuance of a CBDC would represent an important decision to take for central banks, which justifies careful analysis to assess all the economic and financial consequences of it. Adopting a learning by doing approach will allow central banks to gain the necessary expertise and confidence on best-suited design and the appropriate technological choices. This approach is also meant to embark the private sector and ensure that CBDC promotes innovation without disrupting the existing.

Yet, the ultimate decision for central banks to issue CBDC is a strategic one that will have to take into account moving parameters. Successful experimentations are therefore not an end in itself but an important element to inform the important decisions to come.

# Wholesale central bank digital currencies: an overview of recent central bank initiatives and lessons learned

By Phoebus L. Athanassiou<sup>1</sup>

## 1 Introduction

The last five years have seen a growing interest in the possible issuance and use of certain digital assets – namely, virtual currencies, central bank digital currencies and, more recently, stablecoins – as settlement media for transactions processed through platforms operating on the basis of distributed ledger technologies.<sup>2</sup> What began in 2009 as a thought exercise has since evolved to bring a flurry of ideas and initiatives, from public and private actors alike, which could usher in lasting changes in the public's perception of money and currency, and in the structures supporting the processing of money exchange.

It is customary in discussions on the possible issuance, distribution and use of a central bank digital currency (CBDC) to distinguish between retail (or 'general purpose') CBDCs and wholesale (or 'limited scope') CBDCs. The term 'retail CBDCs' refers to electronic forms of central bank money, other than central bank reserves (see below), the primary purpose of which is to serve as settlement media for retail payment transactions. The term 'wholesale CBDCs' encompasses digital forms of fiat money that are only available to a restricted group of designated financial institutions (typically, the monetary policy counterparties of central banks and certain other non-bank entities eligible to open accounts with a central bank-operated real-time gross settlement (RTGS) system) and are destined for use in wholesale settlements (mostly settlement operations between the central bank and its counterparties, interbank payments and the settlement of securities transactions between financial institutions).

One of the received wisdoms in the field of CBDCs is that, unlike in the case of retail variants, whose introduction would be revolutionary, the deployment of a wholesale CBDC would largely be 'business as usual'.<sup>3</sup> This perception is based mainly on three

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<sup>1</sup> Lead Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> For a recent account of the interest of central banks in CBDCs, see Bank for International Settlements (2018). The concept of a CBDC in itself is not new, dating back to the work of Tobin (see, for instance, Tobin (1985)).

<sup>3</sup> See, ex multis, Mersch (2020), Pfister (2020) and Niepelt (2020).

considerations.<sup>4</sup> The first is the fact that central banks are no strangers to the issuance of digital liabilities; indeed, the majority of central bank liabilities are purely digital. The second is that, unlike a retail CBDC, which would be ‘accessible to all’, a wholesale CBDC would only be accessible to a narrow scope of users. Thus, whilst the former would represent a paradigm shift in terms of the ‘opening up’ of a central bank’s balance sheet to the general public and of the way in which its monetary policy is transmitted, the latter would, in most respects, resemble ‘central bank reserves’, which have been issued by central banks in electronic form for several decades and which are only accessible to central bank counterparties (mostly commercial banks) to the exclusion of households and firms.<sup>5</sup> The third consideration is linked to the fact that, because of their narrower target user scope, wholesale variants of CBDCs would, by and large, co-exist with existing forms of legal tender money and its supporting infrastructures – the retail and wholesale payment systems. As a result, the purpose of their issuance would be limited to the achievement of certain efficiency gains, including mitigating settlement risks, reducing currency exchange risks (in the context of cross-border payments) and reducing or simplifying intermediation steps and processes.<sup>6</sup> The above may also explain why central banks have traditionally expressed fewer concerns vis-à-vis wholesale compared with retail CBDCs<sup>7</sup>, but also rather less of an interest in exploring them unlike retail CBDCs.<sup>8</sup>

## 2 Main wholesale central bank digital currency experiments: features, commonalities and lessons

Over the last five years, several central banks around the world have conducted experiments into wholesale CBDCs. This section describes the main features of some of the most advanced central bank and monetary authority-driven wholesale CBDC experiments to date, including an overview of their commonalities and the main lessons to be drawn from them.

The most advanced wholesale CBDC experiments so far are: Project Stella, which is a joint European Central Bank (ECB) and Bank of Japan (BoJ) research project; Project Ubin, backed by the Monetary Authority of Singapore (MAS); Project Jasper, a Bank of

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<sup>4</sup> Other, subsidiary considerations apply, whose importance should not be underestimated. For instance, whereas the deployment of a wholesale CBDC would not, generally, involve a central bank processing personal data (despite the fact that a wholesale CBDC would not be anonymous), in a retail CBDC issuance scenario, a central bank would most likely process some personal data (such as names, account numbers, IP addresses, digital identities and signatures), triggering the application of data protection laws. Similarly, it is only in a retail CBDC scenario that central banks would have to comply with relevant anti-money laundering and counterfeiting - related legal obligations, as their counterparties would include natural persons and consumers.

<sup>5</sup> There is one important difference between central bank reserves and wholesale CBDCs: unlike the former, which are used as an instrument of monetary policy, the latter would be issued primarily as a settlement medium to facilitate payments between those who tender and those who accept it. That said, at its core, the argument remains valid: the issuance by central banks of digital liabilities and the corresponding holding, by third parties, of intangible money claims against the balance sheet of the digital liability-issuing central bank would not represent a genuine novelty.

<sup>6</sup> For the rationale underlying the eventual issuance of wholesale CBDC see, ex multis, Bank for International Settlements (2018), p. 8.

<sup>7</sup> The Block (2020), p. 36.

<sup>8</sup> Boar, Holden and Wadsworth (2020), pp. 4-6.

Canada (BoC) project; and Project Inthanon-LionRock, which is the brainchild of the Hong Kong Monetary Authority (HKMA) and the Bank of Thailand.<sup>9</sup>

Project Stella was launched in December 2016 with the aim of exploring the scope for using distributed ledger technology (DLT) to support and improve the settlement of payments and delivery versus payment (DvP) securities transactions in central bank money and to enable central bank counterparties to maintain reserve balances with the central bank. Project Stella unfolded in four phases, the last of which was completed in February 2020. Project Ubin began in November 2016 as a collaborative project involving, apart from the MAS, the DLT company R3 and a consortium of financial institutions. The aim of the project was to explore the use of DLT for clearing and settlement by placing a tokenised form of the Singapore dollar on a DLT network. Project Ubin had five phases and was completed in the summer of 2020. Project Jasper was launched by the BoC in March 2016, with the support of Canada's largest banks and R3. Similarly to Ubin, Project Jasper involved the issuance by the BoC of a tokenised form of the Canadian dollar, the 'CAD-Coin', for use within the context of a permissioned DLT platform (the 'CAD-Coin platform'), where participating banks would pledge cash collateral to a dedicated, pooled account with the BoC, receiving in return CAD-Coin of equivalent value in their accounts. CAD-Coin would then be used to settle payments to other CAD-Coin platform-participating banks and, once a participant had redeemed CAD-Coin for cash collateral, the BoC would proceed to take the CAD-Coin out of circulation. Although their fundamental approach is the same, the difference between Projects Jasper and Ubin is that, while in Jasper, CAD-Coins could be created and redeemed intraday, in Ubin, banks could acquire and redeem digital tokens 24/7 and keep them on the distributed ledger overnight. (It follows that transfers on the Singaporean DLT platform of tokenised Singapore dollars can take place even outside the opening hours of the Singaporean RTGS system).<sup>10</sup> Finally, the joint Project Inthanon-LionRock was launched in May 2019 to explore the use of a wholesale CBDC for cross-border payments through a network allowing participating banks in Hong Kong and Thailand to conduct funds transfers and foreign exchange transactions on a peer-to-peer basis, helping to reduce settlement layers. The project was successfully completed in December 2019, and its findings were published in January 2020.

The above central bank-run or sponsored wholesale CBDC projects share a number of common threads, which are relevant for identifying the 'pain points' of wholesale CBDCs and assessing the likelihood of their introduction in the foreseeable future.

The first common thread is their rationale, namely to further the central banks' understanding of the possible operational use of DLTs in the wholesale financial markets, with an emphasis on the real-time gross settlement of large-value payments, domestic or cross border, the processing of domestic or cross-border interbank payments, and the DvP settlement of securities transactions. Thus, it would be

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<sup>9</sup> Other examples include Project Khokha, run by the South African Reserve Bank, and Project Aber, run by the Saudi Arabian Monetary Authority and the Central Bank of the United Arab Emirates.

<sup>10</sup> It is worth noting that, during Phase 4 of Project Ubin, the MAS and BoC conducted a successful cross-border payment experiment using their respective CBDCs, in a show of their interoperability (see the report "Cross-Border Interbank Payments and Settlements: Emerging opportunities for digital transformation", November 2018).



reasonable to view these projects as central bank experiments on some of the possible operational applications of DLTs, rather than as attempts to test the potential of the issuance of tokenised central bank money through a DLT platform or to replace centralised wholesale payments or securities settlement systems with distributed ones. (Indeed, none of the various central bank initiatives for updating and improving existing wholesale payment or securities settlement systems advocated the adoption of DLTs, a point to which we revert later in this section.)

The second is their goals: these are to explore the scope for achieving higher speed and greater efficiency in processing wholesale payment transactions, to lower the counterparty risks that such payments entail and to improve overall system resilience through the use of DLTs and a permissioned, DLT-based central bank money token. Indeed, if there is one fundamental reason why wholesale CBDC proposals may appeal to central banks, this is because of their promise to make the wholesale financial system faster, less costly and safer rather than because central banks are actively seeking a radical alternative to the wholesale financial system. After all, contemporary wholesale payments and securities settlements systems proved their worth, in terms of their dependability and robustness of performance, at the height of the global financial crisis and again, more recently, during the COVID-19 crisis. Moreover, central banks either deem DLTs not yet mature enough for wholesale use<sup>11</sup> or they still have concerns about the disintermediation and other economic effects of the wide-scale use of DLTs and their impact on existing market players (see the last section of this paper). This is why all of the DLT-based wholesale CBDC settlement experiments so far conducted by central banks have been exploratory in nature, without any clear actual implementation horizon and without any intention to replace existing arrangements.<sup>12</sup> This is also why the reports published on these experiments have been fairly thin in terms of legal and regulatory analysis.

The third thread is the tools that these projects use to achieve their goals: all of the projects highlighted above involve the issuance (whether directly by the central bank or by the private sector) of a tokenised form of fiat money on a distributed ledger powered by the use of DLT. Thus, what all of the above wholesale CBDC experiments have in common is that they rely on the issuance of a ‘settlement coin’<sup>13</sup> type of token against the pledging, by the target user group, of valuable assets (cash or securities) for use by the members of that group on a distributed, permissioned platform linked to a central bank-operated RTGS system and operating akin to a private RTGS system.

<sup>11</sup> One of the findings of Project Stella is that DLT performance is affected by network size and distance between the nodes making up the distributed ledger. As a result, the BoJ and the ECB concluded that, ‘[G]iven the relative immaturity of the technology, DLT is not a solution for large-scale applications like BOJ-NET and TARGET2 at this stage of development’ (see Bank of Japan and European Central Bank (2017)).

<sup>12</sup> For instance, the BoJ’s webpage for Project Stella clearly states that, ‘[T]he analysis and experimental results presented in Project Stella are not geared towards replacing or complementing existing arrangements, which include central bank-operated payment systems. Moreover, legal and regulatory aspects are outside the scope of the project’ (see the BoJ [website](#)).

<sup>13</sup> ‘Settlement coins are tokens issued by the controlling or designated node(s) to facilitate settlement in the absence of tokenised fiat currencies. The settlement coins are backed by cash deposits made by the issuing node(s) to a trusted third party, such as a custodian bank in the same network. When the participants in the permissioned distributed network need cash, they can redeem their settlement coins with the trusted third party. There are different proofs-of-concept in settlement coins being tested such as the “Citicoins” by Citigroup, “SETLcoin” by Goldman Sachs, and the “Utility Settlement Coin” by UBS with other partners, including BNY Mellon, Deutsche bank, ICAP and Santander’ (International Organization of Securities Commissions, (2017), p. 62).

From this perspective, all of the above experiments are simulations of an RTGS-like system that operates on a distributed (rather than on a centralised) platform.

The fourth thread is also the main take-away from the above wholesale CBDC experiments, namely that, in most cases, it is technically possible to ensure the safe transfer of digital tokens in real time and in volumes corresponding to those expected of an RTGS system by using a combination of a distributed ledger and a tokenised form of fiat money. Although the experiments have therefore been, by and large, successful, this is not to say that they have definitively paved the way for the issuance of wholesale CBDCs. For the reasons explained below, various obstacles still stand in the way of that final step, some of which are legal, whilst others are of a more operational and/or policy nature. Section 3 explores those obstacles in some detail.

### 3 Legal, practical and policy concerns relevant to the issuance, distribution and use of a wholesale central bank digital currency

The issuance, distribution and use of wholesale CBDCs would likely give rise to a raft of concerns, the cumulative effect of which would cast doubt on whether their deployment could be straightforward. The concerns non-exhaustively listed below are broken down, for analytical purposes, into three categories – legal, practical and policy – although some of them could, on account of their nature, fit into more than one category.

#### 3.1 Legal concerns

A first legal concern with regard to wholesale CBDCs, which is also applicable to retail CBDC, is the legal competence of central banks to launch alternatives to fiat money. The existence (or otherwise) of the competence to issue a wholesale CBDC will be a function of local concepts of ‘currency’ and ‘money’ and, being jurisdiction-specific, will call for an interpretation of national and, in the case of the euro area central banks, EU law provisions. It suffices to note that, whilst legal competence-related concerns may appear to be less pronounced for wholesale CBDCs on account of their narrower scope compared with general purpose CBDCs, this narrower scope may, in the end, work against a presumption of central bank competence for their issuance. This is because, unlike retail CBDCs, which would presumably be issued as legally recognised means of payment for the discharge of financial obligations (at least in the case of so-called ‘value-based’ retail CBDCs), wholesale variants would presumably not enjoy legal tender status precisely on account of their more limited purpose. Be that as it may, in those jurisdictions where the law does not grant the central bank the requisite competence (or does not grant it unequivocally), legislative changes would be a precondition for the issuance of a wholesale CBDC, the short or medium-term appetite for which can only be the object of speculation.

A second legal concern with regard to wholesale CBDCs is finality of transfer and, in particular, the question of where this is achieved and when, i.e. the single moment of finality of transfer of wholesale CBDC units, from the account of the transferor to that of the transferee. Considering that all of the wholesale CBDC projects highlighted earlier in this paper contemplate the use of a permissioned distributed ledger to record transfers in tokenised fiat units, the choice in terms of the place of finality is between a permissioned, DLT-powered platform and the centralised books of the wholesale CBDC-issuing central bank. The answer to the 'where and when' question would be of more relevance in a situation where a DLT platform would not, on account of its design and composition, qualify for protection under the relevant national settlement finality regime. Suffice to say that although permissioned DLT platforms are better placed, by design, to operationally achieve finality compared with un-permissioned variants, they might not necessarily fall within the scope of the relevant settlement finality scheme, in which case both the credibility of the transfers of tokens that they record and the reputation of the wholesale CBDC-issuing central bank would be at stake.

A third legal concern with regard to wholesale CBDCs is the legal characterisation, i.e. the fundamental legal nature, of the tokens on which all of the wholesale CBDC experiments rely. Several legal systems across the world regard tokens of value, such as virtual currencies, as 'property',<sup>14</sup> which may explain the emerging consensus that token-based virtual currencies can evidence property rights<sup>15</sup> or, at least, are not incompatible with the law of property.<sup>16</sup> However, assets recorded on a distributed ledger have no inherent legal characterisation other than the one that the law is prepared to attach to them. Moreover, at present, not all legal systems will necessarily recognise fiat tokens as repositories of rights (in rem or in personam), despite their functional equivalence to fiat money (which is protected under both property and contract law). Thus, depending on national law specificities, it may well be the case that, in order for tokenised fiat units to be treated as repositories of rights, jurisdiction-specific normative adjustments would be either advisable or necessary.

A fourth legal concern is whether the outsourcing of central bank settlement accounts necessitated by the use of distributed ledgers for the processing and validation of transactions involving tokenised CBDCs would be permissible.<sup>17</sup> It is only in those jurisdictions where such outsourcing is legally possible that distributed ledgers could legitimately be used for the validation and processing of payments involving wholesale CBDCs. Considering that all/most of the wholesale CBDC experiments examined

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<sup>14</sup> Fox (2008), para 1.140.

<sup>15</sup> There is scholarly support for the proposition that, for the purposes of some civil jurisdictions, virtual currencies, such as bitcoin, should be treated as tangible property (Raskin (2015)).

<sup>16</sup> French legal doctrine appears unanimous that bitcoin (and possibly other virtual currencies) is to be treated as property (see, for instance de Vauplane (2013) and Guinier (2015), p. 58). For an account of the position under English law, see Financial Markets Law Committee (2016). Under Section 90 of the German Civil Code (Bürgerliches Gesetzbuch – BGB), bitcoin does not qualify as a 'thing' (Sache) but instead as an 'object' (Gegenstand), which can be of value and could, therefore, be subject to seizure (see Greier (2016), p. 252). Whether this also means that there is a German civil law ownership right in bitcoin, in which case BGB regulations and protections would apply to their purchase and transfer, is less clear.

<sup>17</sup> In terms of outsourcing, central banks would presumably have the power to create a distributed ledger, and outsource its management to a third party, provided they bear the ultimate responsibility for its operation (see European Central Bank (2000)). Besides, central banks would be expected to have an effective oversight programme in place to monitor the service provider's financial condition and performance (see Bank for International Settlements, Basel Committee on Banking Supervision (2005)).

earlier in this paper rely on the use of distributed ledgers as one of their key design features, this particular concern could sound their death knell, dooming the prospect of the issuance and distribution of wholesale CBDCs.

## 3.2 Operational and policy concerns

Legal considerations aside, the issuance, distribution and use of wholesale CBDCs would also give rise to certain operational, policy and mixed (operational and policy) concerns, of which the salient ones are highlighted below.

One key operational concern with wholesale CBDCs is the choice of the technology that would support their deployment. As explained earlier in this paper, all/most of the extant central bank-driven wholesale CBDC experiments involve the use of a distributed ledger and a permissioned DLT-based token to ensure the faster and cheaper execution of transfers, to reduce counterparty risks and to improve overall system resilience. This design does not appear to have been chosen randomly: it is only by relying on DLTs and distributed ledgers that wholesale CBDCs can unfold their perceived benefits. This is because, as mentioned before, financial institutions already have access to digital central bank money, in the form of reserves, while central banks already have the tools in place to facilitate, through recourse to traditional RTGS systems, the real-time settlement of interbank and other large-value fund transfers in central bank money. It is only by making tokenised central bank money available on a DLT-run platform that central banks can hope to genuinely innovate, namely in the provision of an RTGS-like system allowing direct transactions in fiat tokens without the involvement of the central bank at the settlement layer.<sup>18</sup> Herein lies one of the core weaknesses of wholesale CBDCs: the use of DLTs to put wholesale CBDCs in circulation and verify transactions involving them would mean questioning the DLTs' robustness and dependability. DLTs remain, to this date, relatively untested, with their commercial applications continuing to be the exception rather than the rule. As a result, numerous questions remain to be answered in terms of the operational risk management and governance of DLTs before their use in the deployment of wholesale CBDCs can be considered. This is despite the potential of DLTs to provide higher levels of operational resilience,<sup>19</sup> and their much touted (but, as yet, unproven) superiority in terms of cyber-security.<sup>20</sup> Besides, the use of DLTs for the conduct of financial transactions also raises privacy and confidentiality-related issues since the entities that participate in transaction-facilitating distributed ledgers inevitably share

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<sup>18</sup> This point is cogently made in Pfister et al. (2020).

<sup>19</sup> Decentralisation in the form of a multiplicity of ledgers replicating the same content can, in theory, bring with it enhanced IT safety and system resilience benefits. However, these benefits may, depending on the design of the relevant ledger, come at a price, in the form of loss of confidentiality and privacy.

<sup>20</sup> This author has argued elsewhere that, 'the distribution of DLT-run systems is, at once, a blessing and a curse: on the one hand, it can ensure that if any of its transaction validation nodes were to be compromised, the system as a whole would continue to deliver, protecting system participants from fraudulent transactions; on the other hand, DLTs could be vulnerable to cyber-security risks, precisely on account of the involvement of multiple parties in their deployment, which carries with it the risk of multiple 'entry points' into the system and, consequently, of heightened risks of unauthorised incursions and of tampering with transaction data' (Athanasios (2018), p. 201).

transactional information amongst themselves, rendering essential the use of privacy-enhancing technologies/techniques (PETs).<sup>21</sup>

One core policy question is the eligibility of financial actors to access wholesale CBDCs and, with it, the balance sheet of the CBDC-issuing central bank. Access to accounts with the central bank for interbank settlement purposes is restricted to larger so-called Tier 1 banks (and some large financial market infrastructures (FMI)), notably central securities depositories, which, given the nature of their balance sheet, will typically dispose of sufficient liquid financial assets that they can post as collateral to the liquidity-providing central bank.<sup>22</sup> This is despite the fact that some forms of liquidity may also be available, mostly on a discretionary basis, to ancillary systems, such as central counterparties (CCPs) and automated clearing houses,<sup>23</sup> with a debate ongoing at the time of writing on whether to broaden access to central bank money for the benefit of other legal or natural persons.<sup>24</sup> In a broader wholesale CBDC access scenario, involving a widening of the CBDC-issuing central bank's counterparty framework, banks would lose their privileged position in the settlement of transfers, with some of the payment business migrating to other, mostly non-bank, players active in the field of payments. It is a matter for policy consideration whether the overall market benefits of a broader access approach to wholesale CBDCs for settlement purposes – in terms of greater market efficiency, infrastructure cost savings and transparency – would outweigh the potentially market-destabilising effects of a substantial loss of revenue for Tier 1 banks.<sup>25</sup> To dilute the currently applicable eligibility criteria for access to central bank money and central bank accounts in order to pave the way for the deployment of wholesale CBDCs and guarantee their ability to offer DvP settlement may be to undercut large commercial banks and FMIs,

<sup>21</sup> Conscious of the need for the use of PETs to control access to sensitive private information and of the need to put arrangements in place to ensure accountability, including third-party auditors who can check transactions conducted through DLT-based payment and settlement systems, Phase 4 of Project Stella explored how confidentiality and auditability can be balanced in a distributed ledger environment.

<sup>22</sup> Smaller banks have to open accounts in Tier 1 banks and use them as intermediaries for the settlement of their transactions.

<sup>23</sup> To take the example of the Eurosystem, access to intraday credit through TARGET2 is open to euro area CCPs with a TARGET2 (or another account) with the national central bank of the Member State where they are established, while, in accordance with the TARGET2 Agreement, intraday credit in euro may also be provided to non-euro area CCPs by non-euro area national central banks connected to TARGET2. Similarly, Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act allows the Federal Reserve System to provide support to 'financial market utilities', within the meaning of Title VIII thereof, including CCPs, while Section 23A of the Federal Reserve Act caters for the (indirect) provision of liquidity to the affiliates of regulated banks, including broker dealers.

<sup>24</sup> Article 85(1)(a) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p.1) (European Market Infrastructure Regulation – EMIR) mandates the European Commission to assess, in cooperation with the members of the European System of Central Banks (ESCB), the need for any measure to facilitate the access of CCPs to central bank liquidity facilities. In its response to the EMIR review, the ESCB stressed that '[T]he introduction of any measure concerning central bank facilities in EMIR would have to respect the principle of independence of central banks when they perform their statutory tasks, as set out in Article 130 of the Treaty on the Functioning of the European Union (TFEU) and Article 7 of the Statute of the ESCB or otherwise under national provisions. This implies that members of the ESCB must retain the right to provide access to central bank facilities, including access to central bank credit, at their own discretion, as recognised by Article 85 of EMIR. The members of the ESCB must be free to decide whether or not to provide CCPs with access to central bank facilities, and to define the eligibility conditions these CCPs must meet in order to benefit from such facilities, in accordance with their mandates and in pursuance of their statutory tasks' (see European System of Central Banks (2015)).

<sup>25</sup> It has been aptly argued that direct access to the wholesale payments settlement system would allow non-banks to provide end-to-end payment services, thereby increasing their market share and, as a consequence, compressing the revenues of larger banks (Gouveia, Dos Santos, Fernández de Lis, Neut and Sebastián (2017), pp. 11-13).

undermining their ability to fulfil their crucial risk management/transformation and financial intermediation roles respectively.

We have left for last what is, perhaps, the biggest mixed (operational and policy) challenge to be resolved ahead of any eventual deployment of wholesale CBDCs: how to transfer central bank money to the distributed ledger, which is a hallmark of all/most wholesale CBDC experiments highlighted in this paper. It is recalled that, although ‘safety is not the sole prerogative of central bank money’,<sup>26</sup> the CPMI-IOSCO Principles for Financial Market Infrastructures strongly recommend the use of central bank money in settlement ‘where practical and available’,<sup>27</sup> in the light of the perceived advantages of DvP settlement in central bank over commercial bank money from the perspective of risk mitigation.<sup>28</sup> To tackle the challenge of putting central bank money on the distributed ledger, Projects Jasper and Ubin rely on the digital depository receipt approach, which involves ‘a claim on central bank reserves held in a segregated account against which the central bank issues digital tokens on the distributed ledger’.<sup>29</sup> In a broader access to wholesale CBDC scenario, one option could be to facilitate access by non-bank settlement platforms or non-bank payment service providers to central bank liquidity through their accounts with commercial banks, so as preserve the existing organisational structure of payments while, at the same time, ensuring the integrity of payments and maintaining financial stability. Alternatively, the benefits of which central banks would need to carefully explore, so as to balance financial stability against the disintermediation benefits of DLTs, could include the direct issuance, by central banks, of wholesale CBDCs on distributed ledgers and the connection of those ledgers to private DLT settlement platforms, secured by the deposit, in an escrow-type account held with a non-central bank trusted custodian, of funds to back the wholesale CBDCs’ issuance. Different options would entail different risks and costs, and present different challenges for the relevant central bank, with the choice between them being ultimately driven by policy preferences in terms of ‘the role of central banks as infrastructure providers’, the answer to the question of ‘who should have access to [central bank] money’ and the impact of the implementation of each of them on the transmission of monetary policy.<sup>30</sup> What is clear is that the question of the access of wholesale CBDC DLT networks to central bank accounts and liquidity for the purpose of settling payments, and of its regulation, is bound to feature prominently in the debate surrounding the possible deployment of wholesale CBDCs through recourse to DLTs and distributed ledgers.

## 4 Conclusion

For the reasons explained above, wholesale CBDCs can be something of a minefield – legally, operationally and from a policy perspective. The experiments conducted so

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<sup>26</sup> International Capital Market Association, European Repo Council (2011).

<sup>27</sup> CPSS-IOSCO [Principles for financial market infrastructures](#), Principle 9 (Money settlements).

<sup>28</sup> This policy preference is attributable to the perceived advantages of DvP settlement in central bank money (as opposed to commercial bank money) in terms of risk mitigation, since those paid in central bank money have a claim against an insolvency-remote central bank.

<sup>29</sup> Bech and Garatt (2017), p. 66.

<sup>30</sup> Mersch (2016).



far by some of the world's leading central banks suggest that, technically speaking, it is possible to place tokenised central bank money on a distributed ledger and to then transfer it, in a controlled environment. But what is technically possible in a controlled environment might not be desirable from a policy perspective or unproblematic from a legal standpoint. Moreover, the technologies used by all of the central bank experiments so far remain untested on a scale similar to that which central bankers are accustomed from their experience with the operation of centralised RTGS systems. Hence, also technically speaking, we are still in rather uncharted territory with regard to the scalability of the technologies that would support the deployment of wholesale CBDCs.

Based on the foregoing analysis, the issuance of wholesale CBDCs would not be as straightforward as one might, at first sight, assume, as it would involve choices that are difficult on the policy level, demanding on the technical/operational level and complex in their legal dimension. As a result, the likelihood of a swift implementation of a wholesale CBDC appears remote, despite the more limited scope of its use and its arguably somewhat less innovative nature compared with retail variants. If the author of this paper were to risk a prediction, this would be that the technical challenges will be overcome faster than the policy and the legal ones, which may also explain why legal and policy considerations did not feature too prominently in any of the past/recent central bank CBDC experiments. To conclude, we may still be a long way from the introduction of wholesale CBDCs, despite the fewer challenges they pose compared with the introduction of retail CBDC variants.

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# Retail central bank digital currency: a (legal) novelty?

By Panagiotis Papapaschalis<sup>1</sup>

*Or sappiate ch'egli fa fare una cotal moneta com'io vi dirò. Egli fa prendere scorza d'un àlbore ch'à nome gelso ... e cogliono la buccia sottile che è tra la buccia grossa e 'l legno dentro, e di quella buccia fa fare carte come di bambagia; e sono tutte nere. ... E tutte queste carte sono sugellate del sugello del Grande Sire, e ànne fatte fare tante che tutto 'l tesoro (del mondo) n'appagherebbe. E quando queste carte sono fatte, egli ne fa fare tutti li pagamenti e spendere per tutte le province e regni e terre ov'egli à signoria; e nesuno gli osa rifiutare, a pena della vita.*

Marco Polo – *Milione* (1298) Capitolo 95 De la moneta del Grande Kane

*Peuples de Bétique, voulez-vous être riches ? Imaginez-vous que je le suis beaucoup, et que vous l'êtes beaucoup aussi ; mettez-vous tous les matins dans l'esprit que votre fortune a doublé pendant la nuit ; levez-vous ensuite ; et, si vous avez des créanciers, allez les payer de ce que vous aurez imaginé ; et dites-leur d'imaginer à leur tour.*

Montesquieu – *Lettres persanes* (1721) Lettre 142

## 1 Introduction

Starting an article on retail central bank digital currency with quotations from two antiquated authors may seem an oddity, but it aptly demonstrates a recurring theme: the astonishment of humans before novelty. Marco Polo was positively struck by the power of the Great Khan to impose the circulation and use of tree bark under his seal “for every payment and expense in all provinces and kingdoms and lands under his sovereignty, no one daring to refuse, lest they be put to death”. Montesquieu, on the other hand, was less impressed by the obligations of John Law’s Royal Bank,<sup>2</sup> issued against precious gold and silver: thin air, imaginary riches, dependent on the issuer’s trust.

The same astonishment lingers today at the prospect of central banks around the world issuing a “digital currency” (CBDC). The article will focus on retail CBDCs, i.e. a digital representation of a sovereign<sup>3</sup> currency, issued by a jurisdiction’s monetary authority (and appearing on the liability side of its balance sheet) for use by the

<sup>1</sup> Senior Lead Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> For the sake of accuracy, these were not the first banknotes to be issued in the Occident, but rather those issued by the Riksbank in 1661–1664; Bindseil, U. (2019), [Central Bank Digital Currency: Financial System Implications and Control](#) at p. 309 et seq.

<sup>3</sup> A CBDC is sovereign in nature and therefore distinct to crypto-assets. See the European Parliament [Resolution](#) of 8 October 2020 with recommendations to the Commission on Digital Finance: emerging risks in crypto-assets - regulatory and supervisory challenges in the area of financial services, institutions and markets, at point J.

general public (corporates and natural persons) as opposed to wholesale CBDCs, available chiefly to a central bank's monetary policy counterparties. After presenting the key design variants of retail CBDCs (section 2), the article will consider a number of design-related (section 3) and design agnostic legal challenges posed by CBDCs (section 4) with a view to answering the question: how much of the state of the law needs to change to accommodate CBDC issuance? With few exceptions, the article focuses on public rather than private law, and while the conclusions may be valid in a number of jurisdictions, the article is written with the European Union in mind.

A final caveat: despite a few pilot CBDC projects and a high number of theoretical studies in a number of jurisdictions,<sup>4</sup> the need for a wider CBDC adoption has, at least until the recent past, remained questionable at best.<sup>5</sup> This, coupled with the scarcity of public legal documentation on CBDC projects, means that the conclusions of this article can only be tentative.

## 2 Designing a central bank digital currency

Designing a CBDC implies a vast amount of technical choices relating to the actors, governance, hardware and software necessary for its implementation, as well as the safety and efficiency of the entire infrastructure. The most topical choices from a legal perspective are listed below.

### 2.1 Account opening vs token issuance

Central banks may offer a CBDC to the general public through extending the access to deposit accounts they already offer to monetary policy counterparties. This approach is not technologically innovative, though it may entail scaling challenges.<sup>6</sup> Alternatively, central banks may use the – technologically novel but legally unclear<sup>7</sup> – model of tokens issued through a dedicated ledger, thus ensuring universal access.<sup>8</sup>

### 2.2 Direct vs indirect distribution

In a direct distribution model, the central bank distributes the tokens directly to members of the general public or opens accounts with them. In an indirect distribution model, the central bank distributes the tokens to or opens accounts with intermediaries, which, in turn, face the general public. Such intermediaries may be traditional, e.g. credit institutions, or novel ones, e.g. digital wallet providers, or a mixture of both. A hybrid model<sup>9</sup>, involving the intermediaries issuing their own,

<sup>4</sup> Kiff, J. et al. (2020), [A Survey of Research on Retail Central Bank Digital Currency](#), at p. 58.

<sup>5</sup> On the other hand, Arner, D.W. et al. (2020) at p. 4 argue that this may imminently change.

<sup>6</sup> Bindseil, U. (2020), [Tiered CBDC and the financial system](#), at p. 4.

<sup>7</sup> Bossu, W. et al. (2020), [Legal Aspects of Central Bank Digital Currency: Central Bank and Monetary Law Considerations](#), at p. 9.

<sup>8</sup> Auer, R. and Böhme, R. (2020), [The technology of retail central bank digital currency](#), at p. 94.

<sup>9</sup> Adrian, T. and Mancini-Griffoli, T. (2019), [The Rise of Digital Money](#), also Auer, R. and Böhme, R. (2020), at p. 89.

CBDC-backed stablecoins to the general public, is considered a wholesale CBDC and thus outside this article's scope.

## 2.3 Remunerated vs non-remunerated

A central bank may consider remunerating the CBDC it issues, be it for monetary policy or for financial stability reasons.<sup>10</sup> Such remuneration could be fixed or variable, i.e. linked to other central bank rates: as such, negative remuneration could theoretically be envisaged. Alternatively, as is the case with cash, a CBDC could be non-remunerated.

## 2.4 Substitution vs coexistence with cash

Theoretically, a CBDC could fully substitute (phase out) banknotes and coins. No central bank, however, currently seems to consider this scenario, most pilots focusing on coexistence (and, therefore, exchangeability) between the two forms of currency.

## 2.5 Legal tender as a CBDC design element

Legal tender, the “legally mandated form of money”,<sup>11</sup> is not, *stricto sensu*, a CBDC design element. In fact, as will be discussed under section 4.1 below, legal tender could rather serve as a legal basis sanctioning CBDC issuance: legal tender is attributed by law, not IT architecture.<sup>12</sup> Alternatively, and in theory, a CBDC could be issued without legal tender status. Yet, this theoretical option is riddled with practical difficulties. Especially in a coexistence scenario, with the central bank issuing both a legal tender and a non-legal tender means of payment, either the general public grasps the difference (in which case the CBDC faces an uphill struggle against cash) or it does not (in which case legal uncertainty ensues).

For a legal tender CBDC, the characteristics of legal tender (mandatory acceptance, at full face value, having power to discharge payment obligations<sup>13</sup>) can significantly influence CBDC design choices. For instance, mandatory acceptance would imply that CBDC is compatible with all software and hardware used to make payments (or that specialised software and hardware are made available free of charge), and acceptance at full face value excludes any types of surcharge in CBDC transactions.

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<sup>10</sup> E.g. European Central Bank (2020), [Report on a digital euro](#), at p. 32.

<sup>11</sup> Arner, D.W. et al. (2020), p 6.

<sup>12</sup> However, Bossu, W. et al. (2020), at p. 33 rightfully argue that “attributing legal tender status to a means of payment that cannot be received by the majority of the population might be legally possible but it raises fundamental questions, including from a fairness perspective”.

<sup>13</sup> Cf. Commission Recommendation of 22 March 2010 on the scope and effects of legal tender of euro banknotes and coins (OJ L 83, 30.3.2010, p. 70).

## 3 Design-related challenges

### 3.1 Equal treatment of currency holders

Foreign exchange controls aside, there are no restrictions on the availability of cash. In a direct CBDC distribution model, the central bank becomes the sole provider of CBDC payment services. To emulate the availability of cash, this new role of the central bank would call for the even-handed treatment of the jurisdiction's residents, i.e. through the universal provision of "basic account services"<sup>14</sup> for the use of legal tender CBDC. Depending on whether the central bank's jurisdiction recognises (legal tender) currency as a mandatorily acceptable means of payment within its territory or as a right of its citizens, the central bank may also need to make the CBDC available to citizens having their habitual residence outside the jurisdiction. If the national system is based on digital tokens, it will by default be accessible to foreign residents. If it is account-based, interoperability would be a design choice.<sup>15</sup>

Moreover, in the case of coexistence of a CBDC and cash, a readily available exchange mechanism between the two would need to be established to ensure equal access to both.<sup>16</sup>

### 3.2 Equal treatment of operators and outsourcing of public tasks

In an indirect distribution model, the central bank relies on third parties (intermediaries) and their technology platforms to distribute the CBDC. This poses certain legal challenges.

First, for reasons of technology neutrality and equal treatment of financial operators, interoperability should be ensured among those intermediaries holding or controlling technology for distributing CBDCs. This could either be achieved by the central bank developing the initial infrastructure and releasing it to the intermediaries on a royalty-free basis, or through standard setting and licensing of all essential intellectual property on FRAND (fair, reasonable and non-discriminatory) terms. In the former case, the warranties and representations of the central bank as regards the infrastructure's fitness for purpose may, depending on the terms of release, be grounds for contractual liability.

Second, to ensure non-discriminatory access to CBDC, the offering of "basic account services" as described under section 3.1 above would now need to be required of the intermediaries.

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<sup>14</sup> Cf. Article 17 of Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (OJ L 257, 28.8.2014, p. 214).

<sup>15</sup> Auer, R. and Böhme, R. (2020), at p. 95.

<sup>16</sup> Bank for International Settlements (2020), [Central Bank Digital Currencies: foundational principles and core features](#), at p. 10.

Third, and most importantly, tasks involving the exercise by a central bank of public authority and policy discretion cannot be outsourced, as opposed to implementing tasks not allowing any room for policy discretion – which can be outsourced under central bank supervision. As a result, the central bank must distinguish “outsourcable” activities from “non-outsourcable” ones, examples of the latter being decisions over design CBDC features and technological infrastructure, the fixing of CBDC remuneration and the creation and removal of a liability in the balance sheet of the central bank. By analogy with the treatment of cash, intermediaries’ activities not resulting in a change in the central bank’s balance sheet, e.g. storage of tokens or handling of payments on behalf of the general public, would be permissible.

### 3.3 Gatekeepers – and those who guard them

In a direct distribution scenario, central banks would face the general public in the provision of payment services involving a CBDC, with the resulting disintermediation of traditional payment services providers. Leaving aside the overall policy (and political) discussion on using public funds to compete<sup>17</sup> with the private sector in the provision of retail services,<sup>18</sup> suffice to say that disintermediation comes at a price. Exemptions of central banks from a series of obligations currently imposed on payment services providers may no longer be tenable, for instance:

- know-your-customer (KYC) obligations under anti-money laundering (AML) and combating the financing of terrorism (CFT) legislation;<sup>19</sup>
- transparency, payment account access and liability obligations under payment services legislation;<sup>20</sup>
- the obligation to observe banking secrecy vis-à-vis the CBDC account holder and exceptions therefrom; and
- tax reporting/withholding obligations.

In an indirect distribution scenario, the above tasks would fall on the shoulders of intermediaries. Such intermediaries would include credit institutions, payment systems operators and other traditional payment service providers regulated as such, but also (less stringently regulated) telecommunication companies, wallet providers

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<sup>17</sup> The term is used in a broad, non-technical sense. From an EU law viewpoint, assuming the Eurosystem issues a CBDC in the exercise of its official powers (i.e. pursues an activity not economic in nature), it would not be considered as an undertaking for competition law purposes. Joined Cases C-159/91 and C-160/91, *Poucet v AGF and Pistre v Cancava*, EU:C:1993:63 at paragraph 19.

<sup>18</sup> Khiaonarong, T. and Humphrey, D. (2019), [Cash Use Across Countries and the Demand for Central Bank Digital Currency](#), at p. 26.

<sup>19</sup> Central banks are not obliged entities under Article 2 of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (AMLD) (OJ L 141, 5.6.2015, p. 73).

<sup>20</sup> Article 1(1)(e) Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (PSD2) (OJ L 337, 23.12.2015, p. 35).



and digital assets exchanges. An issue of legal relevance would be whether to regulate and how to monitor the risks associated with the new entrants providing payment services in CBDC, given that the activities of those entities would inevitably differ from those specific to financial institutions, where the focus is on liquidity and capital requirements, aiming at solvency and viability. The involvement of less stringently regulated and technology intensive entities in the distribution and holding of CBDCs may call for the imposition of (additional) KYC, AML/CTF, financial soundness, fit and proper, network information security and business continuity requirements and duties, as well as for a discussion on their future supervision and oversight.

## 4 Design agnostic challenges

### 4.1 Competence and legal basis

Central banks (even those which, for historical reasons, have corporate form) are creatures of public law. Their mandate is prescribed in their statute or central bank law, which also confers upon them competences and powers for the furtherance of such mandate. Such conferral<sup>21</sup> implies that a robust legal basis should underpin all central bank action, lest it be struck down by a competent court as ultra vires. The issuance of a CBDC is no exception.<sup>22</sup> Therefore, a central bank intending to issue CBDC must ensure its statute or central bank law explicitly confers (or can be interpreted to clearly confer) such competence – or else elicit its amendment by the competent authorities of the jurisdiction.

Generally speaking, the obvious legal basis for the issuance of a retail CBDC would be that conferring power on the central bank to issue legal tender currency (banknotes and coins). Issuance of legal tender is a means to control the monetary base and thereby to inform the implementation of monetary policy.<sup>23</sup> Moreover, monetary income (income from assets held against legal tender in circulation) accrues to the issuing central bank, thus safeguarding its financial autonomy vis-à-vis the sovereign. However, an – equally obvious – counterargument would be that the letter of most statutes/central bank laws has been drafted with physical cash in mind, even when this is not explicitly stated.

Depending on each jurisdiction's explicit reference to physical cash and rules of legal construction,<sup>24</sup> a teleological interpretation<sup>25</sup> of the construct "legal tender

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<sup>21</sup> Bossu, W. et al. (2020), at p. 13 speak of the "Principle of Attribution of Powers".

<sup>22</sup> Bank for International Settlements (2020), at p. 11.

<sup>23</sup> For the interaction between banknotes/CBDCs and monetary policy, see Committee on Payments and Market Infrastructures (2018), [Central bank digital currencies](#), Annex A (Principles of Monetary Policy Implementation) at p. 21.

<sup>24</sup> For examples, see Bossu, W. et al. (2020), at p. 16 et seq., especially p. 21 with a chart on central bank authorisation to issue currency among IMF membership.

banknotes”<sup>26</sup> could be put forth. Indeed, the development of private cryptocurrencies and the ensuing crowding out of cash<sup>27</sup> may have the potential to undermine monetary sovereignty. Unlike legal tender, private cryptocurrencies are not credit-risk free, and this may have financial stability implications.<sup>28</sup> Moreover, the legal tender status of cash may not be sufficient to maintain a central bank’s control over its monetary base, because, under the principle of contractual freedom, parties to a contract may freely agree on a different means of payment. From a positive viewpoint, the adoption of a CBDC could bring advantages to citizens (especially the tech-savvier ones) with regard to safety, efficiency and speed of transactions. Indeed, safety, efficiency and speed are the major elements of teleological interpretation. Banknotes started their existence as written (and thus permanent, attributable and transferable) records of obligation precisely because, at the time of their inception, the written form could best guarantee their desired attributes of permanence, attribution and transferability.<sup>29</sup> And banknotes have constantly evolved in tandem with technological advances<sup>30</sup> to maintain and enhance these attributes: from Marco Polo’s stamped tree bark to a uniform industrial production incorporating sophisticated security and counterfeit deterrence features. A fully digital note is merely the next step in this evolutionary journey,<sup>31</sup> as the physical substrate is no longer necessary to guarantee permanence, attribution and transferability.

Alternatively, one could focus on the substance of “legal tender” – fully disregarding the form under which it has circulated up to now. Monopoly of issuance of legal tender is generally entrusted to central banks owing to the public good function of legal tender: mandatory acceptance, at full face value; having the power to discharge payment obligations; serving as a risk free<sup>32</sup> means of payment and store of value accessible to the general public; and as a means of control of money supply for the central bank. A CBDC can fulfil the same functions. It can represent a liability of the central bank, as do physical notes, and thus be a credit-risk free asset, appropriate as a store of value. Account entries or transfer of tokens in the infrastructure of the central

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<sup>25</sup> The CJEU recognises the use of teleological interpretation and gives priority to it over the other methods of interpretation. See Lenaerts, K. and Gutiérrez-Fons, J.A. (2013), [To Say What the Law of the EU Is: Methods of Interpretation and the European Court of Justice](#), at p. 24; e.g. in the CILFIT case, the Court affirmed that: ‘every provision of [EU] law must be placed in its context and interpreted in the light of the provisions of [EU] law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is to be applied.’ Case C-283/81, CILFIT v Ministero della Sanità, EU:C:1982:335, paragraph 20.

<sup>26</sup> The focus is on banknotes because coins, apart from not being a “written” record, are minted on a substrate of intrinsic value, and have smaller face value in comparison with banknotes.

<sup>27</sup> Khiaonarong, T. and Humphrey, D. (2019) at p. 29: “Without a digital version of cash, it is possible that over time cash use will be almost wholly replaced by substitute instruments tied to private bank deposit money”.

<sup>28</sup> Lagarde, C. (2017), [Central banking and fintech – a brave new world?](#) argued that “[i]f privately issued virtual currencies remain risky and unstable, citizens may even call on central banks to provide digital forms of legal tender.”

<sup>29</sup> Zellweger-Gutknecht, C., Geva, B. and Gruenewald, S. (2020), [The ECB and € E-Banknotes](#), at p. 26.

<sup>30</sup> More generally, geography, technology, social factors and politics are key determinants on how money is used: Carstens, A. (2018), [Money and payment systems in the digital age](#), at p. 2 et seq.

<sup>31</sup> On money as “abstract purchasing power” see Mann, F.A. (1992) at p. 29-30. On banknotes being a temporary form of central bank money, Bindseil, U. (2019) at page 311. On “CBDC seem[ing] to be a natural next step in the evolution of official coinage (from metal-based money, to metal-backed banknotes, to physical fiat money), see Mancini-Griffoli, T. et al. (2019) at p. 308.

<sup>32</sup> Panetta, F. (2020), [A digital euro for the digital era](#).

bank (and/or its intermediaries) can result in a discharge of payment obligations for the same amount. The central bank can have a monopoly of issuance, last resort authentication and destruction of the CBDC.

Other than that, the power of a central bank to open accounts for the conduct of monetary policy operations or to provide for the smooth functioning of payments by overseeing and operating payment systems could also be deployed for the issuance of a CBDC, focusing on its relevance for the conduct of monetary policy or on the infrastructure used for its issuance. The above legal bases could be cumulated,<sup>33</sup> e.g. in the case of a remunerated CBDC issued through accounts of a central bank operated payment system.

## 4.2 Access to citizens' lawfully acquired possessions

The peaceful enjoyment of (lawfully acquired) possessions is a fundamental right<sup>34</sup> – the term “possessions” being understood to include “existing possessions’ or assets, including claims, in respect of which the applicant can argue that he or she has at least a ‘legitimate expectation’ of obtaining effective enjoyment of a property right”.<sup>35</sup> CBDC tokens and account balances would fit in such a broad definition. Thus, the sovereign (*in casu*, the central bank) must not interfere with the peaceful enjoyment thereof, neither through control of their use nor deprivation, for instance owing to cyber incidents or unavailability of the CBDC infrastructure. In the case of parallel circulation of cash and a CBDC, the mechanism ensuring exchangeability between the digital and the material form of the currency could safeguard such non-interference.

In the case of a remunerated, directly distributed CBDC, a legal challenge may be posed by the eventuality of negative interest rates on a possession that is also supposed to be a “store of value”. Imposition of negative interest rates on monetary policy counterparties has become an accepted practice in the public interest, i.e. for the effective implementation of monetary policy. However, as credit institutions have attempted to forward negative interest rates to their client’s demand deposits, time deposits and fixed-term deposits, courts have held that such contracts (loans of funds from the depositor to the credit institutions) do not entail a duty of remuneration on the part of the lender<sup>36</sup>. It is unclear whether in the case of a CBDC, account balances could be construed as deposits with the central bank. It is also unclear whether, in view of the right to property, courts will reach the same conclusion regarding new account agreements expressly recognising the eventuality of negative remuneration.

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<sup>33</sup> Arner, D.W. et al., p. 6 discussing the difference between monetary and payment system functions. Specifically in the EU context, cumulation of legal bases is feasible only if a measure simultaneously pursues a number of objectives, or has several components that are indissociably linked, without one being incidental to the other; Case C-211/01, *Commission v Council*, EU:C:2003:452, paragraph 40, and Case C-94/03, *Commission v Council*, ECLI:EU:C:2006:2, paragraph 36. If a measure pursues a twofold aim or has a twofold component and if one of those is identifiable as the main one, whereas the other is merely incidental, the measure must be based on a single legal basis, the one required by the main aim or component.

<sup>34</sup> Article 1 First Additional Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms; Article 17(1) Charter of Fundamental Rights of the European Union.

<sup>35</sup> Case J.A. Pye (Oxford) Ltd and J.A. Pye (Oxford) Land Ltd v. the United Kingdom, application no. 44302/02 [GC], § 61.

<sup>36</sup> For a survey of jurisprudence, see the CMS webpage on [Negative Interest – Current Case Law](#).

Finally, with regard to a token-based CBDC, it is convincingly argued<sup>37</sup> that positive or negative interest bearing would hinder its use as a means of payment, since the face value of the token could differ from its real value owing to the application of interest.

### 4.3 Settlement finality – finality of settlement

Cash payments have immediate finality of settlement: the payment obligation is extinguished through transfer of possession. This is because, unless the payee was not in good faith as to the payer's title or power to dispose, they become the owner of the cash, free from any third-party rights<sup>38</sup>: physical possession equals title in rem and ensures maximum legal certainty as to the current owner.

It is unlikely that such attribute of cash could be fully transferred to a CBDC, as the latter is incapable of being the object of physical possession. It would certainly not be possible with regard to an account-based CBDC, where the account beneficiary has an in personam claim against the receiver of "deposited funds". It would most probably not be possible either with regard to a token-based CBDC, the legal characterisation of which has, given its novelty, yet to be clarified: such discussion is beyond the remit of this article.<sup>39</sup> At best, a jurisdiction's law should define the moment of final settlement for digital currency.

Moreover, given the digital nature of all CBDC variants, the legal concept of settlement finality could also be adapted to ensure a degree of legal certainty in their transfer. Settlement finality legislation is a limited "carve-out" from insolvency law, catering for the legal effect of dispositions in relation to the opening of insolvency proceedings. In payment or securities settlement systems, clawbacks and the unwinding of transactions in the case of a participant's insolvency creates credit and systemic risk which could have a considerable impact on financial stability.

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<sup>37</sup> Bossu, W. et al. (2020), at p. 37.

<sup>38</sup> E.g. Articles 929, 932 and 936 Bürgerliches Gesetzbuch (BGB). See Salomons, A. (2009), [Good Faith Acquisition of Movables](#).

<sup>39</sup> For an analysis of the recent jurisprudence on the legal characterisation of crypto-assets and stablecoins: Zilioli, C. (2020). For an analysis of the technology used for token-based CBDC shaping its legal nature as a currency: Bossu, W. et al. (2020), at pp. 11-13.

Settlement finality establishes a presumption that an order for the transfer of funds (or securities) having entered a system prior to a participant’s insolvency is enforceable and binding on all parties. For settlement finality to apply to a CBDC, the infrastructure used for its storage and transfer would need to qualify as a “system” protected under the jurisdiction’s settlement finality rules. This may require amendments to the latter – particularly in the case of a directly distributed CBDC. The above box contains a

### **The Settlement Finality Directive<sup>1</sup>**

Directive 98/26/EC on settlement finality in payment and securities settlement systems (SFD) applies to systems, defined as formal arrangements between three or more participants, with common rules and standardised arrangements for the clearing or execution of transfer orders between such participants. The formal arrangement must be governed under the law of an EEA country and designated by the competent authority, the law of which is applicable. Only credit institutions, investment firms (or equivalent entities established outside the EEA), settlement agents, clearing houses, and system operators or clearing members of a central clearing counterparty can be participants of SFD designated systems. For retail CBDCs to be made available to households via a Eurosystem operated “CBDC system”, at least their participation in it must be allowed by the SFD.

Furthermore, in accordance with the SFD, “transfer order” means “any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, a central bank, a central counterparty or a settlement agent, or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system”. Therefore, only in the case of a CBDC placed at a recipient’s disposal by means of a book entry on an account could payment orders executed in a CBDC fall under the definition of “transfer order” as laid down in the SFD.

<sup>1</sup> Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.1998, p.45).

jurisdictional example (EEA).

## **4.4 Correction mechanisms**

Particularly – but not exclusively – in a directly distributed CBDC, the central bank would need to be in a position to correct (but not unwind, see section 4.3 above) finally settled transfers of the digital currency in order to reflect the invalidity of the underlying transaction on which they are based.<sup>40</sup> Similarly, in a directly distributed CBDC, the

<sup>40</sup> Allen, S. et al. (2020), [Design Choices for Central Bank Digital Currency: Policy and Technical Considerations](#), at p. 73 et seq.

central bank would need to be able to transfer the account balance or the tokens as a result of universal succession.

The above are not easy tasks, especially in the case of digital currencies for currency areas with non-harmonised civil law. In the euro area context, Chapter 7 of the Draft Common Frame of Reference (DCFR)<sup>41</sup> contains model rules on grounds of invalidity in the case of mistake, fraud, coercion, unfair exploitation or third-party fault. Such model rules could inspire remedies to be “pre-opted into” by CBDC users (transfer of property, unjust enrichment, restoration of the status quo ante), but, failing further harmonisation, mandatory national law provisions will prevail.

The scope of the DCFR includes neither the legal capacity of natural persons nor wills and successions. However, in the latter field, the European Certificate of Succession<sup>42</sup> could provide a harmonised procedural basis for transferring CBDC balances/tokens.

## 4.5 Data protection compliance

As a fungible and bearer instrument, cash is fully anonymous.<sup>43</sup> Its weak traceability hinders monetary policy implementation,<sup>44</sup> which can be improved through (aggregated) data from CBDC circulation. On the other hand, for a CBDC to successfully compete with cash in the public's eye, a degree of privacy protection in its transactions is de facto essential. De jure, this is particularly relevant in jurisdictions recognising privacy and data protection as fundamental rights<sup>45</sup> and extending the notion of personal data to the digital context.<sup>46</sup>

That said, privacy and data protection are not absolute rights. Among others, personal data processing (a broad term encompassing any operation involving personal data) is lawful to the extent necessary for the performance of a contract with the person

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<sup>41</sup> Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) (2009), [DCFR](#).

<sup>42</sup> Regulation (EU) No 650/2012 of the European Parliament and of the Council of 4 July 2012 on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession (OJ L 201, 27.7.2012, p. 107). Pursuant to Article 69(3) thereof, “Any person who, acting on the basis of the information certified in a Certificate, makes payments or passes on property to a person mentioned in the Certificate as authorised to accept payment or property shall be considered to have transacted with a person with authority to accept payment or property, unless he knows that the contents of the Certificate are not accurate or is unaware of such inaccuracy due to gross negligence.”

<sup>43</sup> The anonymity of cash does not preclude, but rather invites, the application of AMF/CFT legislation to it; see Article 2(3)(e) of the AMLD.

<sup>44</sup> Qian, Y. (2019), at p. 10.

<sup>45</sup> E.g. Article 8 ECHR; Modernized CoE Convention 108 for the Protection of Individuals with regard to Automatic Processing of Personal Data; Article 16 TFEU; and Article 8 Charter of Fundamental Rights of the EU.

<sup>46</sup> Under a broad definition of personal data (information relating to a natural person, either identified or identifiable i.e. one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity) the CJEU has recognised dynamic IP addresses as personal data; Case C-582/14, Breyer, EU:C:2016:779, at point 49.

whose data is processed, or a task carried out in the public interest or in the exercise of official authority.<sup>47</sup>

A CBDC in token form and storable offline would be the full digital equivalent of cash and therefore raise no privacy concerns in principle.<sup>48</sup> Similarly, intermediated account models could easily reproduce the privacy architecture of commercial bank accounts. In order to perform their obligations under the account contract, the central bank would have visibility over the CBDC intermediaries' accounts with it (which contain no clients' personal data), but only each intermediary would have visibility into the balances of its clients and the transactions they are involved in.<sup>49</sup>

In a non-intermediated model, compliance with privacy and personal data protection obligations would fall upon the central bank. A combination of the legal bases discussed under section 4.1 above would suffice to establish the lawfulness of such processing for the performance of a task carried out in the public interest. However, owing to the sheer volume of personal data being processed and the use of new technologies, a data protection impact assessment and the implementation of data protection by design would be constitutive elements of any CBDC project documentation.<sup>50</sup>

## 5 Conclusion

Central banks around the globe are considering whether to issue retail CBDCs, each for different reasons, and with a different agenda and design options. Yet, with very few exceptions, central banks are treading slowly and carefully, given the potential for disruption to the financial services industry. A robust legal basis and compliance with applicable law must be an integral part of CBDC design. While the existing body of law can, for the most part, serve account CBDC issuance as is, the need for legislative intervention cannot be excluded, particularly with regard to the regulation and supervision of new entrants in the provision of payment services, settlement finality, and the civil law tools to correct CBDC attribution not in tandem with the underlying transaction. A period of legislative upheaval guaranteeing legal certainty is neither unwelcome nor unprecedented: the law constantly evolves to cater to societal needs

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<sup>47</sup> Article 6(1) of Regulation (EU) 2016/679 of the European Parliament and of the Council 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, and repealing Directive 95/46/EC (General Data Protection Regulation, GDPR) (OJ L 119, 4.5.2016, p. 1) or, for the ECB, Article 5(1) of Regulation (EU) 2018/1725 of the European Parliament and of the Council 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, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (EUGDPR) (OJ L 295, 21.11.2018, p. 39).

<sup>48</sup> Mancini-Griffoli, T. et al. (2019), at p. 310, observing that “[s]ettling a transaction using token-based CBDC would require external verification of the tokens. As a result, transactions might not be entirely anonymous, as is cash. The extent of anonymity would depend on whether wallets are registered and transaction information is recorded”.

<sup>49</sup> Cf. Article 94(2) Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (PSD2) (OJ L 337, 23.12.2015, p. 35).

<sup>50</sup> For a proof of concept on how to allow for privacy in electronic payments, while ensuring compliance with AML/CFT regulations, see European Central Bank (2019), [Exploring anonymity in central bank digital currencies](#).



for fast and remote payment, which cash cannot meet,<sup>51</sup> and disruption is a major part of the history of payments, from bullion to banknotes, to e-money, to CBDCs. Future historians may well treat today's bewilderment in the same way we now condescend to a 13th century Venetian or a 18th century Frenchman in awe before a banknote.

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<sup>51</sup> Qian, Y. (2019).

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## Panel 5

Transparency versus confidentiality of supervisory decisions, documents and information



# Introduction to the panel on transparency versus confidentiality of supervisory decisions, documents and information

By Eleni Koupepidou<sup>1</sup>

## 1 Trend towards transparency in central banking and supervisory policies

The issues of transparency and confidentiality have, increasingly over the years, become a topic of discussion in the context of the performance of our tasks as central bankers and as supervisors.<sup>2</sup> While confidentiality and the obligation to professional secrecy have traditionally been considered a behavioural characteristic engrained in the culture of central bankers and supervisors, and certainly are enshrined in the applicable legal frameworks at EU<sup>3</sup> and national level, transparency policies are increasingly at the forefront in the world of central banks and supervisory authorities.

For the ECB central banking side, the following two examples are noteworthy:

- in the context of the ECB's asset purchase programme<sup>4</sup>, the ECB is publishing increasingly detailed information about its asset purchases and the Eurosystem current holdings;
- the very recent decision to start publishing the opinions of the ECB's Ethics Committee on cases of conflicts of interest and post-mandate gainful employment concerning the members of the ECB's Executive Board, Governing Council and the Supervisory Board.

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<sup>1</sup> Head of the Supervisory Law Division, Directorate General Legal Services, European Central Bank.

<sup>2</sup> See, for example, European Central Bank, [Building bridges: central banking law in an interconnected world](#), ECB Legal Conference 2019, Part 6, "Transparency, confidentiality, and exchange of information between authorities", and European Central Bank, [Shaping a new legal order for Europe: a tale of crises and opportunities](#), ECB Legal Conference 2017, the panel on "Transparency and accountability of central banks and banking supervisors".

<sup>3</sup> Notably, for the ECB, Article 38 of the Statute of the European System of Central Banks and of the European Central Bank and Article 27(1) of the SSM Regulation (Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63)). For an overview of the EU law provisions setting out the confidentiality requirements applicable to the ECB, see the contribution by Michael Ioannidis, "The principle of confidentiality in banking supervision", ESCB Legal Conference 2020.

<sup>4</sup> The ECB's asset purchase programme consists of the corporate sector purchase programme (CSPP); the public sector purchase programme (PSPP); the asset-backed securities purchase programme (ABSPP); and the third covered bond purchase programme (CBPP3).

While it has a much younger history, the ECB's supervisory arm also actively engages with the trend towards transparency, as shown notably by the ECB's decision in January 2020 to publish individual, bank-specific Pillar 2 capital requirements (P2R) for all the banks that it directly supervises. Of course, it is to be noted that the significant institutions whose P2R were published had either already disclosed the requirement themselves or given their consent to the ECB for such publication. However, it remains that the publication of a list of individual bank-specific P2R by the supervisory authority is indicative of a certain trend: towards increased transparency.

## 2 The legal requirements: transparency versus confidentiality?

This trend towards transparency is in line with the transparency principle reflected and enshrined in Article 15 of the Treaty on the Functioning of the European Union (TFEU), which requires EU institutions to “conduct their work as openly as possible”. On this basis, as a rule, EU institutions (including the ECB) ensure the publication of their acts.

Whilst transparency is enshrined in the TFEU as a general principle, at the same time the ECB's discretion is limited by applicable primary and secondary EU law and, in particular, by requirements to respect professional secrecy and confidentiality rules.

## 3 Confidentiality in banking supervision and its rationale

In the area of banking supervision, the main source for the confidentiality obligation is contained in Article 53 of the Capital Requirements Directive (CRD)<sup>5</sup> and its national transposition. This provision imposes on all persons who work for or have worked for a competent authority an obligation of professional secrecy, which prohibits the disclosure of confidential information received in the course of their duties, except in summary or aggregate form.

In addition, a string of preliminary rulings issued by the Court of Justice of the European Union in recent years (see notably the judgments of the Court in *Altmann*, *Baumeister*, *UBS* and *Buccioni*<sup>6</sup>) bring to light a number of issues pertaining, first and foremost, to the clarity and coherence of the rules that govern the obligation of professional secrecy laid down by the EU legislator across the financial and banking sector.

It is clear from the legal framework and its interpretation by the Court that confidentiality should not be considered a privilege bestowed on central bankers and

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<sup>5</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>6</sup> Case C-140/13, *Altmann and Others v Bundesanstalt für Finanzdienstleistungsaufsicht*, EU:C:2014:2362; Case C-15/16, *Bundesanstalt für Finanzdienstleistungsaufsicht v Baumeister*, EU:C:2018:464; Case C-358/16, *UBS and Others v DV and Others*, EU:C:2018:715; Case C-594/16, *Enzo Buccioni v Banca d'Italia*, EU:C:2018:717.



supervisors to allow them to escape their accountability responsibilities. Rather, confidentiality obligations must be understood as flowing from a duty to protect legitimate interests that have been entrusted to central banks and supervisory authorities. In this respect, supervisors' duty of professional secrecy protects the bank-specific information received from credit institutions they supervise. However, the duty to abide by the obligation of professional secrecy is not only meant to safeguard the individual interests of the banks concerned and their commercial position but also to ensure the proper functioning of the system of supervision itself. This has been consistently underlined by the Court in its different rulings. The reason for this underlying consideration, also stressed by the Court, is that the absence of confidentiality is liable to compromise the smooth transmission of confidential information, which is a necessary precondition for monitoring the entities subject to supervision. It is precisely on this broader rationale for confidentiality, i.e. the proper functioning of the system, that the Court of Justice recently rooted the concept of confidential information. The Court clarified that confidential information covers not only information the disclosure of which is likely to affect adversely the interests of a natural or legal person, but also information whose disclosure is likely to adversely affect the proper functioning of the system.<sup>7</sup>

This rationale of the supervisory authorities' duty of confidentiality as a measure to protect legitimate interests explains why what may seem as an ever-growing trend for transparency is not unfettered.

For instance, in the monetary policy field, the Court clarified<sup>8</sup> that the exercise by the Governing Council of its primary law prerogative to decide to make the outcome of its deliberations public (or to keep them confidential) is not subject to the exceptions to disclosure set out in the ECB public access regime.

In the supervisory field as well, there are indications that whenever a balance needs to be struck between transparency and confidentiality requirements, the pendulum does not necessarily lean towards more transparency. First, as already mentioned, the judgment of the Court of Justice in *Baumeister* seems to broaden the concept of confidentiality beyond the protection of individual interests, by including in its scope information whose disclosure is likely to adversely affect the proper functioning of the system. The judgment of the Court in *Buccioni* can also be clustered in this category. While it is true that in this judgment the Court extended somewhat the scope of application of one of the exceptions to professional secrecy, the Court at the same time clarified that disclosure is not automatic, even when the conditions set by Article 53(1) CRD are met and where the requested disclosure is aimed to protect the applicant's rights of defence. On the contrary, the Court indicated that it is for the competent authority to "... weigh up the interest of the applicant in having the information in question and the interests connected with maintaining the confidentiality of the information covered by the obligation of professional secrecy, before disclosing each piece of confidential information requested".<sup>9</sup>

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<sup>7</sup> *Baumeister*, paragraph 35 and *UBS*, paragraph 65.

<sup>8</sup> Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, EU:C:2020:845 and Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, EU:C:2019:1117.

<sup>9</sup> *Buccioni*, paragraphs 39-40.



## 4 Conclusion

The question that comes to mind after this brief introduction is whether, at the end of the day, there really is a tension between transparency and confidentiality. Or whether such tension is only apparent and transparency and confidentiality actually coexist in a non-mutually exclusive relationship.

As the analysis of the panellists shows, it is true that there is a certain tension between the different interests at stake, but the legislator has decided how to weigh those interests and contemplated specific exemptions that the Court has also considered in its rulings.

*Michael Ioannidis* sets the scene and provides a compass to navigate between transparency and confidentiality, starting from a conceptual and broader perspective and narrowing it down to the regime for public access to documents. Michael also draws a map, visualising the relevant provisions in primary and in secondary law.

*Cristina Pérez Cajal* concentrates her analysis on professional secrecy provisions applicable in the supervisory field and gives an overview of the specific rules, elaborating on their application in the case-law of the Court of Justice. Cristina also analyses the exceptions to professional secrecy in the different provisions and how they have been interpreted by the Court.

*Carmen Hernández Saseta* considers the interaction between confidentiality and a specific application of the right of defence in ECB supervisory procedures, which is access to the supervisory file. Carmen also explains how the protection of professional secrecy is balanced with the protection of private interests, such as the right of defence.

# The principle of confidentiality in banking supervision

By Michael Ioannidis<sup>1</sup>

This contribution discusses the relationship between the principles of transparency and confidentiality when dealing with information related to banking supervision. The first section introduces transparency and confidentiality as legal principles. The second section turns to the relationship between transparency and confidentiality when it comes to public access requests, discussing two possible alternatives. According to the first approach, confidentiality is an exception to transparency; according to the second, confidentiality and transparency are two principles standing at the same level, applicable depending on the content of the information at issue. The choice between the two approaches has important consequences related to interpretation and justification of confidentiality rules. This contribution discusses the reasons to side with the second alternative when it comes to banking supervision. This choice is supported by two recent judgments of the Court of Justice of the European Union (CJEU) in the *Espírito Santo* cases. Although these cases do not involve the application of supervisory rules, they may be also relevant for applying the principle of confidentiality in the field of banking supervision.

## 1 Transparency and confidentiality as legal principles

### 1.1 On the concept of principle

The term 'principle' belongs to the casual juridical vocabulary – often used as a rhetorical device in order to enhance the authority of a statement or argument. Principles and their role in legal reasoning, however, have been central issues of legal methodology, especially since the 1950s, when authors such as Roland Dworkin and Robert Alexy sparked the big discussion on principles.<sup>2</sup>

One basic thrust of this discussion was the distinction between 'normal' rules and principles. According to Josef Esser, a principle differs from a rule in that it is not itself an instruction but rather 'the reason, criterion, and justification for the instruction'<sup>3</sup>. Unlike rules, principles do not prescribe a specific form of conduct; they need to be

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<sup>1</sup> Principal Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> The fundamental texts include Esser, J. (1974), *Grundsatz und Norm in der richterlichen Fortbildung des Privatrechts Rechtsvergleichende Beitr. zur Rechtsquellen- u. Interpretationslehre*, 3rd edn.; Dworkin, R. (1967), "The Model of Rules", *University of Chicago Law Review*, Vol. 35, pp. 14-46; Alexy, R. (1979), "Zum Begriff des Rechtsprinzips", *Rechtstheorie, Beiheft*, No. 1, p. 59-87; Alexy, R. (1985), *Theorie der Grundrechte*, Nomos Verlagsgesellschaft. For a comparative introduction, see Reißing, M. (2009), "Prinzipien als Normen mit zwei Geltungsebenen: Zur Unterscheidung von Regeln und Prinzipien", *Archiv für Rechts- und Sozialphilosophie*, Vol. 95, pp. 28-48.

<sup>3</sup> Esser, op. cit., p. 51 et seq.

further specified, and, in this process of specification, other, also competing, principles need to be considered.<sup>4</sup> Dworkin has famously shaped the understanding of legal principles as something structurally different from norms. According to this view, rules are applicable in an ‘all-or-nothing’ fashion. If a certain set of facts is given, the answer the rule supplies must be accepted.<sup>5</sup> By contrast, a principle is something that officials must always take into account ‘as a consideration inclining in one direction or another’<sup>6</sup>. Counterinstances to the applicability of the principle are not treated as exceptions in the way that we speak of exceptions to a specific rule.<sup>7</sup> All of this means that principles have a dimension that rules do not: they have ‘weight’ or ‘importance’. This weight or importance is relative to other principles. When principles intersect, the administrator or judge who must resolve the conflict has to take into account the relative weight of each.<sup>8</sup> For Alexy, the difference between principles and rules is that rules are norms that in all instances can only be either fulfilled or not fulfilled,<sup>9</sup> whereas principles are imperatives that can be satisfied to varying degrees, so that they call for ‘optimisation’ rather than full implementation.<sup>10</sup>

According to another school of thought, principles are *not* logically different from rules but they are ‘very important rules’<sup>11</sup>. In this case too, principles are ascribed some specific function in legal argumentation that is different from a simple norm.<sup>12</sup> They perform the function of structuring the legal material and they guide interpretation or the legislator.<sup>13</sup> They also allocate burdens of argumentation: the one who argues against a principle has to bear the burden of justification – and the CJEU has applied this to mean that principles need to be read widely, while norms contradicting the principle must be read narrowly.<sup>14</sup>

For present purposes, it is not necessary to go deeper into the discussion on principles and their (logical or functional) difference to rules. Some common characteristics emerge in the approaches sketched above: principles contain the reasons and goals that they refer to, they set presumptions and they also call for balancing. For most authors, a basic element of principles is the role of ‘purpose’. According to Joseph Raz, conflicts between principles are determined by assessing their relative importance together with the consequences for their goals of various courses of

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<sup>4</sup> Reßing, op. cit., p. 31.

<sup>5</sup> Unless the rule is invalid, owing to conflict with a higher norm, for example, in which case it contributes nothing to the decision; Dworkin, op. cit., p. 25.

<sup>6</sup> Dworkin, op. cit., p. 26.

<sup>7</sup> Dworkin, op. cit., p. 26.

<sup>8</sup> Dworkin, op. cit., p. 27.

<sup>9</sup> Alexy, R. (2000), "Zur Struktur der Rechtsprinzipien" in Schilcher, B., Koller, P. and Funk, C. (eds.), *Regeln, Prinzipien und Elemente im System des Rechts*, Verlag Österreich, p. 32. Alexy criticises and ultimately reformulates the ‘all-or-nothing’ criterion proposed by Dworkin.

<sup>10</sup> See Alexy (2000), op. cit. pp. 31-52; Alexy (1985), op. cit., p. 75 et seq.

<sup>11</sup> Jakab, A. (2016), *European Constitutional Language*, Cambridge University Press, p. 377 et seq.; Tridimas, T. (2006), *The General Principles of EU Law*, Oxford University Press, p. 29 et seq.

<sup>12</sup> In terms of their forms, principles are sometimes explicitly set out in positive law – indeed the drafters of the EU Treaties were particularly fond of this concept, employing it generously; see von Bogdandy, A. (2009), "Founding Principles", in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, Hart, p. 20. In other cases, principles are derived by acts of interpretation, from legislative texts or from judicial precedents.

<sup>13</sup> See, in detail, von Bogdandy, op. cit., p. 14 et seq.; Jakab, op. cit., p. 381 et seq.

<sup>14</sup> von Bogdandy, op. cit., p. 17.

action.<sup>15</sup> According to Tridimas, unlike rules, which provide answers, principles ‘state reasons which give arguments in one direction but do not necessitate a particular result’<sup>16</sup>.

As will be explained below, these elements are present with regard to both transparency and confidentiality. Transparency and confidentiality have the functions ascribed to principles above: they structure the legal material, guide interpretation and allocate burdens of argumentation. The law-maker – in the case of the EU the Treaty-makers or the legislator – has the primary responsibility for balancing these principles and may decide that certain categories of information are to be governed by the one or the other. Where no such decision has been made, or where the law leaves room for interpretation, it is for the administration and ultimately for the courts to strike the right balance, applying the rationales of ‘weighting’ and ‘optimisation’.

## 1.2 The principle of transparency

### 1.2.1 The different dimensions of transparency

The status of transparency as a principle of European Union (EU) law is well settled. According to the second paragraph of Article 1 of the Treaty on European Union (TEU), within the EU decisions are to be taken as openly as possible. Article 11(2) TEU, requiring EU institutions to maintain ‘an open, transparent and regular dialogue with representative associations and civil society’ is placed in Title II of the TEU, ‘Provisions on Democratic Principles’. Article 15 of the Treaty on the Functioning of the European Union (TFEU), the central provision for transparency in the TFEU, is also located in Part One, entitled ‘Principles’<sup>17</sup>. According to the CJEU, Articles 1 and 10 TEU, as well as Article 15 TFEU, state the principle of transparency, which enables citizens to participate more closely in the decision-making process and guarantees that the administration enjoys greater legitimacy and is more effective and more accountable to the citizen in a democratic system.<sup>18</sup> Academic writing has also, from an early stage, treated transparency as a principle of Union law.<sup>19</sup>

The legislator has concretised the principle of transparency in a number of specific provisions that require EU institutions to share information they hold with the public. These include rules requiring the institutions to submit reports of their activity to the European Parliament and make them public, to hold some of their meetings in public and to allow access to their information following on requests from the public. The

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<sup>15</sup> Raz, J. (1972), “Legal Principles and the Limits of Law”, *Yale Law Journal*, Vol. 81, p. 831.

<sup>16</sup> Tridimas, op. cit., p. 2.

<sup>17</sup> Article 15(3) TFEU is essentially replicated in Article 42 of the Charter of Fundamental Rights of the European Union.

<sup>18</sup> Joined Cases C-92/09 and C-93/09, *Schecke and Eifert v Hessen*, EU:C:2010:662.

<sup>19</sup> Prechal, A. and de Leeuw, M. (2008), “Transparency: A general principle of EU law?”, in Bernitz, U., Nergelius, J. and Cardner, C. (eds.), *General principles of EC law in a process of development: Reports from a conference in Stockholm, 23-24 March 2007, organised by the Swedish network for European Legal Studies*. Sometimes transparency is seen as part of the principle of democracy; see von Bogdandy, op. cit., pp. 50-51.

latter dimension of the principle of transparency has been operationalised by Regulation (EC) No 1049/2001<sup>20</sup>.

The Treaties themselves make a clear link between transparency and the objective of promoting democracy in the EU, and the CJEU has also ruled that the right to public access is a basic pillar of the Union's democratic accountability<sup>21</sup>. Transparency serves accountability and is a prerequisite of the democratic control of public authority. On the basis of this purpose, it covers rules and practices that govern the disclosure of information to institutions, private law entities and citizens in order for them to understand and scrutinise how authority is being exercised.

This means that not every disclosure of information is an expression of the principle of transparency. Often, the reason for allowing access to information is not to enable or to enhance public scrutiny but to fulfil another purpose. For example, rules governing access to the administrative file are expressions of the principle of good administration, rules requiring disclosure in the context of legal proceedings serve the principle of fair trial, while rules regulating the transmission of information to other authorities express the principle of sincere cooperation and serve the purpose of providing those authorities with the information they need in order to discharge their own mandates. Disclosure of information can also be an instrument through which institutions pursue their own objectives. For example, central banks share information in order to shape expectations about the future level of inflation. Even though disclosure of certain information can serve more than one purpose, for instance to account to the public for a certain policy stance (accountability function) and also to steer expectations (instrument function), the two should not be confused.

## 1.2.2 Transparency and banking supervision

These general considerations are also applicable to the Single Supervisory Mechanism (SSM). In the field of banking supervision, the principle of transparency is expressed in a number of specific provisions set out in the SSM Regulation<sup>22</sup> and other European Central Bank (ECB) rules<sup>23</sup>. According to Article 20(1) SSM Regulation, the ECB shall submit in public to the European Parliament and to other EU institutions an annual report on the execution of its supervisory tasks. Beyond this annual reporting obligation, '[t]he ECB shall reply orally or in writing to questions put to it by the European Parliament, or by the euro Group'<sup>24</sup>. The Chair of the Supervisory

<sup>20</sup> Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p.43).

<sup>21</sup> Joined Cases C-39/05 P and C-52/05 P, *Kingdom of Sweden and Maurizio Turco v Council of the European Union*, EU:C:2008:374, para. 45.

<sup>22</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>23</sup> The basic rules on accountability are laid down in the SSM Regulation and in the Interinstitutional Agreement (IIA) between the European Parliament and the ECB concluded in 2013; see 2013/694/EU: Interinstitutional Agreement between the European Parliament and the European Central Bank 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 Single Supervisory Mechanism (OJ L 320, 30.11.2013, p. 1).

<sup>24</sup> Article 20(6) SSM Regulation. The ECB reply shall be given 'in accordance with its own procedures and in the presence of representatives from any participating Member States whose currency is not the euro'.

Board shall also participate in hearings on the execution of the ECB's supervisory tasks by the euro Group in the presence of representatives from any participating Member States whose currency is not the euro or by the competent committees of the European Parliament at the request of such committees (ordinary hearings)<sup>25</sup> and may be invited to additional ad hoc exchanges of views on supervisory issues with Parliament's competent committee<sup>26</sup>. Finally, the Chair of the Supervisory Board may be invited to confidential oral discussions with the Chair and the Vice-Chairs of the competent committee of the European Parliament (confidential oral discussions).<sup>27</sup> Article 20(9) SSM Regulation contains a general requirement of cooperation between the ECB and the European Parliament to allow for democratic accountability and oversight over the exercise of the ECB's supervisory tasks. The principle of transparency is also served by the requirements imposed upon the ECB to provide adequate reasons for its decisions.<sup>28</sup>

The dimension of transparency of the ECB vis-à-vis the European Parliament and the multifaceted questions it poses, also regarding the principle of independence, has recently been the subject of important analysis<sup>29</sup>. This contribution will focus on another expression of the principle of transparency in banking supervision: public access requests for supervisory information.

Information that has not been made public on the ECB's own initiative or by discharging reporting obligations may be disclosed upon request. Such information requests are governed by public access rules. Article 15(3) TFEU gives EU citizens, residents, and businesses the individual right to access documents of the EU institutions, bodies, offices and agencies, subject to certain principles and conditions. For reasons related to the independence and to the specific tasks of the ECB, the drafters of the Treaty provided in Article 15(3) TFEU that this right only applies to the ECB when exercising its administrative tasks. However, the ECB's public access rules, in particular Decision ECB/2004/3 (the Public Access Decision)<sup>30</sup>, do not make a distinction between administrative and other documents. All documents drawn up or held by the ECB fall under the same transparency regime. Documents relating to the prudential supervision of credit institutions also qualify as ECB documents within the

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<sup>25</sup> Article 20(4) and (5) SSM Regulation and No I.2. of the IIA.

<sup>26</sup> No I.2. of the IIA.

<sup>27</sup> Article 20(8) SSM Regulation and No I.2. of the IIA.

<sup>28</sup> See Article 22(2) SSM Regulation and Article 33 SSM Framework Regulation.

<sup>29</sup> Zilioli, C. (2016), "The Independence of the European Central Bank and Its New Banking Supervisory Competences", in Ritleng, D. (ed.), *Independence and Legitimacy in the Institutional System of the European Union*, Oxford University Press; Amtenbrink, F. and Markakis, M. (2019), "Towards a Meaningful Prudential Supervision Dialogue in the Euro Area? A Study of the Interaction between the European Parliament and the European Central Bank in the Single Supervisory Mechanism", *European Law Review*, Vol. 44, pp. 3-23; Fromage, D. (2019), "Guaranteeing the ECB's democratic accountability in the post-Banking Union era: An ever more difficult task?", *Maastricht Journal of European and Comparative Law*, Vol. 26, pp. 48-62; Nicolaidis, P. (2019), "Accountability of the ECB's supervisory activities (SSM): Evolving and responsive", *Maastricht Journal of European and Comparative Law*, Vol. 26, pp. 136-150; Beroš, M. (2019), "The ECB's accountability within the SSM framework: Mind the (transparency) gap", *Maastricht Journal of European and Comparative Law*, Vol. 26, pp. 122-135.

<sup>30</sup> 2004/258/EC: Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3) (OJ L 80, 18.3.2004, p. 42).

meaning of Decision ECB/2004/3<sup>31</sup>. To that extent, the ECB's public access rules go beyond what is required by the Treaty.

In substance, Decision ECB/2004/3 follows the basic logic of Regulation (EC) No 1049/2001, which is applicable to the other EU institutions. According to Article 2(1) Decision ECB/2004/3, '[a]ny citizen of the Union, and any natural or legal person residing or having its registered office in a Member State, has a right of access to ECB documents'. As an instrument reflecting the principle of transparency, the Public Access Decision provides for a general right of the public to access ECB documents and thus its default setting is to allow access.

The general rule in favour of access is qualified by the exceptions contained in Article 4 Public Access Decision. Decision ECB/2015/529<sup>32</sup>, which amended the Public Access Decision, inter alia to account for the creation of the SSM, included exceptions in the Public Access Decision specifically calibrated to the ECB supervisory tasks. According to this Decision, the ECB shall refuse access to a document where disclosure would undermine the protection of the Union's or a Member State's policy relating to the prudential supervision of credit institutions and other financial institutions and the purpose of supervisory inspections, market infrastructures, payment schemes or payment service providers. Moreover, the pre-existing exception contained in Article 4(1)(c) Public Access Decision, requiring the ECB to refuse access to a document where disclosure 'would undermine the protection of the confidentiality of information that is protected as such under Union law', acquired new scope and meaning with the introduction of the SSM, as the ECB became responsible for the implementation of Union legal instruments containing important confidentiality clauses, such as the CRD IV<sup>33</sup>.

## 1.3 The principle of confidentiality

### 1.3.1 Confidentiality: the general contours

Whereas the treatment of transparency as legal principle is well established both in judicial practice and in academic literature, this is not the same for confidentiality.

<sup>31</sup> See also recital (3) of Decision (EU) 2015/529 of the European Central Bank of 21 January 2015 amending Decision ECB/2004/3 on public access to European Central Bank documents (ECB/2015/1) (OJ L 84, 28.3.2015, p. 64). This, of course, does not mean that supervisory documents are related to the ECB's 'administrative tasks' under Article 15(3) TFEU. Also in this regard, the Public Access Decision seems to go beyond what is required by primary law.

<sup>32</sup> Decision (EU) 2015/529 of the European Central Bank of 21 January 2015 amending Decision ECB/2004/3 on public access to European Central Bank documents (ECB/2015/1) (OJ L 84, 28.3.2015, p. 64). The Public Access Decision had been already amended by Decision ECB/2011/6 in order to ensure the protection of the public interest as regards the stability of the financial system in the Union and in Member States, in respect of requests for access to ECB documents relating to ECB activities and policies or decisions drawn up or held by the ECB in the field of financial stability, including those relating to the provision of support by the ECB to the European Systemic Risk Board. Decision (EU) 2011/6 of 9 May 2011 amending Decision ECB/2004/3 on public access to European Central Bank documents (ECB/2011/6) (OJ L 158, 16.6.2011, p. 37).

<sup>33</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).



Academic literature has not been equally receptive to treating confidentiality as a principle, compared with transparency, and judicial references are much fewer. Like transparency, however, confidentiality is a principle shaped by the purposes it serves, structuring legal material and guiding law-making and interpretation. In the case of confidentiality, two aims are involved. First, confidentiality serves the interests of individuals (private persons or legal entities), who could be harmed by the disclosure of the information. Second, it protects the proper functioning of the public service, which is responsible for processing this information, and also for creating new information, when discharging its duties. This second purpose also covers the need to ensure the effective working of composite administrative systems, where Union authorities and national authorities cooperate closely, exchanging information. Trust that the information exchanged will remain confidential is a necessary precondition for authorities to share information they hold and thus for the smooth operation of composite/multilevel systems. With reference to these aims, the CJEU has gradually articulated some basic contours of the principle of confidentiality.<sup>34</sup>

At the level of primary law, Article 339 TFEU is the basic confidentiality provision.<sup>35</sup> It establishes the obligation of Union functionaries 'not to disclose information of the kind covered by the obligation of professional secrecy, in particular information about undertakings, their business relations or their cost components.' Together with provisions of competition and anti-dumping law, Article 339 TFEU has been read by the Court as concrete expression of the 'principle of confidentiality'<sup>36</sup> or of a 'general principle' of protecting business secrets<sup>37</sup>. Although Article 339 TFEU directly refers only to information about undertakings, the phrase 'in particular' shows that 'the principle in question is a general one' and also applies to information supplied by natural persons<sup>38</sup>. The General Court has ruled that the obligation of professional secrecy covers information which fulfils three cumulative conditions: first, the information is known only to a limited number of persons; second, its disclosure must be likely to cause serious harm to the person who provided it or to third parties; third, the interests liable to be harmed by disclosure must, objectively, be worthy of

<sup>34</sup> The following does not cover the specific field of processing data, where Union law explicitly uses the term 'principle of confidentiality' with regard to the processing of personal data. Article 5(1) Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) (OJ L 201, 31.7.2002, p. 37) provides: 'Member States shall ensure the confidentiality of communications and the related traffic data by means of a public communications network and publicly available electronic communications services, through national legislation. In particular, they shall prohibit listening, tapping, storage or other kinds of interception or surveillance of communications and the related traffic data by persons other than users, without the consent of the users concerned, except when legally authorised to do so in accordance with Article 15(1). This paragraph shall not prevent technical storage which is necessary for the conveyance of a communication without prejudice to the principle of confidentiality.' The Court has clarified that the exceptions to this principle are exhaustively listed, see Case C-203/15, *Tele2 Sverige*, EU:C:2015:773, paras. 90 and 102.

<sup>35</sup> The aspect of confidentiality linked to business secrets has also been linked with the fundamental rights established in Article 8 of the European Convention on Human Rights, see Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 3 May 2001, in Case C-315/99 P, *Ismeri Europa v Court of Auditors*, EU:C:2001:391, para. 73 and Articles 15(1), 16 and 17 of the Charter of Fundamental Rights of the European Union, see Case C-1/11, *Interseroh Scrap and Metals Trading*, EU:C:2012:194, para. 43; Case C-450/06, *Varec*, EU:C:2008:91, para. 49.

<sup>36</sup> Case C-264/82, *Timex v Commission and Council*, EU:C:1985:119, paras 24-29.

<sup>37</sup> Case C-1/11, *Interseroh Scrap and Metals Trading*, para. 43; Case C-450/06, *Varec*, para. 49. See also Case C-53/85, *AKZO Chemie v Commission*, EU:C:1986:256, para. 28, where the CJEU has treated specific provisions protecting business secrets as 'the expression of a general principle which applies during the course of the administrative procedure'.

<sup>38</sup> Case C-145/83, *Adams v Commission*, EU:C:1985:323, para. 34.

protection.<sup>39</sup> The third condition requires ‘the legitimate interests opposing disclosure of the information to be weighed against the public interest that the activities of the institutions take place as openly as possible’.<sup>40</sup> This weighting element also indicates the treatment of confidentiality as a principle, potentially competing with the principle of transparency.

All other primary-law references to ‘secrecy’ or ‘confidentiality’ refer to two specific Union institutions: the CJEU and the ECB. Article 35 of the Protocol (No 3) on the Statute of the Court of Justice of the European Union requires that the deliberations of the Court of Justice shall be and shall remain secret<sup>41</sup>. The other references, including the only three times the term ‘confidential’ appears in primary law, are connected with the tasks of the ECB. Article 10(4) of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank requires that ‘the proceedings of the meetings of the Governing Council shall be confidential’<sup>42</sup>. ‘Confidentiality’ is also explicitly referred to with regard to the collection of statistical information.<sup>43</sup> Finally, Article 37 Statute of the ESCB sets out the obligation of professional secrecy in similar terms to those in Article 339 TFEU<sup>44</sup>. This latter obligation is replicated in Article 23a ECB Rules of Procedure and in Article 27(1) SSM Regulation. Neither Article 37 Statute of the ESCB nor 27(1) SSM Regulation expressly indicates what information is to be covered by the obligation of professional secrecy, and the CJEU has not ruled on their interpretation. Considering, however, that the text of these provisions closely replicates Article 339 TFEU, the approach of the Court can be expected to be similar.

### 1.3.2 Confidentiality and (banking) supervision

A major source of jurisprudential reflection on the principle of confidentiality are the relevant provisions contained in supervisory law. All three frameworks regarding the supervision of investment services (Market in Financial Instruments Directive, MiFID II<sup>45</sup>), banking (CRD IV), and insurance and reinsurance (Solvency II) contain confidentiality provisions. Despite their differences, these frameworks use the same

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<sup>39</sup> See Case T-198/03, *Bank Austria Creditanstalt v Commission*, EU:T:2006:136, para. 71; Case T-341/12, *Evonik Degussa v Commission*, EU:T:2015:51, para. 94. In *Adams v Commission*, the Court ruled that the duty enshrined in Article 39 TFEU covers in particular ‘information supplied on a purely voluntary basis but accompanied by a request for confidentiality in order to protect the informant’s anonymity. An institution which accepts such information is bound to comply with such a condition’, para. 34.

<sup>40</sup> Case T-341/12, *Evonik Degussa v Commission*, para. 106. The principle of confidentiality may also limit the Commission’s obligation to transmit documents to national authorities, Case C-36/92, *P SEP v Commission*, EU:C:1994:205, paras. 36-37.

<sup>41</sup> See also Articles 2, 10 and 13 of the CJEU Statute.

<sup>42</sup> Article 23 ECB Rules of Procedure extends the confidentiality regime set out in Article 10.4 ESCB/ECB Statute to the proceedings of other ECB bodies, beyond the Governing Council.

<sup>43</sup> Articles 5.4 Statute of the ESCB and 338(2) TFEU.

<sup>44</sup> According to this provision, ‘[m]embers of the governing bodies and the staff of the ECB and the national central banks shall be required, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy. Persons having access to data covered by Union legislation imposing an obligation of secrecy shall be subject to such legislation’.

<sup>45</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p.349).

concepts and reflect the same structure.<sup>46</sup> They require Member States to impose the duty of professional secrecy upon a circle of persons or authorities who have access to ‘confidential information’ and allow for exceptions in some specific cases, such as in the context of judicial proceedings. None of them contains a legal definition of ‘confidential information’.

These provisions give rise to a number of questions about which information is ‘confidential information’, the scope of the exceptions to confidentiality and what happens in the case of a public access request for confidential information. Recently, responding to preliminary references, the Court of Justice clarified the first two of these questions, defining ‘confidential information’ and the breadth of the exceptions to professional secrecy.<sup>47</sup> In doing so, the Court also clarified the contours of the principle of confidentiality. The Court interpreted these provisions with close reference to their aims, referred to the need to balance them with other conflicting principles and cross-referred ‘by analogy’ to judgments rendered in the other supervisory regimes. These clarifications to the principle of confidentiality are also relevant for addressing the third question: the relationship between public access and confidentiality, which will be treated in the following section.

In *Hillenius*, Advocate General Slynn had already argued that the obligation of professional secrecy laid down ‘the general principle’ in the supervision of credit institutions<sup>48</sup> and should be thus read broadly.<sup>49</sup> The Court agreed with this view and recognised that confidentiality not only serves the protection of the private interest of credit institutions in their business secrets, but also the public interest of effective banking supervision within a Member State and the trust necessary for the exchange of information by the competent authorities.<sup>50</sup> In *Altmann*, Advocate General Jääskinen followed the approach of Advocate General Slynn, opining that Article

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<sup>46</sup> For a detailed and systematic analysis of the three regimes, see Smits, R. and Badenhoop, N. (2019), “Towards a Single Standard of Professional Secrecy for Financial Sector Supervisory Authorities: A Reform Proposal”, *European Law Review*, Vol. 44, pp. 295-318.

<sup>47</sup> For an analysis of these cases, see Fairinhas, C. (2019), “Access to confidential information in the financial and banking sectors: judgements of the Court of Justice in *Altmann*, *Baumeister*, *UBS and Buccioni*”, *Law and Financial Markets Review*, Vol. 13, pp. 203-10; see also the contribution by Cristina Pérez Cajal, “The rule of professional secrecy in banking supervision (*Hillenius*, *Altmann* and *Baumeister*) and exceptions to professional secrecy (*Buccioni*)”, ESCB Legal Conference 2020.

<sup>48</sup> The applicable provision was Article 12(1) of First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 322, 17.12.1977, p. 30), according to which ‘1. Member States shall ensure that all persons now or in the past employed by the competent authorities are bound by the obligation of professional secrecy. This means that any confidential information which they may receive in the course of their duties may not be divulged to any person or authority except by virtue of provisions laid down by law’.

<sup>49</sup> Opinion of Advocate General Slynn in Case C-110/84, not published, *Gemeente Hillegom v Hillenius*, EU:C:1985:333, p. 3950.

<sup>50</sup> Case C-110/84, *Gemeente Hillegom v Hillenius*, EU:C:1985:495, para. 27 (‘The disclosure of confidential information for whatever purpose might have damaging consequences not only for the credit institution directly concerned but also for the banking system in general.’). The prohibition of disclosure had thus to cover statements which persons bound by the obligation of confidentiality make as witnesses in civil proceedings, Case C-110/84, *Gemeente Hillegom v Hillenius*, para. 28-29. According to the Court, it was ultimately for the national judiciary to find the balance ‘between the interest in establishing the truth, which is fundamental to the administration of justice, and the interest in maintaining the confidentiality of certain kinds of information’, Case C-110/84, *Gemeente Hillegom v Hillenius*, para. 33. See also Judgment of 14 February 2008 in Case C-450/06, *Varec*, paras. 51 and 52; Case C-358/16, *UBS Europe and Others*, para. 69; and Case C-594/16, *Buccioni*, para. 39.

54(1), which contained the rules on professional secrecy in MiFID<sup>51</sup>, set out ‘the basic principle’ when it comes to confidentiality and professional secrecy.<sup>52</sup> In its judgment, the Court has recourse to the objectives of MiFID and the context of Article 54 to identify the purpose of this principle. According to the Court,

*[t]he effective monitoring of the activities of investment firms, through supervision within a Member State and the exchanging of information by the competent authorities of several Member States [...] requires that both the firms monitored and the competent authorities can be sure that the confidential information provided will, in principle, remain confidential.*<sup>53</sup>

The ultimate purpose of confidentiality according to the Court is trust.<sup>54</sup> Confidence is at the centre of confidentiality – and not only from a linguistic perspective. The operation of a supervisory system engaging different European authorities requires trust both from the side of the supervised entities and from the cooperating authorities who are called to share information. The Court clearly connects confidentiality with the institutional peculiarities of European administration, which requires autonomous authorities to cooperate closely for the application of Union law. The general principle of protecting confidential information, inferred from the trust-oriented objective and context of Article 54 MiFID, would inform the Court’s subsequent case-law.<sup>55</sup>

In *Baumeister*, Advocate General Bot referred explicitly to the ‘principle of confidentiality’. According to Advocate General Bot, supervision is different from the application of competition rules and the right of access to documents of the EU institutions.<sup>56</sup> Supervisory authorities must enjoy the confidence of the supervised undertakings<sup>57</sup>, and national supervisory authorities themselves should trust each other, since the EU legislature has provided that they are to operate as a network<sup>58</sup>. Indeed, here, supervised entities are in a continuous relationship of oversight to their supervisors. Advocate General Bot derived from the principle of confidentiality concrete practical implications. First, that ‘all the information available to those authorities must be regarded as confidential’<sup>59</sup>. Second, the decision by the EU

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<sup>51</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p.1).

<sup>52</sup> MiFID has been repealed by Directive 2014/65 (MiFID II). However, Article 76 MiFID II is almost the same as Article 54 MiFID, and the changes do not affect the issues discussed in the following.

<sup>53</sup> Case C-140/13, *Altmann and Others*, para. 31. According to the Court, As the Advocate General noted in point 37 of his Opinion, and as is also clear from the last sentence of recital 63 in the preamble to Directive 2004/39/EC, the absence of such secrecy is liable to compromise the smooth transmission of confidential information necessary for monitoring. Therefore, in order to protect not only the firms directly concerned, but also the normal functioning of the markets in financial instruments of the European Union, Article 54(1) of Directive 2004/39/EC imposes, as a general rule, the obligation to maintain professional secrecy; paras 32-33.

<sup>54</sup> See also Duijkersloot, T., Karagianni, A. and Kraaijeveld, R. (2017), “Political and Judicial Accountability in the EU Shared System of Banking Supervision and Enforcement”, in Scholten, M. and Luchtman, M. (eds.), *Law Enforcement by EU Authorities: Implications for Political and Judicial Accountability*, Edward Elgar, p. 43; Smits and Badenhoop, op. cit., p. 298.

<sup>55</sup> Farinhas, op. cit., p.204.

<sup>56</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, EU:C:2017:958, para. 36-37.

<sup>57</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, paras. 48-52.

<sup>58</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, para. 49.

<sup>59</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, para. 54.

legislature to strike the balance in favour of the principle of confidentiality means that the (exhaustively listed) exceptions must be interpreted strictly.<sup>60</sup>

The Court in *Baumeister* did not follow the first conclusion of Advocate General Bot, but accepted the second one. The Court used the double purpose of confidentiality<sup>61</sup> to demarcate the scope of the information falling under Article 54(1) in a different way. Not all information relating to the supervised entity and communicated by it to the competent authority, and not all statements of that authority in its supervision file, including its correspondence with other bodies, are confidential. The general prohibition on the disclosure of confidential information applies to information held by the competent authorities (i) which is not public and (ii) the disclosure of which is likely to affect adversely the interests of the natural or legal person who provided that information or of third parties, or the proper functioning of the system for monitoring the activities of investment firms.<sup>62</sup> The definition of confidential information through the double objective of professional secrecy, namely to serve the interests of the firms directly concerned but also the public interest in the normal functioning of the markets, is restated in *UBS and Others* and *Buccioni*<sup>63</sup>. The principle of confidentiality also guided the approach of the Court regarding the interpretation of its exceptions. According to the Court, MiFID and CRD IV establish the general rule that disclosure of confidential information is prohibited and list exhaustively the specific cases where, exceptionally, that general prohibition does not preclude their communication or use<sup>64</sup>. These exceptions have to be read narrowly.<sup>65</sup>

The clearest and most explicit reference to confidentiality as a principle of Union law is in two recent judgments of the Court of Justice involving the application of Article 10(4) Statute of the ESCB. This provision requires that the minutes of the Governing Council be kept confidential and only the part recording the outcome of the discussions can be disclosed. In the *Espírito Santo* cases, which will be discussed in more detail below, the ECB argued that this provision expressed the 'principle of confidentiality'. Thus, the discretion of the Governing Council to disclose the outcome of its deliberations should be read broadly, in the light of the objectives of confidentiality, namely the independence and proper functioning of the ESCB. In his Opinion, Advocate General Pikamäe explicitly counterposed, for the first time, the principle of transparency with the principle of confidentiality. According to his view, Article 15(1) TFEU and the rules on public access reflect the principle of transparency but on, some occasions, the Treaty-makers (or the legislator) have decided that certain information should be subject to the principle of confidentiality. In that context, 'the principle of transparency

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<sup>60</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, paras. 60 and 65.

<sup>61</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, para. 33.

<sup>62</sup> Case C-15/16, *Baumeister*, para. 35. This is without prejudice to other provisions of EU law that are intended to ensure stricter protection of the confidentiality of certain information, such as under the second subparagraph of Article 58(1) of Directive 2004/39/EC, which provides that '[c]ompetent authorities exchanging information with other competent authorities under this Directive may indicate at the time of communication that such information must not be disclosed without their express agreement, in which case such information may be exchanged solely for the purposes for which those authorities gave their agreement', paras 36-37.

<sup>63</sup> Case C-358/16, *UBS Europe and Others*, para. 65; Case C-594/16, *Buccioni*, para. 29.

<sup>64</sup> Case C-140/13, *Altmann and Others*, EU:C:2014:2362, paras. 34 and 35; Case C-15/16, *Baumeister*, EU:C:2018:464, para. 38; Case C-358/16, *UBS Europe and Others*, EU:C:2018:715, para. 39.

<sup>65</sup> Case C-594/16, *Buccioni*, EU:C:2018:717, paras. 37-38.

gives way to the principle of confidentiality<sup>66</sup>. As the Advocate General suggested, and the Court accepted, this demarcation between the principle of transparency and the principle of confidentiality has important repercussions as to the conditions for accessing information.

## 2 Transparency versus confidentiality

### 2.1 Confidentiality: exception or rule?

As noted above, the Public Access Decision provides for a general obligation of the ECB to disclose information when requested. On some occasions, however, the ECB is obliged to treat certain information as confidential. Such is the case for information 'of the kind covered by the obligation of professional secrecy', the proceedings of the Governing Council, and the information declared confidential by Union law.<sup>67</sup> The latter case has become much more important for the ECB after the creation of the SSM, because the law that the ECB is called to apply for the purpose of carrying out its supervisory tasks reflects the principle of confidentiality in many different situations. This creates an increasing possibility of tension between the postulate for public access under the Public Access Decision and the requirement of confidentiality.

There are basically two alternatives in resolving such a conflict. The first alternative is to treat the rules requiring confidentiality as exceptions to the overall principle of transparency. The second alternative is to accept both transparency and confidentiality as principles establishing different regimes, serving different purposes, and obeying different rationalities. The Treaty-makers or the legislator may decide that certain information should be governed by the principle of confidentiality. According to this reading, (at least some of) the rules requiring the ECB to deny public access requests defer to regimes that are governed, according to the balance struck by the Treaty-makers or the legislator, by the principle of confidentiality.

The choice between the two options has important consequences both with regard to the interpretation of rules requiring confidentiality and to the justification required for non-disclosure when EU institutions apply them. Reading confidentiality rules as exceptions to transparency would require that they are applied narrowly, like all exceptions in EU law, according to the CJEU. Moreover, it would put the EU institutions under the obligation, in line with well-established case-law of the CJEU, to provide the applicant with a statement of reasons that enables him to understand and verify how access to that information would, 'specifically and actually, have undermined the public interest' protected by the respective confidentiality provision.<sup>68</sup>

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<sup>66</sup> Opinion of Advocate General Pikamäe in Case C-442/18, *ECB v Espírito Santo Financial (Portugal)*, EU:C:2019:811, para. 39.

<sup>67</sup> See also Article 8 Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p. 8).

<sup>68</sup> See Joined Cases C-514/07 P, C-528/07 P and C-532/07 P, *Sweden and Others v API and Commission*, EU:C:2010:541, para. 72; and Joined Cases C-39/05 P and C-52/05 P, *Sweden and Turco v Council*, EU:C:2008:374, para. 49.



Prima facie, the structure of the Public Access Decision seems to support the first alternative. Like its counterpart in Regulation (EC) No 1049/2001, Article 4 Public Access Decision is entitled 'Exceptions' and contains the cases that are not covered by the general right to access documents. According to Article 4(1)(a) first indent of the Public Access Decision, the ECB shall refuse access to a document where disclosure would undermine the protection of the public interest as regards the confidentiality of the proceedings of the ECB's decision-making bodies. Article 4(1)(c) of the Public Access Decision requires such refusal where disclosure would undermine the protection of the confidentiality of information that is protected as such under Union law, such as in the case of CRD IV. This legislative technique would seem to imply that an access request for the minutes of the Governing Council or for a supervisory document falling under the confidentiality provisions of CRD IV should be treated through the lens of an exception to the individual right to access.

## 2.2 Confidentiality as rule

### 2.2.1 The general approach of the Court

The treatment of confidentiality as a principle, however, points to the second alternative. With regard to certain fields of information such the deliberations of the decision-making bodies or of supervisory information, the Treaty-makers or the legislator have opted for a different balance between the principles of confidentiality and transparency. On these occasions, the administration, including the ECB as a supervisor, and the courts have to defer to the specific rationality of the specific information field.

The case-law of the CJEU on Regulation (EC) No 1049/2001 supports this approach. The Court of Justice interpreted Regulation (EC) No 1049/2001, linking it with other applicable legal acts on a number of occasions.<sup>69</sup> In *Bavarian Lager*, the issue involved the application of Regulation (EC) No 45/2001<sup>70</sup>, which provided for the confidentiality of personal data, and Regulation (EC) No 1049/2001, which required that the institutions shall refuse access to a document where disclosure would undermine the protection of privacy and the integrity of the individual, in particular in accordance with Community legislation regarding the protection of personal data. At first instance, the General Court had applied restively the exception contained in Article 4(1)(b) of Regulation (EC) No 1049/2001. The Court of Justice disagreed with the restrictive interpretation of the General Court on the grounds that it did not correspond to the equilibrium which the Union legislature intended to establish between the two Regulations in question.<sup>71</sup>

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<sup>69</sup> Case C-139/07 P, *Commission v Technische Glaswerke Ilmenau*, EU:C:2010:376 and Case C-28/08 P, *Commission v Bavarian Lager*, EU:C:2010:378.

<sup>70</sup> Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data (OJ L 8, 12.1.2001, p.1).

<sup>71</sup> Case C-28/08 P, *Commission v Bavarian Lager*, para. 65.



The case *Commission v Éditions Odile Jacob* concerned the relationship between Regulation (EC) No 1049/2001 and Council Regulation (EEC) No 4064/89<sup>72</sup>, which governs the specific field of merger control. The Court accepted that those Regulations have different objectives when it comes to the disclosure of information. Regulation (EC) No 1049/2001 is designed to ensure the greatest possible transparency of the decision-making process of the Union institutions and the information on which they base their decisions. It is thus designed to facilitate as far as possible the exercise of the right of access to documents and to promote good administrative practices. Regulation (EC) No 4064/89, on the other hand, is designed to ensure compliance with the duty of professional secrecy in merger control proceedings. Since those Regulations do not contain a provision expressly giving one Regulation primacy over the other, the Court ruled that it is appropriate to ensure that each of those Regulations is applied in a manner compatible with the other and which enables a coherent application of them.<sup>73</sup>

One way in which the Court has allowed the principle of confidentiality to inform the application of public access rules is by allowing for general presumptions. Although, in general, in order to invoke an exception, the institution concerned must supply explanations as to how access to that document could 'specifically and actually' undermine the interest protected by the exception, the Court has allowed EU institutions to base their non-disclosure decisions on general presumptions, which apply to certain categories of documents, as similar general considerations are likely to apply to requests for disclosure relating to documents of the same nature.<sup>74</sup>

## 2.2.2 The rule of confidentiality in (banking) supervision

None of the major supervisory cases discussed above directly involved a conflict between Regulation (EC) No 1049/2001 and the confidentiality provisions of supervisory law. Indirectly, however, the Court clarified the relationship between public access and confidentiality. Both in *Altmann* and in *Baumeister* the applicants relied on national (German) law on freedom of information (*Informationsfreiheitsgesetz*)<sup>75</sup> in order to request access to various documents held by the Bundesanstalt für Finanzdienstleistungsaufsicht (German banking supervisory authority, BaFin). According to the *Informationsfreiheitsgesetz*, '[e]veryone is entitled to official information from the authorities of the Federal Government in accordance with the provisions of this Law'.<sup>76</sup> The right of access to information does not apply where the information is subject to an obligation of secrecy or confidentiality.<sup>77</sup> BaFin invoked its obligation of professional secrecy to refuse access to the documents requested. Although *Baumeister* did not call for the application of Regulation (EC) No 1049/2001,

<sup>72</sup> Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (OJ L 395, 30.12.1989, p. 1).

<sup>73</sup> Case C-404/10 P, *Commission v Éditions Odile Jacob*, EU:C:2012:393, para. 110.

<sup>74</sup> Case C-139/07, *Commission v Technische Glaswerke Ilmenau*, paras. 53, 54 and 61; Case C-404/10 P, *Commission v Éditions Odile Jacob*, paras. 122-123.

<sup>75</sup> Law on freedom of information (*Informationsfreiheitsgesetz*) of 5 September 2005 (BGBl. 2005 I, p. 2722).

<sup>76</sup> Article 1(1).

<sup>77</sup> Article 3(4).

the *Informationsfreiheitsgesetz*, which lay at the core of the question of the referring court, serves the same transparency purpose and has the same rule (transparency)-exception (confidentiality) structure as Regulation (EC) No 1049/2001. Advocate General Bot opined that the general principle laid down by the EU legislature is that of professional secrecy, and exceptions to that principle of confidentiality must be interpreted strictly and allowed only when they are expressly provided for by MiFID.<sup>78</sup>

The Court seized this opportunity to clarify that ‘the objective served by Article 54 of Directive 2004/39 differs from that pursued by Regulation (EC) No 1049/2001’.<sup>79</sup> While Article 54 MiFID seeks to protect the interests of the persons who provided information or of third parties, or the proper functioning of the monitoring system, Regulation (EC) No 1049/2001 aims to give the public a right of access to documents of the institutions of the European Union which is as wide as possible. This difference in objectives is not only theoretical. It was in light of the transparency objective of Regulation (EC) No 1049/2001, the Court explained, that the requirement has been developed for EU institutions that refuse access to a document to explain how access to that document could ‘specifically undermine the interest protected by one of the exceptions that are provided for to the right of access’. Within the field of MiFID, however, public access requests can only be granted in the situations that are listed exhaustively in Article 54.<sup>80</sup> The effects of the distinction between Regulation (EC) No 1049/2001, which gives precedence to the principle of transparency, and Article 54(1) MiFID, which has as a starting point that information that falls within its scope of application is covered by the principle of confidentiality, reflect on the scope of the obligation to state reasons where access to the requested documents is refused.<sup>81</sup> This position was taken to its logical conclusion by the Court of Justice in the *Espírito Santo* cases.

## 2.3 The Espírito Santo cases

These two cases originated in requests for public access to the decision of the Governing Council to suspend access by Banco Espírito Santo SA (BES) to monetary policy credit instruments and any other related documents.<sup>82</sup> The ECB granted the applicants partial access but refused access to the part of the minutes of the Governing Council recording the amount of credit that had been granted to BES by way of monetary policy operations. The ECB justified its refusal by arguing, amongst other things, that the credit amount was information protected by Article 10(4) Statute of the ESCB and the first indent of Article 4(1)(a) of the Public Access Decision.

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<sup>78</sup> Opinion of Advocate General Bot in Case C-15/16, *Baumeister*, para. 64.

<sup>79</sup> Case C-15/16, *Baumeister*, para. 40.

<sup>80</sup> Case C-15/16, *Baumeister*, para. 43.

<sup>81</sup> Opinion of Advocate General Pikamäe in Case C442/18, *ECB v Espírito Santo Financial (Portugal)*, para. 65.

<sup>82</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, EU:C:2019:1117; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, EU:C:2020:845.

The applicants challenged the refusal of the ECB before the CJEU. At first instance, the General Court agreed with the applicants on the issue at stake<sup>83</sup> and annulled the refusal of the ECB<sup>84</sup>. The General Court ruled that the power of the Governing Council to disclose the outcome of its deliberations was subject to limitations stemming from the public access regime, and in particular from the case-law of the Court of Justice requiring a specific form of justification for the refusal to disclose. Concretely, the ECB could deny access invoking the exception of the first indent of Article 4(1)(a) of the Public Access Decision only if it could explain 'how, *specifically and actually*, disclosure of that information would undermine the public interest as regards the confidentiality of the proceedings'<sup>85</sup>. The General Court found that the ECB had failed to explain how access to that information would, specifically and actually, have undermined the public interest as regards the confidentiality of proceedings of the ECB's decision-making bodies.<sup>86</sup> Moreover, according to the General Court, the non-disclosure of the minutes of the Governing Council had to be treated as an exception to public access and had to be interpreted and applied narrowly.<sup>87</sup> In essence, the General Court concluded that there is a right of the public to access the outcome of the Governing Council proceedings, which can only be restricted if the ECB can provide for certain specific reasons. This was a clear acceptance by the General Court of the first alternative presented above: public access forms the rule in accessing *all* ECB documents, including the minutes of the Governing Council, and confidentiality is the exception.

This finding of the General Court essentially required the ECB to examine and explain in every case the reasons supporting the confidentiality of the minutes of the Governing Council – an assessment that arguably has already been made by the Treaty-makers. The ECB therefore appealed the judgment, arguing that, according to Article 10(4) Statute of the ESCB, the minutes of the Governing Council, including the outcome of the deliberations, are confidential, and disclosure is at the discretion of the Governing Council. When adopting the Public Access Decision, the Governing Council did not limit, and did not intend to limit, its discretion to disclose the outcome of its deliberations, which is grounded in primary Union law. When it comes to the minutes of the Governing Council, the principle of confidentiality, derived by Article 10(4) Statute of the ESCB, prevails over that of transparency, which governs the Public Access Decision.

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<sup>83</sup> The General Court upheld the ECB's refusal to disclose the ceiling for the provision of emergency liquidity assistance contained in the minutes of the Governing Council. The General Court accepted the ECB's reasoning that disclosure of this information would have undermined the stability of the financial system in Portugal and its financial, monetary or economic policy.

<sup>84</sup> Case T-251/15, *Espírito Santo Financial (Portugal) v ECB*, EU:T:2018:234; Case T-730/16, *Espírito Santo Financial Group v ECB*, EU:T:2019:161. The General Court also rejected the justifications that (ii) disclosure of the amount of credit would have undermined one of the following: the financial, monetary or economic policy of the Union or a Member State; the protection of the stability of the financial system in the Union or in a Member State; or the commercial interests of Novo Banco, the economic successor of BES. Critical for this finding was the fact that the approximate amount of credit had been already disclosed *inter alia* by Banco de Portugal.

<sup>85</sup> Case T-251/15, *Espírito Santo Financial (Portugal) v ECB*, para. 65; Case T-730/16, *Espírito Santo Financial Group v ECB*, para. 61, emphasis added.

<sup>86</sup> Case T-251/15, *Espírito Santo Financial (Portugal) v ECB*, para. 124; Case T-730/16, *Espírito Santo Financial Group v ECB*, para. 111.

<sup>87</sup> Case T-251/15, para. 78; Case T-730/16, *Espírito Santo Financial Group v ECB*, para. 58.

According to Advocate General Pikamäe, this was a valid reading of secondary law (the Public Access Decision) in light of a primary law provision (Article 10(4) Statute of the ESCB). According to his Opinion, secondary law rules on access to documents cannot have the effect of, largely, frustrating the effectiveness of the exclusion of the ECB from the institutions to which the principle of transparency applies under Article 15(3) TFEU. Nor can those rules replace the principle of confidentiality with the principle of transparency, with the effect that disclosure of the outcome of the deliberations of the Governing Council would be the rule, and the confidentiality of that outcome would be merely the exception.<sup>88</sup> The General Court had therefore erred when applying by analogy the case-law developed under Regulation (EC) No 1049/2001 to requests for the minutes of the Governing Council.<sup>89</sup> Regulation (EC) No 1049/2001 reflects the principle of transparency. However, the first indent of Article 4(1)(a) Public Access Decision, read in conjunction with Article 15(3) TFEU, Article 10(4) of the Statute of the ESCB and Article 23(1) of the Rules of Procedure of the ECB, starts from the premise that deliberations of the Governing Council are covered by the principle of confidentiality.<sup>90</sup>

The Court of Justice accepted the arguments of the ECB and quashed the contested part of the General Court's rulings.<sup>91</sup> It also gave final judgment on the substance of the matter, dismissing the request of the applicants to access the critical part of the minutes of the Governing Council.<sup>92</sup> According to the Court of Justice, the outcome of the Governing Council's deliberations, like the deliberations themselves, is confidential. The disclosure of the outcome of the Governing Council deliberations is an 'exclusive competence conferred on the Governing Council'.<sup>93</sup> The Director General Secretariat, who is responsible for responding to public access requests according to the Public Access Decision, is required to refuse to grant access to the outcome of deliberations of the Governing Council, unless the latter has decided to make that outcome public in whole or in part.<sup>94</sup> The refusal to disclose the outcome of the deliberations is not subject to the additional condition that the ECB proves how the disclosure would 'undermine the protection of the public interest'.<sup>95</sup> When refusing to disclose documents recording the outcome of the proceedings, the ECB does provide

<sup>88</sup> Opinion of Advocate General Pikamäe in Case C-442/18, *ECB v Espírito Santo Financial (Portugal)*, para. 49.

<sup>89</sup> Opinion of Advocate General Pikamäe in Case C-442/18, *ECB v Espírito Santo Financial (Portugal)*, paras. 57-59.

<sup>90</sup> Opinion of Advocate General Pikamäe in Case C-442/18, *ECB v Espírito Santo Financial (Portugal)*, para. 66.

<sup>91</sup> The General Court had also annulled the ECB's refusal to disclose the information redacted from the Executive Board proposals of 28 July and 1 August 2014 as the ECB refusal to disclose was not sufficiently justified. The ECB had decided, guided by the Executive Board, not to contest this part of the original judgment. The Court interpreted in a broad way the appeal of the ECB as also requesting to quash the original decision of the General Court referring to the proposals of the Executive Board. Based on this broader interpretation of the ECB's request, the Court ruled it inadmissible due to lack of specific reasons; see Case C-442/18, *ECB v Espírito Santo Financial (Portugal)*, paras. 31-32; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, paras 24-26.

<sup>92</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, para. 57; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, para. 64.

<sup>93</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, para. 42; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, para. 50.

<sup>94</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, para. 44; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, para. 51. It can also be derived from this that individual members of the Governing Council are not authorised to disclose the outcome of the deliberations.

<sup>95</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, para. 43; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, para. 50.

an adequate statement of reasons by solely referring to the requirements of the first indent of Article 4(1)(a) of Decision ECB/2004/3<sup>96</sup>, namely by invoking that the requested document is part of the minutes.

These judgments clarify the relationship between transparency and confidentiality in a way that can be also relevant for supervisory documents. Indeed, Advocate General Pikamäe explicitly drew parallels between the supervisory law regime, as treated in *Baumeister*, and access to the minutes of the Governing Council.<sup>97</sup> The *Espírito Santo* cases explain that for some categories of documents, the Treaty-makers (or the legislator) may have decided in favour of the principle of confidentiality. On these occasions, confidentiality is the rule, and access is the exception. This equilibrium takes into consideration various interests, including, crucially, the trust that is necessary for the effective working of composite systems, where Union authorities and national authorities form a highly integrated whole, such as the SSM and the ESCB. In practical terms, this equilibrium should be reflected in the interpretation of the exceptions and in the form of justification required by the ECB. The fact the Public Access Decision, for operational reasons, calls these cases 'exceptions' does not change this fundamental balancing.

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<sup>96</sup> Case C-442/18 P, *ECB v Espírito Santo Financial (Portugal)*, para. 55; Case C-396/19 P, *ECB v Estate of Espírito Santo Financial Group*, para. 45.

<sup>97</sup> Opinion of Advocate General Pikamäe in Case C-442/18, *European Central Bank v Espírito Santo Financial (Portugal)*, *SGPS, SA*, paras. 61-64.

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# The rule of professional secrecy in banking supervision (Hillenius, Altmann and Baumeister) and exceptions to professional secrecy (Buccioni)

By Cristina Pérez Cajal<sup>1</sup>

## 1 Introduction

In the last years, several preliminary rulings of the Court of Justice of the European Union have shed a new light on the concept and the limits of the rule of professional secrecy in banking supervision.

The compliance with professional secrecy is a matter which accounts for a great deal of time and analysis for many in-house lawyers of supervisors, normally articulated in the question of whether a document *may* be disclosed or *shall* be disclosed. But it is not only an internal matter of interest for supervisors. It is also very relevant for supervised entities, as it impacts the extent to which they can access their file held by the supervisor and the exercise of certain rights, such as the right of defence, and, more broadly, for the different stakeholders of the financial industry. In fact, the disputes that gave rise to the preliminary rulings referred to above were brought, not by supervised entities themselves, but by investors, depositors or managers of these entities.

In the case of banking supervisors in the European Union, the obligation of professional secrecy derives from a directive, the Capital Requirements Directive (CRD)<sup>2</sup>. Since a directive needs to be transposed, this means that the professional secrecy duty of banking supervisors is effectively established in 27 national laws, and no less than 21 national laws within the Single Supervisory Mechanism (SSM)<sup>3</sup>. This can obviously lead to certain fragmentation within the Union and even within the SSM.

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<sup>1</sup> Head of the Regulatory and Supervisory Advice Division, Banco de España.

<sup>2</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>3</sup> Participating Member States in the SSM include Member State whose currency is the euro (currently 19) and those whose currency is not the euro which have established a close cooperation between the ECB and the National Competent Authority (NCA) of such Member State. On 24 June 2020, the Governing Council of the ECB adopted a decision to establish close cooperation with Българска народна банка (Bulgarian National Bank) and with Hrvatska narodna banka (Croatian National Bank), following the fulfilment of the necessary supervisory and legislative prerequisites (see respectively decision ECB/2020/30 and ECB/2020/31, OJ L 2241, 13.7.2020, p. 1–3). Since 1 October 2020, the ECB is in charge of the direct supervision of the significant institutions established in the Republic of Bulgaria and in the Republic of Croatia, the common procedures for all supervised entities, as well as of the oversight function over the conduct of supervision of less significant institutions performed by the respective NCA. Therefore, as of today, there are 21 participating Member States in the SSM.



In the case of the European Central Bank (ECB), the confidentiality obligation is established in Article 37 of the ESCB Statute and, for the specific case of its supervisory functions, in Article 27 SSM Regulation<sup>4</sup>, which refers to “the professional secrecy requirements set out in [...] the relevant acts of Union law”, i.e. notably, Article 53 of the CRD.

The basic principle of the rule of professional secrecy, as established in Article 53 of CRD, is the obligation for banking supervisors not to disclose any confidential information or documentation received in the exercise of their duties. This obligation extends to their current and former staff and to any experts acting on their behalf. The protected information can either be information received from supervised entities, from other competent authorities, or statements or reports established by the supervisor.

This rule has a number of exceptions that allow the banking supervisor to disclose confidential information under certain conditions. Some of these exceptions allow disclosure to certain addresses (such as authorities or courts) and others refer to the nature of the information to be disclosed (such as aggregate information or the outcome of stress tests)<sup>5</sup>.

In general, these exceptions designate situations where disclosure is authorised under Union law. By contrast, the existence of a legal duty of disclosure must be based on other provisions of national or Union law. For instance, Union law not only allows but requires disclosure of information in the context of exchange information between supervisors of the Union<sup>6</sup>. This exchange is a fundamental premise of the European passport and the single market of financial services.

The professional secrecy rule for banking supervisors is therefore defined by the interplay of these three elements: the basic principle, its exceptions and the obligation to disclose information to other EU authorities, where applicable.

It is important to mention at this stage that similar obligations are foreseen for the investment and insurance sectors in MiFID II<sup>7</sup> and Solvency II<sup>8</sup>, respectively. This is certainly warranted, given that the supervisors of the three sectors are expected to collaborate and in some Member States both tasks are carried out by the same authority.

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<sup>4</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>5</sup> See Articles 53-61 CRD.

<sup>6</sup> By way of example, see Article 50(1) CRD: “The competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of institutions operating, in particular through a branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another with all information concerning the management and ownership of such institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of institutions, in particular with regard to liquidity, solvency, deposit guarantee, the limiting of large exposures, other factors that may influence the systemic risk posed by the institution, administrative and accounting procedures and internal control mechanisms”.

<sup>7</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

<sup>8</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (OJ L 335, 17.12.2009, p. 1).

The confidentiality rules in the three sectors share a common core and very similar wording, but they differ in certain aspects. Some differences are of substance. For example, Article 76(1) MiFID II allows the disclosure of confidential information to tax authorities while CRD and Solvency II do not contain such an exception. In other cases, the provisions are worded slightly differently without an evident explanation. This raises the doubt of whether a harmonised interpretation is justified or, conversely, a sectoral interpretation should prevail.

Let me anticipate that, overall, the Court of Justice of the European Union has leaned towards a holistic and parallel interpretation of the applicable professional secrecy regime across the three sectors<sup>9</sup>. Therefore, the case law for one sector has an impact on the reading of the rules of the other sectors. However, as the next sections will describe, the differences in wording have also called for a different interpretation in rulings concerning one specific exception.

The following sections will analyse the various judgments of the Court of Justice on the rule of professional secrecy of financial supervisors, in order to explain the purpose of the confidentiality rule (Hillenius<sup>10</sup>), its exceptions (Altmann<sup>11</sup>), the definition of confidential information (Baumeister<sup>12</sup>) and how the rule applies to the particular case of banks in liquidation (Buccioni<sup>13</sup>).

## 2 Hillenius

The first case in which the Court of Justice analysed the professional secrecy rule in any of the financial sectors was Hillenius.

The case goes back to 1985 and concerns the interpretation of professional secrecy provisions in the First Banking Directive<sup>14</sup>. Therefore, while some of its conclusions are still valid, others are no longer relevant because the directive has changed significantly.

In the main case, the Dutch municipality of Hillegom –that had deposited HFL 600,000 with the Amsterdam American Bank NV, which had in the meantime been declared insolvent– sought an order to call Mr. Hillenius as a witness in a civil proceeding with a view to filing a damage claim. The request was based on the obligation to give evidence established in the Dutch civil procedural regulations. Mr. Hillenius, who was an officer of the Dutch supervisor, claimed that he should be exempted from the obligation to give evidence on the basis of the confidentiality obligation established in the banking regulations transposing the First Banking Directive. The dispute on what obligation should prevail reached the Hoge Raad (the Supreme Court of the

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<sup>9</sup> See Smits, R. and Badenhoop, N. (2019).

<sup>10</sup> Case C-110/84, *Commune de Hillegom v Cornelis Hillenius*, EU:C:1985:495.

<sup>11</sup> Case C-140/13, *Altmann and others*, EU:C:2014:2362.

<sup>12</sup> Case C-15/16, *Bundesanstalt für Finanzdienstleistungsaufsicht v Ewald Baumeister*, EU:C:2018:464.

<sup>13</sup> Case C-594/16, *Buccioni*, EU:C:2018:717.

<sup>14</sup> First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 322, 17.12.1977, p. 30).

Netherlands), which referred the matter to the Court of Justice for a preliminary ruling. The main question was whether the confidentiality obligation of the supervisor also applies when a supervisor is called to give evidence in a civil action.

In its judgment, the Court started by examining the purpose of the confidentiality obligation, setting a view that has been upheld in subsequent judgments and still fully maintains its relevance to date.

The court concluded that “If the monitoring of banks through supervision within a Member State and the exchange of information by the competent authorities is to function properly, it is necessary to protect professional secrecy. The disclosure of confidential information might have damaging consequences not only for the credit institution concerned but also for the banking system in general. Consequently, if there was no duty to keep confidential information secret, the obligatory exchange of information between competent authorities might be jeopardised because the authority of the Member State could not be sure that the confidential information it provides to an authority in another Member State will in principle remain confidential.”<sup>15</sup>

Close examination of this statement reveals that, in the view of the Court of Justice, the confidentiality obligation serves three types of interests. First, those of the credit institution concerned, by protecting its business secrets. Banks need to be sure that the information that they provide will be kept confidential, otherwise cooperation will be compromised and effective supervision will be put into question. Second, the public interest of the Member State, which needs to rely on the health of the financial system which in turn depends on its effective supervision. And finally, the single market for financial services, which relies on joint oversight by different authorities which need to trust each other.

Therefore, by extending the aim of the obligation to cover also a public interest objective, the Court of Justice rejected a narrow interpretation of the professional secrecy obligation according to which it would only aim to protect the interest of the supervised entities. Such narrow interpretation, which was not followed by the Court, would have allowed to set aside the secrecy obligation in case of bankruptcy of the concerned entity, as was the case in *Hillenius*, or in case of fraud, as was the in case in *Altmann*<sup>16</sup> and in *Baumeister*.

Consequently, the Court of Justice concluded that in principle the professional secrecy obligation also applies when supervisors are called as witnesses in civil proceedings.

After establishing that the declarations in civil proceedings are in principle covered by the professional secrecy rule, the Court of Justice analysed whether a national law could establish an exception for the case of the provision of evidence in a civil proceeding. And here is where the ruling in *Hillenius* has to be taken with caution because it is partially obsolete due to legislative changes. Instead of the detailed list of exceptions included today in the CRD, the First Banking Directive contained a broad provision which allowed disclosure of confidential supervisory information “by virtue of

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<sup>15</sup> Case C-110/84, *Commune de Hillegom v Cornelis Hillenius*, para. 27.

<sup>16</sup> See *Farinhas, C.* (2019).

provisions laid down by law”<sup>17</sup>. It is in this context, that the Court of Justice concluded that national laws could establish an open list of exceptions. Should one of those exceptions be the giving of evidence in civil proceedings and if the national law had not resolved the conflict with the secrecy obligation of the banking supervisor, as was the case at the time, the national court should find the right balance between the conflicting interests before deciding whether or not a witness who has received confidential information in the exercise of supervisory duties may rely on its duty of non-disclosure. In the weighing up those interests the national court must in particular decide what importance is to be attached to the fact that the information in question was obtained from the competent authorities from other Member States. However, after Hillenius, a detailed list of specific disclosure exceptions, including one for the case of credit institutions declared bankrupt, was included in CRD, making this part of the judgment obsolete. The analogous exception for the supervision of investment firms is examined in Altmann.

### 3 Altmann

Altmann is the first of the recent string of preliminary rulings that have dealt with the rule of professional secrecy, almost 19 years after Hillenius. It was issued in 2014 and refers to the exceptions to the professional secrecy rule contained in MiFID I<sup>18</sup>, particularly the one regarding investment firms that have been declared bankrupt or are being compulsorily wound up<sup>19</sup>.

In the main case, Mr. and Mrs. Altmann sought access from the Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority (BaFin), to documents related to Phoenix, an investment firm in compulsory liquidation whose business model involved a Ponzi scheme which had led to the application of criminal sanctions. The request was based on national freedom of information rules and included audit reports, file notes, internal opinions and activity and field reports produced by the investor compensation fund. The request did not include business or trade secrets of third parties. BaFin largely acceded to the request but denied access to certain selected information (including a special audit report) on the basis of the professional secrecy rule. The decision was challenged before the German courts and after several appeals the Bundesverwaltungsgericht (the Federal Administrative Court of Germany) referred the matter to the Court of Justice for a preliminary ruling.

The question referred to the Court was, in essence, whether a supervisor such as BaFin can rely on its professional secrecy obligation, against a person who has applied for access under freedom of information rules, to deny access to information concerning a particular financial services provider which is in liquidation and has been involved in a large scale fraud recognized by a criminal court.

<sup>17</sup> See Article 12(1) of the First Banking Directive.

<sup>18</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

<sup>19</sup> Article 54 MiFID I. This provision is currently regulated in Article 76(2) MiFID II, with no relevant differences.

The Court of Justice started again by reviewing the purpose of the secrecy obligation, fully upholding Hillenius, also in the MiFID I context (an example of parallel cross sectoral interpretation). However, contrary to Hillenius and in view of the inclusion in MiFID I of a detailed list of exceptions, it concluded very clearly that there are no exceptions to confidentiality other than those specifically provided for in the directive. Therefore, Member States cannot add other exceptions<sup>20</sup>.

While the judgment of the Court does not expressly address the reconciliation of this principle with the principle of transparency in public administration, Advocate General Jääskinen spelled out that, in his opinion, freedom of information requests can only be granted to the extent that they can fit in one of the exceptions to professional secrecy provided for in the Directive and that a balance of interest exercise can only be carried out if disclosure is possible under the applicable exception<sup>21</sup>.

As to the possibility to apply any of the exceptions to the specific case, the Court of Justice first analysed and rejected the application of the exception foreseen for cases provided for in criminal law since, despite the fraudulent nature of the activities conducted by Phoenix, the context of the request was an administrative proceeding reviewing a request for access, not a criminal one.

As to the exception regarding investment firms in liquidation included in MiFID I, the Court of Justice examined the three conditions required for the application of the exception, namely (i) information must not concern third parties; (ii) it must be divulged in civil or commercial proceedings, and (iii) it must be necessary for carrying out that proceeding.

In this case, compliance with the first requirement was undisputed, so the analysis focused on the second. Advocate General Jääskinen produced a very detailed opinion<sup>22</sup> in which he argued that such condition required the civil proceedings to be pending and therefore disclosure was not possible in the case at hand. He argued that the exception does not extend to requests whose purpose is to obtain confidential information held by the competent supervisory authority, so as to discover whether any of that information might assist in a subsequent, independent claim, not being part of existing civil or commercial proceedings.

The Court of Justice, while confirming that disclosure was not possible in the case at hand, produced a much more succinct judgment, in which it merely stated that the case concerned an administrative proceeding not a civil one and hence the requirement was not met<sup>23</sup>. As will be explained later, the differences in detail between the opinion of the Advocate General and the ruling will become relevant in Buccioni.

The bankruptcy of Phoenix, therefore, gave the Court of Justice the opportunity to clarify that (i) Member States cannot add exceptions to the professional secrecy rule other than those contained in the Directive, and (ii) a competent authority supervising

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<sup>20</sup> See Case C-140/13, *Altmann and others*, paras. 34 and 35.

<sup>21</sup> Opinion of Advocate General Jääskinen in Case C-140/13, *Altmann and others*, EU:C:2014:2168, paras. 31 to 33.

<sup>22</sup> Opinion of Advocate General Jääskinen in Case C-140/13, paras. 52 to 56.

<sup>23</sup> See Case C-140/13, *Altmann and others*, paras. 39 and 40.

MiFID I cannot rely on the exception of firms in liquidation to disclose information in an administrative proceeding based on freedom of information rules. But that is not all, because the next case also relates to Phoenix.

## 4 Baumeister

Baumeister is a very relevant judgment in which the Court of Justice clarified the very concept of confidential information. It was issued in 2018.

Mr. Baumeister was one of the investors in Phoenix, the same firm at stake in Altmann. He also relied on freedom of information rules before BaFin to access several documents concerning Phoenix. BaFin invoked its obligation of professional secrecy to refuse access to some of them and this decision was challenged and later appealed.

The matter reached the Bundesverwaltungsgericht which referred to the Court of Justice three questions regarding the interpretation of Article 54(1) MiFID I.

The first question was which information held by the supervisory authority was covered by the term “confidential information”. Should all information held by the supervisor be classified as confidential without further conditions? Or only part of it? If so, what are the criteria to qualify a piece of information as confidential?

The second question pointed at the relevant date for determining the confidentiality.

The third question regarded a possible time-limit of five years after which information could be presumed not to be confidential anymore.

Due to the relevance of the case, the judgment was delivered by the Grand Chamber.

As regards the concept of confidential information, Advocate General Bot argued strongly in favour of an all-inclusive confidentiality of the whole supervisory file. Focusing on the preventive function of supervision and the need to preserve the confidence of supervised entities and other supervisors, he considered that all information relating to a supervised undertaking and received or drawn up by the supervisor is included, without any other requirement, in the concept of confidential information and therefore protected by the professional secrecy rule. This would apply even if the requested information is of public nature<sup>24</sup>. However, the Court of Justice did not endorse this approach.

The Court of Justice first noted that while MiFID I did not state explicitly which information is to be classified as confidential, the fact that Article 54 refers repeatedly to “confidential information” and not, generically, to “information”, implies that a distinction should be drawn between confidential information and other information that is not confidential which the competent authorities hold in connection with the exercise of their functions. Also, since MiFID I made no reference to national law with

<sup>24</sup> In this respect, Advocate General Bot considered that the role of the authorities is not to function as a one-stop shop. Opinion of Advocate General Bot in Case C-15/16, *Bundesanstalt für Finanzdienstleistungsaufsicht v Ewald Baumeister*, EU:C:2017:958, paras. 53, 54 and 65.

respect to the determination of the meaning and scope of the concept of confidential information, in accordance with the Court's settled case law, the concept must be given an independent and uniform interpretation throughout the European Union. Finally, the Court considered that it cannot be inferred from the wording, the context or the objectives of the directive, that it is mandatory that all information held by the supervisor and relating to the supervised entity is confidential.

In order to qualify as confidential, information must comply with two cumulative criteria, which are closely linked to the purpose of the confidentiality rule as established in *Hillenius* and *Altmann*. First, the information must not be public; and, second, the disclosure of such information must be likely to affect adversely (i) the interest of the natural or legal person who provided the information or of third parties; or (ii) the proper functioning of supervision<sup>25</sup>. And all of the above without prejudice to other provisions of EU law that intend to ensure stricter protection (for example, to information provided by other EU supervisors, which cannot be disclosed without their consent).

The Court of Justice also clarified that exceptions to confidentiality do not confer a right of access under freedom of information rules. Consequently, such a right of access would need to be based on another provision than Article 54 MiFID and could only lead to disclosure if one of the exceptions Article 54, which is a *lex specialis*, is applicable<sup>26</sup>. The Court also clarified that, while Member States cannot extend the list of exceptions to professional secrecy in Article 54 MiFID (which is a closed list), they remain free to extend the protection against disclosure to the entire content of the supervisory file<sup>27</sup> or, conversely, permit access to information which is not confidential. Both regimes would be compliant with the directive, which only imposes a minimum<sup>28</sup>.

As regards the second question, the Court of Justice considered that the passage of time is a circumstance that is normally liable to have an influence on the analysis of whether the conditions governing the confidentiality of the information concerned are satisfied at a given point in time. Therefore, the Court ruled that confidentiality of the information must be assessed at the time of examination of the request for disclosure, irrespective of how that information was classified when it was communicated to the supervisor.

Finally, as to the question of a possible five-year time bar on confidentiality, the Court of Justice distinguished between information classified as confidential on account of constituting business secrets and on other accounts. Following previous case law regarding the protection of business secrets, the court found that as a rule, after five years, this information should be considered historical and therefore as having lost its

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<sup>25</sup> Case C-15/16, *Bundesanstalt für Finanzdienstleistungsaufsicht v Ewald Baumeister*, paras. 34 to 37.

<sup>26</sup> The Court of Justice seems to follow here the approach of Advocate General Jääskinen in *Altmann*. Specifically, the Court held that "However, where an individual submits to the competent authorities a request for access to information relating to a supervised entity and they consider, having regard to the cumulative conditions laid down in paragraph 35 of the present judgment, that the information requested is confidential, within the meaning of Article 54(1) of Directive 2004/39, they can grant such a request only in the situations that are listed exhaustively in Article 54." (para. 43).

<sup>27</sup> This is the case of Spain, in accordance with Article 82 of Law 10/2014 of June 26 on the regulation, supervision and solvency of credit institutions (BOE-A-2014-6726).

<sup>28</sup> Case C-15/16, *Bundesanstalt für Finanzdienstleistungsaufsicht v Ewald Baumeister*, paras. 39 to 44.



confidential nature. However, this presumption can be overruled if the party invoking confidentiality proves that such information may still qualify as a business secret, i.e. that it still constitutes an essential element of its commercial position or that of interested third parties. Regarding information classified as confidential on other accounts, such as information related to the supervision methodology and strategy employed by the competent authorities, the Court of Justice clarified that such a presumption does not apply and that confidentiality should be preserved as long as the requirements of confidentiality persist.

## 5 Buccioni

If in *Altmann and Baumeister* the Court of Justice focused on MiFID I, in *Buccioni* the Italian Consiglio di Stato asked the Court of Justice to interpret the equivalent provision of CRD regarding banks in liquidation, with a quite unexpected result.

The background dispute concerns the request of Mr. Buccioni before Banca d'Italia to access some documents related to Banca Network Investimenti, SpA, a bankrupt bank in which he was a depositor and where he had lost over 80,000 euros in excess of the coverage of the deposit guarantee fund. The basis of the request was the right to access administrative documents and its purpose included evaluating whether it was appropriate to file a damage claim against Banca d'Italia. As Banca d'Italia partially denied his request for access to documents, Mr. Buccioni challenged the decision and the dispute eventually reached the highest national instance, the Consiglio di Stato.

The referring Court sought to clarify whether the third subparagraph of Article 53(1) CRD, which provides that certain information “may be disclosed in civil or commercial proceedings”, should be interpreted as precluding supervisory authorities from disclosing information to a person who requests access in order to be able to bring civil or commercial proceedings. In other words, is the exception limited to information disclosed (i) in the course of pending proceedings (as Banca d'Italia contended); or (ii) also for the purposes of (potential) civil or commercial proceedings?

At this point, one could probably assume that the answer was clear, since in the *Altmann* case the Court of Justice seemed to have interpreted the equivalent provision in MiFID I as meaning “in the course of pending proceedings”<sup>29</sup>, rather than “for the purposes” of bringing potential proceedings. However, the case took a rather unexpected turn and the Court of Justice, following the opinion of Advocate General Bobek<sup>30</sup>, took the view that disclosure under the third subparagraph of Article 53(1) of CRD does not necessarily require that the civil or commercial proceedings are already pending.

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<sup>29</sup> Case C-140/13, *Altmann and others*, para. 39: “It does not appear from the order for reference that the dispute in the main proceedings, which concerns an administrative procedure relating to a request for access to information and documents held by a national supervisory authority on the basis of the IFG, is covered by criminal law, since that request was submitted after the criminal convictions of Phoenix’s executives, nor that it is made in the course of civil or commercial proceedings brought by the applicants in the main proceedings.”

<sup>30</sup> Opinion of Advocate General Bobek in Case C-594/16, *Enzo Buccioni v Banca d'Italia*, EU:C:2018:425.

As Smits and Badenhoop (2019) put it:

“The judgement in *Buccioni* is remarkable in two ways. First, it contains a holistic approach to financial services supervision by establishing a parallel interpretation of both MiFID I and CRD IV provisions on professional secrecy and by repeatedly referring to its previous case law on investment services (*Altmann and Baumeister*). Secondly, the CJEU partially follows AG Bobek in his wide interpretation of the derogation ‘in civil and commercial proceedings’ by allowing that these proceedings are not yet started but about to be started once the requested information is accessed. However, the CJUE establishes a more prudent approach to professional secrecy as it grants the supervisory authorities and the national courts a wide discretion in weighing the applicant’s informational interest against the opposing interests protected by the principle of secrecy.”

According to the Court of Justice and the opinion of the Advocate General, this ruling does not contrast with *Altmann* due to the existence of several differences.

On the one hand, it was noted that, while the opinion of the Advocate General in *Altmann* was very clear in specifying that the judicial proceedings must be already pending, the ruling of the Court of Justice in the case did not explicitly establish such a requirement. But even assuming that such requirement was implicit in the *Altmann* ruling, Advocate General Bobek put forward several arguments in favour of not applying an analogous reasoning to this case.

First, he noted that a careful comparison of the provisions regulating the exceptions to professional secrecy in MiFID I and in CRD shows that there are slight differences in wording<sup>31</sup>. Indeed, MiFID I allows to exclude any information concerning any third party, while CRD requires that those third parties are involved in an attempt to rescue the bank. Also, MiFID I explicitly requires that the information is necessary for carrying out the proceedings, requirement which is not foreseen in CRD. Therefore, it could be argued that CRD allows for more disclosure than MiFID I and that both provisions need not necessarily have the same scope.

Also, in terms of procedure, it was confirmed that the winding up procedure concerning the bankrupt bank was still ongoing and that Mr. *Buccioni* had participated in the proceedings as an unsecured creditor. However, access to documents such as the ones he requested from the Banca d’Italia could apparently not have been granted to him within the winding up procedure by means of a request to the liquidators (because liquidators did not possess the types of documents requested) and had to be sought through an administrative proceeding. If the documents cannot be obtained in the civil or commercial proceeding, because the procedural rules do not allow it, and

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<sup>31</sup> Please see below the relevant articles for comparison.  
Article 53(1) third subparagraph CRD IV:  
“Nevertheless, where a credit institution has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties involved in attempts to rescue that undertaking may be divulged in civil or commercial proceedings.”  
Article 54(2) MiFID I:  
“Where an investment firm, market operator or regulated market has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties may be divulged in civil or commercial proceedings if necessary for carrying out the proceeding.”  
The provision in Article 54(2) MiFID I is currently contained in Article 76(2) MiFID II, with no remarkable differences.

cannot be obtained in an administrative proceeding, because the secrecy obligation is interpreted very narrowly, when would the exception apply?

More importantly, on substance, Advocate General Bobek considered that requiring an applicant to bring an action (to be able to obtain the information) in order to find out whether there is a ground to bring an action (to protect his proprietary interest) would undermine the needs of the proper administration of justice.

Considering the differences with Altmann and pondering the effects on the proper administration of justice, the Court of Justice eventually took the view that disclosure was not limited to civil or commercial proceedings that have already been initiated.

Still, considering that derogations need to be interpreted strictly, the Court of Justice made disclosure conditional on stringent conditions. First, access can only be sought by persons directly concerned by the winding up. Second, the applicant must put forward precise and consistent evidence plausibly suggesting that the information is relevant for the purposes of civil or commercial proceedings which are under way or to be initiated, the subject matter of which must be specifically identified by the applicant and without which the information in question cannot be used. And, third, it remains within the supervisor discretion to grant access, as long as it weights correctly the interest of the applicant in having the information in question and the interest connected with maintaining the confidentiality of the information covered by the obligation of professional secrecy (subject of course to the control of the Courts). So, in a way, the Court of Justice went back to Hillenius in this last requirement.

Having explained the case and the ruling, I would like to bring up an example of the difficulties that the transposition of CRD may introduce. In particular, in the case of Spain, the law transposing this exception requires that the information must be requested by the Court<sup>32</sup>. In practice, this implies that the proceedings must be already pending. Therefore, the conclusions of Buccioni have to be taken with caution and in light of the applicable national law.

## 6 Conclusion

The regulation of the professional secrecy rule in the financial sector in three different directives which are transposed in 27 national laws gives rise to fragmentation, both between Member States and across sectors. Considering only the banking sector and the SSM, this involves 21 national laws transposing the CRD, which are not always a verbatim transposition, and which have sometimes been interpreted by the respective competent authorities in a divergent way.

While the ECB resorts to a uniform interpretation based on CRD when it exercises the tasks for which it is directly competent, this does not entirely solve the possible lack of coherence within the SSM, given that differences in application and interpretation may

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<sup>32</sup> Article 82(3)(d) of Law 10/2014 of June 26 on the regulation, supervision and solvency of credit institutions (BOE-A-2014-6726).

remain between significant and less significant institutions in a Member State or between less significant institutions of different Member States.

The judgments in Hillenius, Altmann, Baumeister and Buccioni have shown that the Court of Justice tends to adopt a harmonised approach when interpreting the professional secrecy provisions contained in the directives applicable to the supervision of the banking and investment sectors. Indeed, the different judgments expressly acknowledge an identical purpose of the professional secrecy rule regulated in CRD and MiFID I, and include continuous cross references between them that indicate that overall the Court of Justice does not conceive the different directives in isolation, but rather as an integrated framework.

In these rulings, the Court of Justice has provided guidance for the interpretation and application of the professional secrecy rule, fostering uniform application by the competent authorities and cautiously moving towards more transparency, particularly in Baumeister and Buccioni.

While this is indeed a most valuable contribution, the support that the Court of Justice can provide towards the aim of a coherent framework is limited. Uniform interpretation is subject to the variations between the directives regulating the professional secrecy rule for the different financial sectors and will not always allow to overcome the changes that transposition may have introduced in the regulation. And this has an impact on the level playing field in the banking sector which is particularly strange to the functioning of integrated mechanisms such as the SSM.

Therefore, it seems that there is room for further harmonisation, for example by establishing the professional secrecy rule in a regulation, such as CRR, instead of having it enshrined in a directive<sup>33</sup>. However, for the time being, legal practitioners facing this matter will have to use their best possible judgement with the guidance provided by the Court of Justice.

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<sup>33</sup> Certain scholars suggest the adoption of a single European professional secrecy standard for the supervision of the financial sector. Smits, R. and Badenhoop, N. (2019), in their remarkable study about this subject, proposed the adoption of a new legal act in the form of a regulation based on Article 114 of the TFEU, which would institute a single standard directly applicable across Member States and supervisory authorities of the three sectors. They also argued that this harmonisation effort should lead to enhanced transparency of supervisory files and incorporate the guidance of the recent jurisprudence.

Pascua Mateo, F. (2018), "Harmonising national sanctioning administrative law: An alternative to a single capital-markets supervisor", *European Law Journal*, Vol. 24 Issue 4-5, pp. 321-348.

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Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 322, 17.12.1977, p. 30).

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (OJ L 335, 17.12.2009, p. 1).

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# The interaction between the rule of professional secrecy and the rights of defence. Access to files in supervisory procedures

By Carmen Hernández Saseta<sup>1</sup>

## 1 Introduction

In financial supervision in general and in banking supervision in particular, Union law foresees a general rule prohibiting competent authorities from disclosing information protected by professional secrecy<sup>2</sup>. This means that competent authorities may only communicate or exchange confidential information in those specific cases allowed for, as an exception, by the legal framework.

For the purpose of conducting the supervisory tasks conferred on the ECB by the **SSM Regulation**<sup>3</sup> the ECB is considered to be the competent authority, as established by the relevant Union law, and has the same powers<sup>4</sup>. Moreover, Article 27 of the SSM Regulation establishes the professional secrecy requirements with which the ECB must comply when carrying out supervisory duties. According to this provision, when carrying out its supervisory tasks the ECB is subject not only to the professional secrecy requirements of the Statute of the ESCB and the ECB but also to those requirements established in the relevant Union law.

The important role of professional secrecy in banking supervision has been confirmed by the Court of Justice from the outset. In this regard the Court has emphasised that the goal of professional secrecy is to protect not only the interests of the firms directly

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<sup>1</sup> Adviser, Supervisory Law Division, Directorate General Legal Services, European Central Bank.

<sup>2</sup> All acts of Union law currently in force with regard to the supervision of investment services (**MiFID II**), credit institutions (**CRD IV**) and insurance and reinsurance (**Solvency II**) contain a professional secrecy obligation which applies to the respective supervisory authorities. In particular, Article 76(1) of MiFID II (Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU); Article 53(1) of CRD IV (Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC); Article 64 of Solvency II (Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance) establish the rules governing professional secrecy.

<sup>3</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>4</sup> Article 9 of the SSM Regulation.

concerned but also the public interest in respect of the normal functioning of the markets and the proper functioning of the supervisory system<sup>5</sup>.

Having said this, the rule of professional secrecy is not absolute. In recent cases handled by the Court in relation to professional secrecy in financial supervision it has become evident that the rule should be implemented in a manner that reconciles it with other coexisting interests, in particular the protection of the rights of defence.

The ECB may be confronted by situations in which the interests of certain natural or legal persons may conflict with the rule prohibiting the disclosure of confidential information. A careful balancing of the interests should be conducted in this regard. This article intends to review how the ECB deals with these situations in practice and, specifically, how the ECB grants the right to access the files of parties in supervisory procedures to parties negatively affected by supervisory decisions.

## 2 The right to access the files: rationale and purpose

The rationale and purpose of the right to access the files should inform the interpretation of the legal framework and the exercise of judgement in granting access to the file.

The right to access the files is a procedural guarantee which forms part of the rights of defence of persons negatively affected by a measure adopted by public administrations. At the level of the European Union this right has been extensively recognised in case law<sup>6</sup> and is included in Article 41(2)(b) of the Charter of Fundamental Rights of the European Union<sup>7</sup> (the **Charter**). More generally, respecting the rights of defence is also one particular aspect of the right to a fair trial<sup>8</sup>.

As an institution of the European Union the ECB is bound by Union rules and general principles on due process and should also observe the principles recognised in the **Charter**<sup>9</sup>. Furthermore, Article 22 of the SSM Regulation specifically foresees rules on due process with regard to adopting supervisory decisions, in particular the right to be heard and access to the files of persons who are the subject of the proceedings, as well as the obligation of the ECB to state the reasons on which its decisions are based.

The right to access the files should be distinguished from the right to public access as enshrined in Decision ECB/2004/3<sup>10</sup> on public access to ECB documents.

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<sup>5</sup> See, in this regard, the judgment of the Court of 11 December 1985 in *Commune de Hillegom v Comelis Hillenius*, Case C-110/84, EU:C:1985:495 and the judgment of the Court of 12 November 2014 in *Annett Altmann and Others v Bundesanstalt für Finanzdienstleistungsaufsicht*, Case C-140/13, EU:C:2014:2362, para. 33.

<sup>6</sup> See, among others, the judgment of the Court of 21 November 1991 in *Technische Universität München v Hauptzollamt München-Mitte*, Case C-269/90, EU:C:1991:438, para. 25.

<sup>7</sup> OJ C 326, 26.10.2012, p. 391.

<sup>8</sup> See, in this regard, *Europese Gemeenschap v Otis and Others*, Case C-199/11, EU:C:2012:684, para. 48.

<sup>9</sup> Recitals 54 and 86 of the SSM Regulation.

<sup>10</sup> Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3) (OJ L 80, 18.3.2004, p. 42).



The purpose of the legal provisions on public access is to give the general public the right, as broadly as possible, to access documents held by the public authorities, and to regulate, in detail, how this right may be exercised. The right is, therefore, available to all EU citizens for the purpose of protecting openness and transparency. The right to access documents does not extend, under any circumstances, to information protected under the rule of professional secrecy in financial supervision. As far as the ECB is concerned this is clearly established in Article 4(1)(c) of Decision ECB/2004/3 on public access to ECB documents.

The right to access the file is closely bound up with the right to be heard<sup>11</sup>, and its main purpose is to allow persons who may be adversely affected by a decision to effectively make their views known, at least with regard to the matters taken into account by the competent authority as the basis for its decision<sup>12</sup>. As this article will explain further, the proper implementation of the right to access the file may, under certain conditions, require access to confidential information.

The differences in the rationale for and the purpose of these two rights will necessarily have an impact on the outcome of the ECB's assessment of the accessibility of the documents. Moreover, both rights should be implemented in a manner that respects the substance of the obligation to maintain professional secrecy to the extent possible.

### 3 The right to access the files in supervisory procedures

According to the first paragraph of Article 22 of the SSM Regulation, "*Before taking supervisory decisions [...] the ECB shall give the persons who are the subject of the proceedings the opportunity of being heard [...]*".

The second paragraph of Article 22 of the SSM Regulation includes the right to access the file in the following terms: "*The rights of defence of the persons concerned shall be fully respected in the proceedings. They shall be entitled to have access to the ECB's file, subject to the legitimate interest of other persons in the protection of their business secrets [...]. The right to access the file shall not extend to confidential information*".

The practical modalities of exercising the right to access the files in supervisory procedures are further developed in Article 32 of the **SSM Framework Regulation**<sup>13</sup>.

The following sections analyse in greater detail the persons entitled to access the file in ECB supervisory procedures, the temporary scope of application of this right, the accessible documents, and how access is granted in practice.

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<sup>11</sup> See, in this regard, *Cimenteries CBR and Others v Commission*, Joined Cases T-10/92, T-11/92, T-12/92 and T-15/92, EU:T:1992:123, para. 38, and *ICI v Commission*, Case T-36/9, EU:T:1995:118, para. 69.

<sup>12</sup> See, to this effect, the judgment of the Court of 24 October 1996 in *Commission v Lisrestal*, Case C-32/95 P, EU:C:1996:402, para. 21, and the judgment of the Court of 29 June 1994 in *Fiskano AB v Commission*, Case C-135/92, EU:C:1994:267, para. 40.

<sup>13</sup> Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the ECB and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, p. 1).

### 3.1 Who is entitled to access the file in supervisory procedures?

According to the second paragraph of Article 22 of the SSM Regulation, the right to access the files applies to the “persons concerned”. According to Article 32 of the SSM Framework Regulation the right to access the files applies to the “parties” to supervisory procedures. Article 26 of the SSM Framework Regulation defines the parties to an ECB supervisory procedure as: (i) those making an application and (ii) those to which the ECB has addressed or intends to address a decision. Contrary to how it may appear at first sight, the different wording of the provisions does not indicate that Article 32 of the SSM Framework Regulation has a more restrictive approach than Article 22 of the SSM Regulation.

The second paragraph of Article 22 of the SSM Regulation should be read together with the first paragraph that establishes the protection of the rights of defence of “persons who are the subject of the proceedings”. This concept is equivalent to the definition of “parties” under Article 26 of the SSM Framework Regulation.

The reference to parties as beneficiaries of the right to access the file is also in line with the wording of Article 41(2)(b) of the **Charter**, which refers to the “right of every person to have access to his or her file”.

The wording of Article 32 of the SSM Framework Regulation, which extends the right to access the file to the parties to a procedure, is therefore in line with the rationale and scope of the right to access the file in the EU legal order.

Having said this, the ECB would not be so formalistic as to deny access at all costs to non-parties that could be concerned by a supervisory decision in a manner that is undisputable<sup>14</sup>.

This is, in fact, the case in procedures which assess the suitability of the management bodies of credit institutions. In these procedures the application is normally submitted by the credit institution and the final decision is also addressed to the credit institution. Therefore, only the credit institution qualifies as a “party” under Article 26 of the SSM Framework Regulation. However, if the ECB intends to adopt a negative decision the candidate will also be heard and he or she will be able to access the file subject to the protection of confidential information and the business secrets of the credit institution.

It is not easy to find another situation where a person who does not qualify as a party under Article 26 of the SSM Framework Regulation could be concerned by an ECB supervisory decision.

The case of shareholders, for example, has been clarified by the Court of Justice in the recent **Trasta** judgment<sup>15</sup>. The Court confirmed that the shareholders of a credit institution are not directly concerned, for the purposes of Article 263 of the TFEU, by

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<sup>14</sup> “Concerned” is used here in the meaning of the requirements to contest an act of an EU institution under Article 263 of the Treaty on the Functioning of the European Union (TFEU). See, in particular, the judgment of the Court of 15 July 1963 in *Plaumann v Commission*, Case 25/62, EU:C:1963:17.

<sup>15</sup> Judgment of 5 November 2019, *ECB v Trasta Komercbanka*, Joined Cases C-663/17 P, C-665/17 P and C-669/17 P, EU:C:2019:923.

the ECB decision to withdraw the banking licence of the credit institution in which they hold shares.

Even if the withdrawal of a banking licence is a very intrusive measure that has irreversible consequences for the credit institution (i.e. often, under national law, liquidation), the Court found that although the withdrawal may affect the economic position of shareholders it does not affect their legal rights. The Court acknowledged that the liquidation of the credit institution, which had taken place following the withdrawal, affected the rights of the shareholders. However, as the liquidation did not constitute an implementation of the withdrawal resulting purely from EU law, this fact could not attribute direct concern to the shareholders either<sup>16</sup>.

Reviewing the reasoning of the Court of Justice in the [Trasta](#) judgment as well as that of the General Court in other previous cases such as *HSH v. Commission*<sup>17</sup>, it is difficult to identify other supervisory decisions addressed to credit institutions that could confer direct concern on shareholders.

Nevertheless, this is something for the Court to clarify and this clarification may come sooner rather than later given that there are a number of pending cases that have been brought against the ECB and the SRB by shareholders of credit institutions<sup>18</sup>.

### 3.2 When does the right to access to the files apply?

As access to files is intended to protect the rights of defence of a person subject to a supervisory procedure, such a right necessarily arises while the procedure is ongoing. There is, therefore, no general right to access the file outside the context of an ECB supervisory procedure (in contrast to the public access right).

As clarified in Article 32 of the SSM Framework Regulation, parties are entitled to access the ECB's file after the opening of the ECB supervisory procedure. In the case of procedures initiated at the request of a party it is relatively straightforward to identify the starting point of the procedure. This will normally be the submission of the application or the acknowledgement of receipt of the application. Conversely, when the procedure is initiated ex officio it may be more difficult to identify the moment of opening, which should then be assessed on a case-by-case basis.

After the opening of a procedure the right to access the file is available to the parties until the decision is final (i.e. until it can no longer be challenged in Court). Having said this, parties usually request access to the file during the right to be heard procedure and prior to preparing their observations.

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<sup>16</sup> Judgment in *Trasta*, cited in footnote 15, paras. 108-114.

<sup>17</sup> Case T-499/12, *HSH Investment Holdings Coinvest-C Sàrl and HSH Investment Holdings FSO Sàrl v European Commission*, EU:T:2015:840. In this case the Court rejected standing to shareholders of a credit institution to challenge measures like dividend restrictions and prohibitions, on the grounds that the purpose of the measure was to increase the capital ratio of HSH Nordbank, where the interests of the company and that of the shareholders coincide (paras. 61-64).

<sup>18</sup> See, for example, pending Case C-364/20 P, *Bernis and Others v CRU*, where among other claims the applicants alleged that the General Court had erred in law by assuming that a sufficiently direct legal effect was excluded due to the fact that the implementation of the contested decisions involves the application of national law, available on the Court's [website](#) (Curia).

During the review before the Administrative Board of Review (ABoR), the right to access the file also applies. This is expressly recognised in Article 20 of the ABoR Decision<sup>19</sup> that mirrors Article 32 of the SSM Framework Regulation as concerns the modalities of access to files and the protection of confidential information.

### 3.3 Which documents are included in the file?

According to Article 32 of the SSM Framework Regulation the file should contain all the documents obtained, produced or assembled by the ECB during the ECB supervisory procedure, irrespective of the storage medium. This covers documents provided to and received from the parties, documents sent by national competent authorities (NCAs) and communications between the ECB and NCAs, internal ECB documents such as those sent to the Supervisory Board and the Governing Council, as well as memos, opinions or analyses produced by the ECB's business areas which are relevant to the ECB's supervisory procedure.

This is in line with the case law of the Court of Justice according to which, in order to ensure that the rights of defence are fully protected, it cannot be solely the authority adopting the decision that determines which documents should be in the file. The authority may, however, exclude from the file evidence which has no relation to the facts and the legal grounds on which the decision is based<sup>20</sup>.

Having said this, the file should not contain internal communications of an organisational nature, drafts exchanged at staff level during the preparation process, draft versions of the decisions, or preliminary assessments.

The ECB gathers, on an ongoing basis, a significant volume of information concerning the banks under its supervision. However, the ECB will add only the information relevant to a specific procedure to its corresponding file, i.e. if the information is necessary to substantiate the decision which will be the outcome of the procedure. The ECB maintains the rest of the information gathered from the banks during the ongoing supervision separately from the specific supervisory procedures files.

Not all documents included in a supervisory file will be ultimately accessible to the parties. Article 22 of the SSM Regulation establishes that the right of access to the file shall not extend to confidential information and also that such a right is subject to the legitimate interest of other persons in the protection of their business secrets. Article 32(5) of the SSM Regulation clarifies that confidential information may also include internal documents of the ECB and NCAs as well as correspondence between the ECB and an NCA or between NCAs.

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<sup>19</sup> Decision (EU) 2019/1378 of the European Central Bank of 9 August 2019 amending Decision ECB/2014/16 concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2019/27) (OJ L 224, 28.8.2019, p. 9).

<sup>20</sup> See in this regard, the judgment of 7 January 2004 in *Aalborg Portland and Others v Commission*, C-204/00 P, C-205/00 P, C-211/00 P, C-213/00 P, C-217/00 P and C-219/00 P, EU:C:2004:6, para. 126 and the case law cited.

### 3.4 Which documents are accessible? The balancing of interests

As has already been explained, not all documents included in a supervisory file can be made accessible to the parties.

The ECB assesses, individually, the confidentiality of each document included in a supervisory file. In this assessment the ECB strikes a balance between the interests protected by professional secrecy and the rights of defence of the parties.

The Court of Justice has clarified that not all the information included in a supervisory file constitutes, unconditionally, confidential information that is covered by the obligation to maintain professional secrecy. For it to be classified as confidential the information should fulfil two conditions, namely that (i) it is not public and (ii) disclosure of such information is likely to adversely affect the interests of the natural and legal person who provided that information or third parties or the proper functioning of the supervisory system<sup>21</sup>.

Against this background, as a first step, the ECB assesses whether each document of the file may be considered to be confidential. As a second step the ECB assesses whether information that is classified as confidential should, nevertheless, be accessible to the parties in a specific case in order to fully protect their rights of defence.

To determine whether a specific document is confidential, the ECB takes into account the definition of confidential information and the scope of the exceptions to confidentiality provided under EU directives as interpreted by the Court of Justice rather than under national implementing legislation<sup>22</sup>. This is due to the fact that Article 27(1) of the SSM Regulation requires the ECB to adhere to the professional secrecy obligations laid down in Union directives. By this cross-reference to the provisions of the Union directives, and to the extent to which they are sufficiently clear, Article 27 of the SSM Regulation incorporates these provisions into the SSM Regulation. In other words, the conditions for application of the obligation to maintain professional secrecy flow from the SSM Regulation – which cross-refers to the EU directives – rather than from any direct application of the directives<sup>23</sup>.

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<sup>21</sup> Judgment of the Court of 19 June 2018 in *Bundesanstalt für Finanzdienstleistungsaufsicht v Ewald Baumeister*, Case C-15/16 EU:C:2018:464, para. 46.

<sup>22</sup> Unless these directives provide options or discretions to Member States. In such a case the ECB should rely on the national transposing law.

<sup>23</sup> Several considerations lead to the conclusion that, in the context of Article 27 of the SSM Regulation, “Union law” should not be understood as encompassing national legislation. First, when the legislator intends to oblige the ECB to apply national law, it expressly provides for this, as in Article 4(3) of the SSM Regulation. Second, a systematic approach also weighs in favour of this interpretation. Article 27 is included in chapter IV of the SSM Regulation, which deals with organisational matters and does not refer to the material prudential rules that the ECB has to apply when supervising credit institutions. A teleological interpretation also points in this direction. The professional secrecy obligation establishes a mandate of an institutional nature – this is not compatible with an interpretation according to which national law implementing CRD IV determines the scope of the professional secrecy obligations inherent to the ECB and its staff.

Internal ECB documents and correspondence with other authorities are normally considered to be confidential and are not disclosed to the parties<sup>24</sup>. A free and honest exchange of information and views between authorities is necessary in order to ensure that an efficient supervisory system is in place. It is more likely that competent authorities will exchange honest and reliable information if they know that such information will be protected, as a rule, by professional secrecy. With regard to internal documents, these often contain ECB evaluations or assessments that are part of the process of preparing and drafting a decision, although they do not normally have any evidential value. For this reason, lack of access to these documents should not have a negative impact on the rights of defence. In any event, the ECB assessment and the facts and legal grounds on which the decisions are based are available in the draft decision that is shared with the parties in the context of the right to be heard procedure.

Having said this, to the extent that documents originating from other authorities contain allegations made against the party that the ECB has to examine, or facts or evidence on which the decision is based, such documents will be made available to the party in order to fully guarantee its rights of defence. In the same vein, in the exceptional cases in which internal documents may contain evidence that is essential in order to exercise the rights of defence and which is not reflected in the decision, such documents would be disclosed to the parties.

It should be taken into account that ECB supervisory decisions are, to a large extent, based on the information provided by the supervised entities and, where relevant, by the NCAs or other public authorities, as well as on the ECB's own determinations that are explained in the decision. Therefore, it should not come as a surprise that ECB supervisory files are composed mainly of documents provided by the credit institution (accessible to the originating credit institution but not to third parties), and internal ECB documents and correspondence between the ECB and NCAs or between NCAs that, for the reasons explained, will very often be classified as confidential. This may sometimes disappoint the parties but they need to be mindful of the general prohibition against disclosing confidential information that applies in banking supervision (this is different from other fields of EU law) and also of the fact that before it rejects access to a document the ECB will have conducted a careful analysis of each individual document, taking the interests of the party into account<sup>25</sup>.

If a party considers, having obtained access to the file, that it requires information from a specific non-accessible document for its defence, it may submit a reasoned request to that end to the ECB. If the ECB concludes that it is not in a position to grant such a request it will provide its reasons to the party. If the party disagrees and decides to challenge the ECB's decision not to grant access to a specific document, this should

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<sup>24</sup> This is also the approach of the Commission in the field of competition law. See, in this regard, part 3.1 of the Commission Notice on the rules for access to the Commission file in cases pursuant to Articles 81 and 82 of the EC Treaty, Articles 53, 54 and 57 of the EEA Agreement and Council Regulation (EC) No 139/2004 (Text with EEA relevance) (OJ C 325, 22.12.2005, p. 7).

<sup>25</sup> The content of an ECB supervisory file differs significantly from the typical content of the types of administrative procedures handled by other EU authorities, such as files gathered by the Commission in cases related to competition law. In these cases a significant amount of documents held in the Commission's file are documents containing inculpatory or exculpatory evidence obtained in dawn raids or replies from third parties to questions from the Commission.

be done as a part of a challenge to the final measure as decisions on document access are intermediate steps in the procedure and cannot be challenged autonomously<sup>26</sup>.

### 3.5 How is access granted?

On receiving a request from the parties, the ECB grants access to the files by providing a list of all the documents included in the file, indicating whether they are confidential or accessible and with a brief explanation of the reasons for confidentiality. Together with the list, the ECB provides copies of the documents that are not confidential<sup>27</sup>. The ECB may determine the way access to a file is to be granted, in accordance with Article 32(4) of the SSM Framework Regulation. The ECB normally agrees the method used to grant access with the affected party.

## 4 Recent developments in case law: the implications of Baumeister, UBS and Buccioni

In 2018 the Court of Justice delivered a number of important judgments in the field of professional secrecy in financial supervision. These also have practical implications for the way the ECB grants access to supervisory documents.

On 19 June 2019 the Court rendered its judgment in the **Baumeister** case<sup>28</sup>. In this judgment the Court dealt for the first time with the notion of “confidential information” in the field of financial supervision and clarified that not all information included in a supervisory file is unconditionally confidential. This judgment also contains interesting considerations on the interplay between the principle of transparency and the rule of professional secrecy<sup>29</sup>.

On 13 September 2018 the Court delivered its judgments in the **UBS**<sup>30</sup> and **Buccioni**<sup>31</sup> cases. The former dealt with the notion of “cases covered by criminal law” and the relation between rights of defence and the rule of professional secrecy. The Buccioni case dealt with the interpretation of the exception to professional secrecy provided in the third subparagraph of Article 53(1) of CRD IV, which is applicable to banks in liquidation.

All the cases were originated by a request for a preliminary ruling under Article 267 of the TFEU. They were assigned to the same judge-rapporteur<sup>32</sup> and the judgments

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<sup>26</sup> Order of 9 July 2003, *Commerzbank v Commission*, Case T-219/01, EU:T:2003:201, para. 58.

<sup>27</sup> For reasons of efficiency and provided that the party agrees, the ECB will not re-send copies of the documents that are already in possession of a party.

<sup>28</sup> Cited in footnote 21.

<sup>29</sup> Cited in footnote 21, paras. 38-44.

<sup>30</sup> Judgment of 13 September 2018, *UBS Europe and Others*, Case C-358/16 EU:2018:715.

<sup>31</sup> Judgment of 13 September 2018, *Buccioni*, Case C-594/16 EU: C:2018:717.

<sup>32</sup> The judge rapporteur was José Luís da Cruz Vilaça who also was rapporteur in Altmann.



were given by a chamber of five judges, with the exception of the judgment in the Baumeister case which, due to its importance, involved the Grand Chamber.

In all the cases the Court of Justice started by restating the importance of the rule of professional secrecy in banking supervision and reiterated the key role that this rule plays in the efficiency of the banking supervision system. The Court recalled the findings in the Altmann<sup>33</sup> case, i.e. that the obligation to maintain professional secrecy is designed to protect not only the interests of the concerned firms but also the public interest in the normal functioning of markets.

While remaining mindful of the interests protected by professional secrecy the Court did not accept that financial supervision requires the outright prohibition of the disclosure by supervisory authorities of any piece of information they receive or produce in the context of their supervisory tasks. The Court's opinion did not, therefore, follow Advocate General Bot in the Baumeister case, where he suggested that all information received and produced by authorities in discharge of their supervisory tasks should be included, without any other requirements, in the concept of "confidential information". On the contrary, for the Court, information can be classified as confidential only if it fulfils certain conditions<sup>34</sup>.

Considering that the conditions for confidentiality are that the information must not be public and that its disclosure may negatively impact the interests of the person who provided the information or the proper functioning of the system, it is to be expected that the vast majority of information held by supervisory authorities will be considered to be confidential. Nevertheless, authorities should still check that these conditions are fulfilled before relying on the professional secrecy rule to reject access to a specific document.

In the UBS case the Court recalled settled case law according to which fundamental rights guaranteed in the EU legal order are applicable in all situations governed by EU law and that respecting the rights of defence is enshrined in several principles of the Charter<sup>35</sup>. At the same time, the Court also recalled that the right to access the file is not an unlimited and unfettered prerogative. Fundamental rights may be restricted, provided that restrictions correspond to objectives of general interest pursued by the measure in question and that they do not involve, in the light of the objectives pursued, a disproportionate and intolerable interference which would impair the very substance of the rights guaranteed<sup>36</sup>.

In view of the above the Court concluded that, in the event of a conflict, on the one hand, between the interest of the person subject to a measure adversely affecting him/her in gaining access to the information necessary to fully exercise his/her rights of defence and, on the other hand, the interests protected by confidentiality, the competent authorities or the courts shall seek to strike a balance between these opposing interests in the light of the circumstances of each case<sup>37</sup>. The ECB should,

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<sup>33</sup> Cited in footnote 5.

<sup>34</sup> See part 3.4 of this paper.

<sup>35</sup> The UBS judgment, paras. 50-62, cited in footnote 30.

<sup>36</sup> The UBS judgment, para. 62.

<sup>37</sup> The UBS judgment, para. 69.

therefore, strike this balance of interests when assessing access to a specific document. Interestingly, the Court seems to extend this task even beyond the scope of the relevant supervisory file, as in the UBS case the documents requested were not part of the file corresponding to the administrative procedure relating to the issuance of the decision which had a negative impact on the rights of defence of the party.

In the Buccioni case the Court did not agree with the view of the Commission and several Member States that the disclosure of confidential information under the third subparagraph of Article 53(1) necessarily presupposes that the applicant had already initiated civil or commercial proceedings. According to the Court, such an approach would hinder the proper administration of justice. The Court, therefore, has opened the door, under certain conditions, to the disclosure of confidential documents, for the purpose of judicial or civil proceedings, to persons whose proprietary interests have been prejudiced as a result of the compulsory liquidation of a credit institution before civil and commercial proceedings have been initiated.

In the Buccioni case the Court aimed at protecting other interests, such as the interest in establishing the responsibilities of private and public bodies for damages suffered by the failure of a bank. In any event, according to the Court, the competent authority should always weigh up the interest of the applicant in obtaining the information in question and the interest connected with maintaining the confidentiality of the information covered by the obligation of professional secrecy, before disclosing each piece of confidential information.

## 5 Conclusion

Complying with the prohibition to disclose confidential information is of the utmost importance to the ECB. This is not only to protect the private interests of the credit institutions under its supervision or the business secrets of third parties but also to protect the public interest in ensuring there is an efficient system of public supervision, where both supervised entities and competent authorities need to be sure that the information provided will, in principle, remain confidential. Any inappropriate implementation of this secrecy rule could jeopardise the smooth transmission of confidential information.

The key role of the professional secrecy rule in financial supervision has always been always emphasised by the Court of Justice. At the same time, especially in recent judgments, it is noteworthy that the Court of Justice has examined the rule of professional secrecy in a broader context, taking into account, in particular, the fundamental rights that apply in the EU legal order.

When the ECB is confronted by a request to access supervisory documents, it bears in mind the different interests at stake, in particular the fundamental rights of parties to access supervisory procedures, namely the rights of defence, the right to an effective remedy and the right to good administration. At the same time, the ECB takes into account the interests underpinning the rule of professional secrecy and ensures that confidential information, the disclosure of which may harm the interests of third parties

or the proper functioning of the system, is not disclosed to those who are not allowed to access such information.

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## Panel 6

Judicial review of the acts of EU  
institutions and bodies in a multi-level  
administrative framework



# Introduction to the panel on judicial review in a multi-level administrative framework

By Klaus Lackhoff<sup>1</sup>

Access to an effective remedy before a tribunal, in the event of a violation of the rights and freedoms guaranteed by the law of the Union, is a fundamental right enshrined in Article 47 of the Charter of Fundamental rights of the European Union.

In the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) national administrative authorities and an actor at the level of the Union are, in certain areas, obliged to cooperate in good faith to produce an administrative output. Accordingly, both mechanisms form a system of condensed administrative cooperation between at least one administrative body at the level of the Union and at least one administrative body at the level of each Member State.<sup>2</sup> The envisaged output comprises, in particular, supervisory decisions such as, for example, decisions to approve or oppose the acquisition of a qualifying holding or a decision to adopt a resolution scheme. These are examples of decisions adopted in composite administrative procedures – i.e. procedures in which different administrative bodies must cooperate to create the output.

Composite administrative procedures increase procedural complexity and this procedural dimension may add to already existing complexity in the subject matter. In addition, complexity is an issue in its own right – it creates a burden that supervisors and supervised entities are required to deal with, it can create uncertainty, and it creates a cost.

Moreover, this procedural complexity also raises questions with regard to access to legal remedies.<sup>3</sup> Pursuant to Article 263(4), (1), (3) and (2) TFEU any natural or legal person may contest an act of the ECB or an agency (such as the SRB) addressed to it

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<sup>1</sup> Head of the Banking Law Section, Supervisory Law Division, Directorate General Legal Services, European Central Bank. The author thanks Candice Olivier for her input.

<sup>2</sup> Article 2(9) of Council Regulation (EC) 1024/2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions (OJ L287, 29.10.2013, p.63) (the SSM Regulation) offers this definition: “Single supervisory mechanism” (SSM) means the system of financial supervision composed by the ECB and national competent authorities of participating Member States as described in Article 6 of this Regulation.” 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 and amending Regulation (EU) No 1093/2010 (OJ L225, 30.7.2014, p.1) (the SRM Regulation) does not define the SRM.

<sup>3</sup> See Kämmerer, A. (2016), “Rechtsschutz in der Bankenunion” (SSM, SRM), *WM*, p. 1; Lackhoff, K. (2017), *Single Supervisory Mechanism*, paras. 1072 et seq.; Chiti, M. (2019), “The European Banking Union in the Case Law of the Court of Justice of the European Union”, in Chiti, M. and Santoro, V. (eds.), *The Palgrave Handbook of European Banking Union Law*, p. 105 et seq; Arons, T. (2020), “Judicial Protection of Supervised Credit Institutions in the European Banking Union”, in Busch, D. and Ferrarini, G. (eds.), *Banking Union*, 2nd edn., paras. 3.01 et seq.; Lackhoff, K. (2021), “Procedural law requirements for conducting administrative procedures by the ECB and the SRB”, in Zilioli, C. and Wojcik, K.-P. (eds.), *Judicial Review in the European Banking Union*, p. 146 et seq.

or which is of direct and individual concern to it based on (i) grounds of lack of competence, (ii) infringement of essential procedural requirements, (iii) infringement of the Treaties or of any rule of law relating to their application, or (iv) misuse of power. Alleged non-compliance with procedural provisions can be raised, in particular, through a plea of infringement of an essential procedural requirement or a plea of lack of competence. If one of these two grounds for annulment exists, the court must raise it on its own initiative. Through the pleas allowed by Article 263 TFEU the assessment of the court is confined to a legal review of the contested decision which is carried out based on the factual situation and legal provisions existing at the time the contested decision was adopted.

Since in composite administrative procedures in the SSM and SRM national and European authorities act together, the question arises as to (i) which acts can and should be reviewed (preparatory acts/final acts, instructions and/or the implementing act) and (ii) which courts have the competence to review these acts (EU courts and/or national courts).

In the above situation, revealing the underlying structure of the legal framework is key to making such complexity more manageable. Banking supervisory law, the law of resolution, related procedural rules and court decisions are not always areas in which systemic structures can be easily uncovered. The aforementioned complexity of the subject matter (prudential supervision) and the economic relevance of the prudential rules do not necessarily promote systemic coherence in these areas of law.

Aiming to reveal such systematic structures, Professor Dimitrios Triantafyllou (Legal Adviser to the European Commission) has developed, using a top-down approach, insights into the structural features of composite procedures in the areas of supervision and resolution, and their legal review. To this end he proposes a non-exhaustive typology to classify the diverse composite administrative procedures that could result in decisions being challenged before the Union courts, depending on the institutions and authorities involved: “bottom-up vertical composite procedures”, “top-down vertical composite procedures”, “inter-institutional horizontal composite procedures” or “intra-institutional composite procedures”. The underlying principle that determines the level at which judicial protection may be sought is the creation of legal effects – in his view (only) the legal act that concentrates and absorbs the effects of all the previous (or future implementing) acts is to be contested.

Anastasia Valavanidou (SRB, Bank Resolution Expert) and Asen Lefterov (ECB, Senior Legal Counsel) discuss in their papers the recent case law relating to procedural questions connected with contesting decisions adopted in multi-level administrative proceedings, in particular in relation to the SSM and the SRM. This bottom-up overview circles, in particular, around questions such as who can contest which measures adopted by the ECB and the SRB respectively in composite administrative procedures. Consequently, their papers focus on issues like (i) what are “preparatory acts” and whether they can be contested and (ii) which measures can and need to be contested if national authorities issue a decision based on an instruction.



With regard to the standing of natural and legal persons, Asen Lefterov stresses that the principle of effective judicial protection cannot set aside the conditions laid down in Article 263 TFEU. In his opinion, this is the reason why in *ECB v Trasta Komercbanka* (Case C-663/17 P) the shareholders were not considered to be directly concerned by the ECB withdrawal decision addressed to the bank.

The two papers deal with preparatory acts under the SSM and the SRM respectively. Examples include a proposal of the national competent authority with regard to the decision on the acquisition of a qualifying holding and the ECB's consultation in the context of the SRB's determination of the individual ex ante contributions to the Single Resolution Fund. Both papers explain why the preparatory acts are not independently reviewable and how an action brought against the decision closing the procedure will provide appropriate judicial protection. They argue that in cases where the EU legislature has opted for a composite procedure, with the relevant EU body (i.e. the ECB or the SRB) having exclusive decision-making power, there has to be a single judicial review by the EU courts alone once the decision of the EU body bringing the administrative procedure to an end has been adopted (*Berlusconi and Fininvest*, Case C-219/17 and *Iccrea Banca*, Case C-414/18). Otherwise this kind of decision-making process would not be effective.

On the other hand, there is also a need to challenge the instructions of EU bodies if no discretion remains with the implementing national authority. A national court may always refer a matter to the Court of Justice for a preliminary ruling when the outcome of national court proceedings depends on the validity of an EU measure. However, if an individual clearly has the standing necessary for bringing an annulment action before the Union courts and such an action has not been brought in due time, a preliminary ruling by a national court on the same matter will be inadmissible (*Textilwerke Deggendorf*, Case C-188/92).

Anastasia Valavanidou is also of the view that there is no requirement per se to simultaneously challenge both an instruction at Union level and also the respective national implementing measures. In the case of parallel challenges, the duty of sincere cooperation requires the national court to stay its proceedings pending final judgment in the action for annulment before the Union courts. In the case of annulment of the instruction, it would be for the Union authorities to take the necessary measures to comply with the Court's judgment and for the national authorities to draw the respective implications at national level, taking account of the provisions of the applicable national law. However, challenging national measures would seem to be appropriate when there are issues pertaining to the implementation of the instruction, or when the national authority has been left discretion with regard to additional matters not contemplated by the instruction.

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# The banking union as a new field for composite administrative procedures

By Prof. Dr. Dimitrios Triantafyllou<sup>1</sup>

I will first remind the institutional background of the banking union, with its cooperative structures, which give rise to complex decision making, before turning to the models of composite administrative procedures, first to the ones already recognised as such by the case-law and then to others that are encountered in the daily practice.

## 1 Complex institutional settings entail composite administrative procedures

It is a common place that our banking union (BU) is administered by several actors. Whereas the European Central Bank (ECB) plays the central role as supervisor, it is assisted by the national competent (supervision) authorities (NCA), which supervise the less significant institutions and prepare some important ECB's acts by supplying information or making proposals. Parallel to that supervision circuit there is also the resolution one, composed by the Single Resolution Board (SRB), which adopts resolution schemes and also manages the Single Resolution Fund (SRF), as well as by the national resolution authorities (NRA), which adopt resolution schemes for less significant institutions and assist the SRB in the implementation of its decisions. Last but not least, the European Banking Authority (EBA) is also contributing to the regulatory tasks, not only by preparing regulatory and implementing technical standards for the European Commission's endorsement, but also by issuing recommendations and guidelines on its own. In relation to macro-prudential (national) measures along with the EBA the European Systemic Risk Board (ESRB) also plays a consultation role to be taken into account by the Commission for acceptance<sup>2</sup> or authorisation purposes<sup>3</sup>. Let's leave aside the national Deposit Guarantee Schemes (DGSs), since there is not any European one for the time being, even if they have to consult the authorities of the other pillars in relation to resolution before they decide on alternative use of their funds<sup>4</sup>.

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<sup>1</sup> Legal Adviser at the European Commission. Faculty of Law, Würzburg University. This statement reflects personal opinions of the author and not the ones of his Institution.

<sup>2</sup> Or rejection purposes (by the Council on Commission's proposal), see Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR) (OJ L176, 27.6.2013, p. 1), as amended by Regulation 2019/876 (OJ L 150, 7.6.2019, p. 1).

<sup>3</sup> In the case of important increase of systemic buffers, see Article 133 CRD V (Directive 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers an capital conservation measures, OJ L 150, 7.6.2019, p. 253).

<sup>4</sup> Article 11 of Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, (OJ L173, 12.6. 2014, p. 149).

In the multipolar system of the BU the necessary interactions (consultations, reporting, notifications, approvals etc.) give rise to an important administrative activity, the different actors having to consult and cooperate with each other in order to achieve the best results. The central (European) level may have the last word but depends, to a certain extent, on the national one which is more present on the spot, according to a feature that is typical of every federal structure. On the other hand, one could deplore some fragmentation of tasks between the ECB, the SRB, the EBA or even the ESRB, which may be seen either positively, under a “checks and balances” perspective, or negatively, as a weakness and cause of delays and frictions, because of different players that have to be taken into account. Against this background, the European Commission, as a guardian of EU-law and of the European interest and as initiator of the respective Legislation has to ensure that the system operates properly. It may not be here the right place to develop that it is the institutional balance, along with the democratic legitimacy of the Commission, that require that discretionary powers are not delegated to other agencies<sup>5</sup>, but it is still useful to remind that principle, because it makes the Commission a necessary actor to be added-up to some administrative procedures, which become thereby necessarily “composite”, as composed of several steps involving several actors at national and European level. The recognition of such procedures has the advantage that the whole administrative process culminating in an act is considered as a whole, so that judicial review is only possible against the final outcome thereof. This is of paramount importance both for efficient administration and procedural economy.

It can be assumed that the omission of one of the steps prescribed by the applicable provisions (notification, consultation, opinion, recommendation etc.) will amount to a procedural error that would in most, if not in all cases, be considered as “essential”, because of the missing input, leading to presumably erroneous assessments and to the annulment or invalidity of the act that is taken at the end of the respective procedure<sup>6</sup>.

## 2 Vertical and horizontal composite procedures

Recent experience has shed light on different types of “composite administrative procedures”. In the supervision field, where the ECB has the exclusive competence to supervise credit institutions, although assisted by the decentralised national competent authorities<sup>7</sup>, it is quite common that, in relation to institutions normally supervised by the latter (NCAs) the ECB is the one that finally has to take the decision either to award or to withdraw a license or to approve (or disapprove) the acquisition of a qualified shareholding, since for these tasks the ECB is exclusively competent<sup>8</sup>. Although the national authorities do prepare the file for the proposal and provide with

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<sup>5</sup> Case 9/56, *Meroni and Co., Industrie Mellurigische S.p.A. v. High Authority*, EU:C:1958:7; C-270/12, *Short selling and certain aspects of credit default swaps*, EU:C:2014:18.

<sup>6</sup> According to Article 263 or 267 TFEU.

<sup>7</sup> Case T-122/15, *Landeskreditbank BW*, EU:C:2016:391.

<sup>8</sup> Article 4 of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, (OJ L 287, 29.10.2013, p. 63) (SSMR).

all necessary information (which they even sometimes get from other, e.g. anti-money laundering authorities), it is the ECB that bears the responsibility for deciding in one or the other direction, exercising thereby its discretionary powers. According to the Court<sup>9</sup>, the judicial review has to be exercised at the level at which the legal effects do become apparent for the applicant, the legal effects lying with the ECB's decision itself, to which the preceding procedure "boils down". Any previous steps (like the proposal or other notifications) have therefore preparatory character and cannot be challenged separately from the final decision<sup>10</sup>. One could see here a bottom-up "vertical composite procedure".

Another example of composite administrative procedure can be found in the 2nd pillar (the resolution one), where the SRB decides the amounts that individual institutions have to pay each year to the SRF. The SRB's decision is then passed over to the national resolution authorities that notify them to the credit institutions of their remit, in order for them to pay their due. Here again, one has to look at the level at which the legal effects are produced. The amount of the individual contributions being decided by the SRB, the national authorities do not have any discretion left and only assist the SRB in the implementation of its decision. Hence, the legal review has also to take place before the European judge (GC), an application before the national judge in that respect being of no avail or inadmissible<sup>11</sup>. The legal effects having been produced at European level (on the basis of supervisory information), the steps that follow it in a kind of "follow-up" procedure do not produce further legal effects but merely implement (transmit) the SRB's decision, which absorbs them in what can be called a top-down "vertical composite procedure". Such a procedure can even, in some other cases, culminate at national level, if the decisions are finally taken by the national authorities on request (or instruction) of the European level<sup>12</sup>.

The multiplicity of actors give also rise to cooperation between European authorities and even pillars, as the resolution decision procedure demonstrates. The decision on resolution presupposes a determination by the ECB that a credit institution is failing or likely to fail, followed by a finding by the SRB that there are no alternative private sector means to help it out and an additional finding about the public interest in resolving the bank, instead of merely winding it up according to national insolvency rules. If all three conditions are met, this cooperation between the ECB and the SRB leads to the adoption of a resolution scheme. The procedure is only completed, though, by the approval of the respective scheme by the Commission or even by the Council<sup>13</sup>. Here we have a composite procedure par excellence, in which the different stages are to be considered as preparatory with regard to the final decision to be taken by the Commission (or even the Council). As such, the preparatory steps are normally not liable to any action for annulment before the European courts, because they are

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<sup>9</sup> At first place in the Case C-219/17, *Berlusconi/Fininvest*, EU:C:2018:1023.

<sup>10</sup> As for the national judge, he cannot review the legality neither of the final decision nor of the preparatory acts that preceded it, the latter being "absorbed" in the composite administrative procedure that finds its completion in the final (ECB's) decision.

<sup>11</sup> Case C-414/18, *Iccrea Banca*, EU:C:2019:1036.

<sup>12</sup> E.g. Article 18 (5) SSMR about requests by the ECB to the national competent authorities to open sanction proceedings.

<sup>13</sup> In case of objection because of lacking public interest or of the need to modify the amount of financing by the SRF.

absorbed by the final decision on the resolution which puts the resolution scheme into effect<sup>14</sup>. One could talk here about an “(inter-institutional) horizontal composite procedure”, because it involves institutions/authorities of the same level<sup>15</sup>. In other cases though, where no resolution takes place for lack of public interest, the procedure would probably culminate at national level, where winding-up or insolvency procedure would normally follow<sup>16</sup> the respective assessment<sup>17</sup>, according to the specificities of the applicable national law.

In all these cases, the decision that really produces legal effects is the one that concentrates the effects of all previous (or mere implementing subsequent) steps. Its concentrating and absorbing effect is the one that also determines the level at which judicial protection has to be sought.

### 3 Inter/intra-institutional and soft composite procedures

Of course, one shouldn't limit the (composite) administrative procedures to the adoption of the individual administrative acts. Also the adoption of regulatory acts are the outcome of composite procedures, as shown by the preparation by the EBA of ITS and RTS, following consultations, that are then submitted for endorsement to the Commission<sup>18</sup>, which participates actively in their elaboration, before the formal proposal by the EBA is issued; and it is beyond doubt that only the implementing or delegated acts of the Commission are the ones that produce legal effects towards the outside world. This is another example of inter-institutional composite procedure.

This typology of the composite procedures in the banking union is still not exhaustive. Looking e.g. at the remedy provided for in the SSMR against the decisions of the ECB's Governing Council, which is also of administrative nature, the new decision based on the opinion of the Administrative Board of Review (ABoR) abrogates and replaces the initial Governing Council's decision<sup>19</sup>. In that sense, one can consider the second decision as completing the administrative procedure that led to the decision subject to review. The review decision, once taken, “absorbs” the previous one and

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<sup>14</sup> See Article 18 of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and uniform procedures for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L225, 30.7.2014, p. 1-“SRMR”) (and ECJ AVLB, C-551,552/19 pending).

<sup>15</sup> Cf. Article 32 of Directive 2014/59 of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ L 173, 12.06.2014 p. 190) (BRRD I) for the NRAs.

<sup>16</sup> Article 32(b) BRRDII (Directive 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59 /EU as regards the loss absorbing and recapitalization capacity of credit institutions and investment firms and Directive 98/26/EC (OJ L 150, 7.6.2019, p. 296); cf. below the softer composite procedures, with acts at the European level that orient the action of the national authorities.

<sup>17</sup> In Case T-282/18, *Bernis and others*, EU:T:2020:209, the General Court admitted that the SRB's assessment of the lacking public interest in resolution amounted to a “decision” and dismissed the application of the shareholders because of lacking direct concern, instead of examining beforehand the nature of the assessment in question.

<sup>18</sup> See the numerous empowerments e.g. in CRR.

<sup>19</sup> Article 24 SSMR; see Case T-351/18, *Ukrseľhosprom PCF and Versobank v European Central Bank* (pending) and Case T-564/18, *Ernests Bernis and Others v European Central Bank* (pending).

concentrates the effects of all the procedural steps that preceded it<sup>20</sup>. One can talk here about an “intra-institutional composite procedure”.

And a last word, about the EBA: one shouldn't limit the discussion of the composite administrative procedures to legally binding acts. The EBA also issues guidelines and recommendations within the scope of its competences, namely in relation to the main legal texts on supervision (CRD and CRR in particular)<sup>21</sup>. These EBA texts are by definition not binding, but do produce some indirect legal effects on the participants of the banking union, mainly through interpretation of the legal texts of reference, which can then be followed by general or individual implementing measures at national level. Those national measures will then refer to the EBA's soft law provisions, thereby completing their legal effects on the spot. In this extended perspective one could also see a sort of soft “composite administrative procedure”. Nevertheless, in such cases, the concentration effect is to be found at the (national) implementation level; hence, the judicial protection has to be primarily sought before the national judge. This is without prejudice to the possibility of the national judge to ask for a preliminary reference concerning either the interpretation or even the validity of an EBA's guideline/recommendation, especially if he considers that the EBA exceeded its (albeit soft) powers<sup>22</sup>.

## 4 Conclusion

In conclusion, the complexity that characterizes the actors of the banking union and their interaction gives rise to several types of composite administrative procedures, thereby enriching the features of the (European) administrative banking law. And we have not even tackled the more complex situation of non-centralized group supervision<sup>23</sup> and group resolution<sup>24</sup>, where joint decisions taken by the competent colleges have to be implemented by the agreeing authorities in a cross-border composite administrative procedure, which would deserve a separate statement.

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<sup>20</sup> Case T-712/15, *Crédit Mutuel Arkéa v European Central Bank*, T:2017:900.

<sup>21</sup> Regulation (EU) No 1093/2010 of the European Parliament and the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12), Article 10 ff.

<sup>22</sup> See Case C-911/20, *Fédération Bancaire Française*, (pending).

<sup>23</sup> Article 111, 113, 116 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013 p. 338) (CRDIV); cf. Article 88, 89, 91 BRRD I.

<sup>24</sup> Article 88 ff BRRD.



# Judicial review in the multi-level administrative framework of the SRM

By Anastasia Valavanidou<sup>1</sup>

## 1 Introduction

Only a few years ago, the Union legislature set up the second pillar of the banking union, bringing together the Single Resolution Board (SRB), the national resolution authorities (NRAs) and the Commission.<sup>2</sup> Within the Single Resolution Mechanism (SRM), the centralised application of the resolution framework takes place in principle through composite procedures involving Union and national authorities, which cooperate in this integrated structure. The judicial control of the acts adopted in that context is carried out by Union and national courts, according to their respective competences and the applicable procedural rules.

Against this background, this paper focuses on key procedural aspects of this setting, building on lessons that can be drawn from recent case law of the Union courts.

## 2 Composite procedures in the SRM

Within the SRM, the Board performs its tasks in close cooperation with the NRAs, in accordance with Regulation (EU) No 806/2014 (SRM Regulation)<sup>3</sup>. The effective and consistent application of this framework is ensured particularly by means of guidelines and general instructions to the NRAs as well as by specific decisions of the Board and respective instructions to the NRAs, which, in turn, have to implement them and ensure that their actions comply with them.<sup>4</sup>

In this context, various examples of composite procedures can be found in connection with the exercise of its tasks by the SRB.<sup>5</sup> For a clearer understanding, I will indicatively describe some of them below.

First and foremost, the resolution procedure in accordance with Article 18 of the SRM Regulation. Under this procedure, the ECB's assessment, after consulting the SRB,

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<sup>1</sup> Bank Resolution Expert, Single Resolution Board. The views expressed here reflect those of the author, and not necessarily those of the Single Resolution Board.

<sup>2</sup> As well as, in certain cases, the Council. See Article 18(7) of Regulation (EU) No 806/2014.

<sup>3</sup> 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 and amending Regulation (EU) No 1093/2010, (OJ L 225, 30.7.2014, p. 1–90).

<sup>4</sup> See Articles 29(1) and 31 of the SRM Regulation. See also Decision of the Single Resolution Board of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the Single Resolution Mechanism between the Single Resolution Board and National Resolution Authorities, SRB/PS/2018/15.

<sup>5</sup> See Article 7 of the SRM Regulation setting out the divisions of tasks within the SRM.

that an entity is failing or likely to fail (FOLTF) triggers the SRB's assessment of the other two pre-conditions for resolution, namely whether there are alternative measures available to prevent the failing of the entity and if resolution is in the public interest. Should the SRB consider that these conditions are also met, it should adopt a resolution scheme. The SRB will transmit its resolution scheme to the Commission and it will enter into force if no objection has been expressed by the Commission (or where relevant, the Council) within a period of 24 hours after its transmission.<sup>6</sup> The resolution scheme will be addressed to the relevant NRA, which will have to take all necessary measures to implement it, by exercising its respective powers under national law.<sup>7</sup>

Another example is the procedure for setting the minimum requirement for own funds and eligible liabilities (MREL).<sup>8</sup> In that context, after consulting the relevant competent authorities, including the ECB, the SRB determines the MREL, which the entities under its remit are required to meet.<sup>9</sup> The determination is addressed to the NRAs, which have to implement it in line with the SRB's instructions.<sup>10</sup>

Finally, the process relating to the determination of the ex ante contributions due by individual institutions to the Single Resolution Fund (SRF). Each year the SRB, after consulting the ECB, and in close cooperation with the NRAs, which support the SRB through the collection and provision of data, decides on the amount of the individual contribution of each institution.<sup>11</sup> The SRB's decision is then communicated to the NRAs, which have to notify the institutions and give effect to it accordingly.<sup>12</sup>

## 3 Procedural aspects of the judicial review: lessons from the case-law of Union courts

### 3.1 A single judicial review

Given the number of interactions, Union and national authorities, and respective acts that are involved in such composite procedures, seeking judicial redress may prove to be a complex exercise, giving rise to various questions when it comes to, for instance, identifying the act or acts that should be challenged and the judicial forum before which an action should be brought.

Recent case-law sheds light on these issues. As set out below, the Court of Justice has assessed such composite procedures, considering the exercise of the final,

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<sup>6</sup> Article 18(6) and (7) of the SRM Regulation.

<sup>7</sup> Article 18(9) and Article 29(1) of the SRM Regulation.

<sup>8</sup> Article 12 of the SRM Regulation.

<sup>9</sup> Article 12(1) and (8) of the SRM Regulation.

<sup>10</sup> Article 12(14) and Article 29(1) of the SRM Regulation.

<sup>11</sup> Article 70(2) of the SRM Regulation.

<sup>12</sup> Article 5 of Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund, (OJ L 15, 22.1.2015, p. 1–7).

exclusive decision-making power giving rise to adverse legal effects, as the key factor in determining the allocation of jurisdiction between national and Union courts.<sup>13</sup>

In particular, in *Berlusconi*<sup>14</sup>, a preliminary ruling concerning the neighbouring area of the Single Supervisory Mechanism (SSM), the Court of Justice addressed the question of judicial review of acts adopted in a procedure relating to the assessment of the acquisition of a qualifying holding in a credit institution.

The Court observed in this respect that in cases where the Union legislature opted for a procedure under which national authorities adopt acts that are preparatory to a final decision of an EU institution, which produces legal effects and is capable of adversely affecting a person, it sought to establish a specific cooperation mechanism, based on the exclusive decision-making power of the EU institution.<sup>15</sup>

The Court went on to state that, in order to ensure the effectiveness of such a decision-making process, there shall only be a single judicial review.<sup>16</sup> This judicial review is carried out once the decision of the EU institution ending the administrative procedure has been adopted. And, given the exclusive jurisdiction of the Union courts to review the legality of EU acts<sup>17</sup>, it falls to them to carry it out and rule both on the legality of the final EU act and, incidentally, on any defects vitiating the preparatory national acts that could affect the validity of this final decision.<sup>18</sup> Within this context, as follows from Article 263 TFEU, read in the light of the principle of sincere cooperation,<sup>19</sup> the jurisdiction of the Union courts excludes any jurisdiction of the national courts to review the validity of the respective preparatory national acts.<sup>20</sup>

In its landmark judgment in *Iccrea*<sup>21</sup>, the Court of Justice confirmed that the principles previously set out in *Berlusconi*, with respect to the review of preparatory acts of national authorities in the context of a multi-stage procedure, shall also apply in composite procedures of the SRM.

*Iccrea* is about a preliminary reference made by an Italian court in the context of an action brought by Iccrea Banca against Banca d'Italia. The action at national level concerned a number of Banca d'Italia's decisions and communications in relation to the payment of contributions to the Italian national resolution fund in 2015 and to the SRF in 2016.

Like *Berlusconi*, *Iccrea* also concerned an example of a structure in which the Union legislature sought to establish a specific cooperation mechanism between a Union

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<sup>13</sup> Reference is also made to the view expressed by Professor Triantafyllou in his contribution: "The banking union as a new field for composite administrative procedures", ESCB Legal Conference 2020.

<sup>14</sup> Case C-219/17, *Silvio Berlusconi and Finanziaria d'investimento Fininvest SpA (Fininvest)*, EU:C:2018:1023.

<sup>15</sup> *Ibid.*, para. 48.

<sup>16</sup> *Ibid.*, paras. 48-49.

<sup>17</sup> Under Article 263 TFEU. See, further, by analogy, Case 314/85, *Foto-Frost*, EU:C:1987:452.

<sup>18</sup> Case C-219/17, *Berlusconi*, paras. 43-44.

<sup>19</sup> Article 4(3) TEU.

<sup>20</sup> Case C-219/17, *Berlusconi*, paras. 47 and 57-59.

<sup>21</sup> Case C-414/18, *Iccrea*, EU:C:2019:1036.

authority and national authorities and where the decision-making process can only be effective if there is a single judicial review.

The Court of Justice held that the preliminary reference was inadmissible to the extent that it concerned the calculation of the ex ante contributions to the SRF.<sup>22</sup> In reaching this conclusion, it took the opportunity to clarify important aspects regarding the review of the acts taken in this composite procedure.

In particular, the Court observed that, under the SRM Regulation, the SRB exclusively exercises the final decision-making power regarding the calculation of the ex ante contributions. The role of the NRAs prior to the adoption of the Board's decision is confined to providing operational support to the Board and their findings may not be binding on the Board.<sup>23</sup>

The Court went on to underline that Union courts have exclusive jurisdiction to review the legality of the Board's decision setting the amount of the individual ex ante contributions to the SRF.<sup>24</sup> Same as in *Berlusconi*, in this context, the Union judge will also determine whether preparatory acts of national authorities, taken while cooperating with the SRB, are vitiated by defects that could affect the validity of the final Board's decision.<sup>25</sup> Accordingly, national courts may not rule on the legality of the actions of the NRAs in the stage preceding the adoption of the Board's decisions and cannot issue to the NRAs any order as to how NRAs should act prior to the adoption of the Board's decision.<sup>26</sup>

In a nutshell, the Court held consistently in both *Berlusconi* and in *Iccrea*, that, in such cases, it is the final EU decision that brings the composite procedure to an end, which is capable of producing binding legal effects such as to affect a person's interests, that can and should be challenged before the Union courts. A direct action against that decision is therefore of particular importance. Preparatory acts of NRAs in this process are classified as EU acts and cannot be challenged separately before the national courts. When challenging the final decision, the person concerned may then incidentally challenge the legality of such preparatory acts that would be such as to affect the validity of the final decision. Any national rules that may provide for a separate review by national courts will have to be interpreted accordingly.

By its ruling in *Iccrea*, the Court affirmed the stance, previously expressed in *Berlusconi*, towards a centralised, single judicial review in connection with composite procedures of the SRM. It thereby responded to the need to preserve the effectiveness of the decision-making process while ensuring in parallel the right to effective judicial protection.

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<sup>22</sup> The Court found that the request could not be held to be admissible to the extent that its purpose was to enable the referring court to give a ruling on an issue which, under EU law, falls outside the jurisdiction of the national court. The request for a preliminary ruling was, however, admissible insofar as it concerned the payment of contributions to the Italian national resolution fund in 2015. See *Iccrea*, paras. 33, and 74-75.

<sup>23</sup> Case C-414/18, *Iccrea*, para. 47.

<sup>24</sup> Article 263 TFEU, to which Article 86 of the SRM Regulation also explicitly refers.

<sup>25</sup> Case C-414/18, *Iccrea*, para. 48.

<sup>26</sup> Case C-414/18, *Iccrea*, para. 54.

The principles drawn by the Court in *Iccrea* could consistently find application when it comes to the judicial review of various other acts adopted in the course of composite procedures in the SRM, like the ones referred to above, and beyond.

### 3.2 The implications of the Deggendorf doctrine

Since within the SRM the Board's decisions are given effect at national level by acts of the NRAs, the question then logically arises as to whether a preliminary ruling reference in the context of national proceedings against the NRA implementing measure could be considered as an alternative, instead of bringing a direct action against the Board's decision.

The judgment in *Iccrea*, to which reference shall be made once again, indicates that this may not always provide an adequate option.

According to the Deggendorf line of case-law,<sup>27</sup> which the Court applied in *Iccrea*, while the preliminary reference procedure is an additional channel through which individuals are able to question the validity of EU acts, this route will not be open to a party in national proceedings which could clearly have challenged the respective EU act via an action for annulment but has not done so in due time. In such cases, the national courts must regard the act in question as valid vis-à-vis this party and therefore apply it in any event.

In line with the requirements of good administration of justice and procedural economy, this doctrine is based on the consideration that the action for annulment shall have priority over a reference for a preliminary ruling on the issue of validity, as the appropriate procedural route for reviewing the legality of an EU decision. It also ensures the principle of legal certainty, which the mandatory two-month time limit for bringing an action for annulment is intended to secure, and which could otherwise be circumvented.<sup>28</sup>

It was according to this doctrine that the Court of Justice dismissed as partially inadmissible the preliminary ruling reference in *Iccrea* insofar as it intended to enable the national court to rule on the actions of Banca d'Italia after the adoption of the Board's decision on the calculation of the ex ante contributions.

As held by the Court, *Iccrea Banca* was unquestionably directly and individually concerned by the Board's decision at hand and, while having the right to bring an action for annulment against this decision, it brought such an action out of time.<sup>29, 30</sup> The Court took also into account in this regard that the task of the NRA after the adoption of the Board's decision was confined to notify and give effect to the Board's decision, and not to re-examine the calculations of the Board and alter the amount of

<sup>27</sup> Case C-188/92, *TWD Textilwerke Deggendorf*, EU:C:1994:90, para. 17.

<sup>28</sup> Case C-310/97 P, *Commission v AssiDomän Kraft Products and others*, EU:C:1999:407, paras. 60-61. See further in this respect Lenaerts, *EU Procedural Law*, Oxford University Press (2014), p. 465-466.

<sup>29</sup> In Case T-494/17, *Iccrea Banca SpA v Commission and SRB*, EU:T:2018:804.

<sup>30</sup> Case C-414/18, *Iccrea*, paras. 65-73.

the contributions.<sup>31</sup> On this basis, it was concluded that Iccrea Banca could not question the invalidity of the Board's decision on its ex ante contribution in the national proceedings.

It follows on that, in such cases, where the final Board's decision is simply given effect at national level by a national authority which does not have any discretion left, the legal protection should be sought by means of a direct action at the level at which the decision is taken, namely at Union level.

However, this presupposes that the affected person can establish its legal standing, in accordance with the fourth paragraph of Article 263 TFEU. This may not be always a straightforward exercise, as the case law set out in the next section further illustrates.

### 3.3 Revisiting the standing requirement in direct actions

Standing, a distinct procedural requirement, is governed at national level by the respective domestic legal framework and at Union level by the criteria laid down in Article 263 TFEU. The latter essentially requires natural or legal persons, who are not addressees of an individual act, to establish that they are directly and individually concerned, in the sense of the relevant case law of the Union courts.

While an extensive analysis of this requirement would go beyond the scope of this contribution, there is certainly merit in touching upon this issue, given its relevance in direct actions, by reference to the first cases concerning the SRB.

In *Activa Minoristas*,<sup>32</sup> a case relating to the SRB's resolution scheme in respect of Banco Popular, the General Court dismissed the action brought by an association of former shareholders of Banco Popular as inadmissible due to lack of direct concern. The association had argued in this case that it brought its action on its own name, in order to protect its own interests. The Court observed that the legal situation of the association could not have been directly affected by the resolution scheme, since the association had not yet been established when the resolution scheme was adopted. Accordingly, it dismissed the action.<sup>33</sup>

In *Algebris*,<sup>34</sup> the General Court dismissed as inadmissible due to lack of direct concern an action brought by former bondholders of Banco Popular this time against the SRB's decision not to proceed with a definitive valuation following the resolution action. The Court analysed in this context the relevant provisions of the SRM Regulation in order to assess whether the applicants' legal situation was affected by the decision not to proceed with such a definitive valuation and by the possibility of compensation relating to that decision. The Court concluded on this basis that the applicants could not obtain any compensation on the basis of Article 20(12) of the

<sup>31</sup> Ibid, paras. 57, 58, 67.

<sup>32</sup> Case T-618/17, *Activa Minoristas del Popular v ECB and SRB*, EU:T:2018:608.

<sup>33</sup> For the sake of clarity, it should be noted here that the order in this case concerned only the standing of the association itself and not the standing of its members, former shareholders of Banco Popular.

<sup>34</sup> Case T-2/19, *Algebris (UK) and Anchorage Capital Group v SRB*, EU:T:2019:741. A second case on the same subject-matter, case T-599/18, *Aeris Invest v SRB*, was also dismissed as inadmissible by the General Court and is currently under appeal.

SRM Regulation in the circumstances at hand.<sup>35</sup> Accordingly, the SRB's decision did not produce legal effects capable of affecting the applicants' legal situation and therefore was not of direct concern to the applicants.

At the time of writing, the order of the General Court in this case is under appeal.<sup>36</sup>

Lack of direct concern was also the ground based on which the General Court dismissed an action brought by the shareholders of ABLV Bank against the SRB's decisions not to take resolution action in respect of ABLV Bank and its subsidiary, in *Bernis*.<sup>37</sup> The Court held that the contested decisions did not directly affect the legal position of the bank's shareholders. It took into account in this respect that their right to receive dividends and to participate in the management of the banks had not been affected by the SRB's decisions.<sup>38</sup> In addition, the national authorities had discretion as regards the adoption of measures likely to affect the shareholders' rights following the adoption of the SRB's decisions.<sup>39</sup>

At the time of writing, the order of the General Court in this case also is under appeal.<sup>40</sup>

Finally, as noted already above, in *Iccrea*, the Court of Justice confirmed that credit institutions are directly and individually concerned by the SRB's decisions on the calculation of their individual contribution to the SRF.

### 3.4 Challenging in parallel national implementing measures

Against this background, the following question arises: would it be necessary to challenge in parallel a national implementing measure before the national courts when having lodged an action against the respective EU act before the Union Courts?

In this respect, various elements could be taken into consideration. For instance, whether the national authority has been left discretion on matters not determined by the EU act, whether, generally speaking, standing before the Union courts can be clearly established, or whether there are particular issues pertaining to the correct implementation of the EU act. As a matter of fact, the answer would depend on the specific circumstances of each case.

Considering this question from the perspective of the effects of an annulment of an act by the Union judge, it should be recalled that Article 266 TFEU requires Union institutions and bodies whose acts have been declared void to take the necessary measures to comply with the Court's judgment. Accordingly, they should draw all

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<sup>35</sup> Ibid, paras. 43-56.

<sup>36</sup> Case C-934/19P, *Algebris (UK) and Anchorage Capital Group v SRB*.

<sup>37</sup> Case T-282/18, *Bernis and other v SRB*, EU:T:2020:209.

<sup>38</sup> Ibid, para. 40.

<sup>39</sup> Ibid, para. 43.

<sup>40</sup> C-364/20 P, *Bernis and others v SRB*.



useful consequences from the judgment within a reasonable time, thereby possibly considering also the respective implications for the national implementing acts.<sup>41</sup>

At the same time, the practical implications of an annulment judgment at national level would be determined, in principle, having regard also to the relevant applicable provisions of national law, as the respective national implementing measures may not be rendered automatically void. However, it is questionable whether this would necessarily entail a need to launch a parallel challenge at national level each time.

In any event, in case of such parallel challenges at Union and national level, the duty of sincere cooperation would require the national court to stay its proceedings pending final judgment in the action for annulment by the Union courts.<sup>42</sup>

## 4 Concluding remarks

The issues discussed in this paper clearly illustrate the inherent complexity of the current administrative SRM framework and the various questions and challenges that may arise when seeking the judicial review of acts taken in such multi-level administrative proceedings.

In its recent case law, the Court of Justice shed light on those questions drawing at the same time a delicate balance between the right to judicial protection and the need to preserve the effectiveness of the decision-making process.

At this moment several cases are still pending before the Union judge against decisions of the SRB taken in the execution of its tasks under the SRM Regulation. Their outcomes are eagerly expected as they will certainly bring further, welcome clarity.

However, having considered the structure of the remedies available at Union and national level, we could already observe that a comprehensive system of judicial protection is available, allowing for effective decision-making and for the uniform application of EU law, while ensuring the exercise of judicial control and the protection of the persons concerned.

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<sup>41</sup> As follows also from the case-law, a decision which has already been annulled or withdrawn in the meantime may not compromise any longer the rights or interests of the persons concerned. See Case 3/54, *ASSIDER v High Authority*, EU:C:1955:2.

<sup>42</sup> Case C-344/98, *Masterfoods Ltd*, EU:C:2000:689, para. 57.

# Judicial review in a multi-level administrative framework – the case of the SSM

By Asen Lefterov<sup>1</sup>

## 1 Introduction

The SSM encompasses a complex mechanism for cooperation between the ECB and national competent authorities (NCAs). While the ECB has been conferred exclusive competence<sup>2</sup> in relation to its tasks, the SSM framework foresees that NCAs support the ECB in various steps of its administrative procedures. The SSM cooperation mechanism therefore provides for the adoption of numerous administrative acts as well as exchanges between the ECB and NCAs. The adoption of administrative acts raises the question of judicial review. It is not in doubt that judicial review is ensured in the SSM, as the European Union is a union based on the rule of law, in which individuals have the right to challenge before the courts the legality of any decision or other national measure with regard to the application of an EU act to them<sup>3</sup>. However, given the complexity of the SSM framework the precise mechanism for such a judicial review may sometimes also be complex.

## 2 Multi-level administrative proceedings in the European Union

Administrative procedures, whether in Union or national administrative law, tend to involve multiple stages, authorities and acts. Administrative procedures under Union law may also encompass several jurisdictional environments. Union courts have been able to appreciate the complexity of such administrative procedures with a Union element, and to form a view in the emerging body of Union administrative jurisprudence. The lessons learned in this regard have an impact on judicial review in the context of the SSM.

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<sup>1</sup> Senior Legal Counsel, Directorate General Legal Services, European Central Bank.

<sup>2</sup> Judgment of the General Court of 16 May 2017, *Landeskreditbank Baden-Württemberg v ECB*, Case T-122/15, EU:T:2017:337, para. 63 and the judgment of 8 May 2019, *Landeskreditbank Baden-Württemberg v European Central Bank*, Case C-450/17 P, EU:C:2019:372, para. 49.

<sup>3</sup> Judgment of 27 February 2018, *Associação Sindical dos Juizes Portugueses*, Case C-64/16, EU:C:2018:117, para. 31.

## 2.1 A terminological point

From the outset, it seems appropriate to clarify what is meant by “multi-level administrative proceedings”. This is not a term which is defined in Union law or in the jurisprudence of the courts. Scholars and advocates generally refer, for example, to “composite procedures” or “composite administrative procedures” when discussing procedures involving both national and Union authorities<sup>4</sup> while Union courts have used the phrase “procedure involving several stages” when they refer to internal administrative procedures which involve one or several Union authorities<sup>5</sup>. The term “multi-level administrative proceedings” used in this contribution refers to those administrative proceedings, involving several stages and at least two different authorities<sup>6</sup>, which adopt different acts in those different stages. Moreover, this contribution specifically examines proceedings which take place, at least in part, at Union level. Multi-level administrative proceedings may also, therefore, encompass multiple judicial environments.

## 2.2 Judicial review in procedures involving several stages

Administrative procedures involving several stages were put in place in Union law in various fields long before the establishment of the SSM and the SRM. There are several prominent examples of procedures involving several stages, which had been dealt with by the Court in order to determine the mechanism and the scope of judicial review in such procedures. In particular, Union courts have examined each case from the point of view of the features of the procedure and have allocated a judicial review in accordance with such features. There are two main strands of jurisprudence – the *IBM* case-law in procedures which only involve Union authorities and case-law where there is a jurisdictional issue, given that both Union and national authorities are involved.

### 2.2.1 The *IBM* case-law

The *IBM* case<sup>7</sup> is one of the first landmark cases in which the Court examined the mechanism for judicial review in procedures involving several stages. In this case, two intermediate acts – the initiation of the procedure and the statement of objections – paved the way for the final Commission decision in the administrative procedure involving several stages<sup>8</sup>. The Court found that the final Commission decision was the

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<sup>4</sup> See, for example, the opinion of Advocate General Campos Sánchez-Bordona of 27 June 2018 in Case C-219/17, EU:C: 2018:502, point 60, the opinion of Advocate General Campos Sánchez-Bordona of 9 July 2019 in Case C-414/18, EU:C: 2019:574, point 34.

<sup>5</sup> See, for example, the judgment of 13 October 2011, *Deutsche Post and others v Commission*, Joined case C-463/10 P and C474/10 P, EU:C:2011:656, paras. 50 to 52 and the judgment of 3 September 2015, *Spain v Commission*, Case T-676/14, EU:T: 2015: 602, para. 13.

<sup>6</sup> As such, this definition does not encompass those administrative proceedings which, even though they comprise several stages, always remain within the remit of the same authority from start to finish. This contribution does not, therefore, explicitly cover procedures comprising several stages conducted from start to finish either by the ECB or by NCAs.

<sup>7</sup> Judgment of 11 November 1981, *IBM v Commission*, Case C-60/81, EU:C:1981:264.

<sup>8</sup> *IBM*, para. 2.

only separately reviewable act in the sequence, given that it was the only decision in the sequence producing sufficient legal effect for it to be considered a reviewable act<sup>9</sup>. By contrast, any intermediate act whose purpose was to pave the way for the final decision was deemed to be a preparatory act that could not be the subject of an action for annulment<sup>10</sup>. Nevertheless, the Court emphasised that whilst preparatory acts may not in themselves be the subject of an action for annulment, any legal defects therein may be relied upon in an action directed against the definitive act for which they represent a preparatory step<sup>11</sup>.

*IBM* has provided the standard test to be applied by the Court in order to establish the mechanism for judicial review in procedures involving several stages, whether within one Union institution<sup>12</sup> or between several Union institutions or bodies<sup>13</sup>. The *IBM* solution has been confirmed in various situations, although Union courts have also established some notable exceptions in which the *IBM* solution would not apply.

One notable exception is the situation in *Italy v Commission*<sup>14</sup>. In the context of state aid, the Court found that the Commission's decision to initiate a formal investigation procedure in respect of a measure which the Commission presumed to be new aid had immediate legal effects on the applicant<sup>15</sup>. The Court therefore acknowledged that the Commission's decision to initiate the proceedings could be separately reviewable, independent of the review of the final decision in the procedure involving several stages. In other words, an intermediate decision was found to have independent legal effects, prior to the adoption of the final decision in the procedure involving several stages<sup>16</sup>.

An exception to *IBM* which is similar to *Italy v Commission* was developed in the *AKZO Chemie* case<sup>17</sup>. In that case an intermediate act was deemed to have independent legal effects and to be separately reviewable as it was deemed to be the culmination of a special procedure within the overall procedure<sup>18</sup>. In other words, given that a challenge to the final decision could not encompass a review of the intermediate act, that intermediate act was deemed to produce independent legal effects and, therefore, a separate judicial review at the stage of the intermediate act was justified<sup>19</sup>.

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<sup>9</sup> *IBM*, para. 21.

<sup>10</sup> *IBM*, para. 10.

<sup>11</sup> *IBM*, para. 12.

<sup>12</sup> See, for example, *Deutsche Post*, paras. 50 to 52 and the judgment of 18 December 1992, *Cimenteries CBR and Others v Commission*, joined cases T-10/92, T-11/92, T-12/92 and T-15/92, EU:T:1992:123, paras. 28 and 42.

<sup>13</sup> See, for example, *Spain v Commission*, para. 13, the judgment of 18 December 2003, *Fern Olivieri v Commission and EMEA*, Case T-326/99, EU:T:2003:351, paras. 51 to 54, the order of 2 June 2004, *Pfizer v Commission*, Case T-123/03, EU:T:2004:167, paras. 22 and 26 and the judgment of 3 June 2015, *Luxembourg Pamol (Cyprus) and Luxembourg Industries v Commission*, Case T-578/13, EU:T:2015:354, paragraphs 54 and 62 to 67.

<sup>14</sup> Judgment of 9 October 2001, *Italy v Commission*, Case C-400/99, EU:C:2005:275.

<sup>15</sup> See to this effect *Italy v Commission*, para. 63.

<sup>16</sup> *Deutsche Post*, para. 54.

<sup>17</sup> Judgment of 24 June 1986, *AKZO Chemie BV and AKZO Chemie UK Ltd v Commission*, Case C-53/85, EU:C:1986:256.

<sup>18</sup> *AKZO Chemie*, para. 20.

<sup>19</sup> *Deutsche Post*, paras. 53 and 54.

Yet another exception to *IBM* can be seen in the *SFEI* case<sup>20</sup>, where the Court found that a Commission act closing the proceedings opened by a complaint without making a final decision could have legal effects of its own and would, therefore, be separately reviewable. The main consideration here was that such a decision cannot be followed by any other decision amenable to annulment proceedings<sup>21</sup>. However, the *SFEI* situation concerned a procedure opened by a complaint made by the applicant, which should be distinguished from situations in which no such right exists<sup>22</sup>.

## 2.2.2 Case-law when there is a jurisdictional issue

This contribution would not be complete without referring to procedures involving several stages which also involve a jurisdictional issue – that is to say different administrative acts adopted by Union and national authorities within the same proceeding. When establishing the mechanism used to ensure judicial protection in such cases, Union courts have not explicitly relied on the *IBM* case-law. At the same time, the solution to the jurisdictional issue found by the courts is quite similar to the solution in *IBM* and its exceptions.

A landmark case regarding procedures involving a jurisdictional issue is the *Borelli* case<sup>23</sup>. In that case, even though the Commission adopted the final decision in a multi-level administrative proceeding, the Court found that the decision could not be the subject of an action for annulment, given that it was adopted upon a clear instruction from a national authority, with the Commission having no real discretion<sup>24</sup>. Instead, a judicial review had to be made available, against the instruction of the national authority and before a national court<sup>25</sup>. The solution in *Borelli* is therefore similar, for example, to the outcome in *Italy v Commission*, in that the Court found that an intermediate act had legal effects of its own, even if it was superseded by a later act in the next stage.

The counterpoint to *Borelli* is *Sweden v Commission*<sup>26</sup>. This case deals with a similar multi-stage administrative proceeding in which a Member State adopted a request to the Commission not to disclose certain documents as an intermediate act and the Commission adopted the final decision on the disclosure. Even though within this procedure the Commission could not substitute its assessment for that of a Member State<sup>27</sup>, the Court found that it could also review the assessment originating from the Member State if it has been included in the final decision of the Commission<sup>28</sup>. In

<sup>20</sup> Judgment of 16 June 1994, *Syndicat français de l'Express international (SFEI) and others v Commission*, Case C-39/93 P, EU:C:1994:253, para. 28 and opinion of Advocate General Bot of 3 April 2008 in Case C-521/06 P, EU:C:2008:192, point 115.

<sup>21</sup> *SFEI*, para. 28.

<sup>22</sup> Judgment of 18 May 1994, *BEUC v Commission*, Case T-37/92, EU:T:1994:54, paras. 29, 30 and 36 and opinion of Advocate General Jääskinen of 17 July 2014 in Case C-261/13 P, EU:C:2014:2107, points 68 and 69.

<sup>23</sup> Judgment of 3 December 1992, *Borelli v Commission*, Case C-97/91, EU:C:1992:491.

<sup>24</sup> *Borelli*, para. 10.

<sup>25</sup> *Borelli*, para. 13.

<sup>26</sup> Judgment of 18 December 2007, *Sweden v Commission*, Case C-64/05 P, EU:C:2007:802.

<sup>27</sup> Judgment of 14 February 2012, *Germany v Commission*, Case T- 59/09, EU:T:2012:75, para. 54.

<sup>28</sup> *Sweden v Commission*, para. 94.

contrast to the *Borelli* case, in this case the jurisdictional issue was resolved in favour of the Union courts, given that the Court found that in this case Union law did not establish two powers – one at national and the other at Union level<sup>29</sup>. In the light of the above, the solution in *Sweden v Commission* appears rather similar to the standard *IBM* formula.

## 2.3 Early conclusions on judicial review in procedures involving several stages

These cases provide a glimpse of the Court's thinking when it comes to judicial review in procedures involving several stages and, sometimes, a jurisdictional issue. While the administrative procedures examined in the case-law are very varied, the approach of the Court is consistent. The main objective of the Court is to establish precisely where in these proceedings the immediate legal effects on the position of an applicant are situated. A direct action at the stage at which the immediate legal effects emerge would generally be admissible – whether before Union or national courts, depending on which authority is responsible at the relevant stage<sup>30</sup>. If, however, these effects are only latent and are deferred over time until the adoption of the final decision, a judicial review at the stage of the intermediate act may be deemed to be premature.

Therefore, in order to understand the mechanism and the scope of judicial review in multi-level administrative proceedings in the SSM, one needs to examine precisely where those legal effects are situated in the respective administrative procedures.

## 3 Preparatory acts in the SSM

It is evident that the Court has developed specific mechanisms for conducting a judicial review in procedures which involve several stages as well as several authorities. In particular, the Court has established a certain bar on admissibility, and it is not guaranteed that each and every individual administrative act in a procedure involving several stages may be subject to a separate review, whether by Union or by national courts. This bar is the most evident in relation to preparatory acts, which cannot be subject to a separate judicial review.

### 3.1 The preparatory acts doctrine and its rationale

In the *IBM* case the Court established the general principle that in an administrative procedure involving several stages an act is open to a separate review only if it is a measure which definitively lays down the position of the institution on the conclusion of that procedure. Therefore – as a rule – intermediate acts which pave the way for the final decision will be deemed preparatory and cannot, by themselves, be the subject of an action for annulment. This does not mean that such acts are necessarily excluded

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<sup>29</sup> *Sweden v Commission*, para. 93.

<sup>30</sup> If a jurisdictional issue is involved, such direct action may or may not be supplemented by an ancillary judicial proceeding before another court.

from judicial review. As previously noted, while preparatory acts may not in themselves be the subject of an action for annulment, any legal defects therein may be relied upon in an action directed against the definitive act for which they represent a preparatory step<sup>31</sup>.

The preparatory acts doctrine is supported by several considerations.

First, such preparatory acts do not have any binding legal effects on the applicants. Instead, they have at most procedural and interinstitutional effects which are confined to the next authority in the procedural chain<sup>32</sup>.

Second, the doctrine is also justified by the objective of ensuring the sound administration of justice and the proper course of administrative procedures<sup>33</sup>. As the Court has already held in the *IBM* case, reviewing preparatory acts might make it necessary for the Court to arrive at a decision on issues on which the Commission has not yet had an opportunity to state its position<sup>34</sup>. As a result, the Court will have to anticipate the arguments on the substance of the case, confusing different procedural stages both administrative and judicial<sup>35</sup>.

Third, the doctrine aids procedural economy, as a review of each and every act in complex administrative multi-level proceedings could create multiple judicial proceedings with very similar and interlinked subject matters. It is on this basis that the Court refined the *IBM* doctrine in the *Deutsche Post* case to find that it is not possible for an intermediate measure to form the subject matter of an action if it has been established that the illegality attaching to that measure can be relied on in support of an action against the final decision for which it represents a preparatory step<sup>36</sup>.

As Advocate General Bot noted in his opinions in the *Deutsche Post* and *Jäger and Polacek* cases, in its approach to the judicial review of preparatory acts the Court seeks to ensure effective judicial protection of an individual's rights while the Court also seeks to avoid an increase in the number of actions against preparatory measures, which could paralyse the activity of the institutions<sup>37</sup>.

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<sup>31</sup> *IBM*, para. 12.

<sup>32</sup> See, for example, the judgment of 26 November 2018, *Shindler*, Case T- 458/17, EU:T:2018:838, paras. 39, 40 and 52, confirmed on appeal in the order of 19 March 2019, *Shindler*, Case C- 755/18 P, EU:C:2019:618.

<sup>33</sup> *Deutsche Post*, para. 51.

<sup>34</sup> *IBM*, para. 20.

<sup>35</sup> *IBM*, para. 20.

<sup>36</sup> *Deutsche Post*, para. 53.

<sup>37</sup> Opinion of Advocate General Bot of 30 June 2011 in Case C-463/10 P, EU:C:2011:445, points 78 and 79 and opinion of Advocate General Bot of 5 July 2012 in Case C-402/11 P, EU:C:2012:424, points 47 and 48.



### 3.2 Are there also preparatory acts when there is a jurisdictional issue?

A similar approach may be deemed to apply in some cases which involve a jurisdictional issue, even though the Court does not generally refer to national measures which prepare the decision at Union level as “preparatory acts”<sup>38</sup>.

In particular, *Sweden v Commission* suggests that the intermediate acts adopted at national level could in fact serve as a proposal for the reasoning of the final decision adopted at Union level<sup>39</sup>. Hence, in the same strand of case-law the Court has held that the deciding Union institution, given that it makes the final decision, is responsible for the lawfulness of that decision<sup>40</sup> and that the Court will also have jurisdiction over the final decision of the Commission<sup>41</sup>. Therefore, similarly to the preparatory acts doctrine, in a situation such as that in *Sweden v Commission*, a review of the final Union decision would be admissible, while any defects in the intermediate national measures may affect the final decision unless they have been remedied by the final deciding authority. This means that the deciding authority must be vigilant over those parts of the intermediate national act it incorporates into its final decision, as it needs to be able to defend them.

On the other hand, where the intermediate act has been adopted at Union level and the final decision at national level, the Court will generally support the *Foto-Frost* formula<sup>42</sup>. National courts reviewing the national measure adopted further to a Union act may either hold that the Union intermediate act is lawful or, if they have any doubt, they must submit a request for a preliminary ruling on its validity, since only the Court of Justice may declare Union acts to be invalid<sup>43</sup>.

In such situations, in order to challenge and obtain a review of Union intermediate acts, an applicant before a national court will need to obtain a preliminary ruling on the relevant Union intermediate act<sup>44</sup>. However, the *Deggendorf*<sup>45</sup> case-law suggests there is limited capacity for requesting such preliminary rulings. The Court of Justice has held, in particular, that in circumstances in which the action for annulment would unquestionably have been admissible, a person may not plead before a national court that an act of the European Union is invalid<sup>46</sup>. To this end, an applicant who undoubtedly has the standing to challenge the Union intermediate act must seek direct action before the General Court, within the prescribed time limits. As observed by the Court and the Advocate General Campos Sánchez-Bordona in the *Georgsmarienhütte* case, such a solution is also justified by the consideration that the action for annulment, which is complemented by the possibility of appealing against

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<sup>38</sup> The Court only recently referred to national measures as being “preparatory acts” to Union decisions, see the judgment of 19 December 2018, *Berlusconi*, Case C-219/17, EU:C:2018:1023, para. 43.

<sup>39</sup> *Sweden v Commission*, paras. 87 to 89.

<sup>40</sup> Judgment of 21 June 2012, *IFAW v Commission*, Case C-135/11 P, EU:C:2012:376, para. 61.

<sup>41</sup> *Sweden v Commission*, para. 94.

<sup>42</sup> Judgment of 22 October 1987, *Foto-Frost*, Case C-314/85, EU:C:1987:452.

<sup>43</sup> *Foto-Frost*, paras. 14 and 19.

<sup>44</sup> Judgment of 4 October 2006, *Tillack and others v Commission*, Case T-193/04, EU:T:2006:292, para. 80.

<sup>45</sup> Judgment of 9 March 1994, *TWD Textilwerke Deggendorf*, Case C-188/92, EU:C:1994:90.

<sup>46</sup> Judgment of 14 March 2017, *A and Others*, Case C-158/14, EU:C:2017:202, para. 67 and *Deggendorf*, paras. 17 to 25.

the ruling of the General Court, provides a particularly appropriate procedural framework for a thorough examination, both parties being duly heard, of legal and factual questions, particularly in technical and complex fields<sup>47</sup>.

### 3.3 Intermediate acts in the SSM

Within the SSM the ECB has exclusive decision-making power and is assisted by NCAs in the decentralised implementation of its tasks<sup>48</sup>. There are multiple procedures in the SSM which comprise several stages and produce numerous intermediate acts before the procedure is concluded with a final decision. In some cases such intermediate acts are adopted by the ECB in preparation for its final decision, while in other cases they are adopted by NCAs to support the ECB's final decision. In still further cases the ECB may adopt intermediate acts which could lay the foundation for a final decision at national level.

#### 3.3.1 Draft decisions, requests and notifications by NCAs to the ECB

The most common type of multi-level administrative proceedings in the SSM are those cases in which an NCA lays the groundwork for an ECB decision within the ECB's field of exclusive competences. In this process NCAs may adopt a number of intermediate acts.

One example of the above may be found in the context of the procedures for granting and withdrawing authorisation as a credit institution. This task is exercised exclusively by the ECB vis-à-vis all credit institutions in the SSM<sup>49</sup>. NCAs are involved as the entry point for applications for the granting of authorisation as a credit institution<sup>50</sup> and may adopt a draft decision which proposes that the ECB grant the authorisation<sup>51</sup>. The ECB may adopt or object to that draft decision<sup>52</sup>. NCAs may also initiate the procedure for withdrawing an existing authorisation by making a proposal to the ECB to this end<sup>53</sup>. Both the draft decision to grant an authorisation and the proposal to withdraw an authorisation are intermediate acts in the multi-level administrative proceeding which concludes with the final ECB decision on the matter.

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<sup>47</sup> Judgment of 25 July 2018, *Georgsmarienhütte*, Case C-135/16, EU:C:2018:582, para. 19 and the opinion of Advocate General Campos Sánchez-Bordona of 27 February 2018 in Case C-135/16, EU:C:2018:120, points 40 to 44.

<sup>48</sup> *Landeskreditbank Baden-Württemberg v European Central Bank* (Case T-122/15), para. 63 and *Landeskreditbank Baden-Württemberg v European Central Bank* (Case C-450/17 P), para. 49.

<sup>49</sup> Article 4(1) and Article 6(4) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63) (the SSM Regulation).

<sup>50</sup> Article 14(1) of the SSM Regulation.

<sup>51</sup> Article 14(2) of the SSM Regulation. However, NCAs are not required to refer the matter to the ECB if they do not consider that the applicant complies with all the conditions for authorisation set out in the relevant national law of that Member State. No draft decision pursuant to Article 14(2) will be adopted in such cases.

<sup>52</sup> Article 14(3) of the SSM Regulation.

<sup>53</sup> Article 14(5) of the SSM Regulation.

A similar example is the procedure for assessing the proposed acquisition of a qualifying holding in a credit institution<sup>54</sup>, which is the other “common procedure”<sup>55</sup> in the SSM. This procedure is initiated once notification has been received by the NCA, which is required to prepare a proposal for a decision and submit this to the ECB<sup>56</sup>. The NCA’s proposal is, therefore, an intermediate act in the multi-level administrative proceeding which concludes with the final ECB decision on the matter<sup>57</sup>.

Other NCA acts which could be included in the category of intermediate acts are the NCA requests to the ECB as part of the procedure for determining that a particular credit institution is significant<sup>58</sup>, a determination for which the ECB is competent<sup>59</sup>. NCAs can also notify the ECB of a number of issues which require an ECB assessment, e.g. a change of management bodies<sup>60</sup> or the establishment of a branch<sup>61</sup>. These notifications could also be classified as intermediate acts to the extent that they may pave the way for a final decision of the ECB on the matter.

### 3.3.2 ECB requests to NCAs

The SSM legal framework provides for some instances of ECB intermediate acts addressed to NCAs, which may pave the way for later decisions either by the ECB or by national authorities.

In the first category, the ECB can request an NCA to prepare a draft decision in relation to any supervised entity<sup>62</sup> or to provide information<sup>63</sup>. In such cases the ECB’s request is an intermediate act, as is the NCA’s subsequent act, as both lay the groundwork for a potential final ECB decision at the end of the procedure.

The second category includes the ECB’s requests to NCAs to open sanctioning proceedings<sup>64</sup> or requests to refer a matter to another authority<sup>65</sup>. In these cases the multi-level administrative proceedings may conclude with a final decision at national level, for which the ECB act will be an intermediate step.

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<sup>54</sup> Article 15 of the SSM Regulation.

<sup>55</sup> Part V of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, p. 1) (the SSM Framework Regulation).

<sup>56</sup> Article 15(1) and (2) of the SSM Regulation.

<sup>57</sup> The transmission by the NCA of the notification in accordance with Article 15(2) of the SSM Regulation is also an intermediate act.

<sup>58</sup> See, for example, Article 43(5), Article 58 and Article 68 of the SSM Framework Regulation.

<sup>59</sup> Article 6(4) of the SSM Regulation.

<sup>60</sup> Article 17 of the SSM Framework Regulation.

<sup>61</sup> Article 93 of the SSM Framework Regulation.

<sup>62</sup> Article 91 of the SSM Framework Regulation.

<sup>63</sup> See, for example, Article 97(3) of the SSM Framework Regulation.

<sup>64</sup> Article 18(5) of the SSM Regulation.

<sup>65</sup> Article 136 of the SSM Framework Regulation.

### 3.3.3 ECB's FOLTF assessment notified to the SRB and the Commission

Even though it relates to the broader banking union, rather than to a strictly SSM context, the multi-level resolution procedure in the SRM Regulation<sup>66</sup> is also worth mentioning.

In accordance with the SRM Regulation, a Union resolution regime has been established, empowering a new public authority to intervene to resolve a failing credit institution. The decision to resolve an entity is contained in a resolution scheme, adopted in accordance with a complex administrative procedure involving, for significant credit institutions, the ECB, the SRB, the Commission and the Council<sup>67</sup>. The resolution scheme is implemented by national resolution authorities<sup>68</sup>. The role of the ECB in this process is that it may conduct an assessment of whether a supervised entity is failing or likely to fail (FOLTF). Such a FOLTF assessment is an intermediate act at the very beginning of this multi-stage administrative proceeding.

### 3.4 Are these intermediate acts also preparatory acts?

Which of these intermediate acts are also preparatory acts in the strict sense of the case-law of the Union courts, meaning that they cannot in themselves be the subject of an action for annulment but that, instead, any defects attaching to those measures can be invoked in the action against the final decision in the multi-stage procedure? There are already some indicative answers to this question in the case-law of Union courts with regard to the SSM.

#### 3.4.1 *Berlusconi* (C-219/17)

The *Berlusconi* case concerned the procedure for the assessment of the proposed acquisition of a qualifying holding conducted by the ECB with the assistance of NCAs. The case concerned a preliminary ruling request, made by the Italian Supreme Administrative Court on the basis of an action against Banca d'Italia's acts adopted in the context of that qualifying holding procedure.

Given that the case involved both Union and national authorities, the *Berlusconi* case posed a jurisdictional issue. The Court applied the test developed in the *Borelli* case and in *Sweden v Commission* and sought to establish whether the legislator had opted for a division of powers or for the conferral of exclusive decision-making powers<sup>69</sup>. Given that the Court concluded that the latter was the case, it upheld the approach of *Sweden v Commission*<sup>70</sup>, in order to conclude that the ECB's decision can be the

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<sup>66</sup> 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 and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

<sup>67</sup> See Article 18 of the SRM Regulation.

<sup>68</sup> Articles 18(9) and 29 of the SRM Regulation.

<sup>69</sup> *Berlusconi*, paras. 43 to 45.

<sup>70</sup> *Berlusconi*, para. 48.

subject of an action for annulment<sup>71</sup>. In particular, the Court considered that in this context only the ECB's decision which brings the administrative procedure to an end is capable of producing binding legal effects that affect the applicant's interests by bringing about a distinct change to his legal position<sup>72</sup>. By contrast, the Court found that the NCA's proposals and the preparatory acts adopted in the course of the procedure leading to the adoption of the ECB's decision cannot be subject to a review by national courts<sup>73</sup>. Therefore, following the suggestion of the Advocate General<sup>74</sup>, the Court went a step further than *Sweden v Commission*, ruling explicitly that it has the competence to examine whether the legality of the ECB's decision is affected by any defects rendering unlawful the preparatory acts to that decision that were adopted by Banca d'Italia<sup>75</sup>. In contrast to the Advocate General<sup>76</sup>, the Court stopped short of explicitly linking the jurisprudence in procedures with a jurisdictional issue to the *IBM* jurisprudence which concerns only Union authorities, although the Court did explicitly refer to the NCA's acts as "preparatory acts"<sup>77</sup>.

Given the formulation of the Court's judgment in the *Berlusconi* case, it is conceivable that the solution could also apply to other common procedures in the SSM where the NCAs assist the ECB in the adoption of the final decision by preparing a proposal for the ECB – such as proposals to grant or to withdraw authorisation as a credit institution.

### 3.4.2 *Pilatus* (T-687/18)

The background to the *Pilatus* case concerned the procedure for withdrawal of authorisation as a credit institution. In the case, the applicant contested an ECB email received in the context of a credit institution exercising its right to be heard with regard to the draft ECB withdrawal decision.

The General Court applied the *IBM* jurisprudence<sup>78</sup> to conclude that the actions by the ECB during the hearing were preparatory to the final ECB decision<sup>79</sup>.

The order of the General Court is under appeal at the time of writing<sup>80</sup>.

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<sup>71</sup> See, in this regard, action brought on 23 December 2016, *Fininvest and Berlusconi v ECB*, Case T-913/16, OJ C 63, 27.2.2017, p. 35, which is currently ongoing.

<sup>72</sup> *Berlusconi*, paras. 48, 49 and 52 to 56.

<sup>73</sup> *Berlusconi*, paras. 47 and 57.

<sup>74</sup> Opinion of Advocate General Campos Sánchez-Bordona (C-219/17), points 110 and 111.

<sup>75</sup> *Berlusconi*, para. 57.

<sup>76</sup> Opinion of Advocate General Campos Sánchez-Bordona (C-219/17), points 74, 108 and 109.

<sup>77</sup> *Berlusconi*, paragraphs 57 to 59.

<sup>78</sup> Order of 10 July 2019, *Pilatus v ECB*, Case T-687/18, EU:T: 2019:542, paras. 18 to 20.

<sup>79</sup> *Pilatus*, paras. 23 and 24.

<sup>80</sup> Appeal brought on 20 September 2019, *Pilatus Bank v ECB*, Case C-701/19 P, OJ C 406, 2.12.2019, p. 17, which is ongoing.

### 3.4.3 ABLV (T-281/18 and T-283/18)

The *ABLV* cases concerned the resolution procedure in Article 18 of the SRM Regulation. The ECB assessed two credit institutions to be FOLTF and notified this assessment to the SRB and the Commission. The SRB found that resolution of the two institutions would not be in the public interest.

The General Court applied the *IBM* solution<sup>81</sup> to conclude that the ECB's FOLTF assessment was a preparatory act in the procedure leading to the final SRB decision<sup>82</sup>. The Court also found that the legal status of the applicants had not been changed by the ECB's FOLTF assessments<sup>83</sup>.

The two orders of the General Court are under appeal at the time of writing<sup>84</sup>. The Advocate General has expressed his agreement with the General Court's rulings<sup>85</sup>.

### 3.4.4 Intermediate conclusion

Union courts have applied the existing case-law solutions to the SSM. In particular, Union courts have focused on establishing where binding legal effects are concentrated in multi-level administrative SSM proceedings, so as to permit judicial review specifically at that stage.

The *IBM* solution has been found to be particularly appropriate, as have the solutions found in cases with a jurisdictional issue (such as *Sweden v Commission*). In this context, the Court has even gone one step further than pre-existing jurisprudence in recognising national measures as preparatory acts, establishing its sole jurisdiction to review them as an incidental matter forming part of the review of the final decision in multi-level administrative proceedings. The Court has thereby also improved the consistency of the mechanism for judicial review of national and Union preparatory acts in multi-level administrative proceedings.

## 4 Final decisions and instructions

As explained previously, intermediate acts in multi-level administrative proceedings will very often be deemed to be preparatory acts which cannot be subject to a separate review. This does not, however, mean that multi-level administrative proceedings are exempted from judicial review – it simply means that a particular review mechanism applies.

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<sup>81</sup> Order of 6 May 2019, *ABLV Bank AS v ECB*, Case T-281/18, EU:T: 2019:296, paras. 30 to 32.

<sup>82</sup> *ABLV*, para. 36.

<sup>83</sup> *ABLV*, para. 44.

<sup>84</sup> Appeals brought on 17 July 2019, *ABLV Bank AS v ECB and Ernests Bernis and others v ECB*, Cases C-551/19 P and C-552/19 P, OJ C 305, 9.9.2019, p. 28, which are ongoing.

<sup>85</sup> Opinion of Advocate General Campos Sánchez-Bordona of 14 January 2021 in Joined Cases C-551/19 P and C-552/19 P, EU:C:2021:16.

Final decisions which bring about the legal effects of the entire proceeding will be subject to a separate review. Intermediate acts which are superseded by an implementing act but have an immediate effect on the legal position of an applicant may also be subject to an action for annulment. These are referred to here as “instructions”. In respect of Union instructions to national authorities this seeming contradiction to the general principle in *IBM*, i.e. that only final decisions in multi-stage proceedings can be subject to an action for annulment, is also justified by the considerations put forward in *Georgsmarienhütte*, i.e. that an action for annulment provides a particularly appropriate procedural framework for the thorough examination, both parties being duly heard, of legal and factual questions, particularly in technical and complex fields. Conversely, where an instruction from a Union institution leaves ample discretion to the implementing national authority, an applicant may find it difficult to establish standing for an annulment action against such an instruction. The applicant will then have to follow the route of challenging the implementing national measure and, to the extent necessary, seek recourse to a preliminary ruling on the validity of the instruction.

#### 4.1 Judicial review of final ECB decisions

The review of final ECB decisions adopted in the context of multi-level administrative proceedings is unambiguous. In accordance with Article 263 TFEU, binding decisions of Union institutions are subject to an action for annulment, either by their addressees or by those applicants that can establish direct and individual concern. The ECB’s decision regarding the acquisition of a qualifying holding in a credit institution, which is mentioned in the *Berlusconi* case, was one such final decision.

Excluded from such a review are, however, those ECB acts which, even if final in terms of time, lack binding legal effects – acts which could not be considered reviewable within the meaning of case-law on the basis of Article 263 TFEU. To determine if this is the case the Court will examine the substance of the act and assess its legal effects on the basis of objective criteria, such as the content of that act, taking into account, as appropriate, the context in which the act was adopted and the powers of the institution which adopted the act<sup>86</sup>.

#### 4.2 Judicial review of ECB instructions

In contrast to the SRM, instructions are not a prominent feature of the SSM, in which the ECB has exclusive decision-making powers vis-à-vis credit institutions and certain natural and legal persons. There are, however, several examples of instructions the ECB can adopt and which NCAs are required to implement.

In particular, the ECB has the power to instruct NCAs to make use of their powers under national law where the SSM Regulation does not confer such powers on the

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<sup>86</sup> Judgment of 20 February 2018, *Belgium v Commission*, Case C-16/16 P, EU:C:2018:79, para. 32.



ECB<sup>87</sup>. In addition, the ECB has the power to address general instructions to NCAs with regard to their supervision of less significant institutions<sup>88</sup>.

In the context of close cooperation between the ECB and an NCA from a non-euro area Member State, ECB instructions represent a structural solution for day-to-day supervision<sup>89</sup>. In this realm the ECB is the competent authority but, due to Treaty limitations, the ECB cannot address its decision directly to credit institutions in non-euro area Member States. The ECB therefore relies fully on NCAs for the implementation of its supervisory decisions<sup>90</sup>.

There is, as yet, no case-law on the reviewability of the ECB's instructions mentioned above. It is expected that the mechanism for the judicial review of such instructions will be discussed in each specific case and the Court will reach its conclusions on the basis of the distribution of discretion between the instructing authority and the implementing authority, as well as the legal framework which determines these competences. If the recent *Iccrea* judgment<sup>91</sup> is an indication of what Union courts will consider in the context of the SSM, then the ECB's specific instructions in close cooperation could be the subject of an action for annulment.

With regard to the judicial review of instructions, the *Deggendorf* case-law is once again worth mentioning. In this regard, applicants may be walking a tightrope when determining their recourse to judicial review when they are faced with a Union instruction implemented by a national decision. If the instruction eliminates any significant discretion at national level and if an applicant is directly and individually concerned by the instruction, then that applicant should seek to appeal before the General Court before the two-month deadline expires. However, if the instruction leaves discretion to the national authority a direct action would probably be found to be inadmissible due to lack of standing and the applicant would therefore have to challenge the national measure and seek recourse to the Court of Justice for a preliminary ruling.

## 5 Standing in multi-level administrative proceedings in the SSM

This last point referring to the *Deggendorf* case-law raises the issue of standing to bring an action before Union courts in the case of multi-level administrative proceedings. Standing in such a context may be difficult to establish, given that generally only the final act in the process would be addressed to a natural or legal person. While standing before national courts depends on the domestic legal framework, the admissibility of annulment proceedings before the Court of Justice depends on the conditions stipulated in Article 263 TFEU. In this regard the case-law

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<sup>87</sup> Article 9(1) of the SSM Regulation.

<sup>88</sup> Article 6(5)(a) of the SSM Regulation.

<sup>89</sup> Article 7 of the SSM Regulation.

<sup>90</sup> See further Pizzolla, A. (2021), "Close cooperation and aspects of judicial review", in Zilioli, C. and Wojcik, K.-P. (eds.), *Judicial Review in the European Banking Union*, p. 345.

<sup>91</sup> Judgment of 3 December 2019, *Iccrea Banca SpA*, Case C-414/18, EU:C:2019:1036.

provides that the conditions of admissibility laid down in the fourth paragraph of Article 263 TFEU must be interpreted in the light of the fundamental right to effective judicial protection, but such an interpretation cannot have the effect of setting aside the conditions expressly laid down in that Treaty<sup>92</sup>.

This raises the question of direct and individual concern and interest in bringing proceedings before Union courts. For there to be direct concern, two cumulative criteria need to be met: the contested measure must (i) directly affect the legal situation of the individual and (ii) leave no discretion to the addressees who are entrusted with the task of implementing it, such implementation being purely automatic and resulting from EU rules alone without the application of other intermediate rules<sup>93</sup>. On the other hand, there is individual concern if the decision affects the applicants by virtue of certain attributes which are peculiar to them or they can be distinguished individually, just as for the addressees of the decision<sup>94</sup>.

At the time of writing standing has been considered by the Court in two notable cases involving the ECB.

## 5.1 [Trasta \(C-663/17 P\)](#)

Direct concern has been raised in the case-law of the SSM in the *Trasta* case<sup>95</sup>. In this case the licence of a Latvian credit institution was withdrawn by the ECB and – as a result of the application of national law – liquidation of the credit institution followed. The credit institution – as represented by its former board of directors – and its shareholders brought an action against the ECB’s final withdrawal decision.

In its judgment, the Court of Justice upheld the power of the former board to represent the credit institution for the purposes of bringing an action, given that the credit institution was the addressee of the withdrawal decision<sup>96</sup>.

With regard to the action brought by the shareholders of the credit institution, the Court found that they were not directly concerned by the ECB’s decision. In particular, the Court found that the withdrawal decision had only non-legal, economic effects on the shareholders<sup>97</sup>. Their rights, such as their right to receive dividends and their right to participate in the management, had not been affected<sup>98</sup>. The Court acknowledged that the liquidation affected the shareholders<sup>99</sup>. However, even if the liquidation were considered to be implementation of the ECB’s decision, such implementation resulted

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<sup>92</sup> Judgment of 3 October 2013, *Inuit Tapiriit Kanatami and Others v Parliament and Council*, Case C-583/11 P, U:C:2013:625, paragraph 98.

<sup>93</sup> Judgment of 6 November 2018, *Scuola Elementare Maria Montessori v Commission*, Case C-622/16 P, EU:C:2018:873, para. 42.

<sup>94</sup> *Georgsmarienhütte*, para. 31.

<sup>95</sup> Judgment of 5 November 2019, *ECB and Others v Trasta Komercbanka and Others*, Joined cases C-663/17 P, C-665/17 P and C-669/17 P, EU:C:2019:923.

<sup>96</sup> *Trasta*, para. 78.

<sup>97</sup> *Trasta*, para. 111.

<sup>98</sup> *Trasta*, para. 111.

<sup>99</sup> *Trasta*, para. 113.

from national law<sup>100</sup>. In conclusion – for the shareholders of the credit institution – the ECB withdrawal decision did not satisfy any of the two cumulative criteria for being directly concerned.

In addition, it is worth mentioning that Advocate General Kokott, in her opinion in *Trasta*, also dismissed the possibility of the shareholders bringing an action on behalf of the credit institution, from the perspective of the interest in bringing proceedings<sup>101</sup>. In particular, the Advocate General found that the shareholders bringing an action on behalf of the credit institution would be a remedy which is subordinate to the remedy to an action sought by the addressee of the decision itself<sup>102</sup>.

## 5.2 Activa Minoristas (T-618/17)

Another relevant occasion when standing to bring an action was discussed was the *Activa Minoristas* case<sup>103</sup>. In this case, the applicant lodged an application against the ECB and the SRB for the annulment of the SRB's resolution decision with regard to Banco Popular Espanol. The applicant was an association of alleged minority investors in Banco Popular Espanol. In order to establish whether the association would have standing, the General Court applied the established test for associations to have standing, which includes three possibilities, i.e. cases where (i) the association represents the interests of undertakings which, for their part, have locus standi; (ii) the association is differentiated by reason of the impact on its own interests as an association, in particular because its position as a negotiator has been affected by the measure for which an annulment is sought; or (iii) a legal provision expressly confers on professional associations a number of powers of a procedural nature<sup>104</sup>. To the extent that the applicant claimed to be in the second situation<sup>105</sup>, the General Court concluded that the association was not directly concerned by the SRB's decision, given that the association had been created after the adoption of that decision<sup>106</sup>.

## 6 The need to challenge implementing measures

Finally, some questions remain as to the need to challenge implementing measures in multi-level administrative proceedings.

In those specific cases in which the applicants will have standing and have challenged the Union act which is being implemented by a national measure should they also challenge, in parallel, the national implementing measures?

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<sup>100</sup> *Trasta*, para. 114.

<sup>101</sup> Opinion of Advocate General Kokott of 11 April 2019, Joined cases C-663/17 P, C-665/17 P and C-669/17 P, EU:C: 2019:323, para. 105.

<sup>102</sup> Opinion of Advocate General Kokott, para. 87.

<sup>103</sup> Order of 24 September 2018 *Activa Minoristas v ECB and SRB*, Case T-618/17, EU:T: 2018:608.

<sup>104</sup> *Activa Minoristas*, para. 19.

<sup>105</sup> *Activa Minoristas*, para. 20.

<sup>106</sup> *Activa Minoristas*, para. 25.

The above question relates to the effects of the annulment of a binding instruction on the implementing measures. In this regard, the effects of a possible annulment of the Union's instructions on national implementing measures are governed by the national laws governing such implementing measures<sup>107</sup>. In any event, Union authorities should take the appropriate measures to implement the Court's judgment<sup>108</sup>, which may include, for example, the adoption of a new instruction. If a national proceeding has been lodged in parallel, then the national court would be expected to stay the proceeding pending the outcome of the annulment proceedings<sup>109</sup>.

A similar question arises in case a national decision is being implemented at Union level. Following on from the case-law established in the *Borelli* case, the unlawfulness of a national measure does not directly affect the legality of the Union implementing measure<sup>110</sup>. However, the Court of Justice has recently clarified that the annulment of the national measure would require the Union authority to reconsider the matter<sup>111</sup>.

There has not yet been an occasion for the Union courts to provide guidance as to the answers to the above questions in the context of the SSM.

## 7 Conclusion

The multi-level administrative proceedings in the SSM entail complex interactions and multiple administrative acts which are adopted by Union and national authorities. While the precise administrative procedures are new, similar procedures have been examined by the Court, which has established clear doctrines with regard to judicial review in these types of administrative proceedings. Such jurisprudence is also relevant for judicial review in the SSM and the evidence from the Court's so far limited case-law on SSM procedures suggests that the Court will apply the existing jurisprudence, with minimal adjustments. Therefore, direct actions will lie with the acts which concentrate the binding legal effects in the respective multi-level administrative proceedings. As a complement to these direct actions, the Court has confirmed its competence to review preparatory acts as an incidental matter as part of its review of the final decision in multi-level administrative proceedings.

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<sup>107</sup> Judgment of 2 March 1989, *Pietro Pinna*, Case C-359/87, EU:C:1989:107, para. 13.

<sup>108</sup> Article 266 TFEU.

<sup>109</sup> Judgment of 14 December 2000, *Masterfoods*, Case C-344/98, EU:C:2000:689, para. 57.

<sup>110</sup> *Borelli*, para. 12.

<sup>111</sup> Judgment of 29 January 2020, *GAEC Jeanningros*, Case C-785/18, EU:C: 2020:46, para. 39.



# Concluding remarks

By Chiara Zilioli<sup>1</sup>

## 1 Introduction

As an inevitable result of the coronavirus (COVID-19) pandemic, the 2020 ESCB Legal Conference took place in the form of a “Special Online Edition” and in a changed world. The participants did not travel from the four corners of Europe and beyond to come to the ECB. Nevertheless – thankfully – they still attended, through the digital bridge we established.

On the one hand, we all missed the informal conversations “en marge” of the Conference, and the sharing of new ideas to explore together as well as of local ongoing projects that can become of common interest, joining resources. However, the new “online modality” was more successful than expected: we managed to have a wide audience and to enable participants to take the floor directly and debate with the speakers. We were able to virtually meet and intellectually exchange on six important issues, and this was a great success.

In concluding the 2020 ESCB Legal Conference and looking back at the year, I recalled that the theme of the 2019 ECB Legal Conference had been “**Building bridges**”, and we had referred to the bridges of European integration. Only a few months later, in March and April 2020, we saw those bridges shake. We saw borders close. We saw countries interrupt the free movement of goods in order to hold on to scarce medical supplies.

But those bridges did not fall. **They were able to withstand the earthquake that was the global pandemic.**

Even more: we saw the efforts by EU Member States and the ECB not only to maintain those bridges, but to make them stronger. I am thinking of the SURE Regulation<sup>2</sup> – 100 billion euro to assist Member States in coping with the impact of the crisis on workers. I am thinking of the Next Generation EU package<sup>3</sup>, which – when finalised – will provide 750 billion euro to support Member States in facing the economic and social consequences of the pandemic. The level of solidarity that was unimaginable in 2019 became a reality in 2020.

With the 2020 ESCB Legal Conference, we saw more of the work that goes into maintaining those bridges and reinforcing them against the challenges to come.

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<sup>1</sup> Director General Legal Services, European Central Bank.

<sup>2</sup> Council Regulation (EU) 2020/672 of 19 May 2020 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak (OJ L 159, 20.5.2020, p. 1).

<sup>3</sup> European Council, [Conclusions](#) of 21 July 2020. A political agreement was reached on 10 November.



Whether it is adapting to the **digital transition**, or to the **climate emergency**, European integration keeps moving forward.

## 2 Overview of the panels

The digital transition came to the fore in the first panel. Digital transformation will make **access to EU law and case-law** easier – in particular it will improve the way legal texts can be analysed, searched for and cross-referenced.

We heard about the new features that will be added to our favourite legal tool, EUR-Lex. These include new digital networks, enhanced access to the national law and translation facilities, and visualisation techniques for consolidated texts.

We also learned about recent enhancements to how ECB legal acts are both accessed and presented. This is a body of law that has grown steadily over the last twenty years, and the ECB corner of EUR-Lex is a new feature that will greatly help our work in the future.

We were also informed about how data science and machine learning can help. First, it can help us to understand the development of the EU and European integration over time. Second, it can help us to use new data analysis and visualisation tools to communicate to the general public how the EU works and bring it closer to the citizens.

The second panel looked at the preparations for **benchmark rate transition**, and the role that financial market participants and public authorities can play.

The panel's key focus was how to ensure continuity of contracts that reference a benchmark rate that will cease to be available, following the extensive benchmark reforms over recent years.

For the EU, we learned about efforts to develop appropriate “fall-back” arrangements in contracts, through the Working group on euro risk-free rates. But we also heard that there may still be a problem with so-called “tough legacy” contracts.

The panellists flagged the high risk of litigation as a key concern arising from the transition. They noted that legislative solutions might have a role to play in mitigating that risk. It was even suggested that widespread legislative “retrofitting” of contracts – similar to the retrofitting of Greek sovereign bonds with collective action clauses (CACs) – could be a good solution.

The recent European Commission proposal to amend the Benchmarks Regulation, which envisages that the Commission has the power to designate a “statutory replacement benchmark”, can be seen as an example of a legislative solution. The



ECB's Governing Council adopted its opinion on this proposal on 18 September 2020.<sup>4</sup>

The panel, however, did also acknowledge doubts on whether litigation risk could truly be mitigated by legislative intervention. After all, if legislators try to “engineer” convergence, they could leave the parties with a wealth transfer that they did not intend and to which they have not consented.

The third panel discussed **sustainable finance** and its increasing relevance for central banking. The climate emergency fills us all with fear for the world our children will inherit. As Greta Thunberg put it, “Our house is on fire”. What can we – as lawyers, as central bankers – do?

Building a framework for sustainable finance – and the taxonomies that are needed to facilitate it – is just one small contribution, and we should provide it.

As Frank Elderson said in a speech in May: “The days are gone that central banks did not know how to spell the word sustainability and that supervisors did not know what the sustainable development goals were”. He underlined that “financial firms wield leverage on the real economy and central banks and supervisors wield leverage over the financial sector; this double leverage is an extremely powerful force that can and must be used to achieve the Paris goals”.<sup>5</sup>

From the global perspective, the panel highlighted that transparency, and clear and credible disclosure as to what is a sustainable investment, is essential. Thus, the launch of the World Bank Sovereign ESG<sup>6</sup> data portal will help to foster increased data transparency.

Moreover, the EU Taxonomy Regulation<sup>7</sup> is a good example of legislation that fosters convergence of classifications. But it is not without flaws. For example, the panel suggested that it needs to be adapted to label not only “green” financial products, but also “non-green” financial products. This distinction is key to properly guide the investment decisions of market investors – and of central banks.

When it comes to the Eurosystem, my key takeaway was that, while the climate transition has always been acknowledged as relevant to the secondary objectives of the Eurosystem, it is becoming ever clearer that there is also a direct link to the Eurosystem's primary objective of maintaining price stability. Indeed, climate-related risks and biodiversity loss are a source of financial risk; and to take care of this is very much within the mandate of the ECB and its primary objective.

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<sup>4</sup> Opinion of the European Central Bank of 18 September 2020 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation (CON/2020/20) (OJ C 366, 30.10.2020, p.4).

<sup>5</sup> Frank Elderson video message at the WWF Annual Conference 2020, 15 May 2020, available on [YouTube](#).

<sup>6</sup> ESG – environmental, social and governance.

<sup>7</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).

That's not all: since climate-related risks translate into financial risks they are directly relevant to the work of banking supervisors too.

This is heartening and energising, because it means that the ECB, together with the Eurosystem, is not just an observer, watching and waiting while countries and market participants slowly gather water to put out the fire. Rather, it has the mandate to act and can utilise the EU Taxonomy Regulation for that purpose.

We are all looking forward to the outcome of the ECB's strategy review to see precisely what a central bank's fire extinguisher could look like.

The fourth remote meeting of our online Conference brought our focus back to the digital transition, this time discussing **blockchain** and **central bank digital currencies**.

Our keynote speaker, Silvio Micali, Professor at the Massachusetts Institute of Technology, gave us an insight into the myth and reality of blockchain. He explained that blockchain suffers from a trilemma. You can only ever have two of the following key features: decentralisation, security and scalability.

It is for this reason that, despite the enormous potential of blockchain, it still has some way to go to deliver the solutions of the future. But he was optimistic that once we understand fully what we have and what aspects of blockchain do work, we can then use technology to bridge the gap.

Professor Micali was followed by the panel on central bank digital currencies (CBDC), for which we could not have chosen a better timing, given that the Eurosystem High-Level Task Force report on a digital euro<sup>8</sup> was hot off the presses.

We had the opportunity to learn more from the economists about what is meant by the term "digital euro"; about what advantages a digital euro could offer society; and how this initiative interacts with private innovation. We also learned about the design issues associated with such a project. I found it fascinating how much emphasis was placed on the importance of experimentation – bringing central banks to the forefront of innovation.

From a legal perspective, the panel discussed the different challenges of creating wholesale and retail CBDCs. These topics are not easy. They include the legal basis for issuing a digital currency; how to ensure the finality of transfers; the legal characterisation of tokens; and issues related to the need to respect constitutional rights, anti-money laundering rules, and legislation like the Payment Services Directive. As one panellist rightly pointed out: the technological challenges are likely to be solved sooner than the legal and policy aspects!

With our fifth panel we moved to discuss **transparency versus confidentiality of supervisory decisions, documents and information**, and we were guided – very effectively – through the wealth of legislation and recent case-law on this topic. I would

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<sup>8</sup> European Central Bank, [Report on a digital euro](#), October 2020.

like to mention two particularly valuable points that the discussion in this panel offered us.

First, the dissection of the relationship between confidentiality and transparency under the Treaties and secondary law, which was very insightful. The panellists discussed whether we should see transparency as the rule and confidentiality the exception, or rather whether we should see these concepts as coexisting, as two separate and equally ranking principles under EU law. The panel's discussion of case-law convinced me that indeed we must lean towards an understanding that the two principles coexist, each serving important purposes under the Treaties – on the one hand public accountability and the right to fair procedures and, on the other hand, the proper functioning of the system of supervision.

Second, the panel dealt with an ever-present dilemma for the Single Supervisory Mechanism (SSM). European banking supervision is affected by the fact that the relevant provisions of the CRDIV<sup>9</sup> on professional secrecy, and its exceptions, are implemented by national laws. This allows room for divergence, especially since the exceptions must be interpreted narrowly. However, the panel also emphasised that there is room to ensure consistency: we should not forget that we can rely on relevant provisions of the SSM Regulation,<sup>10</sup> as directly applicable EU law.

Our final panel focused on **judicial review of the acts of EU institutions and bodies in a multi-level administrative framework**.

First, the panel considered the various types of composite administrative procedures which characterise the banking union. The panel noted the complexity of the interaction between the various actors of the banking union: the ECB, SRB, EBA or even the ESRB (for the macroprudential measures).<sup>11</sup> On the one hand, this complexity has a positive side: it ensures a high level of coordination and consultation between the various actors in a “federal” system and provides for checks and balances. On the other hand, the complexity gives rise to a risk of fragmentation, friction and delay. During the discussion, it was also noted that such multi-level procedures raise issues of accountability: prospective litigants might not understand before which court a challenge should be brought.

Thereafter, we delved into a comprehensive overview of how the Court of Justice has applied the principles of judicial review to the banking union's multi-level procedures. The panel looked at the issue of standing to challenge decisions. The panel also recalled why preparatory acts are not independently reviewable and provided us with a helpful overview of the wide range of preparatory acts adopted in the framework of the SSM and the Single Resolution Mechanism. Likewise, the panel helped us to distinguish between reviewable decisions and preparatory acts, noting that

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<sup>9</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>10</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>11</sup> (SRB) Single Resolution Board; (EBA) European Banking Authority; and (ESRB) European Systemic Risk Board.

instructions from the SSM or the SRB to national competent authorities are the appropriate acts to be challenged.

We benefited from a lively discussion, including the difficult issue of the SRB's assessment as to whether a bank resolution is in the public interest, or whether the bank should be wound-up under national insolvency procedures.

Last, the Conference was complemented by, and benefited from, an overview of the **legal aspects of the ECB's response to the COVID-19 pandemic** by our second keynote speaker, Yves Mersch, at the time the Executive Board member of the ECB responsible for Legal Services. In the crisis, we have seen yet again that the ECB and the Eurosystem are one of the crucial pillars that support the bridge of European integration of the European Union. We can be very proud to work for it.

### 3 Some acknowledgements

To conclude, I would like to thank all the panellists and contributors for taking part in the ESCB Legal Conference this year. Their continued investment in exchanging knowledge and ideas is valuable beyond measure. It shows that when it comes to intellectual cooperation, there really are no borders.

Very special thanks are owed to our patron, Yves Mersch. His support and engagement with legal issues and with this Conference – from the very beginning of his time at the ECB right up until the end of his mandate – has been exceptional. Legal issues are at the centre of his interests and this explains the passion with which he engages in legal discussions.

Sincere thanks are due to György Várhelyi, who organised this year's Conference. György is one of the key lawyers in our Financial Law Division. When he began the mammoth task of putting this Conference together, none of us could have anticipated how different – how novel – it would be. Of course, with his wealth of experience and his dedication, we had the right person to steer the Conference into a new reality.

György was supported in the preparation of the Conference and of the book by two colleagues in the Legal Groups team – Tončica Radovčić and Julia Harms. It was thanks to them that we could move almost seamlessly into the virtual world.

Last but not least, I would also like to thank a number of other colleagues in Legal Services, in particular the technology and knowledge management team in DG-L, together with the colleagues in the Directorate Administration and in DG-Communications. Not even a pandemic could stop these colleagues from doing an excellent job organising this event.

My very special thanks go to the teams providing us with Webex support, multimedia services, audio services and filming, who had the unenviable task of guiding technophobic lawyers through the ups and downs of the virtual world. I will not name them all individually, but I am very grateful for their commitment.

Finally, thanks are also owed to our audience: the quality of the reflection depends crucially on the quality of the debate. Seeing our audience online and hearing their questions was very stimulating. We all hope that, with the benefit of a vaccine, the situation will gradually return to normality, and that our ECB Legal Conference 2021 will be in the ECB premises next September.





# Programme

Friday, 11 September 2020

## Enhancing access to EU law and case-law

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09:00 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

09:05 **Enhancing access to EU law and case-law**

In this era of open data, the Publications Office of the European Union in Luxembourg has upgraded its online legal database, EUR-Lex. The information in the database is now presented in a more user-friendly way and is easier to retrieve, helping legal counsels and the general public to navigate and gain insights into the EU's body of law. The Panel will illustrate the new possibilities and unveil upcoming trends and challenges with reference to case studies and specific technologies.

### Chair

Per Nymand-Andersen, Adviser in the Directorate General Statistics, European Central Bank

### Panellists

Valérie Saintot, Head of the Legislation Division, European Central Bank

Dimiter Toshkov, Associate Professor at the Institute of Public Administration, Leiden University

Maria Westermann, Head of Unit, EUR-Lex and Legal Information, Publications Office of the European Union

Discussion with questions from the audience

10:35 End of the Panel

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Monday, 21 September 2020

## **Benchmark rate transition and continuity of contracts: UK, US and EU developments**

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15:00 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

15:05 **Benchmark rate transition and continuity of contracts: UK, US and EU developments**

Efforts on the part of both financial market participants and public authorities across the world have yielded tangible results in the process of benchmark rate reform. As the continued existence of some of the major benchmark rates was no longer guaranteed, central banks developed their own rates, such as the ECB's €STR, with the aim of complementing existing benchmarks and to serve as backstops. However, there are still some issues to be resolved in connection with the benchmark rate transition process. How will smooth transition mechanisms and continuity of contracts be ensured? What roles will market participants, legislators and other public authorities play? How will the regimes in the different jurisdictions interact? The panellists, who have a wealth of experience in these matters in the United Kingdom, the United States and the EU, will deliberate on recent and expected developments.

### **Chair**

Bram van der Eem, Head of Section, Financial Law Division, European Central Bank

### **Panellists**

Sarah Jane Hlásková Murphy, Lead Legal Counsel, European Central Bank

Iliana Lani, Head of the Ratings, Indices and Securitisation Department, European Securities and Markets Authority

Joanna Perkins, Chief Executive of the UK Financial Markets Law Committee

Thomas Baxter, Of Counsel, Sullivan & Cromwell; former General Counsel and Executive Vice President of the Federal Reserve Bank of New York

Discussion with questions from the audience

16:35 End of the Panel

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Friday, 2 October 2020

## **EU Taxonomy and action plan on sustainable finance: what uses may these have for the ESCB?**

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15:00 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

15:05 **EU Taxonomy and action plan on sustainable finance: what uses may these have for the ESCB?**

Addressing the challenges posed by climate change requires efforts from many parties, including governments and other public authorities. These include efforts to further harmonise climate-related disclosure requirements and to improve the reliability and comparability of data. The Panel will look at the Taxonomy Regulation and other recent initiatives aimed at reaching a better understanding of underlying risks. It will examine how such initiatives could improve transparency in the financial markets and whether they could help identify potential measures that the ESCB central banks could implement – either with regard to monetary policy actions or as part of their individual investment strategies. It will also discuss how the Taxonomy Regulation and other harmonisation efforts might affect approaches followed by the supervisors.

### **Chair**

Iñigo Arruga Oleaga, Adviser in the Directorate General Legal Services, European Central Bank

### **Panellists**

Frank Elderson, Member of the Governing Board, De Nederlandsche Bank

Shirmila Ramasamy, Senior Legal Counsel, World Bank Group

György Várhelyi, Lead Legal Counsel, European Central Bank

Discussion with questions from the audience

16:35 End of the Panel

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Monday, 5 October 2020

## Central bank digital currencies

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15:00 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

15:05 **Keynote speech and discussion: “Blockchain myth and reality” – Professor Silvio Micali (MIT, Electrical Engineering & Computer Science Department – Founder of Algorand Inc.)**

15:50 **Break**

16:00 **In the distant future or tomorrow? Policy and legal considerations around central bank digital currencies**

The Panel will explore legal, economic and operational aspects of central bank digital currencies (CBDC), both in general (drawing on international experience) and in the specific context of the euro area. Amongst other topics, the Panel will review the key design options for CBDC and the different objectives that each of them serves. The Panel will then address the different legal considerations around these design options. The Panel will also examine the public law aspects of CBDC – in the specific context of the EU legal order – including their legal basis and issues related to legal tender status. Other legal issues of relevance to CBDC will also be analysed, including settlement finality, intellectual property and competition law, and the implications of CBDC for the Eurosystem’s monetary policy and market infrastructure-related tasks.

### **Chair**

Otto Heinz, Head of the Financial Law Division, European Central Bank

### **Panellists**

Valérie Fasquelle, Director of Infrastructure, Innovation and Payments, Banque de France

Ulrich Bindseil, Director General Market Infrastructure and Payments, European Central Bank

Panagiotis Papapaschalis, Senior Lead Legal Counsel, European Central Bank

Phoebus Athanassiou, Lead Legal Counsel, European Central Bank

Discussion with questions from the audience

17:30 End of the Panel

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Friday, 16 October 2020

## Transparency versus confidentiality of supervisory decisions, documents and information

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9:00 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

9:05 **Transparency versus confidentiality of supervisory decisions, documents and information**

Building on the discussion “Transparency, confidentiality and exchange of information between authorities” held at the 2019 ECB Legal Conference, the Panel will take a closer look at the interaction between the transparency principle (Article 15 of the Treaty on the Functioning of the European Union) and the confidentiality regime for banking supervision set out in (a) Article 37 of the Statute of the ESCB and (b) Article 27 of the SSM Regulation together with Article 53 et seq. of the Capital Requirements Directive IV.

In particular, the Panel will explore the following.

Principle of transparency and access to documents held by the ECB resulting from the conduct of supervisory tasks. The general presumption of non-accessibility and its transferability to banking supervision.

The rule of professional secrecy in banking supervision (Hillenius, Altmann and Baumeister) and exceptions to professional secrecy (Buccioni).

Interaction between rights of defence and confidentiality (UBS); access to files in supervisory procedures (and other EU administrative procedures).

The interpretation of the “bridging clause” in Article 4(1)(c) of the Payment Accounts Directive (PAD), which links the transparency regime of the public access decision to confidentiality regimes. Parallels with the “bridging clause” in Article 4(1)(a) first indent PAD as interpreted in the Banco Espírito Santo case, with specific reference to the Advocate General’s Opinion.

### Chair

Eleni Koupepidou, Head of the Supervisory Law Division, European Central Bank

### Panellists

Cristina Pérez Cajal, Head of the Regulatory and Supervisory Advice Division, Banco d’España

Carmen Hernández Saseta, Adviser, European Central Bank

Michael Ioannidis, Principal Legal Counsel, European Central Bank

Discussion with questions from the audience

10:35 End of the Panel

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Monday, 26 October 2020

## **Judicial review of the acts of EU institutions and bodies in a multi-level administrative framework**

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9:30 **Welcome address and introduction to the Panel**

Chiara Zilioli, Director General Legal Services, European Central Bank

9:35 **Judicial review of the acts of EU institutions and bodies in a multi-level administrative framework**

Within the Single Supervisory Mechanism and the Single Resolution Mechanism, numerous decisions are adopted in composite procedures or by a national administrative authority on the basis of an instruction from an EU authority. Judicial review also takes place at two levels: the Court of Justice reviews the legality of acts of EU institutions and bodies, while the review of acts of national administrative bodies is entrusted to national courts. In this multi-level administrative and judicial environment, how is effective judicial review ensured? Against this backdrop, the Panel will explore the question of which acts can and need to be reviewed (preparatory acts/final acts, instructions and/or the implementing act), and before which courts the judicial review should take place (EU courts and/or national courts). The discussion will be based on recent case-law.

### **Chair**

Klaus Lackhoff, Head of the Banking Law Section, European Central Bank

### **Panellists**

Dimitrios Triantafyllou, Legal Adviser, European Commission

Asen Lefterov, Senior Legal Counsel, European Central Bank

Anastasia Valavanidou, Bank Resolution Expert, Single Resolution Board

Discussion with questions from the audience

11:05 End of the Panel

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Monday, 2 November 2020

## **Keynote speech and discussion: “The ECB’s response to the COVID-19 crisis from the legal point of view”**

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9:30 **Keynote speech by Yves Mersch**

Pre-recorded

### **Questions and answers with Mr Mersch**

Discussion with questions from the audience

16:15 **Closing of the Conference by Chiara Zilioli**

End of the ESCB Legal Conference 2020

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## Biographies

## Yves Mersch

Yves Mersch is a member of the Executive Board of the European Central Bank (ECB). His eight-year term started in December 2012. He was Governor of the Banque centrale du Luxembourg from 1998 to 2012 and has been a member of the Governing Council of the ECB since its creation in 1998.

After obtaining postgraduate degrees in international public law and political science, Mr Mersch started his career at the Luxembourg Ministry of Finance in 1975. Since then he has held numerous public sector positions in Luxembourg and abroad, including at the International Monetary Fund and the United Nations.

Mr Mersch was appointed honorary Professor at the University of Luxembourg in 2014 and received the Lámfalussy Award from the Magyar Nemzeti Bank in 2019.





## Frank Elderson

Frank Elderson, born in 1970, has served as an Executive Director of De Nederlandsche Bank since 1 July 2011. In that capacity he is currently responsible for banking supervision, horizontal supervisory functions and legal affairs. He is a member of the ECB's Supervisory Board. Mr Elderson has participated as an observer in the EU High-Level Expert Group on Sustainable Finance. He is the chairman of the Central Banks and Supervisors Network for Greening the Financial System, and of the Platform for Sustainable Finance in the Netherlands.

Before joining De Nederlandsche Bank's Governing Board, Mr Elderson served as Head of its ABN AMRO Supervision Department (2006-07), Director of its Legal Services Division (2007-11) and its General Counsel (2008-11). He received his professional training as an attorney with Houthoff Advocaten & Notarissen from 1995 to 1998. He studied at the University of Zaragoza, and graduated in Dutch law at the University of Amsterdam in 1994. He obtained an LL.M. degree at Columbia Law School, New York, in 1995.



## Chiara Zilioli

Professor Chiara Zilioli has dedicated her entire working life to the European integration project. In 1989 she joined the Legal Service of the Council of Ministers in Brussels, moving to the Legal Service of the European Monetary Institute in 1995 and subsequently to the ECB as Head of Division in Legal Services in 1998. She was appointed Director General of the ECB's Legal Services in 2013.

She holds an LL.M. from Harvard Law School and a PhD from the European University Institute. She lectures at the Institute for Law and Finance at Goethe University Frankfurt, where she was appointed Professor of Law in 2016, and at the European College of Parma, Parma University. She has published numerous articles and three books. She is a member of the Parma Bar Association.

Professor Zilioli has been married to Dr Andreas Fabritius for more than 30 years; they have four wonderful children.



## Per Nymand-Andersen

Per Nymand-Andersen is an adviser to senior management at the ECB. During his 20 years in central banking, Per has developed his expertise in European banking and financial markets, fintech, securities settlement systems, statistics, data science, management and communication.

Per is the key editor of the ECB Working Paper Series and a lecturer in central banking policies and transparency at Goethe University Frankfurt.

Prior to joining the ECB, he provided market research consultancy services for the European Commission in Luxembourg.

Per has an MBA in Economics and Management Science from Copenhagen Business School, Denmark and a Fintech certificate from Harvard University.

Per is a frequent speaker at international events and is the author of several publications and articles regarding financial markets, statistics, communication and data science.

Further details: <https://www.linkedin.com/in/per-nymand-andersen-81609913>.



## Valérie Saintot

Valérie Saintot, PhD, is Head of the Legislation Division in the ECB's Directorate General Legal Services. She started her career as a lawyer at the European Court of Justice in the Research and Documentation department of the Court and later served as a "lecteur d'arrêts" in the cabinet of the President of the Court of First Instance. On joining the ECB in 1999, Valérie was country rapporteur for Luxembourg, Lithuania and Poland, as well as contributing to several institutional legal dossiers, she represented the ECB as agent in court cases. Valérie held various managerial positions at the ECB in human resources, organisational strategy, financial controlling and communications before returning to the Directorate General Legal Services as Head of the Legislation Division in 2018. She is also responsible for the team in charge of legal knowledge management. In that capacity, she has played a role in developing a strategy to digitalise legal operations and explore opportunities for applying artificial intelligence and machine learning to legal knowledge management, and to modernise the display of the ECB legal framework in EUR-Lex.



## Dimiter Toshkov

Dr Dimiter Toshkov is Associate Professor at the Institute of Public Administration at Leiden University and a former Jean Monnet fellow at the European University Institute in Florence, Italy. His research interests are in European integration, comparative public policy and research methodology. He has published numerous scientific articles on various topics related to the governance and politics of the European Union and its Member States. He is also the author of a major textbook, *Research Design in Political Science*, Palgrave Macmillan, 2016. His work on data visualisation received the World Data Visualization Prize in 2019. You can find him on Twitter at @DToshkov and learn more about his work at <http://dimiter.eu>.



## Maria Westermann

A lawyer of Swedish origin with a Master's degree in German law, Ms Westermann has experience in working with online dissemination of legal documents of the European institutions and bodies, as well as with public procurement and contracts. In particular, she is knowledgeable about access for the public to legislative procedures of the European institutions and to national legislation transposing EU directives. She has worked with the legal data and legal analysis of EU documents since 2011 and is currently Head of Unit, EUR-Lex and Legal Information, at the Publications Office of the European Union.



## Bram van der Eem

Bram van der Eem has been Head of Section in the Financial Law Division of the ECB's Directorate General Legal Services since January 2015. His section advises on EU financial legislation and Economic and Monetary Union (EMU) matters and on financial market infrastructure, as well as with respect to the statistical function of the European System of Central Banks (ESCB). In addition, he oversees the legal advice concerning the ECB's involvement in financial assistance programmes and post-programme surveillance. Bram was previously responsible for legal advice on the ECB's monetary policy and its foreign reserves and own funds management.

Bram van der Eem started his career in 2003 in private practice at the law firm Pels Rijcken & Droogleever Fortuijn, based in The Hague. From 2009 to 2014 he worked in Legal Services at De Nederlandsche Bank and as a seconded adviser to the Central Bank of Cyprus. In 2010 he joined the Legal Committee of the ESCB.

Mr van der Eem is a graduate of the Radboud University of Nijmegen and of the University Paris 1 Panthéon-Sorbonne, where he earned his PhD.





## Thomas Baxter

Thomas C. Baxter, Jr., is a member of Sullivan & Cromwell's Financial Services Group, where he focuses his practice on advising clients in the financial services, insurance, securities and fintech spaces. Mr Baxter's advice relates to complex issues arising from supervision and regulation, investigations and enforcement actions, governance, compliance and risk management, crisis management and organisational culture. He also brings extensive experience dealing with central banks from around the world, and with sovereigns and their instrumentalities, as they address sovereign debt and dollar-liquidity issues. Mr Baxter's deep knowledge in these areas comes from more than 35 years at the Federal Reserve Bank of New York, mostly in senior leadership roles.

Mr Baxter is a frequent lecturer at programmes sponsored by the Uniform Commercial Code Institute, the Department of Justice's Advocacy Institute, the American Bar Association, the American Law Institute, the Bank Administration Institute, the Practising Law Institute, the Federal Financial Institutions Examination Council and similar organisations.



## Sarah Jane Hlášková Murphy

Sarah Jane is Lead Legal Counsel in the Financial Law Division of the ECB's Directorate General Legal Services. She specialises in advising on legal issues relating to the collection and use of statistical information and other sources of data by the ESCB. As part of this, she coordinates legal advice on the development and production of the euro short-term rate by the ECB and provides advice to the ECB secretariat for the working group on risk-free rates. She also advises on the law and regulation of financial market infrastructures, in particular relating to the oversight and operation of payment systems and securities settlement systems. She was appointed Secretary of the Legal Committee of the ESCB in 2020.

Prior to joining the ECB in 2014, Sarah Jane was a Senior Associate in the Competition and EU Law Division of Herbert Smith Freehills LLP in London, with a particular focus on advising clients in the financial services sector. She has a Bachelor of Arts (Hons) and a Bachelor of Laws from the University of New South Wales and a Master of Laws (LL.M.) from the University of Cambridge. Sarah Jane is admitted to practice in England and Wales and in New South Wales, Australia.



## Iliana Lani

Iliana Lani is Head of the Ratings, Indices and Securitisation (RIS) Department at the European Securities and Markets Authority (ESMA). The RIS Department is responsible for the registration, ongoing supervision and policy of credit rating agencies and securitisation repositories. ESMA's RIS Department is also responsible for policy work under the Benchmark Regulation (BMR) and for additional supervisory mandates under the BMR that ESMA will assume from 2022 onwards.

Iliana Lani started her career in 1998 in private practice, working as Legal Counsel at EFG Eurobank in Greece. From 2003 to 2013 she worked at the Hellenic Capital Market Commission, initially as Legal Adviser and from 2010 as Head of the Department of Licensing of Capital Markets Intermediaries. In 2013 she joined the Financial Conduct Authority in London, working in various projects including the implementation of MiFID II and Brexit. She joined ESMA in 2019.

Iliana Lani studied law in Greece, where she was admitted to the Bar. She also holds an MSc in Banking and Finance and an MSc in European studies.

## Joanna Perkins

Joanna Perkins serves as Chief Executive of the Financial Markets Law Committee (FMLC) and is also self-employed as a barrister in independent legal practice at South Square. Before joining the FMLC in 2004, she worked for the Law Commission and managed a project on unfair contract terms. Dr Perkins has held lectureships at Durham University, the University Panthéon-Assas Paris II and Birkbeck College, London. She has published articles on subjects including financial law, financial markets regulation and the conflict of laws. After completing a doctorate in law at Oxford University, where she worked as a college lecturer, she was called to the Bar of England and Wales in July 2001.



## Iñigo Arruga Oleaga

Iñigo Arruga Oleaga is an adviser in the ECB's Directorate General Legal Services, where he has worked since the summer of 2001, with a stint at the Legal Department of the International Monetary Fund in 2008-2009.

In the Directorate General Legal Services, he covers areas including EU economic union and EU financial services legislation. He also represents the ECB in the European Financial Markets Lawyers Group.

Before joining the ECB, he worked at the Court of Justice of the European Union (CJEU), to which he came from legal practice (Madrid Bar). Previously, he worked in commercial banking in New York and Madrid. He studied law and Spanish language and literature at the University of Zaragoza and European law at the College of Europe in Bruges. He lives in Frankfurt am Main.



## Willem Bovenschen

Willem Bovenschen has worked in the legal department of De Nederlandsche Bank (DNB) since 2001. At DNB he is involved in the preparation of the Governing Council and Supervisory Board meetings. He is also a member of the ESCB's Legal Committee and has participated in its meetings since 2002. Mr Bovenschen advises on European law, institutional law and supervisory law.

Before joining the DNB, he worked for four years in private practice as a tax lawyer. He studied law in the Netherlands and in the United States.

He is the author of publications on the topic of the Treaty on the Functioning of the European Union, the financial crisis, supervisory matters, state auditors, delegation, transparency, independence and accountability.



## René Lieshout

René Lieshout has worked in the legal department of De Nederlandsche Bank (DNB) since 2016. At DNB he advises on Dutch civil law, European law and resolution law. He studied law and Italian language and culture in the Netherlands. Before joining DNB he gained experience at the Embassy of the Kingdom of the Netherlands in Italy and law firms in both Italy and the Netherlands. Besides his work at DNB he is the president of Entrée, the association of young friends of The Concertgebouw and the Royal Concertgebouw Orchestra.





## Shirmila Ramasamy

Shirmila Ramasamy is Senior Counsel in the Legal Vice Presidency of the World Bank. She is a capital markets lawyer who works on corporate finance matters and innovative financing mechanisms for targeted development priorities. She has been with the World Bank since 2008 and was part of the team responsible for the design and structuring of the International Finance Facility for Immunisation – a pioneer in sustainable finance markets – as well as a number of other financing initiatives including the Advance Market Commitments and the Pilot Auction Facility for Climate Mitigation. She continues to advise on the implementation of these initiatives and is also legal adviser to the Climate Investment Funds. Prior to joining the World Bank, Shirmila was a structured finance practitioner in London, New York and Singapore – managing cross-border transactions as Managing Associate at Linklaters LLP.



## György K. Várhelyi

György K. Várhelyi is Lead Legal Counsel in the ECB's Directorate Legal Services and an agent of the ECB before the CJEU. He focuses on financial law-related matters such as the legal aspects of the ECB's monetary policy implementation, including non-standard measures.

He previously worked as an attorney at law with Skadden, Arps, Slate, Meagher and Flom LLP and then in investment banking at BNP Paribas. He was in charge of equity and equity-linked capital market transactions and M&A activities in and outside Europe.

Mr Várhelyi has been admitted to the Paris Bar Association. He graduated from the Magistère and holds an LL.M. in commercial and corporate law from the University Panthéon-Assas Paris II.



## Otto Heinz

As Head of the Financial Law Division, Otto is in charge of all financial law-related matters at the ECB. These include the legal aspects of the implementation of ECB monetary policy (including collateral policy, market interventions and global central banking cooperation), financial litigation, regulatory matters, payment settlement infrastructures and foreign reserve management.

Otto is a member of the Legal Committee of the ESCB. In addition, he is Chairman of the European Financial Market Lawyers' Group, comprising senior lawyers from different banks within the European Union.

He previously worked in investment banking for Goldman Sachs, Lehman Brothers and Bank of America in London as a Director. In these roles, he was in charge of debt and equity capital markets and M&A activities in and outside Europe. He also worked for the European Bank for Reconstruction and Development, with a focus on project finance transactions in central and eastern Europe. He has taught part-time at the London School of Economics and the Central European University.

Otto has a BA in economics from the Budapest University of Economics, a Doctor iuris from ELTE University Budapest, an LL.M. in German law from the University of Trier and an LL.M. in European law from the University of Oxford.



## Phoebus Athanassiou

Phoebus L. Athanassiou is Lead Legal Counsel in the ECB's Directorate General Legal Services and a member of the Faculty of the Institute of Law and Finance at Goethe University Frankfurt. He holds a PhD in law and an LL.M. in commercial and corporate law from King's College, London and an LLB in English and European (French) law from Queen Mary College, London.

He has published extensively, with a focus on financial services and capital markets regulation, private international law and institutional issues of relevance to the EU and EMU. He is the author of several books, including *Digital Innovation in Financial Services – Legal Challenges and Regulatory Policy Issues*, Wolters Kluwer, 2018, and *Hedge Fund Regulation in the European Union*, Kluwer Law International, 2009. He is also the editor of the *Research Handbook on Hedge Funds, Private Equity and Alternative Investments*, Edward Elgar, 2011.

He sits on the editorial boards of the ECB Legal Working Papers Series and of the *International In-house Counsel Journal*. He is a qualified Greek lawyer and a Member of the Athens Bar.



## Ulrich Bindseil

Ulrich Bindseil has been Director General of the ECB's Market Infrastructure and Payments since 1 November 2019. Previously, he had been Director General of the ECB's Market Operations (from May 2012) and Head of the ECB's Risk Management Division (between 2005 and 2008). Ulrich began working in central banking in 1994, joining the Economics Department of the Deutsche Bundesbank after completing his economics studies. His publications include *Monetary Policy Operations and the Financial System*, Oxford University Press, 2014 and *Central Banking before 1800 – A Rehabilitation*, Oxford University Press, 2019.



## Valérie Fasquelle

Valérie Fasquelle is Director of the Infrastructure, Innovation and Payments Directorate at the Banque de France.

The Infrastructure, Innovation and Payments Directorate is responsible for the oversight of the safety of payment instruments and for the smooth operation of market infrastructures operating in France (payment systems, central securities depositories, securities settlement systems, central counterparties). The Directorate is also responsible for the production of analyses and surveys on innovation in the field of payments and market infrastructures. Since early 2020, Valérie Fasquelle has led the Banque de France programme for experiments with central bank digital currencies.

Through the various positions that she held, Valérie Fasquelle was deeply involved between 2004 and 2015 in the management of large-scale Eurosystem projects such as TARGET2 and TARGET2-Securities. She had previously worked in the area of payment systems for eight years and acquired her business expertise through the various managerial responsibilities she held during that time, especially within the Banque de France IT Department.

Before joining the Banque de France in 1993, Mrs Fasquelle graduated from the Institut d'Études Politiques de Paris before earning a postgraduate degree in economics from the Dauphine University in Paris.



## Panagiotis Papapaschalis

Panagiotis Papapaschalis is currently Senior Lead Legal Counsel in the ECB's Directorate General Legal Services, dealing with areas including financial market infrastructures (FMIs), fintech and cybersecurity. He has previously worked as Senior Counsel (on secondment) in the International Monetary Fund's Legal Department, where his role included dealing with the provision of technical assistance on central bank, banking and FMI legislation. He has also worked as Legal Team Leader at ESMA. He holds two LL.M. degrees in financial law (from the Aristotle University of Thessaloniki and Fordham University) and is admitted to practice in New York, Greece, and England and Wales.





## Eleni Koupepidou

Eleni Koupepidou is Head of the Supervisory Law Division in the ECB's Directorate General Legal Services. The Supervisory Law Division's fields of expertise include providing legal advice to the ECB's banking supervision arm, for example on the interpretation of the Single Supervisory Mechanism Regulation, the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR), the Single Resolution Mechanism Regulation and the Bank Recovery and Resolution Directive, as well as representing the ECB in related litigation concerning banking and supervisory matters.

She previously headed up the Legal Department of the Central Bank of Cyprus. She has also worked as a lawyer at the Cyprus Securities and Exchange Commission and at law firms in Cyprus.

Ms Koupepidou obtained her LL.B. from Bristol University and an LL.M. in corporate and commercial law from King's College, London. She also completed the Bar Vocational Course at the Inns of Court School of Law in London.



## Carmen Hernández Saseta

Carmen Hernández Saseta works as an adviser in the Supervisory Law Division of the ECB's Directorate General Legal Services. She joined the ECB in 2013 from Banco de España to assist in the preparatory phase and implementation of the Single Supervisory Mechanism (SSM). Prior to working in the legal departments of the ECB and Banco de España, she developed a career in the private sector, practising as a lawyer in the fields of EU and competition law at one of the leading firms in Spain.



## Michael Ioannidis

Michael Ioannidis is Principal Legal Counsel in the ECB's Directorate General Legal Services and a senior research fellow at the Max Planck Institute for Comparative Public Law and International Law in Heidelberg. He graduated with distinction from the University of Athens and continued his studies in Heidelberg (LL.M., 2007), Cambridge (LL.M., 2008) and Heidelberg/Frankfurt (PhD, summa cum laude, 2012). He also holds a degree in European and international economics (Athens University of Economics). Before working for the ECB, he was seconded to the European Stability Mechanism. In his academic capacity, he has been teaching and publishing mainly on issues of international and European economic law and EU constitutional law.



## Cristina Pérez Cajal

Cristina Pérez Cajal currently serves as Head of the Regulatory and Supervisory Advice Division in the Banco de España's Legal Department. Ms Pérez is responsible for legal issues relating to the supervision and resolution of credit institutions, including advising on the drafting of related legislation.

She majored in law and business administration at Comillas Pontifical University in Madrid. Before joining the Banco de España, she worked for the prestigious law firm Uría Menéndez, where her practice focused on M&A and banking.



## Klaus Lackhoff

Klaus Lackhoff has been Head of Section in the Supervisory Law Division of the ECB's Directorate General Legal Services since June 2015. His section deals in particular with CRR-related issues.

Before joining the ECB in 2015, he worked for more than 15 years at an international law firm. He advised on a broad range of financing transactions and on banking supervisory issues and was involved in the ECB's preparations for its supervisory tasks in the SSM and the drafting of the SSM Framework Regulation.

Klaus has earned a Doctor juris from the University of Münster, with a thesis on the freedom of establishment, an LL.M. from the University of Iowa, with a paper entitled Restrictions on State Interference with Commerce in the U.S.A. and the EC, and a Master of European Law degree from the University of Saarbrücken.



## Asen Lefterov

Asen Lefterov is Senior Legal Counsel in the Supervisory Law Division of the ECB.

He has been with the ECB in various roles since 2011, including as a participant in the ECB Graduate Programme, working in the field of banking supervisory law, financial law and policy matters. Mr Lefterov represents the ECB in court on litigation relating to banking supervision.

Prior to joining the ECB, Asen Lefterov worked at law firms in Bulgaria specialising in civil and company law.

Mr Lefterov holds a Master's degree in law from Sofia University and an LL.M. in EU business law from the University of Amsterdam. He has published articles on various aspects of the EU Financial Services Regulation.



## Dimitrios Triantafyllou

Professor Dr Dimitrios N. Triantafyllou is Legal Adviser at the European Commission. After specialising in administrative and economic law at universities in Strasbourg (DEA) and Heidelberg (PhD), he has been working for the European Court of Justice and for the European Commission since 1987.

He has also been teaching in Strasbourg, Würzburg and Paris since 1992.

He has published six books and over 65 articles in several languages. His main points of interest include, amongst others, institutional law, banking law, public procurement and state aid law, public undertakings and utilities, and general principles of law.





## Anastasia Valavanidou

Anastasia Valavanidou joined the Legal Department of the Single Resolution Board (SRB) in 2016. She has been advising on bank resolution matters and acting as agent of the SRB in various cases before the CJEU. In her current capacity of bank resolution expert, she is focusing on resolution planning for banking groups in Spain and Portugal.

Prior to joining the SRB, Ms Valavanidou spent four years as a legal counsel in the legal departments of the ECB and the European Investment Bank. She started her career in private practice in Greece and first gained experience in EU law matters as a trainee in the legal service of the European Commission and the Chambers of the President of the CJEU.

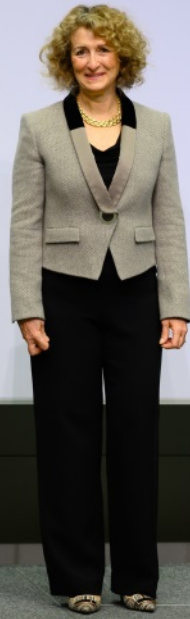
A graduate of the Aristotle University of Thessaloniki, Ms Valavanidou also holds a Master complémentaire en droit européen from the Université Libre de Bruxelles and an LL.M. from Columbia Law School. She is admitted to practice in Greece and in New York.





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Postal address 60640 Frankfurt am Main, Germany  
Telephone +49 69 1344 0  
Website [www.ecb.europa.eu](http://www.ecb.europa.eu)

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